Institutions in the Indian Cotton Trade in the 19th and Early 20th Century

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Between December 1911 and January 1912, Arno Schmidt, the secretary of the International Federation of Master Cotton Spinners and Manufacturers, visited India to gather information on cotton cultivation and trade on the subcontinent at first hand. In his report, he showed himself shocked about certain practices common in Indian cotton trade. For instance, he could witness that Indian cotton was regularly watered in certain regions to arise its weight. Furthermore, he found evidence that the bales of cotton were often tampered by enclosing dirt, stones, cotton waste or cotton of a lower quality. It was evident, he wrote “that every spinner who receives such cotton sustains a heavy loss”\textsuperscript{1}. Such frauds, however, were notorious and had given Indian cotton a bad name for many decades. Schmidt therefore advised European spinners to buy Indian cotton only from „reputable European cotton firms“, which could act as „intermediaries between spinners and farmers“ and could not get hoodwinked as easily as newcomers. „Besides, the spinners have somebody to claim for recourse if a fraud has occured.“ And he concluded that since crooked customs in the handling of cotton were probably more frequent in India than anywhere else, a „cotton broker or exporter was more needed in India than in any other country.“\textsuperscript{2}

The report of Arno Schmidt leads to the topic of my paper. I want to show that the endeavours of the British government to regulate cotton production and in-country trade were doomed to failure due to local business structures in India, and I want to show why exactly for this reason specialised European cotton merchants were necessary to guarantee European spinners a certain quality of Indian cotton. I therewith take a distinctly different position from those prevailing in many studies on commodity trading, which too often reify the international market and portray the “law of supply and demand” as a structural dictator.\textsuperscript{3} Instead I argue for an information based view on the economy as it is postulated by Mark Casson and others.\textsuperscript{4}

Under this perspective, trading companies play an important role in creating a global market,

\textsuperscript{1} Arno Schmidt, Baumwollkultur in Indien. Bericht über Reise nach Indien, Dezember 1911-Januar 1912, hg. vom Internationalen Verband der Baumwoll-Spinner- und –Weber-Vereinigungen, o.O., o.J., p. 34.

\textsuperscript{2} Ibid., p. 84.


since they possess soft skills as knowledge about the reliability of business partners, about local business practices and about the products they traded, as Geoffrey Jones has pointed out. Therefore, they can reduce transaction costs and bring together buyers and sellers on different continents.\(^5\) Trading companies, though they have not found the scholarly attention they deserve up until recently,\(^6\) were – and still are today – important organisations to reduce transaction costs in economic environments, in which formal institutions either lacked or were not sufficient. One way to do this, of course, was by means of a vertical integration of certain transactions within the firm, as Ronald Coase has pointed out.\(^7\) The internalisation of transactions within the firm, however, resulted in new transaction costs within the firma and created path dependencies, which influenced the decisions the firm had to take later on.

I will present these processes by the example of the Swiss merchant house Volkart Bros. Volkart was founded in 1851 in Bombay and Winterthur simultaneously. The firm acted as exporter of Indian commodities into Europe and importer of European industrialised goods into India. The firm opened five additional branches in India and one each in Colombo and London until the end of the 19\(^{th}\) century and later on branches and subsidiaries in China, Japan, Singapore, Germany and the United States. Therewith, Volkart became one of the largest exporters of Indian raw cotton at the end of the 19\(^{th}\) century and one of the top five cotton shippers in the world in the 20\(^{th}\) century.\(^8\)

### 1. The peculiarities of the Indian Cotton trade

After the middle of the 19\(^{th}\) century, the exports of Indian raw cotton were steadily rising. India became the second largest supplier of cotton in the world after the United States.\(^9\) European businessmen, which were active in the chain of transactions between cotton producing countries and the cotton mills in Lancashire and on the European continent had every interest in reducing the numerous incertitudes in this line of trade by installing a set of

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6 This results on the one hand from the discretion of their business and the inaccessibility of their archives, on the other hand from the fact that economists and business historians seemed to underestimate the role of transaction costs in 19\(^{th}\) and 20\(^{th}\) century global trade for a long time.
regulations. Standardised qualities and samples at the Liverpool cotton exchange provided a basis to agree on quality and price of cotton to be delivered in the future. The cotton exchanges of Liverpool and Bremen installed arbitration courts which settled disputes about quality, amount or time of delivery. And ingenious insurance policies and bills of lading tried to share responsibility for the cargo between ship-owners and exporters during transport.\textsuperscript{10} However, all these formal institutions, which ultimately were enforced by European civil law, were completely useless to regulate the quality of cotton offered for sale in local Indian markets. The comments of Arno Schmidt, quoted above, are just one example of the frequent complaints on the quality of Indian cotton and the business practices in India in the 19\textsuperscript{th} and early 20\textsuperscript{th} century.\textsuperscript{11} The reasons for the frequent frauds have to be sought after in the business structures within India. In India, Cotton was not planted on large plantations as in the USA, but it was cultivated by ryots, petty farmers, who planted cotton in addition to other crops and never were able to gather more than one or two bales on their land. Since they lacked capital, they had to sell their crop in advance to local moneylenders. The moneylenders though were not rich enough to do business without credits from traders in large inland towns, who again acted as agents for wealthy native merchants in Bombay and other Indian coast cities. Therefore, the Indian cotton crop was transferred from owner to owner after harvest until it arrived finally at the coast where it was shipped to Europe or Japan. The ryot, who sold his cotton in advance, received no extra-pay for high quality and no discount for poor quality. He was just obliged to provide a certain amount on cotton to his middleman. The same was true for the other dealer in the inland trade. And since cotton generally was sold by weight, each owner was tempted to water the cotton or to admix dirt, seed or cotton of a lower quality to achieve a higher profit. Since all cotton was equally adulterated until it reached the coast, the European or Indian merchants who exported it to Europe or East Asia had no choice but to take it on.\textsuperscript{12}

The manipulations, however, got so frequent that in the 1860s, the British introduced a new law in Bombay, Indian’s first export harbour for cotton, the ‘Cotton Fraud Act’. However this

\textsuperscript{10} Max Ziegler, Der Import ostindischer Baumwolle, insbesondere die Entwicklung der Geschäftsformen, in: Mitteilungen aus dem handelswissenschaftlichen Seminar der Universität Zürich. Neue Folge, Heft 45, Zürich 1922.
act never became operative since the colonial government was anxious not to provoke aversions with Indian merchants and farmers and therefore advised its officials to be very prudent in the application of the new law. Furthermore, the act provoked opposition from the Bombay and Manchester chambers of commerce, since the Indian government took up to raise a duty on every bale of cotton the officials used to control. Hence the Cotton Fraud Act was withdrawn in 1882, wherefore the problem of the adulteration of cotton remained virulent until the 1920s.\(^\text{13}\) The buying of cotton in India was hardly regulated by formal institutions in the 19\(^\text{th}\) and early 20\(^\text{th}\) century. In case of a damage discovered after the transaction had taken place, there was no way to prosecute the native seller.\(^\text{14}\)

Since official regulations didn’t work out efficiently, European merchants hoped on the ability of the Bombay business circles to organise a system of quality control on their own. Salomon Volkart, co-founder of the firm Volkart Bros., wrote in a letter to his agency in Bombay in 1870: „It would be simplest and for all parties concerned the most reliable solution if you could succeed to establish a form of syndicate at the spot there, which took the trouble to classify the shipped cotton according to assessments, the latter being as close as possible to those in Liverpool.“ Salomon Volkart, however, did not seem to be very optimistic on the ability of the Bombay cotton market to organise such a means of control. Therewith he continued: „If it will all come to nothing on the spot there we take comfort in the certainty that you are assigned to buy most of the cotton up-country where you have more occasions and a major security for the selection of the same.“\(^\text{15}\)

Indeed, it was not the self organisation of the Bombay merchants but the opening of up-country buying agencies, which helped the European merchant houses to control the quality of the purchased cotton. Volkart began with up-country purchase of cotton in the 1860s, after the British government and British capitalists had pushed the building of the Indian railways system.\(^\text{16}\) With this step of back-ward integration of purchase, an integration of ginning and pressing became necessary, since up-country, the merchants purchased kappas, cotton with seeds. By the control of the whole commodity chain of purchase, ginning and pressing, established by big merchant houses since the end of the 19\(^\text{th}\) century,\(^\text{17}\) the merchant’s ability

\(^{13}\) Harnetty, Imperialism and Free Trade; see also Charles W. MacAra, Trade Stability and How to Obtain It, Manchester 1925, p. 204ff.


\(^{15}\) Volkart Archive, Winterthur (VA), Privat-Copierbuch 9.1.1867-25.8.1870, 7.7.1870 Winterthur nach Bombay.


to select the purchased cotton was strengthened. In a Volkart booklet from 1921, this development was resumed like this: „With the spread of the Indian railroad network, … the necessity asserted itself to purchase the commodity as often as possible in the area of production by bypassing the intermediaries and led to the opening up of the up-country buying agencies.“ The integration of the up-country purchase and treatment of cotton in India proved to be very successful for Volkart. The firm could raise their turnover and became, together with the Greco-British firm Ralli Bros., the main exporter of Indian raw cotton at the end of the 19th century.

However, a reduction of transaction costs by integrating transactions formerly carried out in the market was only possible if the firm averted opportunistic behaviour of its staff. Defalcation or unauthorized speculative dealing a constant threat for every trading companies since trading business based predominantly on independent decisions of staff members, who were stationed far away from head-office and were therefore difficult to supervise by the principals. Volkart was affected on various occasions by frauds of its employees and hence tried to reduce the menace of opportunistic behaviour by installing varied monitoring devices in its branches and by enforcing the commitment of staff members to the firm by providing adequate wages and excellent social security for European as for Indian staff. These measures endorsed the emergence of an „atmosphere of trust between executive board and staff”, a feature, which, according to a letter from the Winterthur head-office from 1936, “may not prevent the concealment of fraudulent behaviour of employees, as much as of supervisors, but may impede it considerably.” These combined efforts to opportunistic

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20 VB news, No. 9, December 1923, S. 14-16.
23 VA, Dossier 18: Winterthur I - 2 Functions of the HO (Winterthur); Dossier 64: Geschäftsordnung 1915/1921 mit Nachträgen bis 1940 / Upcountry Bookkeeping Instructions 1912-1926 / Upcountry Instructions 1952
behaviour of staff members can be seen as both formal and informal institutions, which helped to reduce transaction costs within the firm.\textsuperscript{26}

The opening of up-country buying agencies furthermore allowed Volkart to establish certain standardised types of cotton in the 1870s, which had distinct attributes in regards to their colour, length of their staple and their firmness. The establishment of these types became very important for the business of Volkart’s. As Salomon Volkart had emphasised in a letter to Bombay in 1870: „If you could succeed in assess certain types of Oomra and to persist on them, this would be of great importance to our business. The qualities should be designated by spezial brands and if they emerged always consistent the customers would know what they had to expect from our cotton at any time.“\textsuperscript{27} The selection of these types was made by reference to the classements of the Liverpool Cotton exchange, which were regarded as standards in the global cotton trade. Volkart called its own cotton types “Bombay Classements”\textsuperscript{28} and succeeded in establishing them as standards for Indian cotton in course of time. Volkart could therefore establish a distinct „brand V.B.\textsuperscript{29}, which was remunerated especially well by certain customers“, as it was stated in a letter from the Winterthur head office in 1922.\textsuperscript{30} In addition, these standardised types allowed Volkart to hedge its transactions on the future markets against price fluctuations.\textsuperscript{31}

\section*{2. Customer’s orientation as informal institution}

In contrast to the purchase of cotton in India, the transport to Europe and the selling in Europe was much better regulated, as I mentioned above. However, since arbitrations and legal proceedings could be very tedious and often resulted in financial losses, Volkart was anxious to avoid them and to do business only with spinners whose reputation was well-known.\textsuperscript{32} On the other hand, Volkart endeavoured to fulfil its contracts under all circumstances.\textsuperscript{33}

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    \item \textsuperscript{27} VA, Doss. 1 - 3. Privat-Copierbuch 9.1.1867-25.8.1870, 22.12.1870 Winterthur an Bombay.
    \item \textsuperscript{28} Calculationstabellen Gebrüder Volkart Winterthur, Winterthur 1873, p. 14.
    \item \textsuperscript{29} V.B. is the abbreviation of Volkart Brothers.
    \item \textsuperscript{32} VA, Dossier 12: Tuticorin / Madras, 5. The Sri Ranga Vilas Case 1931-1938: Winterthur an Tuticorin, 6. Februar 1934.
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trust was a basis in global trade. Georg Reinhart, partner of Volkart since 1904, wrote in a book, published on the occasion of the 75th anniversary of the firm in 1926: “One of the essential reasons for the success of our firm lies in the reliable service to our customers. … Our shippings are rightly noted for their dependability in the whole world.”34 And sixteen years later, the employees of Volkart Madras could read in a staff paper under the title “WHAT WE STAND FOR”: “Firms like Volkart Brothers … do not stoop to shady transactions or treat a contract obligation as if it were a scrap of paper. They feel that they have an ideal to live up to – and they prosper, because their clients instinctively respect them.”35 This maxim of Volkart’s is far from being self-evident. It stood in contrast to the practices of other cotton merchants which were more reckless and were much less afraid to risk differences with their clients.36 Volkart’s regard to the wishes of their clients fulfilled the function of an informal institution, since it reduced the uncertainties inherent in global trade, and was suitable to bind their customers to the firm. A staff member of Volkart’s wrote in the 1960s that „accurate and punctual fulfilment of contracts … are the best advertising in oversea trade, as are prompt handling and fair execution of reclamations. Newspaper advertisements would not help to sell one additional bale of cotton or bag of coffee.”37 Hence in selling, Volkart featured a pronounced customer’s orientation. The establishing of standardised cotton types had transformed an unspecific commodity into a distinct product. This enabled firm to begin with the virtual marketing of Indian cotton. Also at the beginning of the 20th century, many European spinners didn’t trust Indian cotton since it continued to be dirty and tampered. British spinners hardly employed the short stapled Indian cotton, since for the fine cloth produced in Lancashire they relied mainly on American cotton.38 But also spinners on the European continent were tempted to buy the more expensive American cotton, since it was less soiled and was qualitatively steady. That is why in 1917, Volkart made an inquiry by Indian spinners to find out why they could produce a better yarn than European

34 Georg Reinhart, Gedenkschrift zum fünfundsiebzigjährigen Bestehen der Firma Gebr. Volkart, Winterthur 1926, p. 75f.
36 After several staff members of the American Cotton Cooperative Association had joined Volkart’s in the 1930s, the firm discovered that the American managers were not very considerate of the wishes of Volkart’s clients. They rather took into account the fluctuations of prices and used to sell whenever the target price was attained, regardless to which buyer. This caused several frictions in the newly opened branches of Volkart’s in the United States (VA, Dossier 44, VBH Guidelines 1970-1983, verfasst von Peter Reinhart; see also: VA, Konferenz-Protokolle vom 15. Januar 1959 – 30. März 1965: Konferenz vom 9. März 1959).
spinners on the base of Indian cotton. Volkart received very few respondings to their inquiry since Indian spinners were reluctant to share their experience with their European concurrents. However, those responding explained that they were employing a distinct mix of different qualities of cotton depending on the current climate. Furthermore, they used to clean the fibres by the application of additional blows and combs to remove dirt, leaves and dust. The European spinners were answering very positively to the brochure Volkart published with the results of this inquiry. Several spinners announced „that one would be less haughty in matters of Indian cotton … and that one was able to bring out much more from Indian cotton as one used to do up to now, when one thought that for a 20s yarn one could not do below best American“.

In addition, the firm published reports on the development of cotton prices, the prospects on future harvests, estimates of the current world cotton reserves and on the political and economical situation in various countries involved in cotton trading since the end of the 19th century. These reports were destined to the firm’s agents and customers and surely had the purpose to bind the latter closer to the house of Volkart.

The various uncertainties in buying Indian cotton were so big that for a European spinner it would hardly have been possible to buy directly in India. However, also in the American cotton trade, where business practices were much more predictable and transaction costs therefore much lower than in India, European and American spinners never purchased cotton directly in the production areas but always relied on specialised merchant houses as for instance Sprunt and Son, Anderson Clayton or McFadden. At the end of the 19th century, these merchants had established a close network of buying agencies in the American South and selling agencies at the East coast and in Europe. They controlled their own cotton gins and presses, graded their cotton in order to fulfil the wishes of the spinners and had developed techniques of financing their stocks until selling and of hedging their cotton at the Liverpool and New York cotton exchanges. These competences allowed them to guarantee quality, punctual delivery and reasonable prices and made them indispensable intermediaries.
### Abdication of the diversification into the area of industrial business

In the 1920s, Volkart traded a wide variety of articles. The firm exported Indian commodities as rubber, spices, seeds, coconut fibres, coffee or hides to Europe, and it imported European chemicals, cars and machinery into India. Yet, the trade of raw cotton was by far the most important scope of business and for instance generated about two third of the firm’s turnover which came up to over 360 Million Swiss Francs in 1923.\(^{44}\)

The focus on the trading of cotton made perfectly sense from an economic point of view. Volkart knew from long experience, how important it was to have an intimate knowledge of the traded products. In a letter from 1940, this insight was formulated like this: “People without any special knowledge of the articles which they handle and who have no special connections in the countries with which they work cannot possibly expect to compete against firms who know their business by long experience, which means that they know the tricks of the trade as well as the particularities of their respective districts.”\(^{45}\)

How important such a specialised knowledge could be in the volatile commodity trade for instance became clear when the newly opened Singapore branch began with the export of coprah in 1924. Even if Volkart became the principal exporter of coprah from Singapore within one year’s time, the branch made huge losses due to the firm’s inexpertness with the product. The managers of Volkart’s Colombo branch, who had to make the calculations, had assessed that coprah would lose only five percent of its weight during transport. The loss of weight of the Singapore coprah, however, was higher than that, which led to much smaller revenue.\(^{46}\)

Also when in 1936 the Bombay branch wanted to sell 1800 tons of sugar to a customer in Colombo, the lacking experience with the product turned out to be fatal. Two months before Volkart Bombay had closed the transaction, the export of sugar to Ceylon had been forbidden by the Government. The Bombay staff, not very experienced in the trading of sugar had not realised this. As a consequence, the transaction could not be settled and the firm had to look for another customer and sustained a larger loss in the end. People at the Winterthur head office were not very pleased and wondered in a letter to its branches if they could not rightfully take it for granted, that one knew about „such important official regulations as this ban on exports two months after that it came into effect in case that one wanted to carry out transactions on such a large scale.” And they emphasised the importance of a distinct

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46 VA, Dossier 15, The Far Eastern Organisation, II. Singapore, 2. Table of Events.
knowledge of the traded commodity in the trading business in claiming that they took it for certain „that a case with such embarrassments would not have arisen if it had concerned a transaction, which we settle as a matter of routine and in which we know our stuff in every detail, as it is the case for instance in cotton.“

Therefore it is not surprising that the firm pursued a very conservative strategy. In 1922, the head office answered in a letter to its subsidiary in Bremen, which had advocated a strategy of diversification: “We want to … conduct trade in a line business we have had experience in for a long time, and for whose organisation we have spent plenty of money.”

The emphasis on the firm’s main activity in the cotton trade is a sign for the path dependency of Volkart’s business strategies. If this strategy was a good one to pursue was the cause for intensive debates especially after 1926, when the crisis of the world trade hit also the firm of Volkart and led to heavy losses for several years. Under these conditions, the managers in India uttered the opinion that it would be wise to undertake a change of strategy. The firm’s principals, however, remained sceptical. In 1927 for instance, the manager of the Bombay branch advocated the renunciation of commodity trading and the investment in the area of industrial business. His proposal, however, fell on deaf ears. In a handwritten note in the margin on the letter from Bombay, Georg Reinhart, one of the firm’s owners, remarked: „Basicallly, we (V.B.) want to stay merchants and not to become industrialists.“

Also a proposal of the Karachi branch, uttered some years later, to joint venture with Indian businessmen in order to invest in new textile mills, was turned down. The principals claimed that the „problems came from the question of staff matters, since we have no one among our whole staff in India who is experienced and competent enough to guide and control such enterprises, apart from the necessary subaltern sufficiently trained staff. Further concerns came from the immobilisation of the capital linked with financing in such a manner, what runs contrary to our steady attempt to retain our liquidity.“ However, now they showed themselves ready to evaluate their strategy since they very well noticed that „industrialisation in India … made headway at the cost of the export trade of raw materials. This development may possibly push our general business policy to a new orientation, perhaps in the sense of our looking for new fields of activity to replace a recession of export trading, for instance in a more intense participation in the industrial area.“ Therefore they asked their branch managers in India „to supervise the

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course of things and to submit interesting proposals to us, be it only for our preliminary orientation...50

However, a diversification into industrial areas of business did not take place. In the middle of the 1930s, Volkart’s cotton business again became very lucrative. This can be referred principally to the fact that the firm had succeeded in becoming the sole representative of the American Cotton Cooperative Association for China, Japan and India in 1932 and later on also for Europe. By this, Volkart became one of the major importers of American cotton to East Asia.51 Therefore it comes as no surprise that Peter Reinhart, who had become a partner of the firm in 1934, uttered in a letter from Shanghai from the same year the conviction „that we are based on the Indian cotton business and that everything else is only justified if it is either of use for the cotton business, or yields immediately good resultants, or promises to be of use to the cotton business in due time.” A policy of diversification was definitively rejected by Peter Reinhard: „It is much easier for us to achieve something in every area of cotton than in cotton and in all kind of other articles. ... My idea of the development of the firm therefore is shortly: specialists in the cotton trade of various sorts. … But not: bunglers in lace, watches, rubber shoes.”52

In fact, the firm renounced a diversification into the industrial field and kept to the commodity trade. That the house of Volkart nevertheless was able to adjust its policy if necessary became apparent after World War Two, when due to Decolonialisation, the firm’s business in South Asia became more and more difficult. Volkart therefore transferred its activities to the Americas. It intensified investment in the North American and Mexican cotton trade and became one of the main actors in this field. Furthermore, Volkart entered the coffee trade and founded branches and subsidiaries in South and Middle America and became one of the top five Coffee traders in the world and one of the twenty largest companies in Switzerland.53

**Conclusion**

The history of Volkart indicates that a strategy of concentration rather than one of diversification could be a very lucrative strategy in the 20th century world trade. This success was only possible because the firm possessed soft skills, which were unavoidable in the volatile global trade. Only by its specialised competences, Volkart could reduce transaction

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51 VA, Dossier 16: USA, Brazil, Mexico, Guatemala/Costa Rica, Turkey, I. USA: Notiz von Peter Reinhart vom 20. September 1950, „Entwicklung des amerikanischen Baumwollgeschäftes“.
costs and act as a commercial bridge between sellers and buyers on different continents when formal institutions were either lacking or not sufficient. These operations were not only lucrative for the firm itself but allowed also the stabilisation and formation of a global market and of Western consumers’ society. Hence the activities of multinational trading firms helped to raise the wealth of the industrialised nations by facilitating the purchase of tropical commodities.  

However it must be noted that these activities were less lucrative for farmers in Southern countries since they could not profit to a great extent from global commodity trading but became directly dependent from fluctuations in global market prices against which they could not protect themselves. Thewith in a larger context, the history of Volkart is not only a history of success but also one of the different possibilities to raise profits from global transactions in different parts of the world. See f.i. Immanuel Wallerstein, Aufstieg und künftiger Niedergang des kapitalistischen Weltsystems. Zur Grundlage vergleichender Analyse, in: Dieter Senghaas (ed.), Kapitalistische Weltökonomie. Kontroversen über ihren Ursprung und ihre Entwicklungs dynamik, Frankfurt a.M 1979, p. 31-67; William Gervase Clarence-Smith and Steven Topik (ed.), The Global Coffee Economy in Africa, Asia, and Latin America, 1500-1989, Cambridge etc. 2003; Beckert, Emancipation and Empire.

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