

Giacomo Becattini's Prize Lecture: Small Business and Entrepreneurship in the Thought of Alfred Marshall: On their Empirical Basis and General Meaning *2002 Award Winner**

On Marshall's Industrial Field Work

When Marshall shifted his intellectual interests from philosophy and psychology to economics, besides his excellent – for his times – mathematical preparation, he had already got some general ideas on society and the method proper to the study of social issues (see, e.g., Whitaker 1975, Becattini 1975, Dardi 1984, Groenewegen 1995, Whitaker 1996 and Raffaelli 2003). Among the earliest economic readings of a young mathematician there was, understandably, Cournot's book that he appreciated very much, except for what Marshall called the "Cournot problem", i.e., the reconciliation of competitive equilibrium with increasing returns (Cournot 1838). Marshall realised that according to the Cournotian conclusions, the Smithian invisible hand would be frustrated by a tendency of the structure of the competitive markets to become a mosaic of monopolies.

As he wrote to Flux in 1898:

One of the chief purposes of my *Wander-jahre* among factories, etc., was to discover how Cournot's premises were wrong (Cf. Whitaker 1996, vol. II, 227–228).

This *Wander-jahre*, Marshall tells us, spanned several years.

In the years of my apprenticeship to economic studies, between 1867 and 1875, I endeavoured to learn enough of the methods of operation of the greater part of the leading industries of the country. ... This endeavour was associated with an attempt to form a rough estimate of the faculties and training needed for working each (part of machines

used), and the strain involved therein: and my guide – if as generally happened he was the employer or a foreman – would generally answer my inquires as to the wages which each was receiving. (Pigou 1925, p. 358)

Whilst the relationships between Marshall and classical and marginalist economic thought has been deeply explored, Marshall's field work – apart from Groenewegen's masterly work (Groenewegen 1995) – has not received much attention. This is due – partially, at least – to the fact that very few documents of such activity survive. Another cause of such neglect is the widespread belief that it was made in a rather amateurish way, giving rise to some of the most criticised concepts enunciated by Marshall (e.g., external economies, life cycle of the firm, representative firm, etc.). Nevertheless, some writings of the period 1873–74, some letters to his mother from America in 1875, some pages of *What I Remember* by Mary Paley Marshall, his testimonial to the Commission for the 1891 Census, other documents (e.g., the two volumes of *Official Papers* edited by Keynes 1926 and Groenewegen 1996), and some autobiographical memories, can at least give us the scent of such an activity.

In the year 1873 Marshall gave some *Lectures to Women*, discussing the main industrial relations issues of the time (Raffaelli, Biagini and McTulberg 1995). Thanks to an attentive reading of the "Blue Books", some contacts with trade unionist (e.g., T. Burt and J. Holmes), and with some friends of the Trade Unions (e.g., J. M. Ludlow), Marshall came to know a great deal about the working conditions in several British industries of his time (Raffaelli, Biagini and McTulberg 1995). This interest in labour conditions was not merely due to philanthropy, but also – and perhaps even to a greater extent – to the conviction that, throughout its influence on the character of the worker, the organization of labour within the factory influences the rate of increase of labour productivity, which forms the basis of the progress of the competitiveness of the country, as well as of the well being of its inhabitants.

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It was not until 2003 that the Award Winners were formally requested to give a Prize Lecture in connection with the Award ceremony. Therefore, in cases where the lectures were missing the Award Winners were invited in 2008 to deliver a belated Prize Lecture in the form of a manuscript. This essay by Professor Giacomo Becattini was delivered in August 2008.

Marshall started his career as an economist so convinced that the industrial relations of a country have a decisive impact on its competitiveness as to advise his pupil Foxwell: "Firmness of grasp and practical acquaintance with the social relations of industry seem to be the main requirements from the lecturer." (Whitaker 1996, Vol. I, p. 28)

The letters to his mother from the United States of America illustrate another aspect of Marshall's interest in industrial phenomenology. We give the list, probably partial, of the visits he paid to American factories:

Large stove works; Large reaping and moving machine works; large Bessemer works; horse shoe works; huge cotton mill; Mason and Hamlins, Organ Factory; Pacific Cotton Mills; Lowell Manufacturing Works (carpets); Chikering Piano Works; Virginia Consolidated mines; American Glass Manufacture. (Whitaker 1996, Vol. I, pp. 49–82)

Notwithstanding its crudity, this list of visited factories can give us an idea of the wideness and variety of the interests of the young Marshall. Wideness and variety that probably reflect a host of visits previously paid to British factories, since the theme which dominates the letters is a comparison between American and British manufacture. We should also notice that several letters include designs representing processes or implements considered important and/or new.

Further evidence of his attention to industrial phenomena comes from Mary Paley Marshall's delightful *What I Remember*:

In vacations, either at home or abroad, we spent some time in towns, seeing factories and workshops. One year we would go to the pottery district with its problems of localisation of industry and changing fashions.... Another year it would be the light metal trades.... I remember specially the file-making industry of Sheffield where machinery was just beginning to displace manual labour. (Marshall 1947)

Mary meaningfully adds that:

Alfred knew all about machines and tools. ... He could tell beforehand what wages were being paid for any kind of work and was seldom wrong by more than a few pence a week.

And finally, a very interesting notation, characteristic of one peculiar aspect of the Marshallian approach to industrial phenomena: "We used to stand at the gates of factories when work stopped to watch the workers coming out" (see Marshall 1947, pp. 42–43).

If we put all these little pieces of information together, we come to the conclusion, that the young Marshall strove to deepen his knowledge of the economic, technological, psychological and organizational aspects of British industry, but always – we must notice – in the framework of the socio-cultural conditions of the manufacturing communities.

Marshall and British Industrial Statistics

There has been much argument concerning the Marshallian methodological practice of field research, with many critics dubbing it as not properly scientific, but rather "impressionist".¹ Some authors see in it a sort of retrogressive attitude when compared to the contemporary advance of statistical thought. For example, Marshall's

(negative) influence on the faithful Edgeworth (perhaps the strongest statistical theoretician of his time) has been charged with the scarcity of statistically sophisticated papers in the first decades of the *Economic Journal* (see Jha 1973).

The truth is perhaps different: Marshall was certainly convinced of the great importance of statistical data for economic analysis, but had a very low opinion of the quality of British industrial statistics (see Marshall's testimonial 1890).

It is due – we guess – to this low opinion of British statistical data that he preferred Le Play's method of "an intensive study of all the details of the domestic life of a few carefully selected families" (in his case firms) to the prevailing one of "the extensive method of first rapidly collecting a large number of observations with the hope that any inexactitudes and oddities will balance each other out, and subsequently proceeding to interpret the data in the form of statistics." The first of these two methods, he adds, requires a "rare combination of painstaking care in selecting the cases and acute perception and sympathy in interpreting them, is – at its best – the best of them all". But, he acutely concludes: "in ordinary hands it is likely to suggest less reliable conclusions than the other" (see Marshall 1961, Vol. I, p. 97, n. 1).

In this reading of Marshall's thought, his reluctance to apply sophisticated statistic tools appears to be based on his, already mentioned, low opinion of British industrial statistics and to his distrust in an appropriate, improvement of them in the short term.

The point I want to make here is that some far-reaching theoretical changes Marshall introduced already in his (and Mary's) early *Economics of Industry* (see Becattini and Dardi 2006) were based on his intensive, direct, exploration of British manufactures, no less than on a critical examination of both classical and post-classical economic literature.

Small Business and Industrial Districts

When the Marshalls published (1st edition in 1879) their little book, the industrial districts phenomenon had already attracted the attention of many observers (e.g., Cooke 1841, Sargant 1857 and Hearn 1865). Nevertheless, the ideas prevailing in the most popular political economy manuals of the time (e.g., John Stuart Mill and Henry Fawcett) were of little help in interpreting it correctly (see Becattini 1996).

On the way towards a full understanding of this phenomenon there were some obstacles. The two idols of contemporary economists, the "factory system" and the obsession with "large scale economies", attributed a mere residual and transitory role to small firms, and consequently to the aggregates of small factories located in the industrial districts of the British Midlands.

With the introduction of two new concepts – the economies external to the single factory but internal to groups of factories and the "industrial atmosphere" of the manufacturing communities – the situation changed. As a matter of fact, Marshall combined them to forge the idea, not of a mere territorial concentration of factories but rather of a true "industrial community".

¹ Marshall himself, highly praising *Lancashire Cotton Industry* by S. Chapman, defined it: "both a realistic-impressionist study of human life, and an economic treatise" (Whitaker 1996, Vol. III, p. 93).

The starting point of the Marshalls' reasoning was:

The manufacture of a commodity often consists of several distinct stages, to each of which a separate room in the factory is devoted. But if the total amount of the commodity produced is very large, it may be profitable to devote separate small factories to each of these steps. (Marshall and Marshall 1879, p. 52)

[However,] small factories, whatever their number, will be at a great disadvantage relatively to large unless many of them are collected together in the same district. (Marshall and Marshall 1879, p. 53)

The grouping of them in a certain district can have several effects; it can produce:

a) an "industrial atmosphere" that permeates the entire community in which the group of firms is embedded, where "if one man starts a new idea, it is taken up by others and combined with suggestions of their own; and thus it becomes the source of further new ideas";

b) a specialized labour market: "Employers are apt to resort to any place where they are likely to find a good choice of workers with the special skill which they require; while men seeking employment naturally go to places where there are many employers who need such skill as theirs";

c) a climate of trust and loyalty among the members, employers and employed, of the industrial community which represents a true "social capital" of the place²;

d) a multiplicity of "subsidiary industries to meet the special wants of the original population of small factories" (e.g., specialised machinery);

e) a sense of belonging to the producing community.

"Social forces – Marshall concludes – here cooperate with economic ones" (Marshall 1961, Vol. I, p. 271). From the purely business view point:

Thus both large and small factories are benefited...But these benefits are most important to the small factories, and free them from many of the disadvantages under which they would otherwise labour in competition with large factories. (Marshall and Marshall 1879, p. 47)

Marshall defines the industrial district in such a way as to make it an efficient alternative to the vertically integrated factory belonging to a big firm. The subject is highly complex, and we are not going into it here (see Becattini 1990, 2006). We limit ourselves to point out that with his theory of the industrial district, Marshall demonstrates that there are conditions of organization of production (and everyday life) in which even a small factory can be efficient, and the corresponding firm competitive.

Apart from the industrial district theme, the issue of small firms receives more attention in the thought of Marshall, but we are not going into it here. We add only that, generally speaking, Marshall considered them the best nurseries of creativity in business even in what we now call the Fordist age of capitalism.

In conclusion, for a wide number of commodities (i.e., differentiated and personalized), and at certain, not infrequent, socio-cultural conditions, small firms can be efficient and competitive relative to larger and more structured firms.

Had this conclusion been more widely adopted by the leading 19th century economists, we would have had, since then, a two-ways-to-industrialization background to development studies, ins-

stead of the "one best way" we got (see Becattini 2000).

All that has been said so far is presumably valid for a world similar to the world Marshall studied in his youth, in which each firm incorporates, so to speak, a "project of life", and its selling or buying is exceptional. But "when the policy of any particular establishment is likely to be governed, not with a single eye to its own success, but in subordination to some large stock-exchange manoeuvre, or some campaign for the control of markets" (Marshall 1961, Vol. I, p. XII), we plunge into a different world.

Entrepreneurship

We cannot say for certain that Marshall introduced the concept of the entrepreneur into economic discourse. From Cantillon onwards, at least, the concept was latent, if not explicit, in the writings of many economists. But the structure of the classic theory of value represented a formidable obstacle to its *accueil*, because the triggerer of economic activity was considered to be the capitalist trying to make the most of his capital.

The development of a nationwide banking system gradually changed the situation (Bagehot 1873). During the intermediate decades of the century it became possible for a pushing man, with ideas and a sound reputation, to obtain the capital necessary to start a firm. Marshall explores British industry in this period and comes to the conclusion that "it is no more true that a man becomes an employer because he is a capitalist. Men command capital because they have the qualifications to profitably employ labour." (Marshall and Marshall 1879, p. 118) To this far reaching statement Marshall adds the definition of entrepreneurship as a very peculiar kind of skilled work. The required skill consists mainly in: the capacity a) "to go straight to the kernel of the practical problems", b) "to see almost instinctively the relative proportions of things", and c) "to be a leader of men" (Marshall 1961, Vol. I, p. 606). This representation of the capitalist-entrepreneur completes the theoretical *bouleversement* and opens the way to the neoclassical theory of distribution.

Marshall has been charged with an apologetic intent, and nobody can exclude that a reaction to some potentially revolutionary implications of the classical theory of distribution acted upon him, but we want to underline that the industrial phenomena of the period make his position quite understandable. More explicitly, we mean that it is plausible to see a sort of convergence of a certain line of thought (Smith, Senior and Mill), with an original attempt to conceptualize what was really happening – or rather, what Marshall believed was happening. Some doubts are, in fact, possible on the "idealised" role he attributed to the banking system.³

The young Marshall, of course, did not approach industrial phenomena of his time devoid of any theory, nor without a specific hypothesis to verify (e.g., the Cournot problem). Nonetheless, our opinion is that he was strongly imbued by the idea of making political economy more "realistic". This theme of the realism of political economy recurs much in his correspondence, and we believe it was a sincere reaction to the empty dogmatism of many of David Ricardo's epigones. What seems sure is that his visits to manufactures in the Midlands, which gave him the opportunity to exchange views with undertakers, that were, or depicted themselves as, self-

² And adds: "there are often strong friendships between employers and employed" (Marshall 1961, Vol. I, p. 272).

³ On this point, see Becattini and Dardi (2006).

made men, influenced his ideas no less than his ruminations on previous economic thought.

We should not forget that after 1850–60 British manufacturing entered a period of vertical disintegration and specialisation that by itself reduced the average size of the firms in several industries and increased the number of undertakers. This tendency towards vertical disintegration, far from being a negative phenomenon, was the base of a finer distribution of productive functions. The example of the separation of weaving from spinning in the textile – both cotton and wool – industry speaks for itself (Cf. Church 1980). This process made possible the entry of a host of new men scarcely provided with capital, but with a good reputation as regards their honesty and technical expertise. It is in this period that Samuel Smiles's books, such as *Character* and *Self-help*, became best-sellers.

The Italian Revival of Some Marshallian Themes

The students of Italian industrial development after the World War II came to understand Marshall's interpretation of the industrialization process only after a long intellectual struggle (see Becattini and Musotti 2003). In fact, the dominant economic theories, neoclassical or Marxist, conceived the process of disintegration of Italian manufacturing, that followed the so called "Italian miracle" (1951–1963), mainly, or only, as a fragmentation of the largest firms under the challenge of strong leftist unions. Without noticing the territorial distribution of the phenomenon, the majority of the scholars and the politicians held negative opinions on the proliferation of mainly small, sometimes very small, manufacturing firms.

The true meaning of the phenomenon became clear only after the integration of the basic principles of the Marshallian theory of industrial districts (see Pyke, Becattini and Sengenberger 1990). The proliferation of small firms then came to be considered not the mere effect of the decisions of the biggest firms, but the effect of a combination of causes: a) the increase of per capita average income; b) the incipient saturation of the demand for standardized consumption goods; c) the will to escape the factory dependency of the most enterprising among the skilled workers; and d) the tendency of large firms to split processes and decentralize certain phases of production.

Well, one of the protagonists of this saga, certainly not the only one, but perhaps the crucial one, was the small Marshallian entrepreneur.

Two aspects of the problem need clarification. On the one hand we must underline the socially and historically rooted conditions of such a crop. Many new entrants originated from inside the industry (specialised workers, technicians, etc.), but a considerable number of them also came from outside the industrial world (ex-shoppers etc.). It must be added that large part of Italy benefited from a generation of honest and efficient local administrators of low social extraction (e.g., blue collar workers and sharecroppers), frequently harboring left-wing ideas. The constructive dialectics between these two classes of newcomers, small entrepreneurs and local administrators, is at the core of the Italian phenomenon of industrial districts differentiating it from the Victorian one. Despite, we repeat, the insensitivity of all the political parties and of large part of the economics academia.

In conclusion, the nucleus of theoretical innovations related to the Marshallian theory of the industrial district (i.e., the key role of

the nexus local community-industrial development, the minor relevance of the size of the single firm, the emphasis on the alertness – or if we prefer, echoing Keynes, the "animal spirits" – of the entrepreneurs, and upon the intelligence and honesty of local public servants, etc.), shifting the focus from the mere process of the accumulation of capital to the evolution of all the socio-cultural relationships of the places, opened the way to the modern, interdisciplinary, theory of local development.

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