

# Economic Modernization in Late British India: Hindu-Muslim Differences

by

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**Abstract.** The Muslims of South Asia made the transition to modern economic life more slowly than the region's Hindus. In the first half of the twentieth century, they were relatively less likely to use large-scale and long-living economic organizations, and less likely to serve on corporate boards. Providing evidence, this paper also explores the institutional roots of the difference in communal trajectories. Whereas Hindu inheritance practices favored capital accumulation within families and the preservation of family fortunes across generations, the Islamic inheritance system, which the British helped to enforce, tended to fragment family wealth. The family trusts (waqfs) that Muslims used to preserve assets across generations hindered capital pooling among families; they were also ill-suited to profit-seeking business. Whereas Hindus generally pooled capital within durable joint family enterprises, Muslims tended to use ephemeral Islamic partnerships. Hindu family businesses facilitated the transition to modern corporate life by imparting skills useful in large and durable organizations.

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## 1. The Question of Why India's Muslims Are Poorer than Its Hindus

India's Muslim minority, as of the early twenty-first century around 12 percent of its ethnically and religiously diverse population, lags behind the country's Hindu majority economically. The average household income for Muslims is 76.6 percent, and per capita income 72.4 percent, of the corresponding figure for Hindus. In rural areas, the typical Muslim-owned farm is only 41.1 percent as large as the typical Hindu-owned farm. Muslims have relatively lower labor participation rates and higher unemployment rates in both cities and the countryside.<sup>1</sup> The underperformance of Muslims is particularly striking in the management of its private companies. Shortly after India gained independence from Britain in 1947, only one of India's 80 largest publicly traded companies had a Muslim at its helm.<sup>2</sup> A half-century later, in 1997, only one of India's fifty largest business groups was headed by a Muslim.<sup>3</sup> In describing the economic performance of Muslims in independent India, Omar Khalidi infers from such statistics that Muslims "lack the ability to organize and plan enterprises on modern lines."<sup>4</sup>

Khalidi's observation will strike a familiar chord among students of late British India. In the last century of British rule over undivided India, Muslims, more than 20 percent of the population, were under-represented in the most dynamic sectors of the economy. Very few of the leading moneylenders, bankers, industrialists, and traders were Muslim. In western India, the Muslim role in cotton production and shipping, two sectors that were expanding massively, was negligible. In eastern India, Muslims owned few tea

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<sup>1</sup> Shariff and Azam, *Economic Empowerment of Muslims in India*, pp. vii, figures 12, 15, 16, and 18, and tables 6 and 7.

<sup>2</sup> Based on a list of directors in 1951-55, contained in Government of India, *Progress of Joint Stock Companies in India*.

<sup>3</sup> Tripathi, *Oxford History of Indian Business*, pp. 340-342. The term "business group" is defined as a company controlled, directly or indirectly, by a particular family.

<sup>4</sup> Khalidi, *Muslims in the Indian Economy*, p. 88.

plantations and processing enterprises, which had become major sources of wealth. On the eve of India's independence, Muslims owned only two of the country's 111 jute mills. Even in the Muslim-majority provinces of northern India, they were underrepresented among the owners and managers of major industrial and trading companies.<sup>5</sup>

Muhammad Ali Jinnah, who would become the founder of Pakistan, was aware of Muslim under-representation in the ownership of large modern companies. "We claim that we are a nation of one hundred million strong," he lamented a few years before the end of British rule, "and yet have one bank out of the scores which operate in India."<sup>6</sup>

This article explores the historical origins of Muslim under-representation in the management of large Indian firms. Muslims found it relatively harder, it argues, to pool capital within large and durable enterprises capable of exploiting the new technologies of the industrial era. These difficulties were among the unintended consequences of Islamic institutions designed to spread wealth, circumvent inheritance regulations, and facilitate the provision of public goods. The Islamic inheritance system, Islamic partnership rules, and Islamic trusts known as waqfs jointly limited Muslim participation in large and long-lasting enterprises, the hallmarks of a modern economy. These institutions essentially kept Muslims out of economic sectors in which pooling resources within corporations was efficient.

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<sup>5</sup> Talha, *Economic Factors*, pp. 83-88; Cheesman, "Omnipresent Bania"; Ahmad, *Indian Muslims*, pp. 4-6; Ahmad, *Muslim Separatism in British India*, pp. 3-5.

<sup>6</sup> As quoted by Ispahani, *Qaid-E-Azam Jinnah*, p. 132. At the time, India's only Muslim-owned bank was the Habib Bank.

## 2. Popular Explanations and the Neglected Role of Economic Institutions

At least since W.W. Hunter drew attention to Muslim underperformance in 1870 through a book hostile to Muslims and contemptuous of Islam as a religion,<sup>7</sup> the causes of this pattern have been a source of controversy. The factors commonly invoked include conservatism and insularity rooted in Islam, demoralization and self-imposed isolation after the decline of the Mughal Empire (usually taken to have started with the death of Aurangzeb in 1707), and British hiring policies biased against Muslims.<sup>8</sup>

Even collectively, such factors, insofar as they mattered at all, fail to explain the observed historical pattern. Muslims played prominent, and in certain respects leading, roles in South Asian trade prior to the arrival of the Portuguese, and for centuries thereafter; they achieved these successes through remarkable creativity and flexibility. Indian Muslims also played major roles in India's trade with Southeast Asia and Central Asia.<sup>9</sup> Moreover, they played disproportionate roles in the production of textiles, handicrafts, armaments, and luxury goods; and most of India's leading engineers, architects, and physicians emerged from their ranks.<sup>10</sup> Those successes, which spanned more than a millennium, make it unlikely that religious attitudes themselves account for the underperformance at issue here.

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<sup>7</sup> Hunter, *Indian Musalmans*, chap. 4.

<sup>8</sup> For the attitudinal claim, see, for instance, Mondal, "Economic and Social Situations"; for the demoralization thesis, Khan, "Muslim Decline in India"; and for the British bias thesis, Ahmad, *Muslim Separatism in British India*; and Khalidi, *Muslims in the Indian Economy*, especially p. 14. Toynbee, *Study of History*, vol. 8, pp. 200-03, offers a composite explanation involving all three claims.

<sup>9</sup> Chaudhuri, *Trade and Civilisation*, especially chap. 2; Levi, *Indian Diaspora in Central Asia*, chaps. 1-2; Risso, *Merchants and Faith*, especially chaps. 4, 6; Das Gupta, *World of Indian Ocean Merchant*, especially chaps. 3-4, 7; Arasaratnam, *Islamic Merchant Communities*; Pearson, *Indian Ocean*, especially pp. 78-79, 88-89; Digby, "Maritime Trade of India," especially pp. 151-152 and 155-158; Nadri, *Eighteenth-Century Gujarat*, especially chap. 3.

<sup>10</sup> Talha, *Economic Factors*, pp. 15-18; Umar, *Muslim Society in Northern India*, pp. 27-33.

Were the demoralization thesis correct, it would have been evident in the Indian Ocean trade. Yet Muslims continued to be more active than Hindus throughout the eighteenth century. Muslim underperformance relative to Hindus is a phenomenon that dates from the nineteenth century, at least a century after Mughal power started to wane. In any case, there is no plausible mechanism through which an empire's decline can hamper private entrepreneurship for generations on end.

As for the alleged British bias, it may have contributed to Muslim under-representation in the government bureaucracy, which is a matter of record. The British certainly devalued Muslim-dominated professionals that symbolized Mughal rule, such as court poets and calligraphers. However, anti-Muslim British hiring policies would not necessarily account for Muslim under-representation in trade and industry.<sup>11</sup> Throughout the world, various minorities have excelled in commerce in the face of severe discrimination in government employment.

All such explanations that invoke attitudes based on religion or the machinations of non-Indians neglect two simple economic realities. First, the economic performance of a group depends on the institutions through which its members operate; and second, relative economic performance depends, in addition, on the economic institutions of the chosen reference groups. One cannot understand why Hindus have performed better than Muslims over the past two centuries without examining the differences in the institutions under which the two religious communities have conducted business. Although neither Muslims nor Hindus maintained a uniform set of practices, their capital pooling and inheritance practices tended to differ in ways that mattered increasingly, as we shall see,

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<sup>11</sup> For evidence of Muslim under-representation in the public service under the British, see Aziz, *Historical Handbook of Muslim India*, chap. 14.

in the course of economic modernization. Moreover, certain differences were accentuated under British rule, reducing Muslim incentives to take advantage of modern economic institutions. New organizational forms introduced by the British were adopted very disproportionately by Hindus.

### **3. Similarities with the Middle East**

The arguments usually advanced to explain the underperformance of India's Muslims all have Middle Eastern counterparts, which are just as inadequate. When in the late eighteenth century the Middle East's Muslims started falling behind its Christian and Jewish minorities neither attitudinal differences rooted in religion nor third-party biases were the cause. Rather, the bifurcation stemmed from the emergence of modern economic institutions and from differing capacities to exploit the consequent opportunities for economic advancement. As the infrastructure of the modern global economy took shape in western Europe, the Middle East's religious minorities started doing business, by virtue of the choice of law they enjoyed from the dawn of Islam; for their part, Muslims continued to conduct commerce under Islamic law. Accordingly, the underperformance of Muslims was particularly pronounced in cities that traded heavily with the West, such as Istanbul, Cairo, and Beirut; and in sectors where it proved particularly advantageous to use new institutions such as the joint-stock company, the corporation, the stock market, and modern banking.<sup>12</sup>

Could the underperformance of India's Muslims relative to its Hindus be rooted in the institutional variations responsible for the intercommunal variations of the Middle

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<sup>12</sup> For further details, and a critique of alternative explanations, see Kuran, "Economic Ascent"; and *Long Divergence*, chaps. 9-13.

East? There are reasons to expect similarities. First of all, in both India and the Middle East, Muslim underperformance became increasingly conspicuous as the Industrial Revolution made it efficient to use modern organizational forms in an expanding array of sectors. Second, in both regions Muslims were vastly under-represented as owners and as managers in banking and in sectors that relied increasingly on large-scale finance. In the Middle East, these sectors were all dominated by local Christians and Jews, many of whom interacted with westerners under the laws of some western power. In those modern sectors, success required pooling capital on a large scale within durable companies, which could not be done efficiently under traditional Islamic law.<sup>13</sup> In India, Hindus came to dominate the very sectors in which the Middle East's Christians and Jews excelled. Third, certain non-Muslim indigenous communities—in the Middle East, principally Greeks, Armenians, and Jews, and in India, Hindus, Jains, and Zoroastrians—came to dominate modern sectors initiated by foreigners. Finally, in the nineteenth century, when the bifurcations under consideration became noticeable, wealthy Muslims in both India and the Middle East tended to pool capital, run businesses, and transfer wealth across generations under Islamic law.

However, there were also important differences between India and the Middle East. For one thing, the communities that advanced relative to Muslims used quite different institutions prior to the bifurcations in question. In the Middle East, Christians and Jews tended to do business and manage wealth under Islamic law, using the institutional complex that served Muslims. In India, by contrast, Hindus used distinctly

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<sup>13</sup> For the Middle East, see Kuran, “Islamic Commercial Crisis”; “Absence of the Corporation”; and *Long Divergence*, chaps. 3-8. Middle Eastern Muslims gained a significant presence in modern sectors only after the economic jurisdiction of Islamic courts was contracted and far-reaching legal reforms allowed them to pool capital through what we now recognize as modern firms. For India, see Talha, *Economic Factors*, p. 23, and figures provided in this paper.

Hindu practices, as did Sikhs and Jains. For another, the Muslims of the Middle East lacked the choice of law enjoyed by religious minorities; they were required to take disputes to Islamic courts. In India, Muslims had considerable flexibility; as we shall see, certain Muslim groups followed distinctly Hindu practices without drawing accusations of apostasy. The flexibility of India's Muslims rested partly the subcontinent's traditional caste system, which divided all of its major religious groups, including its Muslims, into hereditary occupational groups. Because caste restrictions and traditions trumped religious regulations in many contexts, the business practices of India's religious communities could have had more to do with the caste system than with Hinduism or Islam per se.<sup>14</sup> Shortly we shall return to this possibility.

For now, we need only to recognize that the mechanisms responsible for the two bifurcations may have differed. Although identifying the institutional roots of the intercommunal economic divergence in India can obviously benefit from attention to transformations under way in the Middle East, we must not lose sight of India's particularities. We will start, therefore, by exploring the methods by which Indian Muslims and Hindus traditionally pooled capital to conduct joint ventures and those they used to transfer capital across generations. Differences will emerge that carry implications for the preservation of successful businesses. Next, we shall introduce the institutional alternatives that the British brought to the region. The institutional heritage of the Hindus made it easier, we shall explain, than that of Muslims to take advantage of these new institutions. The key claim of the article is thus that premodern commercial and wealth-management practices delayed Muslim economic modernization, thus

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<sup>14</sup> On the mechanisms by which the caste system shaped the Indian economic trajectory, see Lal, *Hindu Equilibrium*.

contributing to the Muslim underperformance that has been apparent for about a century and a half.

#### **4. Joint-Investment and Inheritance Institutions of Pre-modern India**

Prior to the arrival of the British, Indians pooled resources for commercial ventures through two institutions: the partnership and the joint-family enterprise. A partnership was formed by two or more individuals, not necessarily relatives, for a specified venture, such as a trading mission, or the planting of a crop for one season, or the production of some goods. Its founders, known as partners, contributed either labor, or capital, or both; and at the end of the venture, they split any profits according to a pre-negotiated formula. Any partner could terminate the partnership without notice, triggering its immediate dissolution. The death or incapacitation of a partner would end the partnership automatically, requiring the division of its assets. A group of partners could cooperate indefinitely, but through successive partnerships rather than an organization with an indefinite life. A partner's descendants did not become partners themselves. They could form partnerships only through acts of their own, as individuals contributing personal resources.<sup>15</sup>

A joint-family enterprise pooled the resources of an extended family and exploited them indefinitely as a unit. Resources of the enterprise could be reallocated to new ventures without requiring a new contract. Equally important, the family could gain or lose members without affecting the continuity of its joint enterprise. In most parts of India, male members had the right to withdraw from the enterprise at will, taking with them a share of the family's capital and, of course, a share of its labor. In other places,

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<sup>15</sup> Mayne, *Treatise on Hindu Law and Usages*, pp. 383-86.

this right was restricted; ordinarily, sons could not withdraw capital from the family enterprise until after their father's death.<sup>16</sup>

Four differences between these institutions stand out. First, only the partnership was conducive to pooling resources across family lines. Second, the two institutions differed in terms of the default rule concerning the termination of cooperation. Under a partnership termination occurred automatically at certain contingencies, for instance, the selling of a harvest, or the delivery of a shipment, or a death. By contrast, in a joint family enterprise termination required someone to initiate a division of assets deliberately. Even the death of a father did not require dissolution; a son had to request the release of his share of the assets. Thus, by default the life of a partnership was finite but that of the family enterprise indefinite. Third, whereas interest in a joint-family enterprise passed to the heirs of co-owners, that in a partnership did not pass to survivors. The heirs of a deceased partner were entitled only to shares of the lapsed partnership's assets. The final difference concerns the venture's legal standing vis-à-vis third parties. Whereas third parties treated partners as individuals, the joint-family enterprise was viewed as a unit. Neither enjoyed legal personhood in the sense of having formal rights in a court of law. Yet, the joint-family enterprise held "informal" legal personhood, in other words, de facto personhood in its daily interactions.

These differences are relevant to the puzzle at hand: the underperformance of India's Muslims in the final century of British rule. They mattered because historically the partnership was used very disproportionately by Muslims and the joint-family

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<sup>16</sup> These rights were spelled out in the Mitakshara and the Dayabagha, schools of Indian thought that date from the late eleventh century. The latter, which was dominant only in Bengal, promotes the more restrictive system. See Derrett, "Juridical Framework of the Joint Hindu Family," pp. 28-30; Vesey-Fitzgerald, "Succession of Cognate Collaterals in Hindu Law"; and Kumar, "Private Property in Asia?," especially p. 355.

enterprise very disproportionately by Hindus.<sup>17</sup> These two religious groups also followed different inheritance practices. As we know from the experiences of the Middle East and western Europe, capital pooling and inheritance practices affect the size and time horizon of investments.

The Islamic inheritance system requires at least two-thirds of an estate to be partitioned among surviving children, spouses, and parents, and in some cases more distant relatives as well. Females are entitled to half as much as a male of the same category; thus, a daughter receives half as much as a son. In the pre-modern Middle East, this system created incentives for keeping partnerships small and short-lived; the possibility of untimely liquidation, which rose with the number of partners and the duration of the venture, induced merchants and investors to favor cooperative ventures involving few partners and short time horizons. In turn, this preference for small and ephemeral partnerships had dynamic consequences that helped to delay the Middle East's economic modernization. Small and ephemeral partnerships did not face the coordination, communication, and enforcement problems that larger partnerships inevitably do; consequently, the Middle East did not contribute to the development of the organizational forms characteristic of modern economic life.<sup>18</sup>

Might the same mechanisms account for the economic trajectory of India's Muslims? And might the relative successes of the Hindus have something to do with their use of different, and specifically relatively inegalitarian, inheritance practices?

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<sup>17</sup> Dutta, *Family Business in India*; Timberg, *Industrial Entrepreneurship*, pp. 8-10; Tripathi, *Oxford History of Indian Business*, p. 113; Verma, *Industrial Families*. The partnership was common among Hindu merchants doing business in Central Asia.

<sup>18</sup> Kuran, *Long Divergence*, chap. 4.

The traditional, pre-colonial inheritance practices of Hindus display enormous variety. They reflected, in addition to the Dharmashastras, which are the legal treatises of Hinduism, regional and caste-based customs.<sup>19</sup> Along with differences, these practices had some common features. First of all, women were generally excluded from inheritance.<sup>20</sup> Second, a distinction was made between separate and joint property. Finally, inheritance rights resided not in individuals but in family lines, or stripes. Each son of a family patriarch (karta) represented a stripe that included all of his own male descendants. If a son died while the patriarch was still alive, the rights of his stripe passed *fully* to his own sons; thus, the patriarch's grandsons from his deceased son received collectively what their father would have received had he been alive.<sup>21</sup>

The differences between Hindu and Islamic inheritance principles reflected a deep difference involving property rights in general. In Islamic law, property rights reside in individuals; there is no such thing as collective ownership, except by contract, through a revocable partnership formed by flesh-and-blood individuals. Thus, an estate consists of assets owned by a deceased individual, and these assets are partitioned among individuals. By contrast, Hindu law recognizes individual ownership as well as collective ownership by a family whose membership changes through births and deaths. When a Hindu patriarch dies, he may leave behind, along with personal property, assets belonging to a business collectively owned by his survivors. The survivors may choose to keep the assets together under a new family patriarch.

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<sup>19</sup> The history of the Dharmashastras is surveyed, with a focus on family law and matters of property, by Derrett, "Juridical Framework of the Joint Hindu Family."

<sup>20</sup> A few tribes and castes in northeastern India practiced matrilineal inheritance, along with several in Kerala. See Agarwal, "Gender and Command over Property."

<sup>21</sup> Cornish, *Manual of Hindu Law*, pp. 63-64; Cowell, *Treatise on Hindu Law*, pp. 41-42.

Business assets could get partitioned under both legal systems. Under Islamic law, this happened automatically at the death of their owner. The heirs of a deceased businessman were free to pool their individual shares under a partnership. If they made that choice, all the risks of operating a partnership would come into play; any member could dissolve the partnership without advance notice. This alone would have discouraged the continuation of successful businesses after the passing of the founder. Under Hindu law, the assets of a joint family enterprise could be split at the death of a patriarch, upon the request of a survivor; each stripe could go its own way, under its own family head. A partition of joint family assets could also be initiated by a patriarch; he might do so if, for example, family squabbles made it impractical to maintain a single family business. A partition could come about in one other way. A son could initiate it during the father's lifetime, if the father was deemed unable to have any more sons.<sup>22</sup> Yet, all such forms of partition were frowned upon; viewed as a sign of weakness, they would tarnish the family's reputation and limit its social and economic options.<sup>23</sup>

The differences between the Hindu and Islamic inheritance rules suggest that Hindus enjoyed an advantage over Muslims in preventing capital fragmentation. The denial of inheritance rights to Hindu women and the incentives to keep the assets of Hindu families undivided made it easier for Hindus to prevent capital fragmentation at the death of a member active in business and in control of commercial assets. The historical literature on commercially prominent Indians contains abundant examples of Hindu families that operated enterprises that lasted generations. The Jagatseth family offers an example. Established in 1652 as a moneylending business based in Patna, the

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<sup>22</sup> Cowell, *Short Treatise on Hindu Law*, pp. 41-42.

<sup>23</sup> Dutta, *Family Business in India*, p. 97.

Jagatseth joint-family enterprise had branches in Dhaka, Calcutta, and Benares, among other cities. The family fortune was partitioned in 1822, as a result of a bitter dispute between two brothers. Along the way, on three occasions a partition was avoided by agreeing on a new family head after a period of discord.<sup>24</sup>

India's known family businesses with long histories are overwhelmingly Hindu. This provides a further reason to explore whether the Hindu-Muslim performance gap of interest here is rooted in the traditionally favored commercial and inheritance practices of the two groups. It raises the possibility that the very historical mechanisms responsible for the underperformance of the Middle East relative to western Europe, and of Middle Eastern Muslims with respect to its Jews and Christians, also account for the underperformance of India's Muslims vis-à-vis its Hindus.

## **5. Muslim Practices before and under British Rule**

It so happens that India's Muslims did not necessarily follow Islamic inheritance practices. Prior to British rule, their inheritance practices were shaped, like those of other religious groups, by customs based largely on caste and regional particularities. Mass conversions to Islam did not necessarily affect inheritance practices. The converts joined a new social group, not necessarily coterminous with the aggregate of all Indian Muslims, for the purposes of ritual observance, marriage, and dining, but often without leaving behind their old ways. To a much larger extent than the Middle East, Muslims retained local, non-Islamic customs. This is reflected in heavy Muslim participation in Hindu and other non-Muslim festivals. The Muslim judges (*kazis*) who served Mughal rulers were

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<sup>24</sup> Little, *House of Jagat Seth*, especially pp. vi-xxiii.

remarkably tolerant of practices that would not pass muster under a strict interpretation of Islamic inheritance laws.<sup>25</sup>

Although the dearth of surviving court records from Mughal India precludes the quantification of this tolerance, we know that the British applied Islamic law (*sharia*), and especially the Islamic rules of inheritance, with greater rigor than Muslim judges.<sup>26</sup> So insofar as Islamic inheritance practices mattered to the patterns at issue here, their effects might have become more pronounced under the British.

The British promoted Islamic inheritance practices through common law courts instituted all across India. In doing so, they did not single out Muslims for special treatment. Simultaneously, they took to promoting Hindu inheritance practices among Hindus. Yet British judges of the late eighteenth century were generally unfamiliar with local practices; they could not possibly master all the fine variations across castes, regions, and religions. In need of general guidelines, they took to consulting Muslim “experts” and texts in inheritance cases involving Muslims, and Hindu “experts” and texts in cases involving Hindus. Before long, they developed general patterns and precedents of their own. By the 1860s, Anglo-Indian courts were no longer dependent on Muslim and Hindu advisers; their judges were relying solely on personal experience, the precedents of their own court, and translations of Hindu and Muslim texts. An important consequence of this early form of multiculturalism was the differentiation of Muslim and Hindu practices. Another was the homogenization of each.<sup>27</sup> Certain Hindu practices

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<sup>25</sup> Hardy, *Muslims of British India*, chap. 1, especially pp. 8, 10.

<sup>26</sup> Kozlowski, “Muslim Women and the Control of Property,” especially pp. 171-175; Kozlowski, *Muslim Endowments and Society in British India*, p. 157; and Powers, “Orientalism, Colonialism, and Legal History,” p. 556.

<sup>27</sup> Powers, “Orientalism, Colonialism and Legal History,” p. 555; Kozlowski, *Muslim Endowments and Society in British India*, pp. 109-110; Kelien, “Mutiny and Modernization,” especially. Pp. 558-59.

became less diverse, and the highly varied Islam of Mughal India got supplanted by what may be characterized as a “classical” or “Arabic” form of Islam. To be sure, the British did not eradicate regional and caste-based differences. But they made faith a more important determinant of inheritance practices; and, for each faith, their reliance on a small number of texts reduced the diversity of interpretation.

The inter-religious differentiation and intra-religious homogenization of Indian inheritance practices took place at a time of massive global transformations. Europeans were establishing dominance over the global economy. More critical here, technological advances were generating massive opportunities for wealth creation through large and durable profit-making organizations. The described British policies concerning Indian estate settlements occurred, in other words, at a time when it was becoming increasingly advantageous to have institutions conducive to pooling resources on a large scale and for indefinite periods, and increasingly *disadvantageous* to lack institutions that prevent resource fragmentation.

If the unfolding story has any villains, then, the British must be counted among their ranks.<sup>28</sup> This is because they made India’s Muslims maintain or adopt inheritance practices that posed a disadvantage at a time when adapting to the global economy required capital accumulation and preservation. This does not imply an endorsement of the fashionable “British bias” thesis that we dismissed early on. Insofar as the British harmed Muslims, they did so primarily through measures that strengthened the role of Islam in Indian economic life rather than through job discrimination, the commonly invoked factor. The timing of these measures was critical. Had the same measures been

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<sup>28</sup> Certain Hindu, Muslim, and other religious leaders actively promoted the homogenization of these processes for personal gain. They share responsibility for the ensuing outcomes.

taken two centuries earlier, Muslims restricted to strictly Islamic inheritance practices need not have fallen behind Hindus able to keep family wealth undivided within and across generations. In the 1600s large and durable private enterprises were not yet essential to the efficient exploitation of known technologies.

## **6. Islamic Vehicles to Circumvent Islamic Inheritance Rules**

Under each of our two traditional legal systems, the capital of a successful businessman could be partitioned either during his lifetime or at his death. Yet the incentives to keep the capital of a successful enterprise undivided were greater under Hindu law, and all the more so when the enterprise was successful. The assets would remain in a family enterprise jointly owned and operated by relatives accustomed to working for an organization designed to live on indefinitely. Muslims who lived by Islamic law lacked the option of maintaining the business under an established structure. A compounding difficulty for Muslims is that a successful businessmen operating under Islamic law tended to operate through myriads of partnerships, generally all small and all short-lived. The difficulties of maintaining hundreds of separate enterprises are obvious. If the heirs of a deceased businessman wanted to keep them going, partners from outside the family might opt to go their own ways.

During the nineteenth century, it did not escape notice that estate fragmentation was particularly pronounced among India's Muslims. Moreover, certain prominent people came to consider the spread and enforcement of Islamic inheritance practices the basic cause. Syed Ahmed Khan (1817-98), the Muslim jurist and scholar who founded the Anglo-Mohammedan Oriental College at Aligarh, held the implementation of Islamic

inheritance practices responsible for the impoverishment of Muslims. “The condition of Muslims is deteriorating,” he observed, and “descendants of families which were very rich have become extremely poor.” Moreover, their “properties and estates” were being “sold after being divided into small fragments.”<sup>29</sup>

If Syed Ahmed Khan was right, and Muslim families of British India were indeed finding it increasingly difficult to preserve successful businesses and avoid asset fragmentation, they would have sought to overcome these problems. In fact, they found respite from the application of the Islamic inheritance system by utilizing another institution widely recognized as Islamic, the *waqf-alal-awlad*, Islam’s distinct form of family trust, which is generally known as the family waqf.<sup>30</sup> Used in the Middle East for centuries under various names, the family waqf was rarely used in India before the nineteenth century. Even then, its use became common only in states directly ruled by the British.<sup>31</sup> It speaks volumes that the family waqf became popular just as, and especially in regions where, Islamic inheritance practices began spreading.

Whether or not it is associated with a family, a waqf is an endowment established by an individual to provide a designated service in perpetuity.<sup>32</sup> The endowment that supplied the necessary revenue had to consist of real estate. What made a waqf a “family waqf” is that its principal beneficiaries were the founder’s family and descendants. The founder of a family waqf could retain some control over his endowment by appointing

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<sup>29</sup> As quoted by Carroll, “Life Interests and Inter-Generational Transfer of Property,” p. 258.

<sup>30</sup> Kozlowski, “Muslim Women and Control of Property,” p. 178.

<sup>31</sup> Kozlowski’s *Muslim Endowments and Society in British India*, p. 42. Family waqfs were rarely utilized in the Punjab or in the native states not ruled directly by the British.

<sup>32</sup> Waqfs had been used in pre-British India to support Sufi shrines, tombs, and mosques. In some places they were used also to support Hindu religious institutions. They were founded by emperors, local rulers, other major officials, and wealthy merchants. See Hassan, “Religion, Society and State in Pakistan,” p. 555; and Sovorova, *Muslim Saints of South Asia*, pp. 29, 38. On the waqf institution in general, see Kuran, “The Provision of Public Goods under Islamic Law”.

himself (or herself—a significant minority of family waqfs had a female founder) as its caretaker for life. The caretaker enjoyed the privilege to confer benefits on relatives and descendants of his choice. He could appoint a son as the caretaker, effective before or after his death. Assets placed in a waqf were exempt from Islamic inheritance rules. Prosperous Muslims established a family waqf to reduce their assets going to daughters, younger sons, and disobedient children in general. Disfavored children might be awarded maintenance or a nominal salary.<sup>33</sup>

The family waqf offered many advantages to a wealth holder intent on controlling its uses during and after his lifetime. It also provided an instrument for preventing the fragmentation of his wealth. Could the family waqf have given Indian Muslims the means, then, to compete effectively with the joint family enterprise popular among Hindus? Along with the advantages just cited, it had certain drawbacks. First and foremost, under Islamic law the deed of a family waqf was considered fixed forever. Not even the founder was free to alter its original purpose. Hence, the revenue of the underlying assets could not be used to augment the capital or pursue a new investment opportunity. If the deed instructed the caretaker to divide the revenue equally among four family members, that is what had to be done. The beneficiaries were free to pool their shares through a partnership. As we already know, though, the partnership was poorly suited to long-lived ventures, and its risk of premature liquidation rose with the number of partners. A second drawback is that assets placed in the waqf's endowment could not

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<sup>33</sup> For numerous examples, see Koslowski, *Muslim Endowments and Society in British India*, especially p. 56. One founder was Shaikh Ahsan-ullah Chaudhri, whose family included his wife, his daughter, his three sons, and their wives. Chaudhri established a family waqf and appointed his eldest son as its caretaker. The waqf deed stipulated that the eldest son would receive a monthly salary of Rs.100. The next son was appointed deputy caretaker at a salary of Rs. 90, and the youngest deputy to the deputy at Rs. 80. The daughter would receive an allowance of Rs. 30 per month. The remaining members of the family were granted token sums. Another founder, Basharat Ali had two sons, one a wastrel and the other obedient. He assigned sole control of the waqf to the obedient son, granting only a nominal allowance to the wastrel.

be converted into liquid capital. Whereas a plot of land could be exchanged for another plot with the permission of a Muslim judge, it could not be sold to finance, say, a ship or a factory.<sup>34</sup> Modifying the use of assets was disallowed by Islamic law even if the beneficiaries wanted it unanimously.

The resulting inefficiencies would tend to grow over time. One reason is that descendants of the original beneficiaries were less likely to have close relations than the original beneficiaries handpicked by the founder. This meant that with each passing generation it became increasingly difficult to rely on the family waqf's assets to finance a new business. As a consequence, by the late nineteenth century a significant portion of Muslim capital was tied up in family waqfs, depressing Muslim resources available for investment in new industries of the emerging modern economy. The family waqf thus contributed to Muslim economic underperformance by drawing the resources of wealthy Muslims away from sectors in which success required large-scale capital pooling on a sustained basis.

Hindus were not lacking opportunities to form an irrevocable, indivisible, and perpetual endowment. As with religious functionaries everywhere, the Hindu priestly class, the Brahmins, encouraged gifts for religious and charitable purposes. It was possible to make a gift in perpetuity to finance a religious ritual.<sup>35</sup> Yet, for India's Hindus creating an endowment was not the only, or even the main, vehicle for keeping wealth undivided. Hence, it played a less important role in Hindu than in Muslim economic life.

To sum up thus far, in late British India Hindu and Muslim families tended to use different institutions as means to preserve capital. Hindu families favored the joint-family

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<sup>34</sup> For further details, see Koslowski, *Muslim Endowments*, pp. 255-262.

<sup>35</sup> Mayne, *Treatise on Hindu Law and Usage*, chap. 12.

enterprise, which exploited jointly owned resources under the leadership of a family head. For their part, Muslims used the family waqf, whose assets were managed by a single caretaker for the benefit of designated beneficiaries. In the former case, the resources could be liquid, and they could be reallocated with changing opportunities. In the latter, the assets were limited to real estate, which drastically narrowed the capacity to pursue emerging investment opportunities. Earlier we saw that the joint-family enterprise offered advantages in regard to longevity over the partnership, the institution that Muslims used most commonly to fund and operate cooperative profit-making ventures. Now we see that the Islamic institution conducive to preserving capital indefinitely was poorly suited to operating a business in which success requires the flexibility to reallocate capital across sectors.

## **7. The Rise of the Managing Agency**

In British India, the business community included Europeans. They could have conducted business through organizational forms popular among the indigenous population, such as simple partnerships and joint-family enterprises. Instead, they formed and ploughed resources into joint-stock companies, which were, in essence, partnerships with tradable shares.<sup>36</sup> Unlike a simple partnership, those of a joint-stock company could change hands without renegotiation. Hence, a joint-stock company's legal existence was independent of the composition of its membership.

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<sup>36</sup> Lamoreaux and Rosenthal, "Legal Regime and Contractual Flexibility," sect. 2, identify the properties of these and other popular organizational forms.

Until 1857, joint-stock companies formed under Anglo-Indian laws were all unincorporated. As such, they lacked legal personhood.<sup>37</sup> In an unincorporated joint-stock company, each shareholder is personally responsible for all company liabilities. To protect themselves, the shareholders typically require share transfers to be sanctioned by the entire collectivity. They also meet periodically to set dividends and company policies. Beginning in 1857, all Indian companies, except those in banking and insurance, were allowed to register as a corporation.<sup>38</sup> By incorporating, a joint-stock company obtained legal personhood. Its members acquired limited liability, which shielded their personal assets from the company's creditors. Ownership and management got separated, as individual shareholders lost the right to veto company policies, except by acquiring a majority of the shares.<sup>39</sup>

Prior to the mid-nineteenth century, the management of an Indian joint-stock company was ordinarily entrusted to a mercantile “agency house” equipped with specialized technical skills and business intelligence.<sup>40</sup> Around that time a new entity known as a “managing agency” appeared on the scene. The typical managing agency managed many companies in multiple sectors, including both incorporated and unincorporated companies. Depending on opportunities, it used the capital of existing companies to found new ones, sometimes in emerging sectors. Its essential organizational contribution was the ability to meet the unanticipated credit needs of companies under its umbrella and to reallocate resources across sectors in response to emerging opportunities.

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<sup>37</sup> Of the joint-stock companies in business, all the incorporated ones were registered in Europe, mostly in Britain.

<sup>38</sup> Rungta, *Rise of Business Corporations in India*, p. 64.

<sup>39</sup> On the benefits to investors, see Hansmann, Kraakman, and Squire, “Law and the Rise of the Firm,” especially sect. 3.

<sup>40</sup> Kling, “Origin of the Managing Agency System,” p. 40.

By enabling companies to share risks and by channeling resources to areas where they would be most productive, the managing agency found it easier than an independent company, and much easier than a lone family, to borrow from banks.<sup>41</sup> Usually a managing agency controlled only a minority of the shares of a company under its management.<sup>42</sup> Hence, the shareholders of the typical individual company were free to terminate the agency agreement at the end of a contract period. However, this was a rare occurrence, which suggests that for individual companies the benefits of operating under a managing agency outweighed the risks.

For about a century, managing agencies controlled a huge share of India's industrial assets. Their domination was particularly pronounced in the largest and technologically most advanced industrial companies under private ownership. Before World War I, they controlled almost all the companies that dominated the tea, jute, and mining industries. At the birth of independent India in 1947, more than 90 percent of all assets were under their control in the jute textile, synthetic textile, cement, automobile, and metallurgy sectors.<sup>43</sup> As late as 1955, they controlled more than 70 percent of all the capital belonging to a publicly traded company.<sup>44</sup>

The commercial organizations that Europeans introduced to India—the joint-stock company and the managing agency—were governed by Anglo-Indian law, which was meant to serve all Indians, including indigenous communities. In providing new organizational options to both Muslims and Hindus, they allowed both groups to advance

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<sup>41</sup> Brimmer, "Setting of Entrepreneurship in India," p. 562.

<sup>42</sup> Although it would assume majority ownership of a new company, ordinarily it would sell most of its shares as soon as the company got established and the risk of its failure fell to levels tolerable to individual investors.

<sup>43</sup> Ghosh, "Industrial Concentration by the Managing Agency System," table 1.

<sup>44</sup> Kling, "Origin of the Managing Agency System," p. 38. See also Lamb, "Indian Business Communities," p. 110.

economically. Indians of all faiths gained the ability to exploit new technologies efficiently. Thus, whatever harm British rule did to certain subgroups, such as artisans whose livelihood was destroyed through industrialization, each of the major religious groups gained the ability to exploit new technologies efficiently.

Since our goal is to understand Hindu-Muslim divergence, it makes sense to identify separately what each group gained in terms of new opportunities. To Muslims accustomed to doing business through small and short-lived partnerships, the joint-stock company offered a vehicle for forming large and durable partnerships. The managing agency provided, in addition, the flexibility to reallocate resources quickly across sectors without restricting themselves to tiny and temporary organizations. The assets that they could invest in a modern company were not limited to real estate, as they were with the waqf. As for Hindus who had been doing business through joint-family enterprises, the joint-stock company offered opportunities to pool resources across family lines. It thus enabled them to enter sectors exhibiting substantial economies of scale and scope. Through the joint-family enterprise, Hindus were already able to invest for the long term without locking resources into a particular sector. However, the scale of their operations was no longer limited by their own family's resources. A complementary advantage of shifting resources to joint-stock companies was access to the professional management of a managing agency. Most family enterprises were too small to make professional management efficient.

Both Muslims and Hindus had reasons, then, to shift resources into modern companies. As technological advances steadily enlarged the segment of the economy in which success required long-term investment in heavily capitalized and professionally

managed enterprises, one might have expected both groups to have gravitated to joint-stock companies operating within the managing agency system. How, then, did the two groups respond to the new opportunities? And insofar as the responses differed, did pre-existing institutions play a role?

## 8. Muslim and Hindu Responses Compared

For answers, we must relate evidence concerning use of modern organizational forms to the population shares of the two religious groups. Data sets that lend themselves to identifying pertinent institutional choices allow the identification of Muslim Indians by their names, without room for serious doubt. As for the Hindus, their names overlap with those of Sikhs, who represented 1.2 percent of India’s population in 1931, and Jains, who represented 0.4 percent. It so happens that these two groups followed inheritance practices similar to those of the Hindus. Hence, for our purposes Sikhs and Jains can be treated as part of the Hindu population. Table 1 provides the relevant shares for the last four censuses of British India.

**Table 1.** *Hindu and Muslim Population Shares, 1901-31*

Religion	Year			
	1901	1911	1921	1931
Hindu	71.6	70.8	70.0	69.8
Muslim	21.2	21.3	21.7	22.2
Other	7.2	7.9	8.3	8.0

*Source: Census of India 1931 (I:I).*

*Note:* The “Hindu” figures include Jains and Sikhs. The “other” category includes the Parsees, an economically successful Zoroastrian community that represented around 0.03 percent of India’s population between 1901 and 1931.

One indicator of institutional switching lies in participation on the boards of publicly traded companies. Table 2 presents, for 1920 and 1940, the numbers of Hindus and Muslims serving as a director on the board of a publicly traded company listed in *Investor's India Yearbook*. As the arguments in the previous section would make one expect, it shows that both Hindus and Muslims took advantage of the new organizational forms that the British introduced to India. However, it also points to relatively greater participation on the part of Hindus. Already in 1920 Hindus were overrepresented on boards, and Muslims were underrepresented, vis-à-vis their respective shares of the native Indian population. In the waning decades of British rule, we learn further, the Hindu-Muslim gap was growing. Whereas the absolute number of Hindu directors increased by 158 percent between 1920 and 1940 (from 403 to 1043), that of Muslim directors increased more modestly, by 49 percent.

**Table 2.** *Hindu and Muslim Directors of Publicly Traded Companies, 1920 and 1940*

Year	Hindu population (%)	Hindu directors		Muslim population (%)	Muslim directors	
		number	%		number	%
1920	70.0	403	21.6	21.7	69	3.7
1940	69.8	1043	40.1	22.2	103	4.0

*Sources:* Population shares from Table 1. The 1931 census was used for 1940 because no Indian census was taken in 1941. Figures for directors compiled from *Investor's India Yearbook* for 1920 and 1940.

*Notes:* (1) The total number of directors was 1862 in 1920 and 2604 in 1940. In each case, the vast majority of the rest were Europeans. (2) The "Hindu" figures include Jains and Sikhs. (3) Hindus were disproportionately represented on boards in both years at the 99.9 level of statistical significance ( $\chi^2(1)=22.8$  and 147.2, respectively for 1920 and 1940).

The period covered by Table 2, 1920 to 1940, saw a tripling of the number of joint-stock companies registered in India.<sup>45</sup> In the course of this surge, the share of

<sup>45</sup> The number rose from 2,668 in 1918 to 10,657 in 1938 (Tripathi, *Oxford History of Indian Business*, p. 175).

capital held by companies under the control of native Indians jumped from 13 percent to 34 percent, and those held jointly by natives and Europeans rose from 15 percent to 26 percent.<sup>46</sup> Hence, in the period under consideration not only did Indian business undergo rapid organizational modernization but its ownership became more Indian. Evidently Hindu investors took greater advantage of the new organizational opportunities than Muslims did, and they played a disproportionate role in raising the share of Indian capital in modern businesses.

Additional information is obtainable from court data concerning the organizations that were party to lawsuits.<sup>47</sup> The *Bombay Law Reporter* contains an account of cases that came before the Bombay High Court between 1900 and 1947. Situated in India's largest city and leading commercial center, the Bombay High Court handled cases from all over India, including a disproportionate share of the commercial cases relative to the country's other high courts.<sup>48</sup> If Hindus embraced modern organizational forms more rapidly than Muslims did, this should show up in these records.

**Table 3. Institutions Used by Hindus and Muslims:  
Commercial Cases of the Bombay High Court, 1900-1947**

Religion	Contract		Partnership		Joint Family		Corporation		Total	
	no.	%	no.	%	no.	%	no.	%	no.	%
Hindu	260	42.4	113	18.4	108	17.6	133	21.7	614	100
Muslim	55	43.0	50	39.1	2	1.6	21	16.4	128	100

*Note:* The two distributions across institutions differ at the 99.9 level of statistical significance ( $\chi^2(3)=40.4$ ,  $p=0$ ). The use of contracts did not differ statistically across the two groups ( $t=0.3$ ). Muslims used partnerships disproportionately ( $t=13.6$ ). Hindus used the joint family and the corporation disproportionately ( $t=12.3$  and  $3.6$ , respectively).

<sup>46</sup> The remaining capital, 72 percent and 26 percent, respectively, was in companies controlled solely by Europeans. The figures are for 1918 and 1938. See Tripathi, *Oxford History of Indian Business*, p. 175.

<sup>47</sup> One would expect adjudicated cases to overstate the use of modern organizational forms. This is because individuals would have found it more profitable, on average, to sue a company with deep pockets than a traditional company or an individual, whose ability to pay would be more limited. However, there is no reason to expect the consequent bias to have affected the Hindu and Muslim shares of court participation or their observed uses of modern organizational forms.

<sup>48</sup> In the first half of the twentieth century, India had four chartered high courts. The other three were in Calcutta, Madras, and Allahabad (Ilbert, "British India," p. 306).

Table 3 divides into four categories all cases in which at least one Hindu, or one Muslim, or a Hindu- or Muslim-owned organization, appears as a litigant. It shows that in a bit over 40 percent of all the cases involving Hindus, a Hindu is party to what we are calling a “personal contract,” or simply “contract,” as a short-hand for an agreement entered into as an individual. If a Hindu agreed to buy land or deliver a brokerage service as an individual, that agreement would enter the table as a Hindu contract.<sup>49</sup>

The remaining three categories involve profit-seeking cooperative organizations with which we are familiar: the partnership, the joint-family enterprise, and the corporation.<sup>50</sup> In accord with our earlier findings, Muslims use the partnership more commonly than Hindus; for their part, Hindus make much greater use of the joint-family enterprise. Interestingly, the use of corporations does not differ significantly by religion, which would seem to conflict with the data on directors presented in Table 2.

Table 2 also showed that over the 1920-1940 period Hindus gained an increasing share of the board directorships, in contrast to Muslims, whose share stagnated. Might the data in Table 3 be hiding a similar pattern? Table 4, which splits the 1900-1947 period into two equal subperiods, 1900-1923 and 1924-1947, provides pertinent information. In the first subperiod, the corporation was used about equally by the two groups. In the second period, however, a significant gap emerged, as the frequency more than doubled

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<sup>49</sup> Debt contracts among individuals with no identifiable organizational or sectoral affiliation are excluded from the sample. Here is an example of such a case that involves a promissory note known as *hundi*: “Yogi Kumar issued a promissory note to Mohamed Khan for Rs. 50 in 1903 in Lucknow. Mr. Khan was unable to redeem it due to an error in the form attached to the promissory note. The court orders Kumar to pay Mr. Khan Rs. 50 and accrued interest immediately.” From this brief account of the case, we cannot tell whether the two sides were partners, co-workers in a corporation, or just friends; nor do we learn about the economic sectors of the two sides. The brevity of the account probably means that other information was irrelevant. The cases included in our sample typically contain a much richer array of information.

<sup>50</sup> A few cases involve an organization whose type was unclear. They were excluded from the counts.

among Hindus but stayed roughly the same among Muslims. The second subperiod, 1924-47, overlaps substantially with the period covered by the data on directors, 1920-40. The Bombay High Court data confirm, then, that in final quarter-century of British rule in India the country's Hindus were making the transition to corporate life more rapidly than its Muslims. The second period coincides with the emergence of new opportunities through, on the one hand, British departures and, on the other, the Great Depression. Evidently, Hindus took advantage of those opportunities more readily.

One may wonder whether differences in intra-communal dispute resolution systems, affected the use of Anglo-Indian courts. If Muslim dispute resolution institutions were particularly strong, the presented Bombay court patterns might have reflected the under-representation of Muslims. However, the earlier data on the distribution of company directors makes this highly unlikely. In any case, there is no evidence that Muslim intra-communal mediation or adjudication institutions handled cases involving modern organizational forms.

**Table 4.** *Use of Corporation by Hindus and Muslims: Commercial Cases of the Bombay High Court, 1900-1923 and 1924-1947*

Religion	Subperiod	Total cases	Use of corporation	
			number	%
Hindu	1900-1923	291	38	13.1
	1924-1947	323	95	29.4
Muslim	1900-1923	68	11	16.2
	1924-1947	60	10	16.7

*Notes:* For 1900-1923, the Muslim and Hindu shares are statistically identical ( $t=1.7$ ). For 1924-1947, the Hindu share is greater at the 99.9 percent level of significance ( $t=5.6$ ). Whereas the Hindu share rises significantly across the two periods ( $t=9.8$ ), the Muslim share stagnates ( $t=0.2$ ).

If Muslims made low use of the joint-stock company, they would have had a limited use for managing agencies, because the religious and caste affiliations of investors were highly correlated with those of managing agency directors to whom they entrusted capital. One would expect Muslims to be under-represented among the directors of managing agencies. Data from 1951, a few years after India's partition, bear this out. Of 3,944 domestic managing agencies operating in India in that year, only 43, or 1.1 percent of the total, were directed by Muslims.<sup>51</sup>

## **9. Institutional Determinants of the Divergence**

With the emergence of new economic sectors in which success requires sustained investments in professionally managed and heavily capitalized enterprises, both Muslims and Hindus had much to gain from plowing capital into joint-stock companies operating within the managing agency system. The requisite adjustments required capital owners to trust strangers and also non-human entities. Personalized trust, which develops among people with personal ties to each other and results from repeated interactions within networks of cooperation, was not enough. It had to be supported by generalized trust, which transcends face-to-face interactions and extends to impersonal organizations.<sup>52</sup>

Yet, during the first half of the twentieth century generalized trust was low in India even by today's Indian standards. Although people trusted family members and acquaintances, they tended to distrust strangers and were unaccustomed to dealing with impersonal organizations. Neither Muslims nor Hindus felt comfortable with placing

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<sup>51</sup> Nigam, *Managing Agencies in India*, p. 104-225. The share was generated through a manual count.

<sup>52</sup> On these distinctions, see Putnam, *Making Democracy Work*, especially chaps. 4, 6; Fukuyama, *Trust*, especially chaps. 3, 13; Uslaner, *Moral Foundations of Trust*, chaps. 2, 3, 5; La Porta, Lopez-de-Silanes, Shleifer, and Vishny, "Trust in Large Organizations"; and Mayer, Davis, and Schoorman, "Integrative Model of Organizational Trust."

capital under the control of strangers, as we now do routinely in buying shares of companies with thousands of other shareholders and managers unknown to us personally. However well they understood the advantages of pooling capital with non-relatives within a joint-stock company, they strove to avoid the financial risks inherent in transacting with strangers.

Due to differences between their inheritance systems, Hindus found it easier than Muslims to achieve a satisfactory balance between the two conflicting needs, personal financial control and efficient capital pooling. This is an important reason, we shall now see, why Hindus played a more important role than Muslims in India's transition to corporate life.

Consider first a Hindu family that wishes to broaden its investment portfolio by entering mass manufacturing. To do so, it must raise capital from outside the family, turning its joint-family enterprise into a joint-stock company. The structural similarities between the joint-family enterprise and an agency-managed joint-stock company will facilitate the transition. Though restricted in scale, the former was functionally similar to the joint-stock company, in that a family patriarch managed resources on behalf of family members, usually with the help of selected male relatives. In establishing a joint-stock company formally, a family gained the ability to draw capital into its businesses from non-relatives. It would want to do so in a controlled manner, without opening up its businesses to strangers or losing control over their management. In fact, Hindu families tapped into communal networks, which were usually based on caste ties; and they tended

to limit non-family ownership.<sup>53</sup> In selecting a managing agency, too, they paid close attention to informal bonds.

This is a major theme in historical accounts of Hindu families that ran prominent and long-lasting businesses. The Lalbhai family, a branch of a Gujarati family that amassed a fortune in the seventeenth century, provides one example. In 1897 it founded the Saraspur Manufacturing Company as a joint-stock company, raising part of the required capital from distant relatives and members of their caste. A cousin of the patriarch served as chairman of the company, and three other relatives had a majority share in the managing agency to which it was entrusted. In the first half of the twentieth century, the Lalbhais established nine other joint-stock companies over which they maintained control.<sup>54</sup>

The death of a family patriarch in control of one or more joint-stock companies always carried the possibility of conflict among descendants. One of his sons might want to go his own way, selling his shares to outsiders. If he succeeded, the family would lose its majority control. If the family pressured him to back off, it might be faced with a disgruntled shareholder capable of compromising its ability to present a united front. However, commercially prominent Hindu families had a long tradition of keeping the family united and managing splits amicably. The history of a successful family, usually common knowledge, dampened the risk of converting a joint-family enterprise into a joint-stock company. It also limited the risk assumed by outsiders who invested in a family-dominated company.

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<sup>53</sup> Non-relatives contributed capital on the basis of trust grounded in those same ties.

<sup>54</sup> For more details, see Tripathi, *Dynamics of a Tradition*; Tripathi, *Business Houses*, pp. 88-102; and Hazari, *Structure of the Corporate Private Sector*, p. 247.

With the exceptions addressed below, Muslims did not start from a joint-family enterprise. So for them establishing a family-controlled joint-stock company was not a realistic option. It was much more likely to involve investment in an organization dominated by non-relatives, even strangers. Hence, for Muslims the perceived risks of investing in a joint-stock company were greater than those of Hindus whose capital had been family-controlled.

The Islamic inheritance system posed a further difficulty. Imagine that a wealthy Muslim businessman founds a joint-stock company in which he controls 60 percent of the shares and four others, none a relative, the remaining 40 percent. At his death, his shares fall to his two sons, each of whom receives shares representing 20 percent of the company, and two daughters, who get 10 percent each. The founder's family can retain control of the company by acting in unison. However, under Islamic inheritance rules heirs are entitled to go their separate ways with their shares of the estate. Moreover, they do not need anyone's approval to transfer shares to someone else. Thus, nothing would keep one of the sons in question from selling his 20 percent share to someone unknown to, or disapproved by, the rest of the family. If he did so, the family would lose its majority ownership and, therefore, its control over the company's policies and long-term strategy. The fact that the Islamic inheritance system extended inheritance rights to women compounded the difficulties of maintaining family control over a joint-stock company.

As we saw earlier, under Anglo-Indian law Indian companies could adopt rules that allowed existing shareholders to veto share transfers. These rules were in conflict with a core principle of the Islamic inheritance system: the individual's irrevocable and

unrestricted right to convert his or her share of an estate into cash. Granting families some control over the shares of its members would have amounted to letting laws governing joint-stock companies trump Islamic inheritance principles. Yet, as we also saw, in the course of the nineteenth century British judges were enforcing the Islamic inheritance system more vigorously than the Mughals had. We might add here that Muslims were relatively more aware of legal details, because their schools put great emphasis on Islamic law. For that reason, one might expect conflicts between Anglo-Indian law and traditional legal principles would have weighed more heavily, then, on Muslims than on Hindus.

In a nutshell, although the new organizational options gave Muslims opportunities to accumulate and preserve capital more easily than before, they also put them on the horns of a dilemma: the choice between obeying a religious requirement and limiting commercial risks. To avoid that dilemma, they may have found it convenient to preserve capital within family waqfs, generally considered compatible with Islamic law. The advantages of the waqf, including its Islamic legitimacy, may have outweighed its disadvantages. The evidence presented in previous sections suggests that they did.

One might wonder why the waqf was not used to finance industrial enterprises. First of all, the waqf could not be used to supply the liquid capital such enterprises need. The rules, as widely understood, required the waqf endowment to consist exclusively of real estate. Second, the capital of a waqf was not sufficiently fungible. If a waqf's capital consisted of five stores, by tradition those stores could be swapped for similar stores with the permission of a judge; converting the real estate of existing waqfs into factory would have required legal reinterpretations. For both these reasons, as the British exodus opened

up new opportunities, pre-existing Indian waqfs could not be adapted to new needs. Yet another obstacle to industrial uses of the waqf is that, again under the rules, they were not allowed to merge with other waqfs, or to adjust their functions, in the interest of attracting more capital. Practices could be altered, one might observe, without violating the letter of any given legal requirement. The patterns reported above indicate that, even if the prevailing rules were not strictly binding, the availability of the waqf alternative did not compensate for the Muslim lack of experience with joint-family enterprises.

Because modern organizational forms require the use of written documents, differences in education levels, whether general educational achievement or English-language competence, probably had something to do with the observed patterns. But they could not explain huge inter-communal discrepancies such as those in the director data reported in Table 2. In the period under consideration Hindus dominated commerce even in areas, such as the United Provinces, where the Muslim literacy rate exceeded the Hindu rate.<sup>55</sup> Certain commercially prominent castes that did well in the period, such as the Hindu Baniyas, eschewed English education until much later.<sup>56</sup> Finally, Bengal, where English education started, was a laggard in regard to economic modernization.<sup>57</sup>

The specter of losing control of one's capital through estate fragmentation haunted both Hindus and Muslims. The gist of our argument is that the perceived risks would have been relatively greater for Muslims both because they were subject to different inheritance rules and because they started with different business traditions. It was easier to maintain family control over a company under Hindu inheritance principles

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<sup>55</sup> Kochhar, "English Education in India," p. 2610; and Brass' *Language, Religion, and Politics in North India*, p. 148. The Muslims of the United Provinces were generally poorer than its Hindus.

<sup>56</sup> Tripathi and Mehta, *Business Houses in Western India*, pp. 23-24, 76.

<sup>57</sup> Tripathi and Mehta, *Business Houses in Western India* pp.19-22; and Tripathi, *Oxford History of Indian Business*, p. 71.

than under Islamic principles. Besides, Hindus were already accustomed, through centuries of experience, to operate long-living family businesses and to keep them going by resolving intra-familial disputes.

## **10. The Role of Sectoral Choices**

Thus far the analysis has focused on organizational choices without attention to systematic intercommunal differences in sectoral choice. Yet the identified differences in the use of the corporation could reflect differences in sectoral concentration across the two communities. The corporation would have been less useful to a neighborhood grocery store than to a national bank. The Bombay High Court data permits a refined analysis involving sectoral distinctions.

Table 5 provides the sectoral breakdown of the corporation cases presented in Table 4. As might be expected, it shows that the corporation gained popularity in finance, clothing, and manufacturing, in that order. We already knew that Hindus contributed to the transformation disproportionately. That evidence is replicated here: the increased use of the corporation in these sectors was driven almost entirely by Hindu organizational decisions.

The role of sectoral choices can be examined through multivariate logistic regressions. To facilitate interpretation, we present, in Table 6, the resulting odds ratios. Of the four regressions shown in this table, the first two pertain to the full sample, and the others to the 1924-47 period, when the use of the corporation more than doubled.

**Table 5. Sectoral Breakdown of the Corporation Cases:  
Bombay High Court, 1900-1923 and 1924-1947**

Sector	Subperiod	Use of corporation					
		Total		Hindus		Muslims	
		all	with corp.	all	with corp.	all	with corp.
Finance	1900-1923	60	16	54	13	6	3
	1924-1947	88	48	80	47	8	1
Clothing	1900-1923	78	10	71	9	7	1
	1924-1947	104	27	93	25	11	2
Manufacturing	1900-1923	78	19	57	13	21	6
	1924-1947	86	21	62	17	24	4
Retail	1900-1923	28	3	22	2	6	1
	1924-1947	40	4	36	3	4	1
Agriculture	1900-1923	55	1	43	1	12	0
	1924-1947	57	2	47	1	10	1
Other*	1900-1923	60	0	44	0	16	0
	1924-1947	8	3	5	2	3	1
Total	1900-1923	359	49	291	38	68	11
	1924-1947	383	105	323	95	60	10

\* Services, transportation, and miscellaneous goods.

**Table 6. Odds Ratios of Logistic Regressions on Use of Corporation  
Bombay High Court, 1900-1947**

Independent variables	Full sample		1924-1947 alone	
	Baseline specification			
	(1) Muslim	(2) Muslim Clothing	(3) Muslim	(4) Muslim Clothing
Hindu	1.41	1.18	2.08*	1.98*
Finance		2.99***		3.43***
Manufacturing		1.30		1.02
Retail		0.45*		0.31**
Agriculture		0.11***		0.11***
Other		0.19***		2.05
McFadden R <sup>2</sup>	0.002	0.122	0.010	0.141

\*, \*\*, \*\*\* indicate statistical significance at the 90%, 95%, and 99% levels.

In each of the four specifications, an odds ratio captures the change in the marginal probability of using the corporation as a result of a switch from the baseline

variable to the independent variable. Thus, in specification (2), moving from the residual clothing sector to the finance sector almost triples the odds of using the corporation; and moving instead to the agriculture sector reduces it to around a tenth. The variable “Hindu” is above 1 in all specifications, though statistically significant only in those restricted to the 1924-47 period. Specifications (2) and (4) confirm that the use of the corporation depended on sectoral choice. The odds of using the corporation were much higher in finance, clothing, and manufacturing than in retail or agriculture.<sup>58</sup>

Collectively, these results suggest that in late British India, and especially in the 1924-47 period, the sectoral choices of Indians reflected their institutional capabilities. Hindus tended to use the corporation more readily, because they operated disproportionately in those sectors in which its use was becoming efficient; and they entered those sectors in the first place because they were institutionally prepared to do so. For their part, Muslims tended to stay out of sectors in which traditional partnerships were becoming increasingly disadvantageous. Both sides acted rationally, it appears, given their respective institutional capabilities.

The entire empirical exercise suggests, then, that as the British role in the economy diminished during the half-century leading to Indian independence in 1947 indigenous Indians specialized in ways compatible with their institutional capabilities. Hindus came to play an increasingly dominant role in the sectors in which the use of the corporation was particularly useful. This is consistent with the central institutional claim of the paper, namely, that the institutions through which Hindus pooled resources and

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<sup>58</sup> Adding religion-sector interaction terms to specifications (2) and (4) yields no significant effect. There is nothing to suggest, therefore, that within sectors choices broke down on religious grounds.

transferred wealth across generations provided a better foundation than those of Muslims for making the transition to modern economic life.

## **11. The Case of Nonconforming Hindus and Muslims**

We had mentioned in passing that some Hindus and some Muslims followed practices at odds with the general pattern of their faith. For our purposes here, these subgroups may be characterized collectively as “nonconforming Hindus” and “nonconforming Muslims.”

Although the inheritance practices of most Hindus were geared toward keeping family capital intact, those of Bengali Hindus promoted capital fragmentation, much like the canonical Islamic inheritance system.<sup>59</sup> Our institutional interpretation would make one expect the nonconforming Hindus of Bengal to have done less well commercially in late British India relative to the Hindus of other regions. In fact, in the first half of the twentieth century the most lucrative businesses in Bengal fell under the control of the Hindu Marwari caste, which was concentrated in Western India, unless they were controlled by Europeans.<sup>60</sup>

To turn now to Muslims exempt from Islamic inheritance requirements, if their egalitarianism and their enforcement by Anglo-Indian courts in the settlement of Muslim estates did indeed affect Muslim organizational choices, this should be reflected in relative economic performance indicators.<sup>61</sup> In particular, nonconforming Muslims

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<sup>59</sup> The Hindus of Bengal followed the Dayabagha code rather than the Mitakshara. See the references of n. 16.

<sup>60</sup> Onkar, “Then Came the Marwaris” and Tripathi, *Oxford History of Indian Business*, pp. 127-28, 168.

<sup>61</sup> The term is not meant to suggest that major variations among Muslim practices were limited to inheritance practices. For our purposes here, it is these variations that were critical.

should have started using modern organizational forms more rapidly than their “conforming” coreligionists.

Nonconforming Muslims originated in four castes that maintained Hindu inheritance practices even after conversion to Islam, for many centuries through India’s colonial period. They are the Khojas, Bohras, Memons, and Girasias.<sup>62</sup> Conscious of their particularities, British judges allowed them to keep settling estates as they had for centuries. In 1921, the nonconforming Muslim population was approximately 300,000, which corresponded to 0.4 percent of the total Muslim population of 68.7 million.<sup>63</sup> The Indian census ceased to record caste affiliation after 1921, but the share could not have been much different in 1900, 1940, or 1947.

**Table 7. Conforming and Nonconforming Muslim Directors of Publicly Traded Companies, 1920 and 1940**

Year	Conforming Muslim population (%)	Conforming Muslim directors		Nonconforming Muslim population (%)	Nonconforming Muslim directors	
		number	%		number	%
1920	99.6	27	39.1	0.4	42	60.9
1940		60	58.3		43	41.7

Sources: Population shares from *Census of India 1921* (I:I, 74). Figures for directors compiled from *Investor’s India Yearbook* for 1920 and 1940.

Notes: Nonconforming Muslims were disproportionately represented on boards in both years at the 99.9 level of statistical significance ( $\chi^2(1)=6332.9$  and 4420, respectively for 1920 and 1940).

Revisiting the data on the directors of publicly traded companies, let us disaggregate the Muslim figures to see whether nonconforming Muslims stand out as

<sup>62</sup> The first two are Ismaili Shii, and the latter two Sunni. Only the first three have traditionally concentrated on commerce. On their histories and institutions, see Blank, *Mullahs on the Mainframe*; Engineer, *Muslim Communities of Gujarat*; Papanek, “Khoja Ismaili Community”; Rattansi, “Islamization and the Khoja Ismaili Community”; Lokhandwalla, “Islamic Law and Ismaili Communities”; and Talha, *Economic Factors in the Making of Pakistan*, pp. 87-88.

<sup>63</sup> Timberg, *Industrial Entrepreneurship among the Trading Communities of India*, p. 106; and *Census of India 1921* (I:I), p. 74.

different. Table 7 shows that they were disproportionately likely to serve on the board of a publicly traded company in both 1920 and 1940. This is consistent with our presented thesis. If the Islamic inheritance system was a major obstacle to Muslim adoption of modern organizational forms, Muslims able to circumvent Islam’s egalitarian inheritance provisions would have made the transition to modern economic life more easily.

In turning to data from the Bombay High Court, we find again that nonconforming Muslims show up very disproportionately (Table 8). The two cases involving Muslim use of the joint-family enterprise belong, unsurprisingly, to nonconforming Muslims. This fact accords with their exemption from traditional Islamic inheritance practices. Nonconforming Muslims were also much more likely than conforming Muslims to appear in the records in connection with a corporation.

**Table 8.** *Institutions Used by Conforming and Nonconforming Muslims: Commercial Cases of the Bombay High Court, 1900-1947*

Form of Islam	Contract		Partnership		Joint Family		Corporation		Total	
	no.	%	no.	%	no.	%	no.	%	no.	%
Conforming	40	47.6	34	40.5	0	0	10	11.9	84	100
Nonconforming	15	34.1	16	36.4	2	4.5	11	25.0	44	100
Both	55	43.0	50	39.1	2	1.6	21	16.4	128	100

*Note:* Contracts are used disproportionately by conforming Muslims ( $t=3.1$ ), and the joint-family and corporation by nonconforming Muslims ( $t=4.1$  and  $4.0$ , respectively), all at the 99.9 percent level of significance.

## 12. Conclusions

It is not surprising that the underperformance of India’s Muslims had causes related to the economic trajectory of the Middle East. As in the Middle East, the Islamic inheritance system hampered economic modernization by fragmenting successful businesses, by discouraging the pooling of resources on a large scale, and by driving capital from flexible commercial ventures to inflexible family waqfs. Muslims thus fell

behind not because Islam is averse to commerce, enrichment or innovation but, rather, because it induced Muslims to operate in the emerging modern economy through institutions poorly suited to forming large and long-living enterprises able to reallocate resources efficiently according to changing opportunities. They ended up specializing in economic sectors in which forming large organizations was inessential to success.

However, the parallels end there. In the Middle East, Islamic inheritance practices took shape in the early Islamic centuries, and they became self-enforcing through the insistence of heirs who benefited from their egalitarian features. No outside party played a role in their adoption or perpetuation. By contrast, in India Islamic inheritance practices were poorly enforced through the eighteenth century. Subsequently, they were enforced more tightly, at the initiative of the British. British judges promoted the Islamic inheritance system at a time when preventing capital fragmentation and preserving successful businesses was becoming increasingly critical to economic performance. They made inheritance practices of Indian Muslims take on a Middle Eastern character just as their economic drawbacks were becoming starkly evident in the Middle East itself.

The role of the waqf, too, differed between the two regions. In the Middle East, the waqf, including its variety used to keep wealth within families, played massively significant roles in economic life long before modern technologies raised the costs of immobilizing resources. In India, the waqf was never as important; and the family waqf became an Indian institution only in the nineteenth century. Again, Indian Muslims adopted a Middle Eastern institution poorly suited to a rapidly changing business environment just as the Industrial Revolution and its accompanying institutional transformations generated huge new opportunities for enrichment.

Another critical difference concerns choice of law. In the Middle East, religious minorities enjoyed the freedom to do business under a legal system of their choice; from the dawn of Islam the Muslim majority denied itself that freedom. Hence, as the rise of modern economic institutions in the West made it increasingly disadvantageous to save, invest, produce, and exchange through Islamic institutions, Christians and Jews became “economically westernized,” and their switches enabled them to pull ahead of Muslims economically. In India, non-Muslims, most of whom were Hindus, had not shown much interest in Islamic commercial institutions or inheritance practices. Hence, unlike the non-Muslims of the Middle East, they did not have to decide whether to switch out of Islamic law. As for Muslims, relative to their co-religionists in the Middle East, they had been using Islamic institutions less regularly and less uniformly. Their adherence to Islamic law became stricter under British rule, at least in regard to property relations.

The British administrators of India made their legal system available to everyone, including both Hindus and Muslims. Yet, these communities differed in their incentives to adopt Anglo-Indian institutions. Hindus were able to switch relatively easily, because their traditional instrument for pooling and preserving capital, the joint-family enterprise, was structurally similar to the joint-stock company, one of the organizational forms supported by Anglo-Indian law. They used joint-stock companies to accumulate and exploit capital, gradually increasing the Hindu shares of their owners and managers, at the expense of Europeans. As for Muslims, they made disproportionately few switches. One reason, we have suggested, is that for them the required institutional leap was greater. With the exception of nonconforming groups that followed Islamic practices selectively, they had no tradition of family enterprises. Also, the Islamic inheritance

system made it difficult to maintain control over the use of family capital placed in a joint-stock company. For both reasons, they tended to avoid sectors in which success depended increasingly on use of the corporation.

The upshot is that religion did make a difference to the economic performance of India's main religious groups. The capital pooling and inheritance regimes associated with Islam and Hinduism affected the rates at which Muslims and Hindus took advantage of the new economic opportunities that emerged through the Industrial Revolution and associated global transformations.

This interpretation does not rely on attitudinal differences between the two religions. It does not depend on inter-faith variations in openness to change, aversion to risk, commercial talent, or economic rationality. Islam and Hinduism affected the economic trajectories of Muslims and Hindus by shaping the institutional matrix within which each community made economic choices.

Muslims fell behind Hindus also in areas other than commerce and industry. As already noted, education offers a case in point.<sup>64</sup> Mechanisms leading to differences in either the demand for education or its supply could have contributed to Muslim underperformance, with factors other than commercial institutions playing leading roles. Yet, such alternative mechanisms would not have operated in isolation from those sketched here. Relative to a person serving on a corporate board, an Indian operating a retail store in the manner of his forefathers had less need to acquire a modern education or learn a foreign language. Our central claim is that mechanisms affecting institutional choices regarding investment and inheritance contributed substantially to the observed

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<sup>64</sup> In 1871-72, the share of Muslims in schools recognized by the British administration was substantially lower than the Muslim share of the population in Punjab, Bengal/Assam, Madras, and Bombay (Kochhar, "English Education in India," p. 261).

Hindu-Muslim economic divergence. Those mechanisms would have had second-order consequences that remain to be explored.

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