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PREFACE TO THE SECOND REVISED EDITION

THIS BOOK went out of print in 1948, and since then I have been receiving requests from many quarters to bring out a revised and up-to-date version of it. I could not, however, undertake the work for some time, mainly because of the uncertainties about the future of company management and administration in this country. It was only when the new Companies Bill was finally passed by the Indian legislature that I could direct my attention to the work of revision.

As I started on the work, however, I found that mere revision would not meet the situation. Not only had the facts and circumstances changed considerably since the book was first published in 1938, but the entire economic and social landscape had undergone a transformation, almost beyond recognition. I, therefore, had to completely rewrite the book. Those who have in their possession a copy of the first edition of this book will, I fear, find that the present edition represents an entirely new book.

I would like to take this opportunity of expressing my deep gratitude to the different Chambers of Commerce and Industry, and Associations who have ungrudgingly placed at my disposal the memoranda or notes they had submitted to various Committees and Commissions set up by the Government of India since 1947. Thanks are also due to the Research and Statistics Division of the Department of Company Law Administration in the Ministry of Finance, Government of India. I have freely drawn upon the excellent monthly and annual reports published by this Department. I should like to add, however, that the views expressed herein are exclusively mine and should not be taken to reflect those of the Department of Company Law Administration or of any other organisation of Government.

Calcutta,
November 1955. N. DAS

PREFACE TO THE FIRST EDITION

IN RECENT YEARS many writers have written excellent treatises on the development and organization of the various industries in India, but in very few of these studies has sufficient attention been paid to the details of their organization. The important activities of the managing agents who virtually dominate industrial enterprise in India, their functions as the main providers and guarantors of industrial finance, their recent malpractices and abuses and, finally, their conflicts with shareholders and directors are subjects which need to be carefully studied by every one interested in the industrial development of India. In the present work, an attempt has been made to cover these rarely discussed matters as also the allied subject of mushroom and fraudulent companies. I have also dealt with the recent phenomenal growth of private joint-stock companies and the economic significance of the provisions of the new Indian Companies' Amendment Act. How far my study fills up a gap in the recent economic literature on these subjects, it is for my readers to judge.

To some extent this book is a sequel to my earlier work published last year, *Banking and Industrial Finance in India*. In that book, I studied the development of modern banking institutions in India from an entirely new and objective angle and with special reference to the needs of industry and trade. In the present work, the part that Indian banks can and should play in the matter of financing industrial enterprise in India has been considered in detail and, as before, from a purely economic standpoint. Further, I have attempted to bring out the intimate connexion that subsists in India between the problems of industrial management on the one hand and those of industrial finance on the other.

In conclusion, I would like to express my deep gratitude to the authorities of the University of London who gave me special permission to complete this work within a short space of four months and after a long absence of four years

in India. I am also grateful to my teachers, Prof. Lionel Robbins and Dr. Vera Anstey of the London School of Economics, for their valuable help and guidance. I must also mention the various Chambers of Commerce and Shareholders' Associations in India who very kindly supplied me with copies of their carefully prepared memoranda on the Indian Companies' Act (Amendment) Bill, 1936, and who also replied to a number of questions put by me to them. I only hope that this book will be of at least some use to them.

London School of Economics
and Political Science,
May 1937. N. DAS

CHAPTER I

THE DEVELOPMENT OF MODERN INDUSTRIAL ENTERPRISE IN INDIA

The Beginning

THE DEVELOPMENT of modern industrial enterprise in India is not more than a century old. It is true that a few industrial undertakings were started in the first half of the nineteenth century—by British capitalists in the Bengal Presidency and by some Indian merchants in the province of Bombay, but they were more or less pioneer undertakings started in a rather haphazard fashion and none of them presented the intricate problems of modern capitalistic enterprise—the problems of finance and management.

Even in Western India, most of the industrial enterprise was dominated by the British. Contrary to popular belief, the cotton mill industry of Bombay and other parts of the country was not exclusively Indian, looked at from any point of view—whether financial, personnel or ownership. The first cotton mill was put up in India in 1817 by an Englishman, but it failed. The Fort Gloster Mill was put up in 1830 in Bengal under European management. C. N. Davar's mill in Bombay (established in 1854) was partly owned by Englishmen. Killick, Nixon & Co., a British firm of managing agents, laid the foundation stone of their Kohinoor Mill as early as 1870. Even in later days, we find the Sassoon, Greaves and Cotton, Bradley and Brady interests dominating the industry in Bombay, and the Harveys, Staneses and others setting up cotton mills in Madura, Coimbatore and Cawnpore.[1] As regards the jute

[1] S.D.Mehta, *The Indian Cotton Textile Industry*, Bombay, 1953.

and tea industries, they were exclusively European to start with, and so were the coffee and sugar plantations.

The reasons for this state of affairs were obvious. The traditional industries and crafts of India had declined—partly owing to the impact of machine-made goods and partly owing to the deliberate pursuit of a policy to retain India as a permanent market (almost a dumping ground) for articles manufactured in the U.K. In due course, there was some relaxation of this policy, because it was found that there were some local raw materials which could be processed more economically inside the country than be exported as such to the U.K. Moreover, her economic hold over India having been well secured, the latter country could afford to make a few minor concessions. And, when relaxation came, it was the British merchants with their connexions (and sometimes head offices) in the U.K. who were in a better position to take advantage of the situation than the Indian business community. Secondly, the latter were generally apprehensive of embarking on new ventures and part at least of their apprehension arose from the fact that economic policy was still dictated by British interests in the mother country.[1]

The Swadeshi Movement and After

The year 1905 was a turning period in the history of industrial enterprise in India. The partition of Bengal, announced by Lord Curzon, led directly to the Swadeshi movement urging the boycott of foreign goods and the use by consumers of articles produced locally. The industrial consciousness of the people was stirred to a phenomenal degree almost overnight and there was a great outburst of industrial promotion by Indians themselves. The number of joint-stock companies registered in India rose from 1,340 in 1900 to 2,744 at the outbreak of World War I, and the paid-up capital increased from Rs 34·7 crores to Rs 76·6 crores.

As more and more people turned their attention towards

[1] For a very exhaustive historical survey, the reader is referred to the author's *Banking and Industrial Finance in India*, Calcutta, 1936, Chs. II-VII.

the promotion of new industrial ventures, difficulties began to be encountered. Throughout the three decades between 1920 and 1950, we find entrepreneurs complaining that capital was shy and inadequate both for the launching of new enterprises and for the development of existing ones, and, for this, they blamed the apathy of the general body of investors and the conservative policy pursued by the various banking institutions. Investors and the general public, on the other hand, retorted that it was the defective management of industrial enterprise which was at the root of all the trouble. Echoes of these two conflicting statements can be heard even today, when industrial production has reached a new all-time peak, rapid technological progress has been achieved and production patterns have also altered almost beyond recognition.[1]

Let us, however, go back to the period 1914-47, i.e., the period between the outbreak of World War I and the attainment of independence by India. The impact of World War I on the industrial development of the country was not inconsiderable. Towards the middle of the war, the British Government realised that an industrially developed India could have been of greater use to them even from the limited objective of winning the war. Special attention was, therefore, paid to the development of selected industries and an Industrial Commission was appointed in 1916 to conduct a comprehensive survey of resources and industrial possibilities. The Indian Munitions Board was set up in 1917 to foster the development of certain types of industries and, as a result, several new industries were started and many existing ones were further developed and extended.

As soon as the war ended, however, the new interest displayed by the rulers of the country flagged and even the halting recommendations made by the Indian Industrial Commission were shelved. The net result was that 'beyond affording temporary gains to a few well-established industries, World War I did nothing to set the country firmly on the road to industrialisation. After 1918,

[1] See, for example, P.A.Wadia and K.T.Merchant, *Our Economic Problem*, Bombay, 1954, Chs. XXIV-XXVI.

the few industries which had been established on account of the war either stagnated or decayed; they could not face the competition from advanced industrial countries.'

The inter-war period (1918-1939) was marked also by the lack of a positive and vigorous policy. It is true that the Fiscal Autonomy convention was adopted by the British Parliament in 1921, so that India could follow an independent fiscal policy, but the 'independence' granted was hedged in by a number of restrictions. The same year, an Indian Fiscal Commission was appointed to recommend a suitable fiscal policy and, on the recommendation of this body, the Government of India adopted the doctrine of 'discriminating protection'. This was a step forward, in as much as, from this time onwards, the State ceased to be a disinterested spectator and committed itself to helping industries by the grant of protection in appropriate cases. In the years that followed, the Indian Tariff Board recommended, and the Government of India agreed to, the grant of protection to a number of industries, of which the most important were iron and steel, cotton textiles, sugar, paper and paper pulp, and match industries. But the Commission had laid down three rigid conditions which an industry had to satisfy before it could be granted protection. These were that (*a*) the industry must be one possessing natural advantages such as an abundant supply of raw material, cheap power, a sufficient supply of labour or a large home market ; (*b*) the industry must be one which, without the help of protection, either was not likely to develop at all or was likely to develop as rapidly as was desirable in the interests of the country ; and (*c*) the industry must be one which would eventually be able to face world competition without protection.[1] In the actual application of these conditions, the Government of India was even more rigid than the Tariff Board. Not infrequently, the former turned down the recommendations made by the latter—on the

[1] This is how the Indian Fiscal Commission summed up their general attitude towards the quantity and quality of protection to be given: 'The protection we contemplate is a temporary protection to be given to such industries as will eventually be able to stand alone.'

ground that the Board had not given due attention to all the three 'requirements' of the new fiscal policy.[1]

As has been aptly pointed out by a later commission (the Fiscal Commission of 1949-50), there was a fundamental defect in the approach of the Indian Tariff Board to the problem of protection. 'Protection was not visualised as an instrument of general economic development, but was viewed as a means of enabling particular industries to withstand foreign competition. This resulted in a somewhat lop-sided development. With such an approach, it was not possible for basic and key industries to develop. It is also likely that the protection of isolated industries without a positive effort being made at the same time to provide facilities for the establishment of allied industries added to the total burden on the community.'[2]

The result was that India remained industrially backward even on the eve of the outbreak of World War II. Barring the growth of a few consumers' goods industries (the iron and steel industry was the only exception), there was practically no development in the sphere of capital goods industries. Although India had become a permanent member of the ILO as one of the twelve States of major industrial importance, her economy was weak and her industrial development lop-sided. This was reflected in the figures of workers employed in industries, returned under the Factories Act. Between 1897 and 1914, the number of industrial workers had increased from 421,000 to 951,000, but between 1922 and 1939, it had increased from 1,361,000 to only 1,751,000. Secondly, while India had become independent of foreign countries for the supplies of sugar and cotton goods and was able to meet her own requirements of cement and iron and steel largely from her own production, she was still largely dependent on them for the offtake of a substantial part of her production

[1] For example, the Government of India refused to accept the Tariff Board's recommendation for granting protection to glass and the worsted sections of the woollen industry on the ground that the essential raw materials were not available in the country. Similarly, the locomotive manufacturing industry was denied protection in 1924 on the ground that the home market was not large enough.

[2] *Report of the Fiscal Commission,* 1949-50, Vol. I, New Delhi, 1950.

of raw materials. What was worse was that she had to depend almost entirely on these countries for the supply of machinery and other capital goods. Even the *Economist* of London, in its survey of Indian industrialisation at the end of 1936, observed: 'Although India has begun to modernise her industries, it can hardly be said that she is as yet being industrialised.'[1] Another disinterested observer remarked as follows in 1934: 'With abundant supplies of raw cotton, raw jute, easily mined coal, easily mined and exceptionally high grade iron ore ; with a redundant population often starving because of lack of profitable employment, with a hoard of gold and silver second perhaps to that of no other country in the world, and with access through the British Government to a money market which was lending large quantities of capital to the entire world ; with an opening under their own flag for British business leaders who were developing, both at home and in numerous new countries, all sorts of capitalistic industries ; with an excellent market within her own border and near at hand in which others were selling great quantities of manufactures, with all these advantages India, after a century, was supporting only about two per cent of her population by factory industry.'[2]

Meanwhile, the Working Committee of the Indian National Congress had formulated (in August 1937) a definite policy with regard to industrial and social planning. They recommended to the Congress Ministers, who had assumed power in most provinces, the appointment of a committee of experts 'to consider urgent and vital problems the solution of which was necessary to any scheme of national reconstruction and social planning.' It was emphasised that such a solution would require extensive

[1] It is true that the number of joint-stock companies registered in India and at work increased from 4,708 in 1921 to 11,114 in 1939 and the paid-up capital from Rs 164·5 crores in 1921 to Rs 290·4 crores in 1939, but these figures include banking, loan and insurance companies, trading companies and land and building companies. If the figures for these latter be excluded, the increase works out from 1,701 companies with a paid-up capital of Rs 76·1 crores in 1921 to only 3,278 companies with a paid-up capital of Rs 154·7 crores in 1939.

[2] D.H.Buchanan, *The Development of Capitalistic Enterprise in India*, New York, 1934.

surveys and collection of data, as well as a clearly defined social objective. In July 1938, it was decided, as a preliminary step, to convene a conference of the Ministers of Industries of the various provinces and call for a report on the existing industries operating in different provinces and the needs and possibilities of developing new ones.

This conference was held in Delhi in October 1938, and the thesis was laid down that the problems of poverty and unemployment, of national defence and economic regeneration in general, could not be solved without industrialisation. It was decided that, as a step towards such industrialisation, a comprehensive scheme of national planning should be drawn up—a scheme providing for the development of heavy key industries, medium-scale industries as well as cottage industries, keeping in view the requirements, resources and peculiar circumstances of the country. With a view to giving effect to the above policy, a National Planning Committee was set up. The Committee started functioning almost immediately, but World War II broke out and India was dragged in as a co-belligerent. All the Congress Ministries in the Provinces tendered their resignations by way of protest and many of the leaders were put behind prison bars. The work of the National Planning Committee was, therefore, held up.

World War II and the Post-War Period

The outbreak of World War II found the Government of India almost unchanged in its general attitude towards the development of industries. As the war progressed (particularly after Japan's entry into it), however, Government felt that India should develop as speedily as possible into an industrial arsenal for the Allied forces. The fall of France and the bombing of British ships and the Japanese penetration into the Southern Pacific demonstrated the dangers to an empire with widely scattered lines of communication. India and Australia were accordingly chosen as the centres of supply. By the end of 1941, pig iron production had increased from 1,600,000 tons in 1938-39 to 2,000,000 tons. Finished steel production increased from 867,000 tons in 1939 to 1,400,000 tons in 1942. A big

programme was initiated in 1941 for the expansion of armaments works, explosive plants and small factories. Forty-four firms were licensed to manufacture machine tools, lathes, drilling, shaping and planing machines, furnaces and power blowers. Over 280 new items of engineering stores were being manufactured in India, ranging from small tools and machine parts to heavy calibre guns, torpedo boats and degaussing cables. There was a considerable expansion in the production of drugs, leather manufactures, hardware, glassware, cutlery and optical goods, and the beginnings of a heavy chemical industry were laid in 1941, resulting in the production of sulphuric acid, synthetic ammonia, caustic soda, chlorine and bleaching powder. The value of exports of manufactured articles rose from Rs 47·6 crores in 1938-39 to Rs 81·2 crores in 1940-41. In 1940, the Commerce Member of the Government of India announced that industries started during the war would be adequately protected if they were organised on sound business lines.

Nevertheless, even during the closing stages of the war, British policy was opposed to any *rapid* growth of heavy industries *controlled and managed by Indians*. Secondly, the very conditions created by the war had some adverse effects on industrial development in the immediate post-war period. The capital equipment of almost all industries had been strained to the maximum during the six years of the war. Many factories were working extra shifts and there was a continuous deterioration of plant and machinery, due to want of proper maintenance and replacement. The result was that when the war ended, most of the industries found it difficult to undertake large-scale replacement of worn out plant and machinery.[1] The following figures of industrial production between 1938 and 1946 tell their own story:—

[1] The position in Australia was different. Although Australia served as the other important industrial arsenal for the Allies, a watchful and democratically elected Government saw to it that equipment and machinery were not strained beyond manageable proportions. Secondly, such industries as might be easily converted into civilian production at the end of the war were deliberately excluded from India's share in the war effort.

INDEX OF INDUSTRIAL PRODUCTION
(1937 = 100)

	General Index	*Cotton Textiles*	*Jute*	*Steel*	*Chemicals*	*Cement*
1938 ...	105·4	109·9	98·3	108.0	84·4	124·8
1939 ...	102·7	104·3	92·4	125·0	103·9	152·9
1940 ...	109·9	103·6	96·1	125·5	133·3	152·1
1941 ...	117·8	114·8	92·4	131·1	153·2	185·8
1942 ...	111·2	102·0	99·5	136·7	138·7	194·5
1943 ...	117·0	117·0	84·4	141·5	138·6	188·4
1944 ...	117·0	122·9	86·7	139·6	126·3	182·1
1945 ...	120·0	120·0	84·4	142·9	134·1	196·5
1946 ...	109·0	101·9	84·6	130·0	111·2	181·1

In other words, the increase in industrial output was only about 20 per cent during period of World War II.

The post-war period (1945-1947) saw a steady falling off in industrial *production*. To some extent, this was inevitable, as demand arising out of war efforts had suddenly come to an end. But industrial *activity* did not suffer any setback. The number and paid-up capital of joint stock companies registered and at work in India actually increased from 14,859 and Rs 389 crores respectively in 1945 to 21,853 and Rs 478·7 crores in 1947. Even excluding the figures for banking, loan and insurance companies, trading companies and land and building societies, the picture that remains is one of steady progress.

Developments after 1947

The attainment of independence by India on 15 August 1947, however, made a tremendous difference to the industrial landscape. India was at last completely free to mould her economic destiny in any way she liked: indigenous enterprise was no longer required to function as the camp-follower of foreign interests.

The first three years of independence (1947-50) were, however, marked by various kinds of experimentation. The scars left by the stresses and strains of the war and of the partition of the country had to be attended to first. The new Government, was, however, determined to make a frontal attack on the economic and industrial front as early as possible. So, in April 1948, came the famous Industrial Policy Statement, enunciating the respective rôles of State

and private enterprise. 'A dynamic national policy must be directed to a continuous increase in production by all possible means, side by side with measures to secure equitable distribution. The problem of State participation in industry and the condition in which private enterprise should be allowed to operate must be judged in this context.' The industrial field was accordingly divided into three groups: (*a*) strategic industries which should be the exclusive monopoly of the State, e.g., manufacture of arms and ammunition, atomic energy and railway transport, with the proviso that, in an emergency, Government could take over other industries considered vital for national defence: (*b*) key industries like coal, iron and steel, aircraft manufacture, shipbuilding, manufacture of telephone, telegraph and wireless apparatus, and mineral oils, where existing private concerns would be allowed to operate for the next ten years, subject to the inherent right of the State to acquire any of them in the public interest and to the stipulation that the establishment of new undertakings in this field should be the responsibility of the State and other public authorities ; and (*c*) remaining industries, where private enterprise would be allowed to operate, subject to such Government control and regulation as were considered necessary. A year after, i.e., in April 1949, Government set up a Fiscal Commission (*a*) to examine working of the policy of the Government of India with regard to the protection of industries since 1922 when the last Fiscal Commission reported and (*b*) to make recommendations as to the future policy which Government should adopt in regard to protection to, and assistance of industries, and the treatment and obligation of the industries which may be protected and assisted. Finally, it set up, in October 1950, a committee to consider what amendments were necessary in the Indian Companies Act, 1913, as amended in 1936, mainly for the healthy growth of joint-stock enterprises and the desirability of adequately safeguarding the interests of investors and the general public.

While these commissions and committees got down to work, the Constitution of India was being framed, laying down the 'Directive Principles' of State policy. For the

first time it was laid down, in clear and unequivocal language, that the State shall so direct its policy that (*a*) ownership and control of the material resources of the community are distributed to subserve the common good, and (*b*) the operation of the economic system shall not result in the concentration of wealth and means of production to the common detriment.

The Fiscal Commission submitted its report in June 1950 and the Company Law Committee its report in January 1952. Meanwhile, the Planning Commission had got down to business and in its Report dated 7 December 1952, had laid down the objectives, techniques and priorities in planning. Speaking of the backwardness of the Indian economy, the Planning Commission said in 1952 that 'the problem was not merely one of making the existing economic institutions work more efficiently, or making small adjustments in them. What was required was a transformation of that system so as to ensure greater efficiency as well as equality and justice. There were risks in going too far or too fast in these matters, but the risks of not moving fast enough were no less serious.' And again: 'It is clear that, in the transformation of the economy that is called for, the State will have to play the crucial rôle. Whether one thinks of the problem of capital formation or of introduction of new techniques or of the extension of social services or of the overall re-alignment of the productive forces and class relationships within society, one comes inevitably to the conclusion that a rapid expansion of the economic and social responsibilities of the State will alone be capable of satisfying the legitimate expectations of the people.'[1]

The Commission also referred specifically to the relative shares of the public and private sectors in the ownership of productive capacity and reiterated the division of the sphere of responsibility laid down in the Industrial Policy Statement of 1948. In regard to the private sector, the Commission bluntly stated that 'private enterprise should have a public purpose.' There was no such thing under

[1] Planning Commission, *The First Five-Year Plan*, New Delhi, 1952.

modern conditions as completely unregulated and free private enterprise. 'The view that private enterprise can function only on the basis of unregulated profits is an anachronism.'

In pursuance of these objectives, industrial enterprise in India has reached a new phase of development today. The concept of a Welfare State and of a socialist pattern of society has brought in new issues and problems for those who guide and control enterprise in the private sector. On the other hand, the assumption of increasing responsibilities by the State in the actual management of industrial enterprises has thrown a tremendous burden on the limited entrepreneurial ability available in India. Although the 'public sector' has come to stay as an integral part of India's economy and policy, the manner and pace of public ownership, management and, where introduced, control are having their repercussions on the 'private sector' as well.[1]

The problem today, therefore, is not merely one of finance, nor even of management: the problem today is how contemporary social and economic facts and circumstances can sustain the healthy development of free enterprise—whether in the public or in the private sector.

[1] N.Das, *The Public Sector*, New Delhi, 1955.

Chapter II

THE FINANCING OF INDUSTRIAL ENTERPRISE IN INDIA: PRINCIPLES AND TECHNIQUES

The Principles of Financing Industry

WHEN INDUSTRIES in India were grouped in small villages and towns and in small establishments, and when they catered for limited markets, the problem of financing them was very simple.[1] Capitalist economy and large-scale production, however, brought in their train the formidable problem of finding finance for them: competition on a large scale, which is the keynote of modern capitalistic organisation, demands that an enterprise, in order to be able to hold its own, must be in a position to get the necessary finance smoothly, regularly and easily, and at a reasonable rate.

Far too many conflicting and vague statements regarding the 'financial requirements' of industries in India have been made in recent years. Not infrequently, people have forgotten the fundamental distinction between block or fixed capital and working capital, and have stated that it is the business of banks or the State to find both. On the other hand, it has been asserted by many upholders of the doctrine of 'free enterprise' that the necessary block or fixed capital must come from the general public or at best from 'institutional investors' and that once this is obtained, no well-managed concern need have any difficulty in obtaining the requisite working capital or even capital for extension and replacements.

Let us first analyse the financial requirements of modern industry. In general, industry needs two types of capital,

[1] N.Das, *Banking and Industrial Finance in India,* Calcutta, 1955.

viz., (*a*) fixed or long-term capital for the purchase of block assets such as land, machinery and buildings, and (*b*) working or short-term capital for financing stocks of raw materials, stores and finished products and for meeting day-to-day requirements. In addition, it requires capital for extension and replacement which is usually of a long-term nature, though a part of it may be considered to be medium-term. Even as regards working capital, that part of it which is necessary for holding a minimum level of raw materials, stores and finished goods in an industry is of the nature of permanent capital and only the balance may be treated as short-term capital.

There is, however, no unanimity of opinion regarding the periods for which short-term, medium-term and long-term capital is required by industry. The Committee on State Industrial Finance Corporation in West Bengal, which reported in 1951, regarding short-term credits as those lent for periods up to one year, medium-term credits as those advanced for periods varying from one year to ten years, and long-term credits as those made for periods over ten years. This classification should not, however, be regarded as sacrosanct: it can only serve as a working guide.[1]

The relative proportion between block and working capital required in an enterprise varies from industry to industry. As the process of production becomes more and more roundabout or capitalistic, the proportion of fixed to working capital required increases. In such industries as hydro-electric, iron and steel, mining, petroleum refining, and even in jute and cotton, block capital is very large as compared to working capital. On the other hand, in the case of the cottage and small-scale industries, where production is carried on under the simplest conditions and with the most inexpensive tools and implements, the reverse is the case. But it is not improbable that in some such cases, although the proportion of fixed to working capital is not

[1] The Committee on Finance for the Private Sector, popularly known as the Shroff Committee, which reported in April 1954, also tentatively accepted this classification in the absence of anything better or more precise.

large, the *actual volume* of working capital needed is still very considerable.

The amount of working capital needed in an industry would depend mainly upon the value of the output and the average length of time occupied by the productive process. But there are other governing circumstances as well. The time at which a manufacturer gets paid and the methods of buying raw materials and effecting sales often affect the amount of working capital needed by a particular enterprise or industry.[1]

Capital Requirements in some of the more important Industries in India

It is very difficult to make an exact estimate of the capital requirements of particular concerns in an industry, because the estimate must of necessity vary with what one considers to be the 'optimum size' of a unit in that industry. Nevertheless, it is necessary to get some concrete figures in order to appreciate the magnitude and complexity of the problem of industrial finance in India. Certain figures about average or representative establishments in some of the industries are to be found in the various reports of the Indian Tariff Board, but most of these have become out-of-date, partly on account of the steep rise in the general price level since 1939 and partly because new machinery and techniques are rapidly replacing old methods of manufacture in almost all branches of industry. Thus, in the cotton mills industry, the introduction of superior varieties of looms, the automation of looms and the almost complete substitution by machinery of manual methods of bleaching and dyeing in the finishing or processing departments have considerably added to fixed capital costs, while superior types of labour deployment have also had their repercussions on the ratio of labour to capital equipment.[2] Similarly, in the jute mill industry, although the capital lying

[1] P.S.Lokanathan, *Industrial Organisation in India*, London, 1935.

[2] S.D.Mehta, *The Indian Cotton Textile Industry*, Bombay 1953. Dr.Mehta has also pointed out that, between 1937 and 1951, the financial implications of mill operation grew considerably in dimension, the assets of 50 typical companies surveyed by him having recorded an advance of the order of 175 per cent.

within the industry was estimated at Rs 30 crores in 1953-54, the industry's annual wage bill totalled to Rs 25 crores plus the cost of pensions, maternity leave and benefits, crèches, canteens and schools, etc.[1] No wonder, therefore, that the industry found it difficult to carry out, unaided, the vast programmes of rationalisation and modernisation which were considered essential if it were to maintain its position in the world market in the face of stiff competition.

In so far as the iron and steel industry is concerned, the position had become even more serious. In 1954, the modernisation programmes of the two major companies (Tata Iron and Steel Co., Ltd. and the Indian Iron and Steel Co., Ltd.) were estimated to cost about Rs 75 crores, but it was obvious that this huge sum could not be found from the domestic capital market (including banks). The international agencies for the supply of finance to underdeveloped countries, therefore, had to come to the rescue of this essential industry and a considerable proportion of the capital required was advanced by them under suitable guarantees and with the blessings of the Government of India.[2]

The above instances could be multiplied over the entire field of large-scale industry in India today. Techniques and methods of production have made such a tremendous advance during the past quarter of a century that an industry which seems to cater even for the limited domestic market must make heavy investments in the latest and most up-to-date machinery. It is true that under the umbrella of protection, or of a planned reservation of certain sectors for small enterprises, it may become possible for less efficient units to function for some time, but as every student of economics must realise, such 'protection' cannot be continued indefinitely. In other words, sooner or later, the minimum economic unit, with its minimum requirements of capital, must be accepted as the normal feature in every modern industry. Secondly, even the small industries are

[1] *Financial Times*, London, Supplement on Jute, 29 March 1954.
[2] M.P.Gandhi, *Major Industries of India Annual*, 1954-55, Bombay, 1955.

no better placed than the big industries in respect of their financial requirements. The quantum of their requirements may be relatively small, but the difficulties they have to encounter are not any the less.

Industrial Finance Abroad: Introductory

The question of industrial finance in India and the policy of Government with regard to this particular problem have been so hotly debated in recent years that a proper analysis of the fundamental forces at work is impossible without a comparative study of the agencies of industrial finance in countries that are economically more highly developed than India. The study is also important from another point of view. Ever since the days when industrial finance in India presented itself as a problem of some magnitude, people have been loud in their complaint that India has not been following in the footsteps of countries which possessed 'ideal organs of finance' for the promotion and development of their industries. The traditional and conservative ways of banking on the part of the Imperial Bank of India and other joint-stock banks only served to confirm a suspicion that things were manipulated in this country in a certain way by certain people with interested motives. Until lately, it was openly stated that the State evinced little or no concern for the growth of industrial enterprise, and this lack of enthusiasm was attributed by many to the overwhelming influence which foreign vested interests enjoyed in India and also to the obvious fact that those who governed and directed the industrial policy of the country were not responsible to the representatives of the people for what they did or omitted to do.

Industrial Finance in England

We shall start our study with England, not only because her models have been more or less copied in India but also because her industrial life is decidedly longer and more varied than that of any other country in the world. The first thing that strikes an observer here is that the relations between the British financial world and British industry, as distinguished from British commerce, have never been

very close. The proprietors of British banks have invested but a small proportion of their funds in industry and the requirements of the latter have been met more by the 'extremely varied facilities and unrivalled financial machinery of the English capital market' than by the direct participation of banks in industrial ventures.

This peculiarity has been due to historical reasons. In England, commerce preceded industry and London's financial organisation adapted itself to the needs of her commerce. 'The exceptional merits of the City of London lay in the facilities given by the short-term money market for the employment of home or foreign funds; in the financing of trade and commerce, also both home and foreign; and in the issue of foreign bonds, as distinguished from the financing of British industry.' On the other hand, when British industry began its growth in the nineteenth century, there was no particular reason why it should look to the London market for its financial requirements. Industry in those days was, so far as each unit was concerned, on a comparatively small scale; the capital was provided privately and it was built up and extended out of profits; in so far as it required assistance from banks, it found it from the independent banks, often family banks, which in general had their headquarters in the provinces, and particularly in the Midlands and the North, where the new industries flourished. Moreover, there had existed for many years a large class of investors with means to invest, who exercised an independent judgment as to where to invest, and who did not rely, as in some countries, entirely on their bankers. Although it made full use of the banking facilities offered by the joint-stock banks, industry maintained its independence of any financial control by the latter.

Generally speaking, until very recently, industrial investment in England has not been 'guided' by any financial institution or organisation of any standing or reputation. A few Issue Houses occasionally entered into the field of industrial promotion, and the organisations of stockbrokers have often been known to give advice, but banks or other financial institutions hardly fathered an issue or were in

any way responsible for it, beyond seeing that the prospectus of a projected company complied generally with the law and that the issue was, on the face of it, respectable. There were practically no established houses to assist the investors in subscribing to shares in local industries and enterprises; the real issuer was 'the company itself, if it was a strong or a good one, or a finance company or syndicate—few large, many small, some good, some indifferent, some bad, and sometimes it was a company or a syndicate got together for the sole purpose of making a particular issue.'[1]

The current requirements of industry were supplied by the joint-stock banks. They increased the supply of capital by collecting lodgements from the public; by compounding these lodgements with their own capital and reserve funds they converted a large number of small quantities and short lengths of capital, individually ineffective, into an aggregate available for productive employment; finally, by a continuous re-distribution of this capital among the points of highest yield, they maximised its earning capacity. This last service of continuous re-distribution of available funds was performed in the City of London by the short-term money market which gave facilities for the employment of home or foreign funds. The money market supplied the day-to-day needs of industry with an elasticity and efficiency that were unknown in any other financial system of the world. On the other hand, intermediate credit (i.e. credit advanced for periods ranging from one or two up to five years) and long-dated capital were not adequately supplied by this market, this being due in part to the historical organisation of British industry and in part to the fact that industry, having grown up on strongly individualistic lines, was anxious to steer clear of anything which might savour of banking control or even interference.

The most important feature of the English credit system was the Bank of England, which stood at the apex of the entire banking organisation of the country. By its control over the cash base of the country, the Bank of England

[1] *Report of the Committee on Finance and Industry*, London, 1931.

was in a position to regulate the volume of bank deposits, so long as the joint-stock banks adhered to their assets. With the same weapon in its armoury, it could also offset any change which might be made in those practices. The link between the Bank of England and the commercial banks was established through the discount market which was the first outlet of any surplus funds held by the banks and from which funds were withdrawn when they found it necessary to replenish their reserves. If the withdrawal caused a shortage of funds in the market, the market borrowed in some form or other from the Bank of England, and the accommodation thus given by the central institution provided the means of replenishing the cash resources of the commercial banks.

Businessmen in England thus depended on the ordinary credit mechanism of the country for the accommodation they required for purposes of trade and industry. For historical and sociological reasons, the system had worked wonderfully well, although the contact between industry and credit had never been very close and intimate. But, with the rise of highly industrialised systems in other countries of Europe and in America, England also found that the old practice of 'little conscious direction of the national activities to definite ends' no longer paid; the feeling grew that her former policy of *laissez-faire* would not ensure her prosperity in a crowded and increasingly competitive world. The question of finding new and up-to-date agencies of industrial finance began to attract the attention of businessmen and financiers in England as well.

As a direct sequel to the above, there came into existence, during the inter-war period, a number of specialised institutions for providing finance to certain types or groups of industry. In addition, the ordinary joint-stock banks and even the Bank of England began to evince a more direct interest in the actual promotion and development of industry. Of these, mention may be made of (*a*) the Securities Management Trust, a subsidiary company formed by the Bank of England towards the close of 1929 to assist the process of rationalisation and reconstruction in industry; (*b*) the Bankers' Industrial Development Com-

pany, a private company set up in 1930 with the Governor of the Bank of England as Chairman;[1] and (*c*) the Credit for Industry Ltd., launched in March 1934, mainly to provide capital for plant and other purposes for small and medium-sized business. The three institutions mentioned above played only a limited part in promoting industrial ventures: the gap in the financial machinery for meeting the requirements of small and medium industries could not be fully bridged by them.[2]

Two new institutions were accordingly set up in the post-World War II period. The first of these was the Industrial and Commercial Finance Corporation formed in 1945 when the war was drawing to its close. The object was to provide medium-term finance or long-term capital for the smaller and medium-sized industrial or commercial business, where the amounts involved (ranging between £5,000 and £200,000) would not justify, or even possibly permit, the making of a public issue of capital. In the first eight and a half years of its existence (up to the end of March 1953), however, this Corporation was able to push its loans and investments up to only £26·3 million as against its total assets (actual as well as potential) of £45 million. This happened, not because the Corporation was tight-fisted in its interest rate or 'vetting' policy, but because 'the small and medium industrialist was not avid for finance for fixed capital. The disturbingly low level of real investment in small British business was not due to lack of investible funds but to the lack of incentive to expand business activity under conditions of crippling taxation.'[3]

The second institution was the Finance Corporation for Industry, Ltd., also set up in 1945, 'to assist the quick rehabilitation and development, in the national interest, of large industries—those not covered by the Industrial and

[1] The Bankers' Industrial Development Company was characterised by many as 'a national consortium of British bankers—a partnership between the Bank of England and the leading houses of the City of London, formed to make available for British industry the amplest resources of the nation.'

[2] For details, see S.K.Basu, *Industrial Finance in India*, Calcutta, 1953.

[3] Norman Macrae, *The London Capital Market*, London, 1955.

Commercial Finance Corporation.'[1] It resembles the Bankers' Industrial Development Company in the sense that it takes no initiative in the reorganisation of industry and its primary objective is to provide finance. But it is really a much more ambitious version of the latter in that the emphasis has been shifted from salvage to development. 'It will seek out its own spheres of activity and not wait till the corpses are brought in.' Secondly, it has not been debarred, in the process of financing, from participating in the equity of the business it assists: it can, if it so chooses, subscribe to the initial share capital of such business.

Although the Finance Corporation for Industry, Ltd., made a disappointingly slow start, up to March 1953, it had lent £61 million of which £39½ million went for the heavy investment programme in the steel industry. It is true that the funds that it has called in from its shareholders (mainly insurance companies and investment trusts) and then re-lent, could otherwise have been invested on the open market, but the mere fact that it has not aroused loud criticism from the institutions that are its shareholders suggests that it has fulfilled a moderately useful rôle.[2]

Industrial Finance in Germany

We may now return to a study of the relationship between banks and industry in Germany.[3] A very large section of Indians desire that India should take a leaf out of German industrial history and develop her industries after the German fashion. Even apart from this consideration, the study is important because, of all the Continental countries, Germany shows *par excellence* how economic circumstances forced bankers to associate themselves with industrial development, and how industries themselves

[1] The Finance Corporation for Industry, Ltd., is wholly owned by a consortium of insurance companies, trust companies and the Bank of England in the proportion of 40, 30 and 30 per cent respectively. The authorised capital is £25 million, but its called up capital is much less. The bulk of its resources is provided by the exercise of its borrowing powers amounting to four times the authorised capital, i.e., £100 million.

[2] Macrae, op. cit.

[3] A very comprehensive account will be found in P.B.Whale, *Joint-stock Banking in Germany*, London, 1930.

were forced to count on the support and guidance of banks.

Let us first analyse the historical forces at work. The close association between banks and industry in Germany arose out of the necessities of the situation—from the scarcity of capital and of independent investors. 'The comparative poverty of Germany about the middle of the last century and the great demand for capital to supply the needs of her rapidly growing industries led naturally to the development of banks which took a large and active part in providing the capital requisite for the creation and extension of business undertakings, both by the grant of long loans and by the floatation of joint-stock companies. In order to compete with England, which had the advantage of an early start, industry in Germany had to turn to banks for its capital requirements. Accepting the heavy responsibility of supplying capital to industry, banks on their part were compelled to keep in more intimate touch with, and maintain a more continuous watch over, firms with which they had allied themselves than were the English banks.'[1]

It was not exactly an *absolute* shortage of capital that resulted in this peculiar relationship between German banks and industry. Capital there was, but it was misdirected. 'Those who had the necessary funds were for the most part neither willing nor fitted to become progressive entrepreneurs themselves, nor would they entrust their money to others who had the required qualities.' Hence there was an urgent need for some agency which could obtain the confidence of the investing classes and use this confidence to direct the capital towards sound industrial undertakings. The new credit banks filled in this gap.

The close co-operation between banks and industry in Germany was accelerated by some of the outstanding features of industrial and economic life there. During the closing years of the last century kartellization, or the association of industries horizontally related, began to dominate the economic landscape in Germany: industry became

[1] *Report of the Committee on Finance and Industry*, London, 1931, pp. 162-3.

powerfully equipped through efficient organization to meet competition abroad and to secure a stable and remunerative price in the home market. 'But large and highly organized industrial interests called for large and similarly efficient industrial finance. The advantages which industrial groups had gained by close co-operation under the kartel system were realized by the banking interests, which not only began to form syndicates or consortiums among themselves in order to distribute the risks and burdens of large-scale finance, but also began to demand representation on the advisory councils of the concerns or groups which they financed.[1] By the beginning of the twentieth century the greater banks had their recognized industrial areas, so to speak. The economic expansion had created on the one hand such heavy demands for credits of all descriptions, and claimed, on the other hand, the public trust in such a measure that, broadly speaking, the means and position of private houses were no longer equal to the requirements. The process of concentration and affiliation in industry necessitated the broadening of the capital and credit basis of the banks themselves, and this latter process in its turn enabled the banks to form a close alliance with industrial concerns.[2]

What is often overlooked in all discussions about the German banking system is that the special services to industry were performed not by a separate or special type of credit agency, but by the ordinary joint-stock or commercial banks. The various activities carried out in the British banking system by various kinds of agencies were executed in Germany by the joint-stock banks alone: these latter comprised the functions of a commercial bank, mortgage bank, discount house, issue house, company promoter, bill-broker, and stockbroker. 'The German Great Bank, unlike the English Investment Trust, does not specialize in investment business alone, but combines the functions of an investment bank with those of an ordinary commercial bank.' The ordinary credit banks carried on various lines of business which to an outsider would seem rather

[1] *The Bankers' Magazine*, London, April 1931.
[2] Leopold Joseph, *The Evolution of German Banking*, London, 1913.

risky and speculative. But, inside the integrated system, there was a considerable amount of specialization. The various routine transactions were done by the respective departments, while the higher financial activities, such as the floating of State and municipal loans, syndicate operations in connexion with the promotion of industrial undertakings, etc., were dealt with by the managing directors themselves with the help of their secretaries.[1] Organization, elaborate and methodical, characterized the German system and gave it power. In banking, as in industry, though the individual units were often large enough by themselves, the method of the kartel was frequently adopted. On the one hand, each of the leading banks had a large group of allied banks, working in general co-operation with it; on the other, in addition to this primary grouping, they were specially organized in their own ways to deal with large financial propositions. The result was that, in Germany, risks which even the largest banks might regard as dangerous were made quite manageable by distribution.[2]

Let us now analyse the transactions which took place between a bank and a particular customer undertaking. These transactions were very varied—a sort of 'an indivisible many-sided whole, rather than a sum of separate relations.' The first connexion arose in the matter of current account which was distinct from cheque account. When a current account relationship existed between the two parties, money claims arose on both sides and 'these claims were not settled individually, but were treated as items in an account of which the balance was struck periodically.' The average German firm depended to a remarkable extent on this arrangement not only for its working funds but also for the purpose of extending its permanent assets in anticipation of recourse to the investment market. The current account relationship was very important, as it was a continuous connexion and thus gave the bank an insight into most of the money transactions of a

[1] *Written Evidence of Dr. L. Nemenyi before the Indian Central Banking Committee*, 1931, Vol. II.

[2] H. S. Foxwell, *Papers on Current Finance*, London, 1912.

customer; it also provided much of the data required for estimating the risk involved in the intermittent capital transactions; and it led up to capital transactions even more directly, in the sense that improvements and extensions of plant were often undertaken by means of current account credit which was repaid later with the proceeds of a capital issue. The industrial current account was the pivot of all transactions between banks and industry; promotion and issue transactions, direct participation in industrial undertakings and co-operation in management through Boards of Supervisors—these stood in very many cases in a close causal sequence with bank credit.[1]

The second important connexion arose in the matter of promoting companies and equipping them with capital. The more common method of promotion in Germany was what was called 'the simultaneous method' whereby the entire capital was taken over in the first instance by the promoters themselves. What happened was this. After the plans of a new company had been examined and approved by a bank, a so-called 'syndicate' (a sort of temporary association of various banks and also of private men for the sake of floating a new concern) was formed, and the shares of the new company were taken up by the promoters, that is, the members of the syndicate. This, however, was only the first step. For the satisfactory termination of the whole transaction, the shares taken over at the time of promotion had to be placed before the investing public. This also was done by the syndicate or consortium. The time was always chosen carefully, according to the conditions of the share market. The syndicate divided the shares between the applicants, but the period of sale was always regulated in such a manner that the shares could be sold at the highest price obtainable. In all this, banks played the part of middlemen only: they simply held securities for a certain length of time, and lasting participation in industrial undertakings was never their general policy.[2]

The third and last important connexion arose in the representation accorded to banks on the Board of Supervisors

[1] P.B.Whale, *Joint-stock Banking in Germany*, London, 1930.
[2] Ibid.

of an industrial undertaking. This Board came in between the Executive and the General Meeting of shareholders to keep a check on the executive in the interests of shareholders and had got considerable powers over both. By this means banks strengthened their connexion with the undertakings in question and exercised more influence on their policy and more insight into its execution.

It may be asked how German banks managed to maintain such a close alliance with industry without involving themselves in trouble. The secret was that every line of the activities of a German credit bank was self-balancing. 'The short-term deposits were used only for short-term credits, whereas the loans on long terms were based, without exception, on such resources as could be safely locked up for long periods. The latter were granted to industry and agriculture in the form of debentures, and the debenture bonds which were issued against these loans were again sold to capitalists who were willing to invest their money for a long period against a guaranteed interest.' The German banks did not unduly 'lock up' their assets: they could take an active share in industrial banking simply because they had vast resources of their own and large reserves.[1] Although it is true that German banks invested in the shares of their customers' concerns, it is not true, contrary to the general opinion held in India, that they tied up their depositors' funds to any appreciable extent in illiquid assets. The total of illiquid assets was almost invariably covered by the capital and reserve resources of a bank. Then again, even when a certain amount of 'locking up' became unavoidable, the risks were mitigated, firstly, by diversifying their interests and, secondly, by maintaining secret reserves. Thus, in syndicate operations, the capital invested was constantly changed from one investment to another, and the holdings of banks in the different syndicates were kept very confidential.[2]

[1] Reisser tells us, as the result of an enquiry into 169 banks, that the paid-up capital and reserves of these banks was 45 per cent of their liabilities, while the proportion in England at that time was only 9 per cent.

[2] *Written Evidence of Dr. L. Nemenyi, before the Indian Central Banking Enquiry Committee,* 1931, Vol. II.

A Comparison of the English and German Systems and Some Recent Developments

The English banking system was an instance of excessive division of labour, but it suited the temperament of the English people and had historical forces behind it. In Germany, banking was more non-specialized, and it was almost a marvel that ordinary commercial banks should engage in activities of so diverse and complex a character and yet maintain their soundness and liquidity. As we have seen already, this was achieved by a punctilious insistence on self-balancing transactions and by a judicious distribution of risks. The German system provided a very efficient machinery for investigating business ventures and at the same time was strong enough to sustain the heavy risks to which industry is exposed. The companies enjoyed expert financial advice and assistance; the banks, by virtue of their position as directing heads of industrial groups, obtained a comprehensive view of economic conditions which enabled them to promote amalgamations and introduce or, if necessary, even force through schemes of rationalization or other remedial measures. The investing public also benefited inasmuch as it obtained as a matter of course a large measure of security through the active intervention of banks. Moreover, as the German banker undertook a more definite responsibility and a greater risk in connexion with capital issues, he was naturally more concerned about the success and stability of the securities issued under his name than the average English banker.

On the other hand, certain weak features of the German system should not be overlooked. While the charge of having caused the annihilation of small business in Germany should not be laid at the door of the credit banks, it cannot be denied that one of the far-reaching results of the direct intermingling of the vital interests of the banks and of industry has been that the value of the small capitalist and investor has been somewhat overlooked, and the State has often been forced to step in to avert a crisis.[1] Moreover, in the years before the War, the ordinary industrial

[1] *The Banker's Magazine*, London, April 1932.

or commercial firm of moderate means often found its freedom of action conditioned by the goodwill of its bank, even when it was in a sound and fairly prosperous state itself. Although initiation in industrial combination did not actually come from the banks, it is difficult to dispute the fact that banks had some part in the development. At a very early stage they helped to prepare the way by encouraging fusions between individual undertakings, and thus reducing the number of competitors. Throughout, their attitude towards fusions was sympathetic, even while it remained passive. Finally, once the plans for combination had reached a certain stage and were within a measurable distance of fruition, the banks gave active support to ensure their success.[1]

Another weakness of the German system lay in the relation of banks to the short-term money market. In their desire to meet the credit needs of their industrial customers on the cheapest terms, the banks placed their acceptances at the disposal of their customers to a very large extent. Such acceptances were used largely to obtain long-term credits. Now, a demand for long-term credit for capital investment means more bank acceptances and a tendency towards over-burdening of the money market, with the result that the interest rate of legitimate short-term credit reflected in the discount rate is forced up without justification and at a time when trade expansion may be vitally necessary. The practice of the banks employing the nation's liquid resources as long-term advances to industry had a disturbing influence on the money market on more occasions than one and, paradoxical though it may seem, the rapid reconstruction of Germany's industrial plant after World War I with the active help of banks was, through its effect on the money market, a major obstacle to the desired expansion of the country's foreign trade.[2]

In spite of these weaknesses, the system was undoubtedly suited to the genius of the German people, and a signal success in so far as the industrial development of the country

[1] J.H.Clapham, *The Economic Development of France and Germany*, Cambridge, 1928.

[2] J.W.Angell, *The Recovery of Germany*, New Haven, 1929.

was concerned. The banks assisted with their credit in the development of production on a large scale and their decentralization of establishments, combined with an elaborate and methodical organization, had enabled them to keep a finger 'on everything that was going on'. Finance and industry had gone hand in hand and the grim determination of the German people to achieve a rapid economic development had only strengthened this process of alliance. The influence of the old bureaucracy also was not negligible: it was this bureaucracy that ensured economic stability by restricting the liberty of the industrial unit and thus built up a banking tradition which lost none of its essential characteristics during the difficult inflation years.[1]

Developments in Germany during the inter-war period have, however, revealed the weaknesses in this relationship between banks and industry to a very large extent. War profits increased the power and independence of industry as against banks, and banks were seriously affected by the fall in the value of the mark.[2] Although stabilization came after some time, banks could not go back to their strong pre-World War I position. As a matter of fact, the balance sheets of the leading German banks, while showing substantial expansion in resources, seemed to bear a greater resemblance to the normal English balance sheet than did the majority of the German balance sheets in pre-war days. Moreover, the melancholy bank failures that took place in Austria and Germany in 1930 and after, showed far too clearly that the system of mixed industrial banking had helped to make Germany's economy more vulnerable. Germany's economic depression of 1932-3 was certainly aggravated, and her financial crisis caused, by the destruction of her working capital during the inflation period and by the sudden withdrawal of foreign confidence and money, but there is not a shadow of doubt that her system of intimate alliance of banks with industry had made her position inherently weak.[3]

[1] *The Bankers' Magazine*, London, June 1930.
[2] H. Schacht, *The End of Reparations*, translated by Lewis Gannett, London, 1931.
[3] Dr. Erich Roll in *The Bankers' Magazine*, London, February 1933.

So when the crisis came, nothing could lessen the steepness of the crash.

One of the most striking features of German banking legislation during the inter-war period was the separation of commercial from investment banking. Following the crisis of 1931 and the complete breakdown of the German banking system, a Commission of Investigation was set up in 1934 and, later, a new law, the German Credit Act of 5 December 1934, was passed. Under this Act, banks were called upon to maintain a fairly high standard of liquidity and to limit their holdings of real estate and speculative investments. Permanent participation and investment in property and buildings were not to exceed the capital and reserves of the credit institution concerned. As a result, syndicate participation by the five big Berlin banks declined from 168 million Reichsmarks in 1929 to only 83 million Reichsmarks in 1939.

Another interesting development in Germany during the inter-war period was the financing of industry largely out of undistributed profits. According to one estimate, during the decade ending in 1942, nearly 10,000 million Reichsmarks out of a total of 14,000 million Reichsmarks required by industry was found by the ploughing back of profits. Business credits by banks declined from about 40 per cent of the total balance sheet in 1938 to about 20 per cent in 1942.

In England, on the other hand, the tendency has been for a much closer association between banks and industry than there existed before. The Big Five in the English banking system have now got considerable investment in industrial shares and debentures, and although they are still unwilling to be drawn into too intimate a relationship with industry, the connexions which the inter-war years have brought about, are likely to endure.

Since the end of World War II, the situation has altered still further in the United Kingdom. The question is no longer whether the existing institutions are able to provide finance to those who require it, but whether real investment is increasing at as fast a rate as it should. 'The real problem today does not seem to lie in the lack of appropriate

financial institutions: it lies instead—and here is another inconvenient political fact—in the level of tax rates on business profits.'[1]

Mixed Banking in India on the German Model

It has been suggested by many that Indian joint-stock banks should pursue a policy of mixed banking, i.e., combine investment banking with commercial banking, on the lines followed by German banks before 1934. Now, few of the joint-stock banks in this country are fitted to embark on the undoubtedly difficult and complex policy of mixed banking. This is for a variety of reasons. Firstly, although the size of the scheduled banks has increased during the last decade, they are still small when compared with their Continental counterparts. Secondly, their deposit assets which consist largely of customers' deposits liable to be withdrawn at short notice, cannot obviously, without incurring serious risks, be locked up in long-term loans or advances to industry. Thirdly, the necessary technical and entrepreneurial ability, which is required if mixed banking policy is to be successful, is still lacking among our bankers. The large number of bank failures which have occurred from time to time since 1913 do not offer much hope for this type of banking. The whole history of industrial finance in India shows that investment banking by institutions which are organised as commercial banks inevitably leads to speculation and rash promotion. The remarks made by a German banking expert (Dr.O.Jeidels) before the Indian Central Banking Enquiry Committee about a quarter of a century ago, hold good even today. 'It is not to the advantage either of the commercial banking system or Indian industries that any of the weaker banks should participate in industrial financing. This new class of business requires much experience and an established policy of sound banking. It also demands considerable capital and a firm resistance to speculative temptations which easily arise in a line of business where securities are created and sold. The bulk of the joint-stock banks in India are at present not ready for this activity, and even

[1] Macrae, op. cit.

the larger ones can cultivate it only slowly, with great caution, and preferably under competent guidance as participants in strong syndicates.'

Another point that is important for India to remember is that in Germany block capital was hardly, if ever, provided by banks. Their share and syndicate operations were in the nature of guarantees only: they did not supply the initial block capital themselves. As regards the success of the current account system in Germany, it should not be forgotten that this was due ultimately to the fact that the savings of the community there (which are the ultimate source of capital) were poured into those credit banks in enormous quantities for years together.[1]

What is needed in India, therefore, is not so much mixed banking on the German model, but the setting up of special institutions to cater for the requirements of various types of industry. It is not denied that there is room for further improving the facilities for current finance, but this should be done through the existing mechanism of the ordinary joint-stock banks and loan offices. As regards long-term and medium-term finance, Government have already taken note of the 'gap' which exists in the country and set up, within the past three or four years, quite a number of special institutions. We shall study the working of these institutions in a subsequent chapter.

[1] Solomon Flink, *The German Reichsbank and Economic Germany*, New York, 1930.

CHAPTER III

THE FINANCING OF INDUSTRIAL ENTERPRISE IN INDIA: YESTERDAY AND TODAY

How Fixed Capital is Raised for Industry in India

SO FAR, MOST of the major industries in India have obtained their fixed capital either by public or private subscription of shares or debentures of the undertaking, or by direct deposits, or by the system of providing money on private account by an individual or partnership. The part played by these diverse methods has of course varied from industry to industry, but the recent tendency has been towards securing the initial block or fixed capital by public or private subscription of shares or debentures.

While it is true that the market for equities has gradually broadened in India, it has been the experience of industries in general that it is more difficult to raise such capital in India than in the more industrialised countries of the West.[1] The figures of paid-up capital of joint-stock companies in India in recent years show that, notwithstanding the launching of a number of new undertakings involving fairly large capital expenditure, the *average* paid-up capital of joint-stock companies in India has not registered any significant increase.[2]

Some idea of the sluggish conditions obtaining in the capital market even in recent years can be had from the figures of consents granted for new issues by the Controller of Capital Issues under the Capital Issues (Continuance of Control) Act, 1947, and of the actual amounts raised by such

[1] *Report of the Committee on Finance for the Private Sector*, Bombay, 1954.

[2] See Appendix I. It should be remembered in this connexion that part at least of the increase in recent years is attributable to the issue of bonus shares.

companies as have furnished the relevant returns. They show that the amount of capital sanctioned bears little relation to the actual amount of capital raised. Taking an average of the seven years 1948-54, the annual amount sanctioned (i.e. industrial issues consented to) was Rs 60 crores, whereas the amount of capital actually raised was an average of only Rs 18·5 crores per annum.[1]

It may be noted in this connexion that most of the paid-up capital in joint-stock companies in India is ordinary or common stock. Preference shares have been issued in some cases, but they have not been very popular in India. According to a recent study made by a Calcutta economist, the only industry which has made any substantial use of the device of preference shares is the jute industry and the Tata Iron & Steel Co., Ltd.[2] It appears that both preference and deferred shares are popular mainly in such undertakings as have a well-established record of activity and whose future prospects also appear to be fairly bright to the general body of investors.

Unlike in Western countries, debenture finance has not played an important part in meeting the fixed capital requirements of industry in India. In Europe, extensions and replacements, or even normal working expenses, are generally met by the issue of debentures. In India, on the other hand, debentures form a very small proportion of the total capital of industrial undertakings. According to a study made by the Indian Central Banking Enquiry Committee in 1931, the debenture floatation was insignificant, as would be evident from the following figures:

	Joint-stock companies on the Calcutta list	*Joint-stock companies on the Bombay list*
Share Capital	... Rs 76·30 crores	Rs 52·83 crores
Debentures	... Rs 8·65 ,,	Rs 17·51 ,,

The position has not altered substantially during the past twenty or twenty-five years. Out of 60 jute mills quoted

[1] Vide Annual Reports on *The Working of Capital Issues Control* issued by the Government of India, Ministry of Finance, Department of Company Law Administration.

[2] S. K. Basu, *Industrial Finance in India*, Calcutta, 1953.

in the *Investors' India Year Book, 1955*, only 18 had issued debenture capital and the percentage of debentures to the total capital was only 9·5. Out of 63 cotton mills quoted, only 10 had issued debentures which represented 1·2 per cent of the total share capital. In the coal industry, the proportion of debenture to share capital was a little higher, i.e., about 11·0 per cent.[1] On the other hand, the premier iron and steel concern in India, the Tata Iron & Steel Co., Ltd., has generally relied on the method of issuing debentures to finance extensions and replacements, and its appeals to the Indian capital market for debenture loans have always had a ready response.

In the inter-war period, both preference shares and debentures became extremely popular with investors in European countries and the U.S.A. This was because the average investor wanted to have a fixed return on his money rather than a share in the full risks of the industry. The tendency was also partly the result of an increase in the amounts of capital accumulated by financial institutions such as insurance companies: these latter naturally preferred their industrial investments to be in the form of preference shares and debentures rather than ordinary or deferred shares.

The reasons for the unpopularity of debentures in this country are many and sometimes contradictory. According to some witnesses who deposed before the Indian Central Banking Enquiry Committee in 1931, debentures were not a popular method of investment with Indians, because speculation had an attraction for most of the Indian investors. The main consideration with them was capital appreciation rather than a steady yield, and debentures offered little scope in the former direction. But this does not offer a satisfactory explanation. It is well known that every year large sums of money are invested in fixed interest-bearing Government securities, postal cash certificates, national savings certificates and municipal and port trust loans. If speculation were the prime consideration, why should Indian investors put such large sums of money in Government and quasi-Government bonds?

[1] Vide Appendix II.

The real reason for the comparatively limited use made of debentures as an instrument for attracting capital appears to be due to the fact that debentures suffer from a double disadvantage. If a fixed return is the primary consideration, the investor would naturally prefer to put his money in Government and quasi-Government bonds rather than in industrial bonds or debentures, for, after all, the former are much safer than the latter. The fact is that the average investor is not yet industrially minded and, in the absence of specialised institutions like issue houses to help the debenture issue and also to educate the investing public, most debentures have to fend for themselves. Barring one or two companies like the Tata Iron & Steel Co., Ltd., debentures, wherever issued, were taken up by former Indian princes or by wealthy merchants. Unlike in Western countries, debenture issue has never been broad-based in our country.

A further explanation of the relative unpopularity of debentures can be found in the attitude of commercial banks in India. For reasons which are not quite clear, industrial concerns which have issued debentures have not been looked upon with favour by joint-stock banks. According to the Central Banking Enquiry Committee, industrial concerns which had issued debentures found it difficult to secure bank loans and cash credits on the usual terms. Perhaps some of these banks thought it was not safe to lend money to an undertaking which already had such heavy debt charges.

Nevertheless, the difficulties of obtaining initial capital for industrial ventures in India appears to have been somewhat exaggerated. During the past thirty years or so, industries floated on sound lines and having reasonable prospects of success have not experienced much difficulty in securing financial support from the investing public. This view has been expressed at successive intervals before various Committees and Commissions by the Bengal Chamber of Commerce, the Exchange Banks Association and the Imperial Bank of India. The Fiscal Commission which reported in 1950 also remarked on the fact that many of the witnesses laid greater stress on 'other factors'

inhibiting industrial enterprise in India rather than on the lack of capital.[1]

It appears that it is only new industries which have sometimes failed to secure adequate support from the investing public. But this is true not merely of India but also of other countries. A special handicap in India has been the stepmotherly attitude of Government until 1947, i.e., until India attained her independence. As long as the economic and fiscal policies of Government were guided by extra-national considerations, it was not reasonable to expect the investor to take kindly to every new issue, howsoever attractive it might look on paper. In view of past history, the investor could never be sure of Government's intentions in the matter of industrial development and he could not be blamed if, at times, he wanted to look a bit more carefully before he leapt.[2]

The problems of long-term finance are not, however, confined to the raising of initial capital by means of floatation. As has been stated already, an industrial undertaking requires fairly long-term financial accommodation during the period of development of its business and it is in this sphere that many industries have experienced, and are still experiencing, difficulties. The amount of capital realised by the sale of shares is soon exhausted in acquiring the land, setting up the factory, installing the machinery and providing other facilities to get the concern going. The concern is then faced with the acute problem of finding the requisite funds to develop and carry on the business. In many industries, several years may have to elapse before an undertaking can reach the stage of earning profits, and it is during this 'period of gestation' that it may find that it cannot have any long or medium-term credit on easy terms.[3]

The above difficulties have often been due to the fact that many undertakings were under-capitalised from the

[1] *Report of the Indian Fiscal Commission,* Vol. I, New Delhi, 1950, pp. 175-80.

[2] The Hon'ble Shri R. K. Shanmukham Chetty expressed a similar view in the Indian Legislative Assembly in November 1947, while speaking on the Industrial Finance Corporation of India Bill.

[3] For details, see S. K. Basu, *Industrial Finance in India.*

very start. Not infrequently, a few promoters or entrepreneurs would commence business with the barest minimum of capital and would make no provision for unforeseen (but sometimes very common) items of expenditure. During the inter-war period, when money was relatively plentiful, a number of new industrial enterprises were started in the country, mainly because the 'climate of investment' appeared favourable. As soon as a slump appeared, these undertakings found that they could not get the additional long-term or medium-term finance to carry on their business. The result was that many of them had to go into liquidation before they could even commence production.[1]

The difficulty of finance has been particularly evident in relation to the problem of rationalisation in some of the industries in India. Plant and machinery in some of the older industries in India (e.g. cotton, jute, iron and steel and collieries) have become archaic and out-of-date and, therefore, badly require replacement and modernisation. The introduction of new techniques and labour-saving devices in industries in European countries also places Indian undertakings at a considerable disadvantage and makes it imperative that money should be found for rationalisation. Unfortunately, however, many desirable programmes of rationalisation have not been carried out, partly because the requisite funds were not available.[2] The failure in 1931 of the ambitious scheme of rationalisation in the Bombay cotton mill industry is paralleled by the slow progress, in recent years, of similar efforts in the sugar industry, the jute industry and the cotton textile industry.

How Working Capital is Found for Industry in India

Coming now to the question of working capital, one is surprised at the variety of ways in which this has been found by different enterprises and industries in India. Broadly speaking, there are four sources of getting working capital—

[1] The Annual Reports of the Registrars of Joint-stock Companies in Bengal and Bombay are replete with instances of this kind.

[2] Another obstacle in the way of rationalisation has been the hostile attitude of labour which resists it on the ground that it would lead to displacement of labour.

(1) public deposits; (2) private deposits or money on private account provided by one or more of the entrepreneurs, their friends, or the managing agents; (3) advances by indigenous shroffs; (4) advances by joint-stock banks. We shall consider the part played by each of them in the financing of the short and medium-term requirements of industry in India.

(1) Public Deposits

We may start with the public deposits.[1] This system has prevailed almost solely in the cotton textile industry of Bombay and Ahmedabad—particularly in the latter. The system arose owing to the imperfect banking development of the country: on the one hand, people naturally had more confidence in, and preferred to entrust their savings to, those men in their communities whom they knew and with whom they could deal without the formalities necessary in dealing with banks; on the other, the mill owners of Bombay and Ahmedabad were ready to accord to depositors a safe return with certain other advantages which the latter could not possibly get from banks run on western lines or from indigenous shroffs. So arose an arrangement whereby the mills got—in the days prior to World War II—most of the working capital from the public on short-term deposits, usually for six months or a year. The importance of this system in the thirties of the present century is illustrated by the following figures.[2]

	Bombay (*Figures for 64 mills*)		Ahmedabad (*Figures for 56 mills*)	
	Lakhs of rupees	*Percentage of total finance*	*Lakhs of rupees*	*Percentage of total finance*
1. Amount loaned by the Managing Agents ...	532	21	264	24
2. Amount loaned by banks	226	9	42	4
3. Amount of public deposits	273	11	426	39
4. Amount of share capital	1,214	49	340	32
5. Amount of debentures ...	238	10	8	1

[1] These 'public deposits' provide both fixed and working capital, but separate figures as to the extent to which they provide these two items are not available.

[2] *Indian Central Banking Enquiry Committee, Minority Report,* 1931. The figures relate to October 1930.

It will be seen from the above that, during the thirties, public deposits were the most important source of industrial finance for the cotton textile industry in Ahmedabad, and they were in excess even of the amount raised through share capital and debentures. In Bombay, the importance of public deposits was much less, but until 1921 (when public confidence in the Bombay cotton mills was rudely shaken), public deposits played as important a part there as they did in Ahmedabad.[1]

Over the past two decades, however, there has been a substantial decline in the volume of public deposits, particularly in Bombay. In Bombay, public deposits fell from an average of Rs 4·3 lakhs per mill in 1930 to Rs 2 lakhs per mill in 1937, while in Bombay and Ahmedabad taken together, public deposits fell from Rs 12 lakhs per mill in 1935 to Rs 7·5 lakhs per mill in 1939.[2]

This tendency gathered strength during the years following the declaration of World War II, with this difference, that very soon managing agents were supplying the finance, enabling themselves to redeem, more or less completely, their own commitments, and to reduce the volume of deposits. This is also indirectly confirmed by the rate of expansion in, and the volume of bank finance available to, cotton mills in Bombay and Ahmedabad from 1930 onwards. There was a ten to twelve-fold rise in the utilization of normal banking facilities between 1930 and 1954. The stake of banks in the mill industry has risen not only in terms of volume, but also in terms of its proportional significance.[3]

The public deposit system of finance has played a very important part in the development of the Indian cotton textile industry. At a time when banking facilities were inadequate, these deposits were a virtual godsend to most cotton mills in Bombay and Ahmedabad. The rates of interest paid on the deposits have never been exorbitant and have generally varied from $4\frac{1}{2}$ to $6\frac{1}{2}$ per cent. In no case were these rates more than 1 per cent above the rate at which loans were advanced by banks and not infrequently

[1] *Indian Central Banking Enquiry Committee Report*, 1931, Vol. III.
[2] S. D. Mehta, *The Indian Cotton Textile Industry*, Bombay, 1953.
[3] *Reserve Bank of India Bulletin*, April 1952.

they have been even ½ per cent less. Looked at from the interest rate point of view, therefore, these public deposits were never 'costly'. Instead, they were a real convenience to the cotton mills of Bombay and Ahmedabad in as much as they enabled the mills to keep their interest charges low and to borrow at cheap rates to pay higher dividends—a feat which would not have been possible if the whole of the working capital had to be raised by other methods. On the other hand, this system of industrial finance had some inherent weaknesses, which were demonstrated during the depression of 1925-30. In times of stringency, it was those mills whose financial position was not very strong which found real difficulty in obtaining deposits, although it was these very mills which needed help: the tendency of depositors to withdraw their money on the slightest rumours of difficult times ahead invariably put the mills in an awkward position. That is precisely what happened in Bombay and, to some extent, in Ahmedabad during 1925-26 and during the four years thereafter. Public confidence was shaken and depositors were anxious to withdraw their deposits from all mills—good, bad and indifferent. Some mills had to close down and others had to borrow money from friends and indigenous bankers at high rates of interest. The depositors could not of course be blamed for the way in which they had behaved. They could not possibly follow the movements of the money market and understand what was happening; they were in the position of unsecured creditors, and as there was no intervening banking institution between the mills and themselves, they were apt to be easily led away by any bazaar gossip regarding the solvency or otherwise of a concern.[1]

Subsequent to 1930, there developed in Ahmedabad a system of long-period deposits, from five to seven years. and many mills came to be financed in this manner. A system of 'inter-deposits', i.e., deposits as between one mill and another, also became prominent during the post-depression years: the profits of a mill held in the form of reserves were often 'deposited' with another mill which was

[1] For a detailed account, see Indian Tariff Board, *Cotton Textile Industry Enquiry*, 1932, Vol. IV.

believed to be in a sound position. While these new developments made the danger of sudden withdrawal of deposits more remote, they hampered the proper development of the investment market. This undue reliance on public deposits restricted the supply of good industrial securities, shares, debentures, etc., available for an ordinary investor, and unduly narrowed the market for such investment. Secondly, the losses which occurred in a crisis or panic owing to such money being locked up in almost fixed capital assets, had the effect of discouraging many Indians both from investing in industrial shares and from putting their money in deposit with a bank or with anyone else.[1]

(2) Private Deposits or Money Provided on Private Account

While the system of industrial finance through public deposits has held, and still holds, in the cotton textile industry of Bombay and Ahmedabad, the method of finding working capital from private deposits or from money on private account provided by one or more of the entrepreneurs, their friends or the managing agents is to be found in almost all the medium-sized and comparatively new industrial enterprises in India. Exact figures as to the extent to which private deposits or money provided on private account have contributed to the 'financing' of the various industries are not available, but figures quoted by the Indian Tariff Board in connexion with their enquiries on the match, paper and sugar industries show that, until the outbreak of World War II, these represented between 20 to 30 per cent of the short-term and medium-term requirements of most of the Indian-owned concerns in these industries.[2] In not a few industries, new undertakings were set up with inadequate capital in the hope that once the land had been acquired, buildings constructed and the initial machinery and equipment installed, friends or managing agents would provide the further funds required to keep the enterprises going.

[1] P. S. Lokanathan, *Industrial Organisation in India*, London, 1935.
[2] For details, see S. K. Basu, *Industrial Finance in India*, Ch. V.

As regards money directly advanced by the managing agents, we have already seen what large sums of money were provided by them in the cotton textile industry of Bombay and Ahmedabad. We shall study the subject of the economic significance of the managing agency system in the industrial organisation of India in a subsequent chapter, but it may be mentioned here that managing agents have played quite an important and direct part in the matter of providing industrial finance in India. In the tea industry, firms of managing agents have often granted advances against the mortgage of gardens, buildings or machinery or the hypothecation of crops. In the jute industry, on the other hand, the direct assistance of the managing agents has not been needed in this regard, firstly, because the normal requirements of the industry could easily be met by the issue of additional shares and debentures, and secondly, because banks have usually been willing to offer the necessary accommodation to the jute mills, as the latter had a well-established reputation for efficiency and integrity.

The loans given by managing agents to the concerns they manage have usually been given at only ½ per cent above the bank rate and sometimes at par with the bank rate. In the successive crises which overtook the tea and sugar industries during the past twenty years, it was these loans by the managing agents that saved many of the concerns of Bengal, Assam, Bihar and U.P. from ruin. The same thing happened in the coal-mining industry and in some of the under-capitalised concerns in other industries.[1]

Looked at from the standpoint of efficiency, these private deposits and moneys obtained on private account have been much more useful to industry in India than public deposits. The danger of sudden withdrawal of deposits was absent in this method of finance, as those who had made the deposits or advanced loans were themselves vitally interested in the concerns and hence preferred to 'see the matter through' rather than withdraw their money. Secondly, as there were

[1] *Capital*, Calcutta, *Annual Trade and Industry Supplement*, 1952.

no proper banking facilities available for new and middle-sized concerns, such methods of finance were the only solution. Finally, in a period of depression or difficulty, when banks were reluctant to make advances even to fairly solvent concerns, it was these private deposits and money provided on private account by entrepreneurs, their friends and managing agents that helped many of the concerns to pull themselves through.

This method of finance had some drawbacks as well. Very often a managing agent managed a number of concerns and in such cases, when all the concerns needed financial help, it became too much of a burden for the agent to accommodate all of them. During the difficult period of 1925-30, a number of managing agents in Bombay took upon themselves the work of directly assisting with money *all* the concerns that were under their management, and the task proved far too heavy for them. The managing agency firms themselves were ruined as a result of their bold efforts to bolster up the cotton mills. Secondly, although not to the same extent as public deposits, the system of private deposits also hampered the proper development of the investment market. When industry could depend so much on direct financial assistance by private individuals, it was not unnatural that the ordinary investor from the public would not feel interested in industrial ventures or industrial securities, and tended to retire all the more into his habitually shy groove.

(3) Indigenous Shroffs or Bankers

In the past, neither public deposits nor private deposits and private loans were adequate to meet all the various needs of industry in India, and hence industrialists and entrepreneurs often had to approach indigenous shroffs or bankers for financial assistance. While it is difficult to assess to what extent industrial enterprise in India was dependent on the services of this financial agency in the period prior to World War II, certain broad generalisations are possible. Firstly, old and established industries (e.g. cotton, jute, and iron and steel) were more or less independent of the indigenous banker, as they could get their capital without much difficulty

from either the public or the regular joint-stock banks. Secondly, under-capitalised or small concerns in some of the newer industries (e.g. paper, sugar, match, small tools and implements, etc.) had often to turn to them for finance, as they had no public deposits to fall back upon and their resources by way of private deposits or loans were also extremely limited.

The indigenous bankers (they should be distinguished from moneylenders, pure and simple) had a flourishing business all over the country during the early years of British rule in India. Political turmoil and incessant wars, however, severely affected their business. The impact of a new economy and changes in the whole basis of India's trade, external as well as internal, hastened their downfall. The creation of Government treasuries and the establishment of banking institutions on western lines operated to their further disadvantage, and, with the decrease in the volume of their business, their resources also diminished.[1]

When the small concern resorted to the indigenous banker, it did so partly out of necessity and partly out of preference. The small industrialist had to go to him because he could not get accommodation from any other source. He went to him also because the latter was better acquainted with his means, character, and trading methods: he was content to pay the latter's charges, high though they might be, rather than 'expose himself to the enquiries, the regularised procedure and (as he believed) the greater risks of a joint-bank with a grilled counter and uniformed peon in the doorway.' A regular bank would demand of him a trade bill, a deposit of valuable securities, or at least a friend's counter-signature on his promissory note: the indigenous banker, on the other hand, lent on personal knowledge, and often on a simple personal bond, relying on his own acuteness to forestall a possible failure on the part of his debtor. As a result, he had to charge a high rate of interest. Coal companies, for instance, had to borrow money from indigenous bankers at as high a rate

[1] N. Das, *Banking and Industrial Finance in India*, Calcutta 1934, Chs. II and III.

as 12 to 18 per cent, and sometimes even at 24 per cent. Industries like leather, tanning, oil mills, rice mills and small tea gardens, had to pay as high as 15 to 20 per cent even when they borrowed on the security of their assets.[1]

The importance of indigenous bankers in the field of industrial finance pure and simple has diminished considerably during the past quarter of a century. Some of them have organised themselves into joint-stock banks while others have literally wound up their business. It will be no exaggeration to say that, today, except in the remote areas, where organised banking facilities are still not available, indigenous bankers do not wield much power or authority as providers of industrial finance. Nowadays, the main concern of the shroff is the provision of short-term credit for trading purposes, although the Bombay Shroffs' Association is reported to have claimed, as recently as 1954, that small industries were obtaining considerable accommodation from them. Even here, the Committee on Finance for the Private Sector has referred pointedly to the fact that most of these shroffs do a lot of non-banking business and are unwilling to shed the same. They have, therefore, recommended that the question of linking indigenous bankers directly with the Reserve Bank should be pursued only if 'they legally segregate their non-banking business and discard it within a specified period.'[2]

(4) Joint-stock Banks

It is recognised by all students of banking and industrial finance that 'the chief reliance of the average industrial concern for meeting the demands of variations in cash requirements is the commercial bank, which may make a direct loan on the borrower's own rate, or may in effect make the loan by discounting the notes or accepted drafts or trade acceptances of the borrower's customers.' Now, in so far as the financial requirements of the major industries are concerned, we may leave out of account the

[1] *Indian Central Banking Enquiry Committee Report*, Vol. II.
[2] *Report of the Committee on Finance for the Private Sector*, Bombay, 1954.

exchange banks, co-operative banks and land mortgage banks. Although the exchange banks have got large deposits in India and possess big capital and reserves, their principal business is the financing of India's foreign trade and occasionally of her inland trade: they hardly take any part in the financing of industry. The co-operative banks, on the other hand, are concerned mostly with agricultural credit and in the few cases where non-agricultural credit societies have been formed, the beneficiaries are Government officers, contractors, small traders, artisans, weavers and so forth. Large-scale industry is completely out of their purview and, even in the sphere of cottage industries, co-operative societies meet a relatively negligible part of their total credit requirements.[1] Land mortgage banks also have got little connexion with industrial finance, as they are mostly engaged in meeting the requirements of agriculturists for long-term credit for the redemption of mortgages of land, for the clearance of debt and for land improvements.

From the standpoint of industrial finance, therefore, the most important agencies are the joint-stock banks and the loan offices, with the State Bank of India (the former Imperial Bank), with its network of branches all over the country, at their head. Of some importance also are the insurance companies, some of which invest their funds in shares and debentures of industrial banks or concerns and make deposits with, and grant loans to, mofussil banks and loan offices, which in their turn often utilise these resources in financing industries.

As we have noted already, the practice of joint-stock banks in India in regard to industrial finance is based largely on the British tradition of commercial banking, under which banks as a rule provide only the working capital requirements of industries on the security of floating assets, and eschew long-term advances against fixed assets. The following table gives an analysis of bank advances as on 30 June 1953, according to their purpose:

[1] *All-India Rural Credit Survey Report*, Vol. II, Bombay, 1954. It is only in the State of Madras that co-operative societies of artisans and craftsmen have made substantial headway.

	Scheduled banks	*Non-scheduled banks*	*Total*	*Percentage to total advances*
		(*In crores of rupees*)		
Industry ...	188·98	6·52	195·50	33·4
Commerce ...	262·65	18·08	280·73	47·9
Agriculture ...	22·99	2·12	25·11	4·3
Personal and Professional ...	41·00	11·28	52·28	8·9
All others ...	29·25	2·95	32·20	5·5
Total ...	544·87	40·95	585·82	100·0

It will be seen that of the total advances of banks amounting to Rs 585·82 crores, about one-third or Rs 195·50 crores had been lent to industries.[1] Since 1953, both the quantity and the relative percentage of advances made to industry have increased.[2]

How are these advances made? According to the Committee on Finance for the Public Sector, although a few banks in India make advances to industries against fixed assets and a few others indirectly partake in long-term industrial finance through (*a*) purchases of shares and debentures of industrial concerns, (*b*) making advances against such shares and debentures and (*c*) investments in the shares and bonds of the Industrial Finance Corporation of India and State Financial Corporation, the share of commercial banks in such financing is relatively small.[3]

This has led to a good deal of criticism by industrialists and businessmen. Although the rigidity complained of before the Indian Central Banking Enquiry Committee during 1929-31 no longer exists, industrialists still assert that the system is not flexible enough. 'While it is not denied that the first business of commercial banks is to maintain a liquid position so as to meet all liabilities on time, it should be possible for the scheduled banks to borrow from the Reserve Bank of India against their medium-term or long-term advances. The Reserve Bank should also consider the possibilities of lending to the banks against

[1] *Report of the Committee on Finance for the Private Sector*, Bombay, 1954.
[2] See Appendix III.
[3] On 30 June 1953, such investments aggregated Rs 58·28 crores only, as against Rs 195·50 crores advanced to industry.

shares and debentures and fixed assets of industries which are pledged with them as security for loans.'[1] Most of the leading banks in India, on the other hand, have expressed themselves strongly against any form of direct participation in long-term advances to industries, mainly because the experience of long-term industrial advances by Indian banks has been none too happy in the past.[2]

Prudence dictates that participation by ordinary commercial banks in long-term industrial finance should be exceptional. It is an established fact that, within the limits of their resources, these banks have been providing finance to parties *who really deserve them*.[3] Ordinary commercial banks are quite in order when they say that if long-term advances have to be made, these should be for moderate amounts, in consonance with ordinary banking prudence and consistent with the maintenance of liquidity.

This does not mean that there is no room for improvement. As has been pointed out by the Committee on Finance for the Private Sector, the first Five-Year Plan envisaged an *expansion* of Rs 158 crores in the short-term requirements of industries during the period 1951-52 to 1955-56, which principally the scheduled banks were expected to provide. The figures of industrial advances of scheduled banks during 1951-53 showed that, barring seasonal variations, there had hardly been any significant change either in their advances or in their deposits. The situation, however, improved considerably in 1955, when advances to industry reached the figure of Rs 241 crores or 38·6 per cent of the total advances.

Various suggestions were made by the Committee on Finance for the Public Sector to improve matters in so far

[1] Memorandum submitted by the Federation of Indian Chambers of Commerce and Industry before the Committee on Finance for the Private Sector, quoted in the Report of the latter.

[2] As recently as during World War II, the failure of a large number of banks in Bengal was attributed, among other reasons, to their long-term advances to industrial concerns.

[3] The following sentence in the concluding chapter of the *Trend and Progress of Banking in India for the year 1953*, Reserve Bank of India, Bombay, 1954 is worth quoting: 'There is reason to believe that the working capital requirements of organised industry are being met at present in fair measure.' Similar sentiments have been expressed in the Report for the year 1954.

as the short-term requirements of industry were concerned.[1] Thus, they said that the Bill Market Scheme of the Reserve Bank of India might be liberalised and so could existing remittance facilities. Subsidies might also be given to banks to open branches in rural areas and adequate security arrangements could be made for banks operating in these areas. Finally, mobile banks could be started which would make banking facilities available even in small villages.

Some of these suggestions are already being pursued by the Central Government and the Reserve Bank of India. Following the submission of a Report by the Committee of Direction of the All-India Rural Credit Survey in August 1954, the Imperial Bank of India was taken over by the State in 1955 and re-named the State Bank of India.[2] In the words of the All-India Rural Credit Survey Report, the objective was 'the creation of one strong, integrated, State-sponsored, State-patterned commercial banking institution with an effective machinery of branches spread over the whole country, which, by further expansion, can be put in a position to take over cash work from non-banking treasuries and sub-treasuries, provide vastly extended remittance facilities for co-operative and other banks, thus stimulating the further establishment of such banks, and, generally, in their loan operations, follow a policy which, while not deviating from the canons of sound business, will be in effective consonance with national policies as expressed through the Central Government and the Reserve Bank.'

All these show that Government are now fully aware of the legitimate requirements of industry and trade, and are taking all possible steps to ensure that the commercial banks, the State Bank of India and the Reserve Bank play their respective rôles in the economic development of the country as effectively as possible. 'The measures taken and proposed to be taken seek not merely to extend commercial and co-operative banking facilities to the rural and semi-urban

[1] For details, see the *Report of the Committee on Finance for the Private Sector*, Bombay, 1954.

[2] The State Bank of India was actually formed by the amalgamation of the Imperial Bank of India, ten major State-associated banks and a few small State-associated banks.

areas, but also aim at the provision of adequate finance to the industrial and urban sector in view of the objective of providing an integrated credit structure suited to the needs of a developing economy.'

Seasonal Requirements of Industry and the Bill Market Scheme

In the thirties of the present century, a good deal of criticism was levelled at the fact that no well-developed and expansive bill market existed in the country. Now, a typical commercial bill is created in this way: a manufacturer, say, a cotton mill, sells goods on three months' credit to a wholesale dealer and, as a preliminary condition of the credit, the dealer accepts a draft drawn on him by the mill. Such a bill is self-liquidating in as much as it arises out of a *bona fide* sale, and has got behind it the backing of goods sold. When the manufacturer is in need of cash, he approaches his bank with a request to discount his bill. If the manufacturer is of good standing, and if the acceptor of the bill is also reputed to be sound, the bank gladly discounts such a bill, especially when he knows that the Central Bank would, in its turn, re-discount the bill.

Until lately, this method of obtaining money by discounting bills was not very common and for a variety of reasons. Firstly, the major part of Indian business consisted of agricultural produce, and there was not the same chance to create bills there as in manufacture. 'When crops are marketed, they are sent on their way to the consumer by small merchants through large ones, and it is evident that in practice such small merchants are not in a position to grant credit to the large ones. On the contrary, it is the bigger merchants who often advance money to the smaller traders to buy agricultural produce for themselves.' Secondly, even where commercial bills could be created, the banks were reluctant to discount them, because they could re-discount them only at the Imperial Bank of India, but they did not like that the said bank, their rival in so far as commercial business was concerned, should know their bill portfolios. Thirdly, the system of cash credits was considered more convenient both by banks and by

borrowers. And hence there was no particular preference on either side for commercial bills as an instrument of credit. Finally, a high stamp duty on bills also acted as a deterrent.[1]

Although the Reserve Bank of India was established in 1935, the facilities for re-discounting bills at the Bank were not accorded to the various joint-stock banks until 1952. Until this latter date, the scheduled banks had been generally raising funds for meeting their seasonal requirements either by the sale of their investments in Government securities to the Reserve Bank or by borrowing from the latter against these securities under Section 17(4)(*a*) of the Reserve Bank of India Act, 1934. In November 1951, the Reserve Bank of India raised the bank rate from 3 to 3½ per cent and also suspended its open market purchases policy—mainly with a view to curbing the inflationary spiral. Simultaneously, as a result of an outcry from the business community, it initiated an alternative mode of accommodation, viz., the Bill Market Scheme.[2] The scheme followed in broad outlines the system that prevailed before the establishment of the Reserve Bank under which the Imperial Bank of India could borrow, during the busy season, funds from the Currency Department against internal bills or *hundis* drawn for financing *bona fide* trade or by the conversion of advances granted for the same purpose. During the first year, the scheme was restricted to scheduled banks having deposits of Rs 10 crores or more. The Bank undertook to make demand loans at its banking offices in India to the eligible banks against the security of promissory notes maturing within ninety days, obtained by them from their constituents. This was not exactly a case of re-discounting of commercial bills by the Reserve Bank, but one of making loans to scheduled banks on the lodgement of such bills as security. In order to encourage the bill habit, the Reserve Bank decided to charge interest, on advances under this scheme, at ½ per cent below the

[1] S. Bhatter and L. Nemenyi, *The Reserve Bank of India and its Functions*, Calcutta, 1933.

[2] The scheme was introduced as an experimental measure early in January 1952, but it proved to be so satisfactory that it was subsequently made a permanent feature of the Indian money market.

Bank Rate and also agreed to bear half the cost of stamp duty incurred in converting demand bills into usance bills, although the duty had already been reduced in 1940 to two annas for every thousand rupees or part thereof. In June 1953, the scheme was extended by the Reserve Bank to scheduled banks having deposits of Rs 5 crores or more and in July 1954, it was further extended to cover all scheduled banks holding a licence, irrespective of the size of their deposits.[1]

Now, the bill market was a common feature of the business and banking system in the U.K. in the days prior to World War I. In the inter-war period, however, the London Bill market was relegated into a secondary place, as, due to tariffs and trade barriers, international trade had shrunk considerably. The emergence of New York after the first World War as a rival centre of world finance also affected the London Bill market to some extent. With the fall in the bill business, the London Discount market took to the discounting of the British Government Treasury bills, so that it became more or less a market in Government paper.

In India, the bill market has not developed as fast as it should have done—even after the grant by the Reserve Bank of new facilities in 1952. The reasons are as follows: Firstly, the bulk of the financing of foreign trade is done by foreign banks, commonly known as the Exchange banks. The majority of both the export and import bills are drawn in sterling and such bills are obviously not suitable for negotiation in a bill market in India. Further, in the absence of any Acceptance Houses in India, export bills are invariably payable outside India and hence are not good for sale in this country nor eligible for re-discount with the Reserve Bank. The import bills, on the other hand, are for small amounts and hence are not helpful in promoting a bill market. Secondly, in the case of movement of goods within the country, it is still customary for the seller to extend an open account credit rather than draw a bill. Even banks prefer giving cash credit or overdraft against

[1] This last extension was made on the recommendation of the Committee on Finance for the Private Sector.

the storage of goods pending movement rather than accept a bill, as they can, in the former case, recall the advance at short notice in case the borrower's financial position is adversely affected. In the case of a bill, they would have to wait until its maturity.

We thus see that the Bill Market Scheme as framed by the Reserve Bank departs from the traditional method of re-discounting of bills. Under this arrangement, short-term credit is advanced to meet the *bona fide* requirements of trade and industry, permitting the banker at the same time to make withdrawals and repayments into the account as often as he likes. As the scheme provides for advances and not re-discounting facilities, the banks are able to minimise interest charges by borrowing according to their needs and by remitting spare funds to reduce their indebtedness.[1]

The Bill Market Scheme has by now been in operation for over three years and a half and the progress made during this period is encouraging as would be evident from the following figures:

Gross Advances (i.e., exclusive of repayments) made by the Reserve Bank of India.

(In crores of rupees)

	Under Section 17(4) (a), i.e., against Government securities.	*Percentage of total.*	*Under Section 17(4) (c), i.e., against bills under the scheme.*	*Percentage of total.*	*Total.*
1951	77	—	—	—	77
1952	164	66·8	82	33·2	246
1953*	130	66·3	66	33·7	196
1954	189	56·3	147	43·8	336
1955 (1st half)	91	40·2	135	59·8	226

* The fall in 1953 is due to the fact that this was a quiet year for banks.

The Rôle of Special Institutions

As has been stated in a preceding section, the share of commercial banks in the long-term financing of industry

[1] Article on 'The Bill Market Scheme in India' in the *Reserve Bank of India Bulletin*, September 1955.

has been rather small in this country. We have also seen in an earlier chapter how, even in the U.K., special institutions have been set up, over the past twenty years or so, to meet the long-term requirements of particular classes of industry. On the Continent also, notwithstanding the tradition of 'mixed banking' which held sway, it has been found necessary to set up institutions dealing exclusively or mostly with the long and medium-term requirements of industry. The Industrial Mortgage Banks of Finland, Hungary and Saxony and the National Economic Bank of Poland were typical examples of such efforts. In Canada also, an Industrial Development Bank commenced operations in November 1944, while a separate Industrial Finance Department was created in 1946 in Australia within the Commonwealth Bank of that country. Similar developments have taken place in the comparatively underdeveloped Latin American countries as well. 'Fomento' credit organisations or specialised institutions to assist in the mobilisation of capital for production purposes and to provide long-term credit to industries have been set up in Mexico, Brazil, Chile, Argentina and Colombia, mostly during the years following the end of the second World War.[1]

What is the *raison d'être* for establishing such special institutions for the provision of long-term industrial finance? The main reason is that, on the one hand, the ordinary joint-stock banks cannot afford to lock up their capital and other assets in long-term projects and, on the other hand, there is an unwillingness, for various reasons, on the part of the average investor to subscribe readily to shares or debentures floated by industrial companies. While the mobilisation of domestic capital as well as the development of a capital market which would ensure a regular flow of new money into industries at a reasonable rate of interest, is necessarily a long-term process, corporations, in which the Government, the central banks, commercial banks and insurance companies and other financial institutions can all participate, help to stimulate industrial

[1] N. Das, *Studies in Indian Economic Problems*, Calcutta, 1954.

development and ensure that capital flows into the most productive channels.

The Industrial Finance Corporation of India

The first specialised institution to be set up in this country was the Industrial Finance Corporation of India. Established under a special Act in 1948, the Corporation is expected 'to make medium and long-term credits more readily available to industrial concerns in India, particularly in circumstances where normal banking accommodation is inappropriate or recourse to capital issue methods is unpracticable.' The authorised capital of the Corporation is Rs 10 crores, divided into 20,000 fully paid-up shares of Rs 5,000 each. To start with, 10,000 shares of the total value of Rs 5 crores were issued. Of the capital issued in the first instance, the Central Government and the Reserve Bank subscribed 2,000 shares each; scheduled banks subscribed 2,500 shares; investment trusts, insurance companies and other similar financial institutions another 2,500 shares, and co-operative banks, 1,000 shares. The capital structure of the Industrial Finance Corporation of India is thus neither wholly owned by the Central Bank nor wholly independent of State ownership and control.[1]

As regards investible funds, besides the share-capital, the Corporation is authorised to issue bonds up to five times the paid-up capital and to accept deposits from the public repayable after not less than five years. The shares of the Corporation are guaranteed by the Central Government as to both repayment of principal and payment of the annual dividend at a minimum rate fixed by Government by notification at the time of issuing the shares.[2] In the same manner, the bonds and debentures of the Corporation are guaranteed by the Central Government in respect of the repayment of the principal and payment of interest.

[1] The capital structure of the Industrial Finance Corporation of India has been criticised in some quarters as affording no opportunity to private individuals to become its shareholders. But there is no special reason why private individuals must necessarily be permitted to hold shares in an institution of this kind. Anyway, this 'lacuna' has been made good in the case of State Financial Corporations.

[2] The guaranteed dividend was fixed at 2¼ per cent.

The adequacy of the capital structure was criticised by many at the time the Bill was being debated in the legislature. It was argued that, even with the use of its borrowing powers, the resources of the Corporation would be very meagre and totally inadequate for securing the rapid industrialisation of the country. 'It will have a paltry amount of Rs 50 crores where hundreds of crores are required.' But the critics entirely missed their mark. Firstly, it was never intended that the Corporation would pour out its funds for every category of industry or for every type of requirement. The Corporation is designed merely to *supplement* the capital needs of industry and to assist only such industries as are unable to raise the additional capital in the open market. Secondly, as the working of the Corporation over the past few years has shown, it has had difficulties in investing even a much smaller sum than Rs 50 crores.

The Corporation can finance 'industrial concerns' only. This has been defined under the Act to mean any public limited company or co-operative society incorporated by an Act of the legislature and registered in India and engaged in the manufacture or processing of goods or in mining or in the generation or distribution of electricity or any other form of power. By an Amendment Act in 1952, the scope of the Corporation's activities has been extended to cover 'companies engaged in shipping' as well.

The Corporation can transact the following kinds of business: (*a*) guaranteeing loans raised by industrial concerns which are repayable within a period not exceeding 25 years and which have been floated in the open market; (*b*) underwriting the issue of stocks, shares, bonds or debentures by industrial concerns; (*c*) granting loans or advances to, or subscribing to debentures of, industrial concerns, repayable within a period not exceeding 25 years. No accommodation is, however, to be given under (*a*) and (*c*), unless it is secured by a sufficient pledge, mortgage, hypothecation or assignment of Government or other securities, stocks, shares, or secured debentures, bullion, movable or immovable property or other tangible assets. Further, the Corporation must not enter into any arrangement under

(*a*) and (*c*) with a single industrial concern for an amount equivalent in the aggregate to more than 10 per cent of the paid-up share capital, and in no case exceeding Rs 50 lakhs.[1]

A good deal of criticism was levelled at the Corporation in 1953-54 about the manner in which it disposed of its loan applications. Charges of nepotism and partiality were laid at the door of the management and so much public passion was roused that the Government of India was compelled to set up a Committee of Enquiry. This committee made an exhaustive analysis of the loans sanctioned by the Corporation up-to-date and submitted a report to Government in May 1953. The Report exonerated the management from charges of favouritism, but said that some at least of its advances were unhappy and could have been avoided.[2]

The loans sanctioned by the Corporation since its inception till 30 June 1955 aggregated Rs 28 crores. It is significant, however, that a number of companies, for various reasons, mostly on account of changes in the economic conditions in the country, or changes in their plans, did not avail themselves of the loans sanctioned to them. Up to the end of June 1955, the loans actually availed of amounted to only Rs 14·5 crores, while another Rs 4·5 crores (already sanctioned) was in the process of being disbursed. These figures show that the real trouble is not lack of funds, but the inability of suitable parties to come forward and secure the accommodation offered.

The Industrial Finance Corporation Enquiry Committee made a number of suggestions on matters of policy which may well bear repetition. For example, it suggested that

[1] The underlying object of putting such a limit on the accommodation is to ensure diversification of the risks of investment. Recently, however, the limit of the amount has been raised to Rs 1 crore, as it was felt that the limit of Rs 50 lakhs was rather inadequate. As a matter of fact, the Corporation can now make advances even exceeding Rs 1 crore to a single concern, if the loan is guaranteed by the Government of India.

[2] As a result of the public agitation, the then non-official Chairman (Mr. Shri Ram) had to resign on 14 February 1954 and his place was taken by a senior official of the Government. Later, the Act was amended so as to provide for a full-time Chairman who could devote all his time and attention to the affairs of the Corporation. The first full-time Chairman (Mr. K.R.K.Menon) took office on 6 August 1955.

(*a*) no loans shall ordinarily be granted in respect of industries where 'the saturation point' has been reached, (*b*) Government should issue directives to the Corporation regarding the principles to be followed by the latter in granting loans, (*c*) Government should give to the Corporation a clear indication as to which regions should be treated as backward, with a view to enabling the Corporation to give a preference to such areas and (*d*) the Corporation should not participate in equity or risk capital until the Reserve Fund of the Corporation has aggregated to Rs 5 crores. Most of these recommendations were accepted by Government. It is pertinent to point out, however, that the Industrial Finance Corporation represents a new experiment in the field of industrial finance, and principles can be evolved and practices established only in the light of experience.[1]

An important lacuna in the Industrial Finance Corporation Act of 1948 was that it could make advances only to industrial concerns already engaged in business: it could not make any advances to concerns which were about to engage in business. This was rectified by the Industrial and State Financial Corporations (Amendment) Act of 1955, which received the assent of the President on 10 September 1955.[2]

A most important criticism of the working of the Industrial Finance Corporation of India is that it does not provide equity or risk capital. There is no legal bar to the Corporation's undertaking this type of financing (the Corporation is empowered to underwrite shares under Section 23 of the Act), but this has not been attempted in actual practice, mainly because, under the Act, the Corporation had to dispose of any such shares within a period of seven years. The Committee on Finance for the Private Sector recommended that this limitation should be removed and it is

[1] Seventh Annual Report of the Industrial Finance Corporation of India for the year ending on 30 June 1955.

[2] The Committee on Finance for the Private Sector also made certain suggestions with a view to making the Corporation a more useful instrument of industrial finance. It pointed out that there was avoidable delay in sanctioning loans, that the terms for loans were often unduly harsh and that the rates of interest charged were sometimes on the high side.

gratifying to note that the Amendment Act of 1955 has liberalised the Section by saying that the stocks, shares, bonds or debentures acquired could be retained, with the permission of the Central Government, even beyond the period of seven years. To what extent this will induce the Corporation to participate in equity or risk capital yet remains to be seen.

State Finance Corporations

The Industrial Finance Corporation of India caters primarily for the needs of large-scale undertakings: its clientele is also restricted to public limited companies. But the smaller and medium-sized industries (and many of these were private limited companies) have problems of their own and special institutions are required to cater for their needs. So in 1951, the Government of India placed on the Statute Book a State Financial Corporations Act. Under the Act, the States could set up local Financial Corporations with a view to providing medium and long-term credit to small and medium-sized industries which fell outside the purview of the Central Corporation.

The Act, though closely patterned after the Industrial Finance Corporation of India Act of 1948, made three important departures. Firstly, the designation of 'industrial concern' was widened to cover private limited companies, partnerships and even proprietary concerns. Secondly, members of the public and even non-scheduled banks were permitted to subscribe to the share capital of State Corporations.[1] Thirdly, State Financial Corporations can give guarantees and make loans and advances for a period of not more than 20 years as against the 25 years of the Central Corporation.

Since the passing of the Act of 1951, State Financial Corporations have been set up in a number of States (Punjab, Saurashtra, Travancore-Cochin, Bombay, Hyderabad, West Bengal, Assam, Bihar, Uttar Pradesh and Madhya Bharat). These Corporations are miniature editions of the Corporation at the Centre. Under the Act, the

[1] The number of shares allocated to such parties has, however, been restricted to 25 per cent of the total number of shares.

maximum authorised capital of a State Corporation can be Rs 5 crores. It can also issue bonds and debentures like the Central Corporation, but the total amount thereof must not exceed five times the amount of the paid-up share capital and reserve fund of the Corporation. It may also accept long-term deposits from the public under certain terms and conditions.

Most of these State Financial Corporations have been at work for only a couple of years or so and it is too early yet to say to what extent they have been able to meet the requirements of those parties for whose benefit they were set up. It appears, however, that although a number of applications are received, a majority of the applicants do not furnish the necessary information in respect of the installed capacity of their plant and machinery, annual production, estimated increase of output as a result of the proposed expansion, cost of production and their annual profit and loss accounts. The result is that many applications have to be rejected outright. Secondly, State Corporations have to deal not only with corporate concerns but also with partnerships and proprietary concerns including joint-family businesses. It has been found from experience that many concerns offer properties for which the relevant documents of title are not available or there are complications which have to be removed before the title can be accepted as clear and marketable.[1] As has been stressed by the Board of Directors of the Punjab Financial Corporation, an organised system of industrial banking must demand a minimum standard of working efficiency and book-keeping system on the part of the borrowers, but unfortunately many of the applications show considerable reluctance to disclose full facts of their affairs or to take the Corporation into their confidence.[2]

Other difficulties which these State Financial Corporations have to contend with are that many borrowers ask for advances solely against stock in trade: this, however, is the normal function of commercial banks and is outside

[1] Second Annual Report of the Bombay State Financial Corporation for the year ended 31 March 1955.

[2] First Annual Report of the Punjab State Financial Corporation for the year ended 31 March 1954.

the scope of activities of a Financial Corporation, the main function of the Corporation being to grant advances, whether for capital expenditure or for working capital, against block assets comprising land, buildings, plant and machinery. Another problem which presents itself to these Corporations is that statistics in regard to the various industries are not readily available, and, in the absence of such information, it becomes extremely difficult to make a proper assessment of the scope and prospects of an industry.[1]

As the Act stands, these Corporations can provide financial assistance only to those industrial units which are in a position to offer tangible assets as security. This means that they can merely supplement the existing capital resources of an industry and there will always be need, on the part of the industrial concerns, to raise a substantial part of their requirements from other sources. The extent of assistance that these Corporations can offer in furthering industrial development would, therefore, depend (*a*) on the sufficiency of private capital investment in the industry and (*b*) on the efficacy of the measures that are taken, from time to time, to develop fresh investment opportunities in the industrial sector and generally to strengthen and stabilise the industries.

The Industrial Credit and Investment Corporation of India, Ltd.

This is a privately owned and managed Corporation set up in 1954, but it had the blessing of the Central Government from the very outset. Some time in 1953 a three-man Mission sponsored by the Government of India and the World Bank decided that what the country needed was a special institution of the type of the Industrial and Commercial Finance Corporation of the U.K., as, because of its quasi-Government character, the Industrial Finance Corporation of India had not been able to meet the long-term requirements of industry as effectively as it should have done.

[1] First Annual Report of the West Bengal Financial Corporation for the year ended 31 March 1955.

The Corporation was launched with a paid-up share capital of Rs 5 crores, subscribed wholly by domestic and foreign private investors, with the former holding about 70 per cent of that capital. In addition to the share capital, the working funds of the Corporation consist of an interest-free deposit of Rs 7½ crores advanced by the Government of India out of the Technical Corporation Administration rupee counterpart funds. Finally, the Corporation was granted by the World Bank a long-term loan of Rs 5 crores, guaranteed by the Government of India. The initial working capital of the Corporation thus amounted to Rs 17½ crores, but it was empowered to borrow up to three times the total amount of its paid-up capital plus the Government deposit. The total resources available would thus be about Rs 50 crores.[1]

This private Corporation is expected to operate with the utmost flexibility and undertake, among other things, direct lending and investment, underwriting of issues, and provision of technical and managerial aid to the private industrial sector. There is no direct Government participation in the management of the Corporation, except that Government appoints one Director on the Board. This new institution is expected to stimulate the expansion and modernisation of existing undertakings and also promote the participation of private capital, both internal and external, in new industry. It is not improbable that, in course of time, this Corporation would develop into an Investment Trust, specialising in making available to private enterprise a part of the risk capital required and also the technical know-how of modern industrial process.[2]

National Industrial Development Corporation

This is a State-sponsored Corporation with capital provided entirely by the Government of India, launched also in 1954. This Corporation represents an effort to tackle the problems of industrialisation and unemployment in the country from the angle of shyness of capital and enterprise.

[1] *Major Industries of India Annual*, 1954-5, edited by M. P. Gandhi, Bombay, 1955.

[2] N. Das, *Studies in Indian Economic Problems*, Calcutta, 1954.

There are important sectors where, for various reasons, private capital and enterprise are not coming forward at all. The National Industrial Development Corporation will start new industries in these sectors and manage them through the initial process of development till they reach the stage of earning profits. At that stage, they can be handed over to private enterprise, if considered necessary and desirable.

According to Government spokesmen, this Corporation will not enter into competition with industries already well established in the country. Instead, it will explore the possibilities of developing new industries and select schemes to be taken in hand. If private entrepreneurs were forthcoming for the establishment of such units, the Corporation would help them on the technical side as well as through participation in financing the units. Alternatively, the Corporation would itself establish and operate new industrial units. This Corporation is conceived mainly as an instrument for securing a harmonious development of industries in both the public and private sectors. It will not, however, undertake the financing of industries except in so far as this becomes incidental to the development of certain special categories of industries.[1]

Although the National Industrial Development Corporation was launched in 1954, its first meeting was held only in September 1955, in Bombay. This meeting approved a few schemes of industrial development and initiated their processing or investigation. The Board also decided to adopt measures to provide financial assistance for the rehabilitation and modernisation of the Indian jute industry. It set up a Committee consisting of people connected with the industry and decided that, on the recommendation of the Committee, long-term loans would be given to approved mills, bearing interest at only $4\frac{1}{2}$ per cent per annum.

A second meeting of the Board of the Corporation was held in Calcutta in October 1955, where problems of the iron foundries and forges were discussed and investigations

[1] Vide the Budget Speech of Mr. C. D. Deshmukh, Finance Minister of India, on 28 February 1955.

were initiated concerning the manner in which these and other industries like the fabrication of steel structurals, the manufacture of printing machinery and the manufacture of wood pulp, could be developed in the quickest possible time.[1]

Other Investment or Development Corporations

State-sponsored institutions or Corporations for the development of industries have been functioning for some time past in some of the States. An Industrial Investment Corporation was established in Madras in March 1949, with an authorised capital of Rs 2 crores, the Government of Madras taking 51 per cent of the shares.[2] The shares are guaranteed by the Government of Madras both as regards repayment of principal and payment of interest. The primary function of the Corporation is to grant accommodation for the acquisition of fixed assets, but under certain circumstances it provides loans for working capital also. As in the case of other State Financial Corporations, the borrowing powers of this Corporation are restricted to five times the amount of its paid-up capital and it can accept deposits repayable after the expiry of not less than 5 years. To all intents and purposes, the Madras Corporation is indistinguishable from other State Financial Corporations: having been established before the State Financial Corporations Act came into being, it claims to have been a pioneer in the field of investment banking at the State level.

A Development Corporation, on a slightly different model and with a different objective, is being set up in West Bengal also.[3] This Corporation will derive its authority from an Act passed by the State legislature. It will undertake development schemes within the State, but its activities need not be confined to the promotion of industrial enterprises only. It can undertake development schemes in other spheres as well, e.g., reclamation and improvement

[1] *The Journal of Industry and Trade*, New Delhi, November 1955.

[2] The balance is restricted to scheduled banks, insurance companies, investment trusts and corporation banks.

[3] This should be distinguished from the West Bengal State Financial Corporation set up on 1 April 1954, under the State Financial Corporations Act, 1951.

of land for establishing townships or executing housing schemes, water supply, drainage and irrigation, fisheries and even dairy farming.

Finally, mention may be made of a few private investment companies which have been set up with a view to providing finance to industry. Of these, the most important are (*a*) the Industrial Investment Trust, Ltd., registered in 1933 at Bombay, with an authorised capital of Rs 2·5 crores and a paid-up capital of Rs 1 crore, (*b*) the Investment and Finance Company, Ltd., registered as a private limited company in 1896, but converted into a public limited company in 1935 (headquarters at Calcutta), with an authorised capital of Rs 16 lakhs and a paid-up capital of Rs 9 lakhs only, and (*c*) the General Investment and Trust Co. Ltd., registered in 1908 as a public limited company with an authorised capital of Rs 12 lakhs and a subscribed capital of Rs 5 lakhs, also with headquarters at Calcutta. All these companies were formed to invest the monies subscribed by the shareholders in the shares of carefully selected companies, but, in actual practice, they have 'selected' only such concerns as are managed, directly or indirectly, by themselves.[1]

A Résumé

We thus see that, since the end of World War II, there has been a considerable spurt of activity in the sphere of industrial finance. A number of Investment or Development Corporations have been set up, either with direct participation by the State or with its blessing, to meet the diversified requirements of industry. The entrepreneur in the private sector has now a wide selection of institutions to which he can turn and he should no longer complain that the available credit mechanism is defective or inadequate. The country has travelled a long way from the days when the Indian Central Banking Enquiry Committee submitted its Report. If private industrial enterprise is still 'under a handicap' today, the causes thereof must be sought in spheres other than those of finance.

[1] *The Investor's India Year Book, 1955.* Calcutta.

CHAPTER IV

THE MANAGING AGENCY SYSTEM AND ITS ROLE IN THE FINANCING OF INDUSTRY

Introductory

IT HAS BEEN universally recognised that the successful financing of an enterprise depends on sound and efficient management, but nowhere is the truth of this statement as pointedly demonstrated as in India. The managing agency system arose in India during the latter part of the nineteenth century, and this system of organisation and management gradually spread to almost all industrial enterprises—Indian as well as British.[1] The rise of the managing agents was due to the fact that they filled the rôle of promoters and pioneers in many of the newly established industries in India; they came into prominence because it was they and they alone who could supply a regular team of trained and efficient managers; and they gathered power as they found that the capital market was shy, and that industry looked to them for financial aid, both direct and indirect. The continuance and prevalence of the managing agency system has been due more to this last factor than to any other. Banks were not prepared to finance the long-term needs of industry, and were unable to provide anything more than 'circulating capital' and that also for short periods; on the other hand, many of the enterprises were under-capitalised at the very outset, and needed financial assistance or guarantee at every stage of their work. So the managing agency system came to dominate Indian industry. As has been aptly stated by the Company Law Committee, 'history, geography and economics all combined to create

[1] For a detailed account, see P. S. Lokanathan, *Industrial Organisation in India*, Ch. I.

and develop a system which, in some of its distinctive features, still retains its unique character.'[1]

Managing Agency System sustained by lack of a properly organised Capital Market

As we have seen already, until 1947 the country lacked a properly organised capital market. An integrated capital market, with issue houses or investment syndicates occupying a central position in it, provides the main channel through which private investments are made in all advanced countries of the world. In India, these functions were carried out largely by the managing agents, who were thus able to entrench themselves in a very strong position in the private sector of the country's economy. It could even be argued that their existence was, in itself, an impediment to the growth of an organised capital market.

The financial assistance rendered by managing agents has been both direct and indirect. In a previous chapter, we have noted instances of direct financial aid rendered by managing agents to the concerns they manage. Here we shall consider some further aspects of managing agency finance as prevalent in India.

Ever since the system came into existence, managing agents (particularly in Bombay and Ahmedabad) started the practice of purchasing the shares of the companies they managed in the names either of themselves or of their friends, and even took up debentures floated (often by themselves) by those companies. In Calcutta and Madras, on the other hand, where the managing agency firms were the inheritors of the tradition of the early European Agency houses, many of them carried on a large banking business in addition to their other activities. There were many instances of firms investing their funds in several industrial concerns and some of the leading managing agents (e.g. Messrs. Andrew Yule & Co., Ltd., of Calcutta) hardly ever borrowed money from any joint-stock or exchange bank to finance the companies they looked after.

Equally important were the various indirect methods by which managing agents assisted the financing of industries.

[1] *Report of the Company Law Committee,* New Delhi, 1952.

These had resulted partly from the methods employed by banks in granting loans to industry and partly from the fact that, apart from the managing agents, there were no important entrepreneurs who could get the confidence either of the investing public or of the banks. We shall consider these various indirect methods one by one.

We have seen that, until lately, joint-stock banks in India were very rigid even with regard to the grant of short-term credit. They made advances only against tangible and marketable securities lodged or pledged with them and in addition or alternatively they wanted the several responsibilities of at least two persons or firms unconnected with each other in general partnership. These practices compelled the managing agents to come forward and give the necessary guarantees to the banks. Except in Calcutta, for instance, most banks up-country and in Bombay insisted on the signature of the managing agents even when goods were hypothecated; and when goods were not hypothecated the guarantee of the managing agents on notes of hand, in addition to the signature of a director of the company, was insisted upon.[1] This rather exacting requirement was defended by bankers on the ground that 'the banker cannot know at any given time what the exact financial position of the company is, and he has greater confidence in the agency firm, and is willing to advance only on the guarantee of the agents.' It was indeed unfortunate that banks in India were not willing to take the reasonable risks they often did in other types of lending operations and, by their rigidity, helped to strengthen the hold of managing agents on industrial enterprise in India.

Even with regard to public deposits which formed such an important source of finance to the cotton textile industry, it was the name of the managing agents that ensured a steady flow of deposits. In Ahmedabad, for instance, deposits were automatically renewed for years together in those mills which were controlled by reputed firms of managing agents. On the other hand, during the depression of 1929 and after, public deposits were withdrawn

from those concerns where managing agents were reputed to be inefficient, lazy or dishonest.[1]

In the matter of issue of shares and debentures also, the standing and reputation of managing agents largely determine the success or failure of the issue. Even a very cursory analysis of Indian industrial history shows that, in the early stages of pioneering of industry in India, it was the managing agents who 'drew out' capital from the small class of investors that existed. Only recently, even in well-established industries like cotton, jute, coal, or iron and steel, the promotion of a concern without the backing of a big firm of managing agents, was very difficult, if not altogether impossible.[2]

The question has repeatedly been asked why industry in India was so utterly dependent on managing agents for its finance. As has been hinted already, this dependence was the result of certain fundamental gaps in the economic system of the country. Three broad reasons may be mentioned. Firstly, the Indian investor was notoriously shy, and did not, until very recently, care to invest his capital in debentures or shares as did the investor elsewhere. Secondly, in India there were neither issuing houses nor securities companies which in other countries float new concerns and take up the risks in their initial stages, nor did our banks pursue a policy sympathetic and elastic enough for the varied needs of industry. Finally, there was a general tradition in the country, from the time of its early industrial beginnings, that the financing of industry was the privilege and duty of private managing agency firms. It was only when the burden of finance became heavy that people began to wonder whether it was inevitable that industry must look to the managing agents for all help, inspiration, and guidance.

The Cost of the Managing Agency System of Finance

The managing agency system has been assailed from various quarters for its alleged inefficiency, and the opportunity it has given for lazy or fraudulent management, but

[1] Indian Tariff Board, *Cotton Textile Industry Enquiry*, 1932, Report.
[2] *Annual Review of Commerce*, Bombay for the year 1953.

very few people have attacked the system on the score of its financial policy. One writer has suggested that the system of managing agency finance reveals certain characteristic defects. He has stated that, owing to the prevalence of the managing agency system of finance, industry has come to be dominated too much by financial considerations, and too little by industrial ones; he has further asserted that owing to the managing agency system of industrial finance, no mill company has been able to develop its own system of financing independently of the managing agents; and finally, according to him, the managing agency system of finance has led to enormous speculation in the shares of cotton mill companies.[1]

The present writer is not an apologist for the managing agency system, but he believes that the financial policy of the managing agents has been their least objectionable feature. When it is said that, under the managing agency system of finance, industry is dominated too much by financial considerations and too little by industrial ones, and it is pointed out that in the cotton textile industry of Bombay and Ahmedabad, transfers of agency often took place because one firm happened to be less solvent financially than another, it should not be overlooked that this would have become more or less inevitable under any form of management. Similar instances are not rare in Great Britain and the U.S.A., and in these latter countries one finds hundreds of large-sized private limited companies changing hands from one set of proprietors or managers to another because the former are unable to provide or find the necessary finance. The managing agency system of finance does not exaggerate financial considerations at the expense of industrial ones any more than any other system of finance.

Next, the charge that owing to the managing agency system of finance, no mill company has been able to develop its own system of independent finance, is like arguing

[1] P. S. Lokanathan, op. cit., pp. 225-8. The present writer, however, agrees with Dr. Lokanathan that many managing agents in India are inefficient and their services costly in the sense that they are not technical experts and that they pay too little consideration to such matters as modern machinery, organization, and marketing.

in a circle. We have seen already that the managing agency system of finance arose *because of* the fact that there was no system of independent finance. No blame, therefore, attaches to the agents for the fact that independent systems of finance could not be developed by the concerns they managed. As a matter of fact, it is *not* true that all concerns managed by managing agents are dependent on them alone for their finance. The concerns managed by European and up-country Indian managing agents have been notable exceptions to the general dependence of enterprise in India on managing agency finance.[1]

Finally, the charge that the managing agency system of finance has led to enormous speculation in the shares of certain cotton mill companies does not stand the test of reason. It is true that certain managing agents have taken an active part in the speculative 'corners' on the Bombay Stock Exchange, but this has no direct connexion with the *financial* activities of the managing agents in respect of their companies. Even if they had not been the financial guarantors of their companies, they would have indulged in those speculative activities. It is also debatable whether these speculations have been the result of the managing agency organization or whether they have arisen directly out of the fact that most of them were traders first and industrialists afterwards.[2]

Viewed in its proper economic background, the managing agency system of finance has, on the whole, been both inexpensive and efficient. This has been recognized in the findings of the various Tariff Boards and of the Central Banking Enquiry Committee of 1929-31, and must be conceded even by the most uncompromising critics of the system. Managing agents have, in almost all industries, found the bulk of the initial capital of a company and have provided it with necessary financial accommodation (both direct and indirect) at all stages of its development and particularly during lean years. For this particular service,

[1] Memorandum on the Indian Companies' Act (Amendment) Bill, 1936, submitted by the Bengal National Chamber of Commerce to the Government of India.

[2] *Report of the Bombay Stock Exchange Enquiry Committee*, 1924.

which is unique in the industrial history of the world their charges have not been excessive, and during the inter-war period of depression many of them advanced money to the companies on the most liberal terms, often ready to forgo not only the interest but a substantial portion of the principal as well.[1]

No accurate figures are available of the part played by managing agency firms in recent years in providing finance to industry. Mr. C. D. Deshmukh, the Finance Minister of India, however, quoted some figures on the occasion of the debate on the Companies Law Bill. According to him, the managing agents had contributed Rs 29·26 crores to 1,720 companies managed by 1,340 managing agency firms. This works out at 13·6 per cent of the aggregate paid-up capital of these companies. As regards loans and advances made or guaranteed by managing agents, they were of the order of Rs 18·31 crores in a total of Rs 76·45 crores of all kinds of loans and advances, which gives a percentage of 23·95.[2] It cannot, therefore, be said that financing of industry by managing agents has become a myth or phantom: although contributing much less than, say, twenty years ago, managing agents still continue to provide, both directly and indirectly, a good portion of the finance required by industry.[3]

[1] Indian Tariff Board, *Cotton Textile Industry Enquiry*, Vol. I of Evidence and Memoranda, p. 95.

[2] These figures relate to the year 1951-52. This figure of Rs 18·3 crores is made up of Rs 10·54 crores advanced direct by the managing agents and Rs 7·77 crores guaranteed by them. Vide speech delivered by Mr. C. D. Deshmukh in the Lower House of the Indian Parliament on 19 August 1955.

[3] See also D. K. Dutt, *Industrial Management in India*, Calcutta, 1955, Ch. X.

Chapter V

MANAGEMENT BY MANAGING AGENTS

Functions of Managing Agents

BROADLY SPEAKING, managing agents in India have performed three important functions. Firstly, they have pioneered new industries, and played the rôle of promoters: they discovered an industrial proposition, assembled the elements of the business, and finally procured the funds necessary to put those elements into operation. Secondly, they have provided the finance required for industries in respect of both fixed and working capital. Finally, they have performed the day-to-day management of industries—a work that is performed in other countries by a manager or a managing director.

Regarding their work as pioneers and promoters, it is undoubtedly true that in the past they have been more or less instrumental in developing many of the industrial enterprises in India. They brought into existence a means of producing wealth which had not existed before. In due course, however, managing agents were definitely pushed into the background in so far as their pioneering and promoting activities were concerned. This happened for three reasons. Firstly, not every managing agent could claim the ability, prudence, or resources of the great business houses by which the system was founded, although every agent, whatever his capacity for fulfilling the functions of managing agents, had benefited by the tradition, and to a large extent owed his existence to it. Secondly, with the progressive industrialization of India, the range of pioneer enterprises became steadily restricted. New enterprises started on the model of older ones already in existence, and

the problem became one more of management and finance than of pioneering. Finally, and this is perhaps the most important, very slowly and steadily there grew up a separate class of entrepreneurs who did not always belong to the established 'firms' of managing agents and who, therefore, preferred to do the major work of promotion themselves, although they found it convenient and useful to consult managing agents or banks.[1]

As to the part played by managing agents as providers or guarantors of finance, we have seen in the previous chapter that but for them many of the industrial enterprises of today would have been non-existent. They bridged important gaps in the financial structure of industry and enabled it to continue its slow but steady career of development.

Finally, we come to the rôle of managing agents as managers of industry. It is this aspect of their work that has been subjected to the bitterest criticism from the public, and it would, therefore, be proper to analyse in detail their duties as managers of industrial enterprises and to consider how far they have abused their position as trustees and managers.

The Dominance of the Managing Agency System

It is interesting to note in this connexion that the system has been found to be so 'convenient' by our industrial entrepreneurs that it has almost become the 'rule' to entrust the management of companies to firms of managing agents. Sometimes this is entrusted to old and well-established firms, but more often, when new industries are started or new companies are floated, managing agencies are formed by the promoters and their friends and specific 'agreements' are signed between one of these firms and the first Board of Directors even before a company has started functioning. The abnormal hold of the managing agency system on industrial enterprise in this country becomes evident when a comparison is made between the state of affairs prevalent in 1935 and that subsisting in 1955. The

[1] Memorandum of the Bombay Shareholders' Association on the Indian Companies' Act (Amendment) Bill, 1936.

percentage of companies managed by managing agency firms increased from 75 in 1935 to over 95 in 1955—a considerable rise, particularly when it is borne in mind that during this period the entire system had come in for a good deal of public criticism.[1]

The managing agency system is unique in the world, having no counterpart elsewhere. The nearest approach to the system is the Group System of administration in the gold mining industry in South Africa. Of late, however, certain traits of the managing agency system have been introduced in management practices in the U.K. and the U.S.A. In the U.K., in certain categories of industry (e.g., shipping), the companies are managed by 'managers' or 'agents', under managing agreements somewhat similar to managing agency contracts. In the U.S.A., a holding or controlling company becomes interested in a number of concerns, to whom all sorts of technical and financial advice are regularly provided. The key positions in the companies are held on the nomination of the holding company which receives a fee based on gross revenues or net profits, for the various services rendered.[2]

The dominance of managing agents in the sphere of industrial activity in India has been due to certain special circumstances. Firstly, in many industries, the managing agents themselves or their friends have got holdings of substantial blocks of shares. In the cotton textile industry of Bombay the percentage of shares held by managing agents is on an average, 40 to 60 per cent., and in exceptional cases it is as high as 90 per cent. In the jute mill and coal industries, also, managing agents or their friends hold an important percentage of shares in the concerns they manage. Secondly, control is secured by managing agents as the principal creditors (or guarantors of credit) of the companies managed. Sometimes managing agents are the largest debenture holders, having charges on the

[1] These percentages have been worked out from the particulars given in the *Investors' India Year Book* for 1935 and 1955 respectively—an authoritative publication by Messrs. Place, Siddons & Gough of Calcutta.

[2] George T. Trundle (Ed.), *Managerial Control of Business*, New York, 1948.

assets and undertakings of the companies. Thirdly, even when managing agents do not hold any substantial percentage of shares in their concerns, they are assured of their control because the majority of shareholders, being distributed over long distances, are unable to unite effectively against their dictatorial management. Fourthly, although the managing agency system has been in existence in India for well over a century, the Indian law relating to companies did not statutorily recognize them or curtail their activities until 1936, and consequently unscrupulous managing agents could easily do a lot of things without actually transgressing provisions of the law. Finally, and this is most important, managing agents have secured enormous control by means of their written agreements.

Managing Agency Agreements

Managing agency agreements have come in for a good deal of criticism in recent years and hence it is important to analyse what they imply. A managing agency agreement is, strictly speaking, a written agreement between a firm of managing agents on the one hand and an industrial concern (a partnership or a joint-stock company) on the other by which the former undertakes to 'manage' the concern in return for a certain office allowance with or without some commission on sale, output, or profits.

Until 1936, these agreements were of two kinds—terminable and non-terminable. In Bombay and Calcutta a managing agency agreement was usually fixed for a specified initial period, at the end of which the discontinuance of the agreement was dependent on an extraordinary resolution of the company to that effect. The usual period in Bombay was from 30 to 40 years, while in Calcutta it was from 10 to 20 years. The majority required for an extraordinary resolution was invariably three-fourths in Calcutta, while in Bombay it was often as high as four-fifths, and sometimes even five-sixths, including in some cases a provision to the effect that a specified minimum of paid-up share capital should be represented. In Ahmedabad, on the contrary, with hardly any exception, the agreements

were subject to no time limit and were more or less permanent and non-terminable.[1]

As these managing agency agreements were outside the purview of law until the passing of the Indian Companies' Amendment Act of 1936, they tended to be very arbitrary and autocratic—particularly in Bombay and Ahmedabad. Thus, the Ajit Mills, Ltd., Ahmedabad, started in 1931, appointed agents who were the sole managing agents and were non-changeable, non-removable, and permanent secretaries, treasurers, and agents. The New National Mills, also of Ahmedabad, by their agreement with the managing agents, provided that the appointment of the agents was not liable to be revoked or cancelled on any other ground except their voluntary resignation in writing.[2]

The Act of 1936 introduced certain important changes regulating the managing agency agreements. For the first time, managing agents were brought within the purview of the Act, and a complete set of new sections was introduced, defining their status and also their rights and liabilities. The Act defined a 'managing agent' as 'a person, firm or company entitled to the management of the whole affairs of a company by virtue of an agreement with the latter, and under the control and direction of the directors except to the extent, if any, otherwise provided for in the agreement, and includes any person, firm or company occupying such position by whatever name called.' The special clauses dealing with managing agents were, however, so framed that they did not destroy the system, but continued it with reasonable safeguards.

The very definition of 'managing agents' removed the menace of their usurping all residual powers to themselves: it was no longer possible for them to maintain that they were not subject to the control of the directors. Much more far-reaching, however, were the provisions relating to the duration of appointment, and the duties and liabilities of the managing agent. It was provided that all new appointments of managing agents were to be for a period not

[1] Indian Tariff Board, *Report on the Cotton Textile Industry Enquiry*, 1932.

[2] Ibid. Vol. II of Evidence and Memoranda.

exceeding twenty years at a time, and even in the case of existing agencies, notwithstanding the terms of their agreement or any provisions in the Articles, their period of office was to come to an end after twenty years if it did not automatically come to an end earlier within that time. Secondly, it was provided that, notwithstanding anything to the contrary contained in the Articles or the agreement, a company might remove a managing agent if he was convicted of certain criminal offences. Moreover, in general, the appointment, dismissal, or variation in the terms of appointment of managing agents was made dependent upon the approval of the shareholders, and it was specifically provided that a change or assignment of his remuneration or any part thereof effected by a managing agent would be void as against the company.

Remuneration of Managing Agents

The managing agency agreement (or 'articles of association' as it is sometimes called) contained a stipulation regarding payment of a certain office allowance with or without some commission by the company to the agents. A good deal of criticism has been levelled at these stipulations on the ground that they are arbitrary, excessive, and unfair. It would, therefore, be proper to consider what these remunerations include and whether industry has been justified in making these payments to the managing agents.

Firstly, we may take up the so-called 'office allowance'. In Bombay and Ahmedabad in particular, a certain fixed monthly or annual sum of money has been invariably given to managing agents for their head office expenses. This covers 'head office accommodation, rent and taxes thereon, lighting, fans, managing agents' clerical establishment, share of services of dispatch, enquiry and cash departments; in several instances, part-time services of a senior accountant and the secretarial staff; and, in several cases, all postages, stationery, telegrams, and menial staff.' In Bengal, however, a separate office allowance has not usually been insisted upon, unless, of course, the managing agents were compelled to appoint extra or

special staff for the individual requirements of a company. Many industrial units, however, made a sort of 'fractional contribution towards the expenses of a federal constitution.'

The second method of payment was by way of certain commission with a stipulated minimum which was payable under all circumstances, whether the industrial companies made profits or not. This had to be paid, without exception, by all concerns under managing agency control. The commission was calculated in one or other of three ways: (*a*) on production; (*b*) on sale; or (*c*) on profit. In the early days of the establishment of the cotton mill industry, commission on production (or output) was the vogue. The system, however, led to over-production and sacrifice of quality to quantity, as managing agents were always tempted to increase the volume of output in order to make higher profits. It was, therefore, largely abandoned towards the close of the nineteenth century, and the system of commission on profits was adopted. 'Of the 71 mills which were members of the Bombay Millowners' Association in 1928, only one mill paid commission on production; one mill was managed by a managing director whose remuneration was fixed by the Board of Directors; 8 mills paid commission on sales, and 61 mills paid commission on profits.' The rate was usually 10 per cent on profits. In Ahmedabad, however, the commission was calculated on gross proceeds of sales and the rate varied from 3 to 4 per cent. In the other industrial centres of the cotton industry, the most common method was that of a commission on output, but there were a fair number which paid commission on sales and a few which calculated it on profits. In the jute industry, the majority of the mills paid commission on sales, but there were a few which paid commission on profits besides a minimum commission and a generous allowance for office expenses. The same was the practice in the coal industry. 'A commission of $7\frac{1}{2}$ per cent on profits was the usual remuneration for managing agents engaged in the sugar industry, although, in the case of several companies floated after protection was granted, provision had been made for commission on sales, and

in some cases for a combined commission on sales and profits.'[1]

Of the three systems in vogue, there is no doubt that the system of commission on profits was the best. 'The great defect of the system of commission on production was that it tended to concentrate attention on output rather than on quality, but a greater objection to that system was that it removed the incentive to the disposal of production at the best possible price. These same objections applied, though to a lesser degree, to the system of commission on sales. The mills which adopted this system, unless they were managed by agents who held the majority of the shares, were naturally concerned only with getting rid of their production and not with the price at which it was disposed of.' Moreover, where the managing agent was paid on production or sales, his interest became divorced from that of the shareholders by making him reluctant to agree to short-time working when necessary in the interest of the industry as a whole: he became interested primarily in the output of his own concern and hardly cared to consider the far-reaching consequences of excessive output in the profit-making capacity of the entire industry.

Critics of the managing agency system have contended that the remunerations drawn by the managing agents are arbitrary and excessive. Apologists of the system have, however, retorted that a managing director would have charged as much, if not more. 'Managing agents manage as well as finance, whereas managing directors would manage but not finance, and hence industry should be prepared to pay slightly more to the managing agents.' There are, however, three important points to be considered. Firstly, for the direct services that managing agents perform in respect of finance, they always get a separate remuneration (viz., interest) and they should not be anxious to get something 'extra' for the indirect services they perform by way of securing loans from others or by guaranteeing the loans. Secondly, while a new or difficult enterprise should always be prepared to pay more for

[1] Memorandum of the Bombay Shareholders' Association on the Indian Companies' Act (Amendment) Bill, 1936.

management, the burden of payment must be gradually scaled down, as experience is gained and as industry becomes well established. Thirdly and finally, the main objection of critics has been not so much to the office allowances and regular commissions paid, but to certain arbitrary devices that are sometimes adopted to get additional or secret profits or both. It is to these that we should now turn.

The first device consisted in calculating the managing agent's remuneration on profits before depreciation was set aside. Not only this: very often in calculating the percentage, interest on loans and advances, profits by way of premium on shares sold, profits on sale, proceeds of forfeited shares, or profits from the sale of the whole or part of the undertaking in the company, were not excluded from gross profits, with the results that the managing agents were able to bite off a much larger share of the cake than they should. To quote some instances: in 1921, the Simplex Mills Co., Ltd., earned a premium of over Rs 10 lakhs on the issue of additional capital, and the managing agents charged commission on this: again, in 1935, the Tata Power Co., Ltd., issued to its shareholders as well as sold in the open market certain shares which had been previously forfeited for non-payment of calls, and earned a large amount of premium on the sale of these shares, the managing agents charging their commission on the premium so earned.[1]

It has been contended by some apologists of this method of calculating commission on profits that it does not in itself adversely affect the financial position of the industrial company, because (so the argument runs) if depreciation and other elements were deducted the scale of commission which is normally 10 per cent would have increased and the net cost to the company would have remained more or less the same. This does not, however, seem to be correct. Firstly, many companies have charged less than 10 per cent commission even after allowing for depreciation, and it does not, therefore, hold that a rate round about 10 per

[1] *Ibid.*

cent on gross profits is, so to speak, the absolute minimum. Secondly, any attempt to increase the rate to more than 10 per cent (when commission is calculated after making certain deductions) would have been resisted, because a rate like 15 or 20 per cent would, on the very face of it, have seemed excessive and exorbitant.

The second device to get an additional remuneration for managing agents was by the method of compensation. If the business of a company was transferred during the pendency of the agreement to another party, the managing agent had the right of continuing in office in spite of the change of ownership; in case of refusal, he was entitled to claim compensation. In Bombay when a company was wound up, the managing agent was entitled to claim compensation, according to the general practice, on a scale equivalent to the commission earned by him during the previous five years, and, in individual cases, even a higher rate of compensation was claimed. At Ahmedabad, the general practice was to claim compensation at a rate ranging from five to seven times the average annual commission earned by the managing agent over a period of five years. In the latter place, sometimes the managing agent was entitled to compensation even if the agency had been terminated by mutual agreement. On the other hand, in Calcutta there were no agreements containing a provision for the payment of compensation as in Bombay and Ahmedabad. Even in those few cases where provision existed for compensation, it was expressly provided that such compensation would be payable only if the winding up took place at the instance of a party other than a creditor, and the amount payable would be mutually agreed upon, failing which it might be settled by arbitration.

A third device to get additional remuneration was by inserting clauses in the agreement for supplementary or secret profits. In one managing agency agreement there was a reference to 'every profit, remuneration, and compensation including any profit which they (the managing agents) might make as the agents for the insurers of the properties, assets, and effects of the company, and any profit which they might make under any arrangement with

the agents of the company for selling cloth, yarn or muccadams of the company.' The latter class of profits clearly pointed to the fact that there was an arrangement for some additional (and secret) profits in addition to the usual office allowance and commission.

All these show that although the normal office allowance and commission payable to managing agents were not excessive, the special devices resorted to by some managing agents to get more out of a company were both unfair and excessive. The managing agency system came into disrepute mainly because it had given opportunities to some unscrupulous (and dishonest) persons to get various kinds of extra remuneration without actually transgressing the law relating to companies.

The Act of 1936 sought to tackle the above question of remuneration. It laid down that no managing agent, appointed after the amending Act came into force, could stipulate for his remuneration anything other than a percentage of the net profits of the company, with a provision for minimum remuneration in the case of inadequacy or absence of profits, together with an office allowance. Any other form of remuneration had to be specially sanctioned by the shareholders. The mode of ascertaining the net profits was also laid down in detail and a list of deductions (e.g. the usual working charges, interest on loans and advances, repairs and outgoings, depreciation, bounties or subsidies received from the Government or a public body, profits by way of premium on shares sold, etc.) enforced a reasonable basis for the calculation of profits.

Assignment of Functions and Interests by Managing Agents

Another abuse that had crept into the managing agency system was the practice of assignment of functions and interests. In Bombay and Ahmedabad, the agreements generally provided that the managing agent might assign to a third party his interests or his duties under the agreement, and for this assignment no specific sanction of the directors was required. The Indian Tariff Board came across a case in 1932 in which the managing agent could assign not merely his interest in the profit of the company,

but the agreement itself, to a third party. This agreement was executed by one of the most important managing agency houses of Bombay. To quote some specific instances: Messrs.Currimbhoy Ebrahim & Sons, Ltd., mortgaged their agency commissions in several companies under their control, and as a result the mortgagee acquired considerable influence in the management of the affairs of those companies; again, the partners of Messrs. Morarjee Goculdas & Co. mortgaged their commission in the Sholapur and Morarjee mills with the result that the mortgagees acquired undue influence over those mills. Similarly, in Ahmedabad it was not unusual in agreements to provide for the right of the managing agent to assign at will not merely his interest in earnings but also the whole agreement. A usual feature of the system in Ahmedabad was that the right to the commission earned by the managing agent was divided among several persons holding fractional shares, these persons generally being those who had helped the managing agent in the promotion and financing of the company in the early stages. Even in Calcutta where such sweeping rights of assignment without the sanction of the company were unknown, there were certain types of agreement in which the powers conferred on the managing agents could be vested in their assigns as well as successors.

This system of assignment was open to objection for two main reasons. Firstly, as a result of these assignments companies became subject to undesirable outside influence, and shareholders became all the more powerless to exercise any check on these outsiders. Secondly, the *raison d'être* of the managing agency system was the financial standing of the managing agent behind his company. If, therefore, the managing agent was reduced to a financial state where he had to mortgage his commission, the credit of the company suffered irretrievably.

Inter-investment of Funds by Managing Agents

Another feature of the managing agency system was the practice of inter-investment of funds among companies under the same agents. This was prevalent in the cotton textile industry of Bombay and Ahmedabad, but it

was not confined to that industry alone. Almost all industries managed by managing agents shared this feature.

Inter-investment took two forms: surplus funds raised on the credit of one company would be invested in other companies under the same managing agent, or debentures issued by one company would be subscribed to entirely or mainly by other companies in the same group or in companies in which the managing agent had an interest. Now, when everything went well, this inter-investment did not cause any particular harm to any of the enterprises. On the one hand, the comparatively weak concerns profited by this inter-investment; on the other, the comparatively strong ones were satisfied, because their funds were quickly invested and were at the same time (especially when it was a cash investment) easily realizable. But, over a long period, this practice had definite drawbacks. What really happened was that, although the financial position of an individual company was strong, its shareholders were often deprived of its benefit by being called upon to assist weaker sister concerns which were managed by the same managing agent. Not only did it involve serious unfairness to shareholders of the concern whose funds were thus transferred, but the practice often led to the perpetuation of thoroughly insolvent concerns which it would have been to the interest of the industry as a whole to have closed down.

Loans to Managing Agents

Another far-reaching abuse of the system was the practice of managing agents taking huge loans or advances from the companies they managed. The allegation that many managing agents took such loans or advances was hotly denied by the Bombay and Ahmedabad Millowners' Associations before the Indian Tariff Board Cotton Textile Industry Enquiry of 1932, but the Bombay Shareholders' Association proved in 1935, with the help of facts and figures, that the evil existed. Nor was this evil confined to the cotton textile industry. The loans taken by Messrs. Vakil Ankleseria & Co. from the Western India Oil Distributing Co., Ltd., brought infinite trouble upon the company which was eventually saved only by reorganization.

The loans obtained by Messrs. J. F. Madan & Co. from the Madan Theatres, Ltd., tell a similar tale. The function of managing agents is to finance companies. To allow companies to finance managing agents is, to say the least, fundamentally wrong. Such abuses of the system have had far-reaching consequences. Apart from inflicting heavy losses on individual companies, their shareholders, and their creditors, the general confidence of investors in the integrity of managing agents was rudely shaken by these questionable methods of 'management'.

Restrictions imposed by the Indian Companies (Amendment) Act of 1936

Besides prescribing the duration of managing agency agreements and specifying the duties and liabilities and remuneration of managing agents, the Indian Companies (Amendment) Act of 1936 absolutely prohibited the practice of giving or guaranteeing loans to such agents. The inter-investment of funds by managing agents when they had several companies under the same management was also forbidden. Similarly, the employment of the funds of a company in the purchase of the shares and debentures of another company under the management of the same managing agents was prohibited. Managing agents were also prevented from carrying on, on their own account, business which was of the same nature as, and directly competed with, the business of the managed company. Finally, the practice of managing agents packing the Board of Directors with their own nominees was rendered difficult by a Section directing that no managing agent should be allowed to nominate more than one-third of the total number of directors.

These and other extensive changes introduced by the Amendment Act of 1936 were assailed by certain sections of businessmen at that time as having violated the fundamental principle of the sanctity of contract. It was asserted that existing contracts were being interfered with and a company was being prevented from choosing the form of management, and also the basis of remuneration, which it considered to be the best in its own interests. It was even

stated that 'undue legislative restrictions like those embodied in the Act would kill a system which had rendered such splendid service to industry in the past.'[1] It was also suggested that limiting the period of managing agency to twenty years was quite inadequate, in view of the fact that industrialisation in India was still in a nascent state. 'It takes about ten to fifteen years for any industry to be established on a profitable and economic basis and it would not, therefore, be sufficient inducement to the managing agents to develop an industry if they are to relinquish the fruits of labour so soon after they have succeeded in developing it. . . . Further, the restrictive clauses, by dissuading managing agents from embarking on new industrial ventures, would only retard the industrial development of the country.'[2]

These gloomy prophecies did not, however, materialise. As we have seen already, not only has there been since 1936 no relaxation of the grip of the managing agency system over private industrial enterprise in this country, but there has been a further extension of it. It is true that certain glaring malpractices which were rampant before 1936 were prevented, but business acumen soon got to work and was able to find ways and means of circumventing the legal restrictions imposed. In not a few instances, many managing agency firms sought the assistance of lawyers and other experts versed in company law and, with their help, devised ways and means of keeping within the letter of the law and at the same time continuing their undesirable practices in a disguised form.[3]

The continuance of this unsatisfactory state of affairs was

[1] Circular letter No. 193/1936 of 20 June 1936, from the Bengal Chamber of Commerce, Calcutta on the Indian Companies' Act (Amendment) Bill, 1936.

[2] Memorandum of the Federation of Indian Chambers of Commerce and Industry on the Indian Companies' Act (Amendment) Bill, 1936.

[3] Some firms paid fabulous fees to lawyers and experts for this service, while others maintained a separate section, ostensibly to comply with the provisions of the Companies Act, but really to find ways and means of circumventing them. The author himself was informed by some of his lawyer friends how very much their services were being sought by managing agency firms mainly with a view to helping the latter to remain law-abiding and at the same time continue all the 'advantages' previously enjoyed.

facilitated by the unpreparedness or ineffectiveness of the procedure in administering the Act as it stood. Notwithstanding the amendments made in 1936, the Indian Companies Act had a number of loopholes which became evident only as the years passed. 'Large changes had taken place in the organisation and working of joint-stock companies, and, over a wide sector that was dominated by new elements in trade and industry, the character of company management had also materially altered. In many cases, conventional methods of company management were discarded in favour of less orthodox and more venturesome techniques, which the existing company law was unable to control adequately.' But much more serious than the obvious loopholes was the inadequate and perfunctory manner in which the Act was administered. The Company Law Committee had to admit that the Indian Companies Act was perhaps the most under-administered of all the Central Acts relating to trade and industry.

This was due to a number of facts. Firstly, although the legislative and executive authority in respect of the regulation and inspection of joint-stock companies vested in the Central Government, in practice the Central Government had very little to do with the administration of the Companies Act. They were content to delegate all their functions under the Act, except a few, to the Governments of the Provinces (later, States). The powers thus delegated were so extensive that, for all practical purposes, the responsibility for the administration of the Act had rested with the State Governments, as if the Indian Companies Act were an Act of the State legislatures and not of the Indian Parliament.[1] The reasons for such delegation were partly historical, partly constitutional and partly financial. The doctrine that Government must concern itself with the general state of the economic health of the country became familiar only after India had attained her independence. As a result, 'the full social implications of Company law were hardly realised and the administration of the Act was regarded primarily as the negative function of preventing

[1] For a statement showing the nature and extent of the powers delegated, see *Report of the Company Law Committee*, New Delhi, 1952.

the Joint-Stock Companies from contravening the statutory requirements. This negative function could be performed as easily by the Provincial Governments as by the Central Government.'

Secondly, on the plea of observing 'economy' in administration, the power to appoint Registrars of Joint-Stock Companies was delegated to the Provincial (State) Governments. They, however, took very little interest in the administration of Company law and the position in 1952 was that, barring Bombay and West Bengal, none of the States had any full-time Registrars, although the number of joint-stock companies at work in India had exceeded the figure of 22,000 since 1947. In all other States, the Registrar's duties were 'performed' by officers of the State Government in addition to their other duties. No wonder that the total budget in respect of the establishments of the Registrars of Joint-Stock Companies in *all* the States never exceeded Rs 5 lakhs per annum!

The cry for company law reform, therefore, gathered momentum from about 1947 onwards. Having obtained freedom, the attention of the leaders and those in authority was turned towards the need for reform: the organisation and management of joint-stock companies could no longer be left at the point at which it stood in 1936.

Chapter VI

THE NEW INDIAN COMPANIES ACT AND ITS ECONOMIC SIGNIFICANCE

An Historical Retrospect

FOLLOWING THE ENGLISH Companies Act of 1844, an Act for 'the registration of joint-stock companies' was, for the first time, enacted in India in 1850. Under this Act 'every unincorporated company of partners associated under a deed containing a provision that the shares in the stock or business of the said company were transferable without the consent of all the partners, and also every company established for some literary, scientific or charitable purpose, which did not carry on any business for the pecuniary benefit of any of the proprietors or shareholders' became entitled to registration, and the Supreme Courts of Calcutta, Madras and Bombay were authorised to order such registration. The privilege of limited liability was not, however, conferred on the members of such companies.

Another Act was passed in 1857 'for the incorporation and regulation of joint-stock companies and other associations, either with or without limited liability of the members,' but, under this Act, the privilege of limited liability was not extended to any company formed for the purpose of banking or insurance. This latter disability was removed by an Act passed in 1860.

It was not until 1866, however, that a comprehensive Act was passed[1] affirming the principle that 'no member of a joint-stock association shall be liable for more than the unpaid portion of his share, and that, in the case of guaranteed companies, no member shall be liable beyond

[1] Act X of 1866.

the amount of his guarantee.' This Act was recast in 1882[1] embodying the amendments that had been incorporated in the company law in England up to that time.

Between the years 1882 and 1913, five amending Acts[2] were passed in India, but these related to minor amendments only. Finally, in 1913, a comprehensive Act was passed,[3] following the English Companies (Consolidation) Act of 1908. Some minor amendments were made later in the Indian Act between 1914 and 1932.

By this time the situation had become ripe for a thorough overhaul of company legislation. Firstly, the Act of 1913 and the subsequent amending Acts had not taken into account a system which was in vogue in India but unknown in England, viz., company management through managing agents. Indian company law had followed the English law rather too closely and remained conveniently silent about this important economic institution in India. The result was that unscrupulous persons had begun to take advantage of the loopholes and omissions in the law, and abuses and malpractices by some managing agents had become far too common a phenomenon. Secondly, while in England some modifications had been made in the law in the light of experience, no corresponding steps had been taken in India. In 1926, a Committee presided over by Mr. Greene, K.C., examined the existing law and made extensive recommendations, and many of these were subsequently incorporated, with or without modification, in the Companies' Consolidation Act, 1929. India, however, continued to labour under the antiquated Act of 1913 (as amended in a few particulars between 1914 and 1932). Finally, no serious attempts were being made to study the Indian company law from a comparative standpoint—in the light of the experience of joint-stock associations in other countries. In 1908 and again in 1911, comparative analyses of the company law of the United Kingdom, India, Canada, Australia, New Zealand and South Africa were

[1] Act VI of 1882.
[2] Act VII of 1887, Act XII of 1891, Act XII of 1895, Act IV of 1900 and Act IV of 1910.
[3] Act VII of 1913.

prepared in England by direction of the Board of Trade,[1] but no serious effort was made to secure uniformity of the company laws of the Empire, nor did India ever seek to amend her laws in the light of the working of the company law in other parts of the Empire.

Agitation for removing the defects of the Indian Act continued ceaselessly after 1930, and at last in September 1934 the Government of India placed a lawyer[2] with experience in the administration of company law on special duty to examine the materials collected and to make proposals for the amendment of the Indian law. This lawyer's report was published in January 1935, and his proposals were further discussed by a small committee of business experts specially convened for the purpose. In this committee representatives of diverse interests—Chambers of Commerce, Shareholders' Associations, Millowners' Associations, and the Imperial Bank of India—took part and made their suggestions. Out of these proposals and discussions there crystallized a Bill to amend the Indian Companies' Act of 1913 and this was introduced into the Indian Legislative Assembly by the Law Member, the Honourable Sir N. N. Sircar, in March 1936. The Bill went to a very representative Select Committee and came back to the Assembly with a number of important modifications in August 1936. After this, the progress of the Bill was rapid: there was an exhaustive discussion on almost every clause of the Bill on the floor of the Assembly, but the Honourable Member-in-charge piloted it so very skilfully that it emerged from the Assembly and received the assent of the Viceroy before the end of the year.[3]

The revision of the law in England in 1929 took the form of a consolidating Act which completely replaced the Act of 1908. In India, however, the form of the Act of 1913 was retained and the changes, extensive though they were, were introduced in the form of amendments.[4] In the

[1] *Comparative Analysis of the Company Law of the United Kingdom, India and the Dominions*, 1911 (Cmd. 5864), p.6.

[2] Mr. S. C. Sen, a solicitor of Calcutta.

[3] The Act came into operation on 15 January 1937.

[4] This was done because there were 'manifest advantages in retaining the form of the existing Indian Act with the administration of which the courts were familiar.'

amendments, the pattern followed in the overhaul of the English law was adopted where the problems dealt with were problems common to India and England. There were, however, some special clauses—for the first time—for problems peculiar to India herself, for example, those connected with the managing agency system.

As was well put by Sir N. N. Sircar in the Indian Legislative Assembly, the new Act[1] was based on two considerations: firstly, that every attempt should be made to make extremely difficult the malpractices which had come to light as a result of the working of the Act of 1913; secondly, that the provisions for stopping these apprehended malpractices must not be so unreasonable and onerous as to keep away honest men from having anything to do with joint-stock companies. As a matter of fact, the new Act attempted to arrive at a mean between two extreme views—one view which is difficult to shake off from one's mind, viz., that businessmen or, for that matter, any set of men can be made honest by force of statute, and that all possible avenues of dishonesty and malpractice can be effectively stopped by legislation, and the other view that nothing can be done thereby and hence things should be left to run their usual course. The new Act recognized that the management must have some freedom in pursuing its policy, and that it would be unwise to lose all sense of proportion about the abuses in which, after all, only some companies had indulged; it also emphasised that no legislation, howsoever comprehensive, could possibly rouse those shareholders who had made up their minds to slumber.

Between 1936 and 1955, there were further periodical amendments of the Act, necessitated by the defects disclosed in the Act and also by the constitutional changes introduced by the Government of India Act, 1935. Some further formal amendments had to be made when India attained her

[1] The new Act dealt with six different problems: (*a*) mushroom and fraudulent companies; (*b*) provisions relating to the issue and contents of prospectuses; (*c*) increased disclosure to shareholders of the financial position of companies and increased rights of shareholders in connexion with the management of companies; (*d*) managing agents; (*e*) provisions applicable to winding up; and (*f*) special provisions to govern banking companies.

independence and, later, when, in 1950, the constitutional status of India was changed into that of a Sovereign Democratic Republic.

These amendments did not, however, meet the situation adequately. Several lacunae in the Act of 1913 (as amended by the Act of 1936) and the defects in its administration 'had enabled some businessmen and financiers, with no long and honourable traditions of service to the community, to misuse and sometimes to pervert the provisions of the company law to serve their private ends, while the absence of any adequate and effective organisation for the administration of the Act, rendered remedial action extremely difficult. As long as the war lasted, the expansive pull exerted by the war economy on domestic production masked these malpractices, but the end of the war brought them to the surface and exposed them to the full view of an increasingly critical public, which had been already hit hard by the aftermath of the war, and was thereafter apt to ascribe most of its post-war ills to these undesirable practices in trade and industry.' As a matter of fact, several Commissions and Committees (e.g. the Fiscal Commission, the Income-tax Investigation Commission and the Planning Commission) had drawn pointed attention to some of these practices. A demand for early reform of the company law was, therefore, reiterated by the shareholders as well as the general public.

Meanwhile, a comprehensive enquiry into the working of the company law had been made in the U.K. and other Commonwealth countries. Towards the end of World War II, i.e. in 1943, a Company Law Amendment Committee, more familiarly known as the Cohen Committee, was set up in the former country with Lord Justice Lionel Cohen as Chairman. This Committee submitted a most comprehensive report after a laborious enquiry spread over two years. In South Africa, a Commission, known as the Millin Commission, also went into the question of company law reform in that country and made some important recommendations. Similar enquiries were initiated in Canada, Australia and the U.S.A.

As a first step, the Government of India appointed in

1946 Mr. Tricamdas Dwarkadas, as an officer on special duty, to indicate fully the lines on which the Indian Companies Act should be revised, not only in view of the amended provision of the English Companies Act, but also in the light of the developments in trade and industry since 1936. Between 1946 and 1947, Mr. Dwarkadas submitted his recommendations in three parts, but was unable to complete his assignment on account of his other preoccupations. The Government of India thereupon appointed Mr. V. T. Thiruvenkatachari, Advocate General of Madras, to carry out some further studies in the matter and advise Government. Mr. Thiruvenkatachari completed his task in October 1948.

The reports of Messrs Dwarkadas and Thiruvenkatachari were subjected to a detailed departmental scrutiny in the old Ministry of Commerce.[1] The proposals formulated as a result of this scrutiny were embodied in a 'Memorandum on the Amendment of the Indian Companies Act' and circulated to all State Governments and organised industrial and commercial bodies in December 1949. Comments and observations were received during a period of over six months in 1950, running into many hundreds of pages of printed matter.

Thereupon in October 1950, the Government of India set up a Committee (popularly known as the Company Law Committee) with Mr. C.H.Bhaba, a former Commerce Minister of the Government of India and a prominent businessman, as Chairman, 'to consider and report what amendments were necessary in the Indian Companies Act, 1913, as amended as Act XXII of 1936, with particular reference to (*a*) the formation of companies and day-to-day conduct of their business, (*b*) the powers of the management *vis-à-vis* shareholders, and the relations between them, (*c*) the safeguards required against abuse of such company practices as the interlocking of directorates, voting control by majority interests in company ownership and management, etc., which might be prejudicial to the public interest, and (*d*) the measures necessary to promote efficient and

[1] Mr. N. K. Majumdar, a former Registrar of Joint-Stock Companies, West Bengal, was placed in charge of this work.

economic management of companies.' The Committee submitted its report to Government in January 1952. This report was very comprehensive in character: it not merely analysed the growth of companies and company law in India, but also made various recommendations in regard to the (*a*) constitution and incorporation of companies, (*b*) shares and share-capital (*c*) company meetings and proceedings, (*d*) management of companies—by managing agents as well as managing directors or managers, (*e*) accounts and audit, (*f*) inspection and investigation and (*g*) winding up of companies. Finally, it recommended the setting up of a Central Authority to direct and supervise the administration of the Indian Companies Act.

The Company Law Committee stated that if Government accepted their recommendations, these should form the basis of a consolidating measure and not merely of an amending Bill. Accordingly, they annexed to the Report an addendum attempting redrafts of several sections of the Indian Companies Act and also drafts of some new sections, based on analogous provisions of the English Companies Act.[1]

Government lost no time in acting on the Report. The Member-Secretary of the Committee was placed on special duty to give practical shape to the recommendations in the form of a Bill, but the actual draft could not be made ready until the middle of 1953, as differences of opinion arose between different sections of the Congress Parliamentary Party as to the extent to which some of the restrictive and penal provisions (particularly those relating to managing agents) should be incorporated in the Bill.[2] There were some who felt that the recommendations of the Committee did not go far enough and they insisted on certain additional provisions being included. Eventually, a compromise was

[1] For the materials incorporated in this section, the author has drawn freely on the Report of the Company Law Committee.

[2] It is interesting to recall that one of the members of the twelve-member Committee (Mr. Mohanlal L. Shah—later, Minister of State in the Ministry of Finance in the Central Government) submitted a note of dissent on some points, particularly on the sections relating to managing agents. He felt that some of the changes recommended by the Committee 'had overstepped the practical necessities and requirements of the situation.' (p. 213 of the Company Law Committee Report).

reached and the Companies' Bill, 1953, was introduced in the Lok Sabha (lower house of the Indian Parliament) on the 2nd September of that year.[1] After some general discussions, the Bill was referred to a Joint Committee of both the houses in May 1954. The Committee held 61 sittings in all, made important changes in the original Bill and submitted its report on 2 May 1955.[2]

Discussions in the Joint Committee were prolonged, often revealing a wide divergence of views. As a matter of fact, out of 49 members of the Joint Committee, as many as 14 submitted separate notes or minutes of dissent. The Bill was, therefore, hotly debated in the legislature and some members wanted further 'improvements' to be made in the Bill as amended by the Select Committee. At a certain stage, the Finance Minister (Mr. C. D. Deshmukh), who was piloting the Bill, threatened to resign if the Bill, as amended by the Joint Committee, were not accepted by the legislature substantially without modification. Tempers, however, soon cooled down and, after the debate on the controversial clauses was over, the Bill was passed by both houses without much difficulty. The Bill received the assent of the President early in 1956. (The exact date on which the Act is to come into force has not been formally announced yet, although it is understood that it is Government's intention to bring it into operation with effect from 1 April 1956).[3]

Considerations behind the New Act

The Act of 1955, like the earlier Act of 1936, was based on two considerations. Firstly, it was considered necessary that the malpractices which had come to light since 1936 should be stopped by suitable legislation and by the setting up of appropriate machinery to administer the same. Secondly, the State must step in to protect the interests of the shareholders and the general public against

[1] Bill No. 46B of 1953. It was a Bill of formidable size, running into 612 clauses and 12 schedules. It was the longest Bill ever presented to the Indian Parliament.

[2] When it emerged from that Joint Committee, the Bill had 649 clauses and 12 schedules. The final Act consists of 658 clauses and 12 schedules.

[3] The Act is both an amending and a consolidating piece of legislation.

the 'tyranny' of managing agents, managing directors or managers. In addition, there was a third and, according to some the most important consideration, viz., that private industrial enterprise, as organised under joint-stock companies, must fit in with the general pattern of State policy, which had undergone radical changes since the days of 1936. An important directive principle of this policy, as embodied in the Constitution of India, was that 'the State shall so direct its policies that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment.' The changes made in the Bill in the Joint Committee stage were in recognition and furtherance of this principle, although, in the opinion of some, the Committee (and, later, the Indian Parliament) did not go far enough towards securing this objective.

In the light of the above facts and circumstances, we shall now try to assess the economic significance of the changes introduced by the new Act in so far as they have a direct bearing on industrial enterprise in this country.

Managing Agents and Restrictions on their Powers under the New Act

As we have noticed already, the most important (and the most controversial) section of the Act has been the part dealing with managing agents. The very first clause in this part states that the Central Government may, by notification in the official gazette, declare that, as from a specified date, all companies in certain classes or types of industry or business, shall cease to be managed by managing agents at the end of three years from the specified date or on 15 August 1960, whichever is later. A second clause says that, after the commencement of the Act, a managing agency company shall not be managed by another managing agent. In all other cases, the appointment or re-appointment of managing agents by a company must be approved first by the company itself at a general meeting and then by the Central Government. Even here, Government shall not accord its approval unless satisfied

that (*a*) it is not against the public interest to allow the company to have a managing agent and (*b*) the managing agent proposed is, in its opinion, a fit and proper person to be appointed or re-appointed as such and the conditions of the managing agency agreement proposed are fair and reasonable. Then there are the further provisions that (*a*) after the commencement of the Act, when a managing agent is appointed for the first time it shall not be for a period of more than 15 years and (*b*) in cases of re-appointment, it shall not be for a period of more than 20 years at a time.

Restrictions have also been imposed on the number of companies on which a person can serve as a managing agent: after 15 August 1960, no person shall hold office at the same time as managing agent in more than ten companies. As regards existing managing agents, it has been provided that the term of every managing agent shall terminate on 15 August 1960, unless he is re-appointed for a fresh term before that date *in accordance with the provisions of the Act.* There are also provisions for automatic vacation of office by a managing agent if he is adjudged insolvent or has been convicted for any offence and sentenced to imprisonment for a period of not less than six months. In cases of fraud or breach of trust, or of gross negligence and mismanagement, a managing agent may be removed from his office by a resolution of the managed company. Finally, it has been laid down that a transfer of his office by the managing agent shall not take effect unless it has been approved both by the company and by the Central Government and that, after the commencement of the Act, managing agencies shall not be heritable.

As regards remuneration, the Act says that a managing agent shall not ordinarily be paid, by way of remuneration, any sum in excess of 10 per cent of the annual net profits of the managed company and that additional remuneration can be paid only if such payment has been sanctioned by a special resolution of the company and been approved by the Central Government as being in the public interest.[1]

[1] The Act also lays down in detail how 'net profits' are to be calculated for this purpose.

The Act also places restrictions on the powers of managing agents. The managing agent of a company is to exercise his powers subject to the superintendence, control and direction of its Board of Directors and subject also to the provisions of the memorandum and articles of the company. Restrictions have also been placed on (*a*) the grant of loans to managing agents by the managed company, (*b*) the grant of inter-company loans under the management of the same agency firm, (*c*) purchase by a company of shares, etc., of other companies in the same group, (*d*) engagement by a managing agent in business competing with the business of the managed company, and severe penalties have been prescribed for contravention thereof.[1] Finally, further restrictions have been imposed on the right of the managing agent to appoint directors: he would now be able to appoint not more than two directors where the total number of directors exceeds five, and not more than one director where the total number does not exceed five.

These various restrictions have been assailed by some as extremely harsh, by others as grossly inadequate. The former school of thought is represented by businessmen and industrialists and also by a section of economists: the latter by the more radical parties and by another section of economists. Let us examine, as objectively as possible, the arguments which have been put forward by these two schools of thought.

As has been pointed out by the former, the Act went far beyond the original recommendations of the Company Law Committee. That Committee had given the matter very careful thought from every conceivable angle and had definitely stated that 'under the present economic structure of the country, it would be an advantage to continue to rely on the managing agency system. . . . Shorn of the abuses and malpractices which have disfigured its working in the recent past, the system may yet prove to be a potent instrument for tapping the springs of private enterprise.' The Act, however, while not openly and expressly abolish-

[1] Some of these restrictions were already in existence in the Amendment Act of 1936, but they have been further tightened up in the Act of 1955.

ing the system, has introduced provisions of a sweeping character which might 'lead to its virtual abolition.' 'The psychological effect of these provisions will prove to be far more disastrous to the economy than the physical effect of the provisions.'[1] 'The Act bears the mark of the preconceived ideas of certain powerful political elements obsessed with the idea of gradually abolishing the system, but the problem which it has failed to solve is that of an alternative form of managerial organisation to replace the managing agents. That the system is indispensable in the present circumstances is proved by the fact that it has been found necessary to allow in notified industries the appointment of 'Secretaries and Treasurers', whose functions, powers and terms of appointment differ only slightly from those of managing agents. . . . It is not advisable to place needless restrictions on the working of all joint-stock companies because of the malpractices of a *few* . . . . If the Government are in favour of abolishing the managing agency system, they should try to foster some alternative system of management.'[2]

To these arguments, the reply of those who think that the provisions of the Act do not go far enough (in so far as managing agencies are concerned) is that 'the capital market is more developed today than it was in the nineteenth century and it would not be difficult now to raise capital from the market in the absence of the managing agency system.' Why then give a lease of life to a system which is a relic of industrial feudalism in the country and already stands self-condemned?[3] As regards the argument that the Act has gone much further than the Company Law Committee had recommended, and for no obvious reasons, the reply is that 'certain significant and quite large-scale developments in the sphere of industrial management of finance have taken place since 1952, brought about by

[1] Observations made by Mr. N. C. Karayalar on the Report of the Joint Committee on the Companies Bill.

[2] Note of dissent by Messrs. Tulsidas Kilachand and G. D. Somani on the Report of the Joint Committee on the Companies Bill.

[3] Note of dissent by Messrs. M. S.Gurupadaswamy, V. K. Dhage, B. C. Ghose and Amjad Ali on the Report of the Joint Committee on the Companies Bill. Similar views were expressed—but in much stronger language —by Mr. T. K. Chaudhuri in a separate note of dissent.

the impact of planning and the entry of the State in an active rôle initiating and sponsoring industrial development, and these have rendered the earlier conclusions of the Company Law Committee quite out-of-date.' As such, not only are the restrictive provisions not onerous, but positively half-hearted and weak. 'They would neither end nor mend the system.'

Where does the truth lie between these two conflicting and gloomy prognostications? While it is difficult to make a prophecy about the future, certain general observations may be made. Firstly, the argument that the restrictive provisions would affect the *financing* of future industrial enterprise in the country is perhaps the weakest argument in favour of relaxation of the restrictions. As we have seen already in the earlier chapters of this book, industrial finance is no longer provided, to any significant degree, by managing agents. As a matter of fact, the nature of modern capitalistic enterprise is such that it is now beyond the resources of any managing agency firm to provide such finance. Moreover, the financial gap has been, and is being, successfully bridged by the setting up of a number of special institutions and even if managing agents were to withhold their finance in the few cases where they still provide it, the 'loss' to industry, in the present circumstances, would be of no consequence.

Much more important, however, is the question whether the restrictions will have such an adverse psychological effect that they would inhibit the flow of enterprise into the private sector. While it would be foolish to dogmatise on an issue of this kind, the author is of the opinion that no such adverse consequence is likely to follow merely as a result of the restrictive provisions of the Act. It is true that, under the new scheme of things, managing agents would no longer be able to make the high profits they were making for so long.[1] But the maximum still permitted (viz., 10 per cent of net profits) is a sizeable remuneration and will continue to attract private enterprise. Secondly, the provisions of the Act relating to 'Secretaries and Treasurers' afford an opportunity to existing managing

[1] Vide Appendix IV.

agencies to transform themselves into these more acceptable functionaries. It is true that 'Secretaries and Treasurers' will be entitled to only 7½ per cent of net profits as remuneration; they will have no right to appoint directors; and, lastly, they will have no right to sell goods manufactured by a company nor purchase machinery, stores or raw materials, nor trade in them. These are minor curtailments of existing privileges and are not likely to have any adverse effect on industrial enterprise. As we shall see in a subsequent chapter, over the past quarter of a century, entrepreneurs in India have shown themselves capable of a resistance which has confounded their best friends and worst critics: there is no reason to think that they would not be able to rise to the new challenge which has been thrown at them.

Let us not forget that the new Act does not abolish the system. It merely prescribes certain standards of management and to some extent circumscribes the extravagant privileges of the managing agent *vis-à-vis* his company. Apart from any ideological considerations, this is necessary in the interest of shareholders who are spread all over the country and who cannot, therefore, take any organised and timely action against the all-powerful body of managing agents. It would be wise to remember, however, that, mere abolition of the managing agency system would not usher in the millennium: much more would depend on the growth of a better standard of business efficiency and honesty. Human institutions, whether Government bodies or private undertakings, are exactly as good or as bad as human beings are, and a Board of Directors can become as good or as bad as any managing agency firm.

Directors and Limitations on their Powers under the Act

The second important set of provisions in the new Act are those relating to Directors and their powers. The safeguards relating to managing agents have been provided because many of them had taken undue advantage of their position as managers of industry. While there have been no malpractices on a similarly large scale by Boards of Directors of joint-stock companies in India, cases have

occurred where some directors have tried to monopolise the Board for themselves, and have also managed their concerns inefficiently or dishonestly. Provision has accordingly been made in the Act designed to give the shareholders some ultimate control over the Board of Directors.[1]

The new Act prescribes that public companies should have at least three directors and private companies at least two. Only an individual, and not any firm or company, can become a director. In the case of public companies, and their subsidiaries, not less than two-thirds of the total number of directors should be persons whose period of office is liable to determination by rotation: and, every year, one-third thereof must retire by rotation. In connexion with the election of directors, there should be a separate resolution for each director. An interesting provision of the Act is that for minority representation on the Board: the Statute includes a permissible provision in the articles of a company whereby not less than two-thirds of the total number of directors may be elected according to the principle of proportional representation.[2]

Restrictions have also been placed on eligibility to directorship. Officers and employees of the company or of its managing agents or their subsidiaries, and co-sharers in the managing agency remuneration, are not eligible for election as directors in the two-thirds quota reserved for shareholders except on the authority of a special resolution passed after 'special notice' as required by the Act. As under the old Act, undischarged insolvents, persons of unsound mind and convicts are not eligible for appointment as directors.

An innovation in the new Act is that no person who has attained the age of 65 years can be appointed as a director, unless the shareholders specifically approve of the same by a resolution passed after special notice. Another innovation is the ceiling to the maximum number

[1] It would be interesting to recall that the Amendment Act of 1936 also contained several provisions (*a*) limiting the powers of Directors and (*b*) enlarging the powers of shareholders.

[2] In a great majority of the federating States of the U.S.A. the method of election according to the principle of proportional representation is in vogue.

of directorships that a person can hold: the ceiling is fixed at twenty directorships. Finally, the shareholders are given power to remove any director before the expiry of his office.

The Act has imposed several other restrictions on the powers of directors and the manner in which they should be exercised. The Board is expected to meet at least once in three months. Certain powers may be exercised by the Board meetings. The power to make calls, to issue debentures or borrow moneys otherwise, to sanction contracts in which any director is interested, to invest in shares and debentures of companies under the same management, to appoint as manager or managing director a person who is already occupying that position in another company, and to fill casual vacancies in the Board—all these powers can be exercised by the Board only at Board meetings, and not by any individual director. Appointments of sole selling agents made by the Board must be approved by the shareholders in a general meeting within six months of the appointment. Finally, in the case of public companies and their subsidiaries, the directors cannot, without the consent of the shareholders by ordinary resolution, (*a*) sell, lease or dispose of the whole or substantially the whole of the undertaking, (*b*) remit or extend the time for repayment of any debt due to any director, (*c*) invest otherwise than in trust securities the sale proceeds of the undertaking or its property or premises, (*d*) borrow moneys beyond the paid-up capital plus the free reserves of the company[1] and (*e*) contribute to charitable or other funds (not connected with the business of the company or the welfare of its employees) for more than Rs 25,000 in any financial year, or in excess of 5 per cent of its net profits on the basis of an average of the three preceding years.

Under the old Act, loans to directors and to firms and private companies with which they might be connected were prohibited. The new Act has extended this restriction further: in future, in addition to the above restrictions, loans to any public company the directors of which are accus-

[1] Temporary loans from bankers in the ordinary course of business are excluded for this purpose.

tomed to act in accordance with the directions or instructions of any director of the lending company, may be made only with the consent of the Central Government.

The Act has prescribed a ceiling of 11 per cent of the net profits as the *total outgo* from a company (public companies and their subsidiaries) on account of the remuneration of its directors, managing agents, secretaries and treasurers, managing directors and managers.[1] Managing directors and directors in the wholetime employment of a company may be remunerated at a percentage of the net profits, but such percentage should not exceed 5 per cent where there is only one director and 10 per cent in the aggregate where there is more than one such director. Other directors whose remuneration does not include any monthly payment may be paid a commission on the net profits of the company, provided this is authorised by a special resolution of the shareholders, and the total outgo from the company on this account does not exceed one per cent of the net profits where the company is managed by a managing agent, managing director, manager, secretaries or treasurers or a wholetime director, and three per cent in other cases.

The scheme of company management as envisaged under the new Act is that the immediate responsibility for ensuring that the management is conducted in accordance with the provisions of the law shall be on the directors. Accordingly, the Act imposes severe penalties on directors for certain defaults. A company directorship will, therefore, entail heavy responsibilities of a much more onerous nature than ever before.

These limitations on the powers of directors have been criticised by a section of the people of India. It has been said that these special liabilities and responsibilities have been borrowed blindly from the English Act, but the traditions of company management in India are different. It has been asserted that they are unnecessarily stringent and

[1] In computing this ceiling, sitting fees given to directors for attending Board meetings will be excluded. This ceiling will not apply in the absence or inadequacy of profits, but the total outgo in that case must not exceed Rs 50,000 per annum. The Central Government are, however, empowered to relax this restriction in appropriate cases so as to permit a higher remuneration.

that they would deter good and reasonable men from serving on Boards of Directors in future.[1]

The provisions of the Act which have come in for the largest measure of criticism, particularly from the business community, are those relating to (*a*) the right of a minority of shareholders to representation on the Board of Directors, (*b*) the prescription of a maximum age limit of 65 years for directors, and (*c*) the ceiling on the total remuneration which can be paid to directors, managing agents, secretaries and treasurers, managing directors and managers. It has been asserted, for instance, that minority representation in the manner contemplated under the Act (under certain circumstances, Government are empowered to nominate directors to represent the interests of 'minority' shareholders) goes against all principles of democracy and smacks of the 'reservation of seats for minority interests' in the political sphere. As regards the prescription of a maximum age limit of 65 years for directors, while it is true that, under certain circumstances, Government may permit relaxation, it has been pertinently asked why no such age limit is fixed in regard to the appointment of Ministers and Deputy Ministers under Government. Finally, it has been asserted that the ceiling on the remuneration which can be paid even to managing directors, managers and wholetime directors, coupled with the severe penalties which may be imposed on directors for defaults under the Act, will deter many honest and peace-loving people from accepting directorship of joint-stock companies, and, as a result, management will become the poorer.[2]

Are these criticisms valid? In the opinion of the author, they are not. A careful perusal of the so-called restrictive provisions would show that they have been enacted in the best interests of company management in the country. They merely seek to regulate the conduct of directors, and not one of the provisions can be said to be unusual. It would be important to remember in this connexion that the system of managing agencies is likely to disappear from the

[1] Memorandum of the Federation of Indian Chambers of Commerce and Industry, New Delhi, on the Companies Bill.

[2] Memorandum submitted by the Bengal Chamber of Commerce and Industry, Calcutta, on the Companies Bill.

country in the course of the next few years and their place would be taken by managing directors, managers and Boards of Directors. As the Board of Directors is the ultimate executive authority, it is necessary that its duties and responsibilities should be clearly defined and its powers regulated in the public interest. As was pointed out by the Finance Minister in his speech before the Lower House of Parliament on 10 August 1955, abuses in company management had occurred not merely in companies managed by managing agents but also in companies managed by directors: hence it was necessary to impose certain restrictions on the latter as well.

A few words may be said here on the vexed subject of remuneration. While it is true that the scale of future remuneration to be received by managing directors, managers and directors will be less than they are receiving now, there is no reason to think that this would deter honest entrepreneurs from coming forward to play their part in the public sector. Firstly, even in the U.K. and in other countries of Europe, the remunerations received by managers of industry in the post World War II period have been much less, in real terms, than they were earlier, and yet this has not stifled business enterprise. Secondly, and this is more important, the business community in India should not consider itself to be a class apart from the rest of the society. When the avowed goal is the establishment of a society in which inequalities of wealth must be reduced to the barest minimum, no patriotic businessman can afford to stand aloof or refuse to play his part.

Other Duties and Obligations under the New Act

The third important set of provisions relates to other duties and obligations, safeguarding the interests of shareholders. The provisions regarding managing agents and directors also mean, in effect, additional power for shareholders, but, besides these, some other specific safeguards have been provided.

For instance, the new Act has made many changes of a significant nature in regard to the prospectus. These closely follow the provisions of the English law on the subject.

Under the new Act, the information to be given in the prospectus is more extensive than under the old Act; and, in addition to civil liability, criminal liability of two years' imprisonment with or without Rs 5,000 fine is prescribed for certain mis-statements. Among the new items of information to be given in the prospectus, mention may be made of the following: (*a*) the prospectus must show the subscribed capital of the managing agent (where the prospectus is issued, on behalf of the managed company, by a firm of managing agents) ; (*b*) the time of opening of the subscription lists should be disclosed in the prospectus; (*c*) the substance of any contract or arrangement whereby any option or preferential rights of any kind are given, or proposed to be given, to any person to subscribe for any shares or debentures, should also be disclosed; (*d*) in respect of any property to be acquired, the prospectus should disclose the nature of the title; (*e*) the prospectus should give information about the general nature of every material contract and not merely some specified contracts; (*f*) in regard to preliminary expenses, the prospectus should disclose the persons to whom such expenses have been, or will be, paid, as also details of the expenses of the issue and the persons by whom they would be paid; (*g*) in the case of a company which has already been carrying on business, or where it is proposed to acquire a business which has been carried on for less than three years, the prospectus should disclose the length of time through which the business has been carried on; (*h*) if any reserves or profits of the company or any of its subsidiaries have been capitalised, particulars of the capitalisation should be given in the prospectus; and (*i*) the prospectus should also disclose particulars of the surplus arising from revaluation of the assets of the company or of any of its subsidiaries during the two preceding years, and the manner in which such surplus had been dealt with.

The Act also requires reports of accountants and auditors to be attached to the prospectus, in regard to certain matters, on the lines of the English law. Another restriction imposed by the Act in regard to the prospectus is that, if a prospectus is issued which includes a statement purporting to be made by an expert, the written consent of the expert

to its issue should be obtained, and, further, the expert should be one not connected in any way with the formation, promotion or management of the company. Finally, if the 'minimum subscription' is not subscribed within 120 days of the issue of the prospectus, then the moneys should be refunded to the applicants within 10 days thereafter.

A major change introduced by the Act—and one that has no parallel in the laws of any other country in the world—is the restriction on the kind of shares that may be issued. The Act does away with 'deferred shares'[1] or any type of share carrying disproportionate rights in regard to voting, dividend or other privileges. There are to be only two kinds of shares in the future—equity and preference. All voting rights are to be proportionate to the amounts paid up on the shares. The Act also provides an appellate machinery to deal with those cases where a party feels aggrieved by the refusal of directors to register a transfer of shares.

The Act imposes two important restrictions in regard to the transfer of registered office. If the registered office is to be removed outside the local limits of any city, town or village where it is located, it may be done only with the consent of shareholders by a special resolution. And, if the removal is to be from one State to another, then not only should the consent of the shareholders by special resolution be obtained thereto, but confirmation of the same should also be obtained from the appropriate Court, and, in addition, notice thereof should be given to the Registrars of the State from which it is removed and the State to which it is removed.

The old Act contained very few provisions in regard to shareholders' meetings. The new Act regulates this matter in some detail. The Registrar has been given power to extend the time for holding the meeting under certain circumstances. On the other hand, the Central Government is empowered to direct the calling of an annual general meeting where there has been default in holding one. The length of notice required for calling shareholders' meetings

[1] Existing 'deferred shares' are to be brought in line with the new provisions within a year of the commencement of the new Act.

has been increased from 14 to 21 days and it has been provided that the notice should specify not only the date, place and hour of the meeting, but also all material facts in regard to any special business to be transacted at the meeting. To enable shareholders hailing from distant places to exercise their membership rights effectively, the Act permits even non-members to be appointed as proxies. Further, members having several votes will henceforward be permitted to cast some only of their votes if they so choose, and they would also be at liberty to cast some votes in favour and some against.

Under the old Act three kinds of resolutions were recognised in respect of a shareholders' meeting, i.e., Ordinary Resolutions, Extraordinary Resolutions, and Special Resolutions. The category of 'Extraordinary Resolutions' has been abolished under the new Act, and in its place has been introduced a new category, called 'Resolutions requiring special notice'. In respect of this new category of resolutions, notice of the intention to move the resolution must be given not less than 28 days before the meeting. The definition of 'Special Resolutions' has also undergone a substantial change, the requirement now being that the number of votes cast in favour of the resolution should be three times the number cast against it.[1]

The Act has introduced several new provisions in regard to accounts. The more important changes relate to the responsibility for ensuring that proper accounts are kept, which is now fixed on directors and managing agents. Another major change is in regard to the accounting provisions relating to holding companies and subsidiary companies. The balance sheets of holding companies should have attached not only the Balance Sheet, Profit and Loss Account and Auditor's Report of their subsidiaries, but also several other statements and particulars.

In regard to audit, the changes made in the Act closely follow the provisions of the English law. An auditor, once appointed, would, by virtue of the new provisions, get a

[1] It may be mentioned incidentally that the matters in regard to which the consent of shareholders by special resolution is required are many more under the new Act than under the old Act.

sort of semi-permanence, for, it would be extremely difficult to dislodge him under the new procedure. Further, the Central Government may appoint an auditor if a company fails to do so. The auditor is now given statutory right to receive notices and other communications relating to general meetings, and speak thereat on matters with which he is concerned as auditor. Finally, the auditor will now certify that the Balance Sheet and Profit and Loss Account reflect a 'true and *fair* view' of the affairs of the company, and not a 'true and *correct* view', as hitherto.

One of the weakest points of the old Act was the laxity of provision relating to inspection. The conditions to be fulfilled before Inspectors could be appointed were extremely difficult to comply with, and the result was that, even in cases of gross mismanagement, the shareholders were unable to do anything effective and the Registrar was a mere onlooker. This lacuna in the statute has been removed. Any two hundred members may now apply for the appointment of an Inspector. Further, under certain circumstances (this is wide enough to cover almost all contingencies), the Central Government may, on its own initiative, appoint Inspectors. The Inspectors have also been given wide powers under the new law: they can, for instance, where they consider it necessary, inspect the affairs of allied concerns. The procedure for launching prosecutions or resorting to other effective methods to protect the interests of shareholders, has also been considerably simplified.

These rather far-reaching provisions have given rise to considerable misgivings among the business community in India. It has been argued that, in their anxiety to safeguard the interests of shareholders, the rights of the directors and managing agents have been sacrificed and the door has been laid open for harassment by individual hostile shareholders. Now, a close analysis of the new provisions shows that they would not afford much opportunity to a minority of hostile and reckless shareholders to stir up trouble against the management. The provisions may be slightly 'inconvenient' to the management, but they are not likely to make administration 'difficult' for the latter. Of course, if a majority of shareholders take up a hostile attitude, then

they would be able to make things awkward for the management, but if such a state of affairs ever takes place, it would perhaps be more logical to conclude that something is really wrong with the management. It can, therefore, be concluded that no powers have been granted under the new Act whereby a minority of shareholders can disturb the efficient administration of a company. The basic aim of the Act is to encourage and reasonably safeguard private investment in fields not marked out for the public sector and to regulate it for the common good. 'The overall objective is one of growing hedges rather than finding fetters for private enterprise.'[1]

[1] Speech of Mr.C. D. Deshmukh in the Lower House of the Indian Parliament on 10 August 1955.

CHAPTER VII

THE AUTHORITY FOR THE ADMINISTRATION OF THE COMPANIES ACT.

Historical Background

AS HAS BEEN NOTICED already, the weakest feature of Company law in this country prior to the enactment of the new legislation lay in the administration of the Act. The Company Law Committee had referred to this fact in pointed terms in their Report, 'We have received numerous complaints from the representatives of the business community as well as of shareholders and the general public about the inadequate and perfunctory manner in which the provisions of the existing Act relating to inspection and investigation were administered. Some of them went so far as to suggest that the Indian Companies Act was, perhaps, the most unadministered of the Central Acts relating to trade and industry.' Indeed, the memoranda submitted by the various Chambers of Commerce to the Company Law Committee pointed out that 'even the existing provisions had not been adequately utilised by Government in appropriate cases' and that 'the malpractices which have ensued flow not so much from the absence of powers under the existing Act as from the dilatoriness of their exercise.'[1] As a matter of fact, there was no proper Central Authority to administer the Act as it stood.

Recommendations of the Company Law Committee

The Company Law Committee, therefore, suggested that a Central Authority should be created by statute to administer

[1] Quoted by the Company Law Committee in their Report.

Company Law. The case for a *Central* authority was based on the following considerations. Firstly, the working of joint-stock companies has a very close bearing on the economic development of the country, and it was not possible for State Governments to take that comprehensive view of the economic terrain which the Central Government alone could. Secondly, the necessity for a uniform policy called for uniform administration of the instruments of that policy. Thirdly, the historical reasons which underlay the decentralisation of the administration of the Indian Companies Act, no longer existed. Lastly, the financial argument which, in the past, induced the Central Government to transfer their powers or duties to State Governments were neither valid in actual practice nor could this be used as an argument against the setting up of suitable administrative machinery.

The justification for setting up an *effective* organisation for continuously watching the activities of joint-stock companies was given by the Committee itself under five principal heads. Firstly, 'the law can function only through the formulation of precise definitions—definitions not merely of concepts or categories, but also of conditions or circumstances in which certain provisions would be applicable, while in others they would have no relevance. Unfortunately, no definition, however well-drafted, can comprehend the multitude of characteristics that really matter, while the characteristics that matter may themselves vary from case to case. The intention of the law may thus be frustrated, both because it is often impossible to include all relevant examples or types, and also because astute lawyers can evade the law by superficial clauses, leaving the real character of a transaction unaffected.' Hence the need for continuous watch by a properly constituted and organised authority. Secondly, 'while law must necessarily frame definitions of concepts, categories and the relevant conditions or circumstances in more or less *general* terms,' only an appropriate authority can apply the law to marginal cases or decide in which cases relaxations can be made. Thirdly, 'the history of company law in this country shows how amendment of the Indian Companies Act has always lagged

many years behind current practices in company formation and management. Only an appropriate organisation, whose function is to maintain a close watch over the working of joint-stock companies can oversee the operation of the Companies Act and can keep track of new tendencies and developments and recommend suitable changes in the existing law.' Fourthly, 'even the most well-conceived and well-designed of laws is liable to become ineffective and to fall into disrepute, if there is no regular machinery for making any use of it.' Fifthly, 'the general lack of financial knowledge and alertness on the part of investors and the general public in this country, makes it all the more imperative that there should remain in existence an authoritative body to keep a continuous watch over company promotion and management.'[1]

Following, therefore, the example of the U.K. where the Board of Trade functions as the authority for the control and supervision of the working of joint-stock companies, and of the U.S.A., where the corresponding functions are discharged by the Securities and Exchange Commission, the Committee recommended that a Central Authority should be set up in India as well. The Committee then considered the advantages and disadvantages of the two alternative types of such authority, viz., a Central Department dealing with joint-stock companies on the same lines as the Board of Trade in the U.K. and a Central Statutory Authority on the model of the Securities and Exchange Commission of the U.S.A., and decided in favour of the latter. It suggested that the statutory authority should be called 'The Corporate Investment and Administrative Commission',[2] and that it should consist of a Chairman and not more than four members who should combine suitable administrative experience, practical knowledge of company law and knowledge of company finance and accounts.

[1] *Report of the Company Law Committee,* New Delhi, 1952.

[2] This name was suggested because, according to the Committee, the proposed Commission should not merely administer matters that arise out of the working of joint-stock companies under the Indian Companies Act, but also maintain a close and continuous watch over the investment market 'from the earliest stage of the promotion of a company to its management and final dissolution.'

As regards the functions of the Commission, the Committee's views were that it should (*a*) carry out such duties as might be entrusted to it under the new Companies Act, (*b*) keep the investment markets in the private sector of the economy under continuous observation, (*c*) carry out such other functions relating to capital issue control, regulation of stock exchanges and any other subject connected with the promotion and formation of joint-stock companies as might be delegated to it by the Central Government and (*d*) build up a cadre of trained technical and administrative staff competent to analyse and study prospectuses, company accounts and problems of investment finance. For the field organisation, the Committee recommended that the country should be divided into a suitable number of regions, with wholetime Registrars and adequate staff to support them.

Central Department aided by Advisory Commission

The Bill which was introduced in the Legislature did not provide for a Statutory Central Authority as recommended by the Company Law Committee. The Select Committee, however, considered the matter, but felt that it would be better to place the responsibilities for the due fulfilment of the functions under the Act squarely on the Central Government. It, therefore, stuck to the scheme, proposed in the Indian Companies (Amendment) Act of 1951 (Act LII of 1951) and re-introduced in the draft Bill, under which an *Advisory* Commission was set up to *advise* Government in regard to the exercise of the various powers conferred on them by the Act.

It was this departure from the recommendations of the Company Law Committee which evoked the severest criticism. It was argued that departmental control would be dilatory and obstructive. 'The approval of Government on the most meticulous detail would not only hamper the functioning of private enterprise but might allow some of the evils and abuses to invade the administration also, since the fates and fortunes of companies and individuals would be involved.' Prior consultation with the Advisory Commission would not be an adequate safeguard, nor would

the provision that, in some matters, the orders passed or notifications issued or rules framed, would have to be laid before each House of Parliament.[1] Secondly, while major issues of economic policy should certainly be determined by Government, a Statutory Authority would, according to many, have created more confidence and possessed greater elasticity and initiative than a Central Department. 'Only a Statutory Authority can maintain its independent character and avoid suspicion of bias or partnership in the discharge of its functions.' Even those who felt that the new Act did not go far enough in regard to its penal provisions felt extremely unhappy that the Select Committee had not recommended the establishment of a Statutory Central Authority.[2] 'The scheme proposed by the Select Committee vests large-scale powers in various matters in a Government department. This would create pressure-group politics in collusion with interested winner groups and departmental executives.'[3]

Central Department of Company Law Administration

Notwithstanding the above objections, the recommendations of the Select Committee were accepted almost *in toto* by Parliament, and the Bill as amended by the Committee became an Act. Government's 'case' in departing from the recommendation of the Company Law Committee appears to have been that, 'having regard to the basic economic importance of the Companies Act to the functioning of the private sector, Government could not possibly divest themselves of their responsibilities for the administration of the Act by delegating the same to a Statutory Commission, over which Government could have at best only a limited and perfunctory control.' The Select Committee took the view

[1] Although the latter provision would give an opportunity to Parliament to raise any issue by motion—on the analogy of the 'prayer' motions in the House of Commons—the House will be able to act only after the executive has exercised its authority, and such action may not be effective. Then there are groups of cases in which consultation with the Advisory Commission is not obligatory at all.

[2] Vide 'Minutes of Dissent' of (*a*) Messrs.M. S. Gurupadaswamy, V. K. Dhage, B. C. Ghose and Amjad Ali and (*b*) Mr.T. K. Chaudhuri.

[3] The Finance Minister himself admitted, in his winding up speech after the third reading of the Bill, that the assemblage of powers vested in Government was 'enormous and probably without parallel elsewhere.'

that, in practice, it was not possible to separate the economic and technical aspects of the administration of the Companies Act and, therefore, decided that both must remain the direct responsibilities of Government.[1]

In accordance with the provisions of the Act, a new department known as the Department of Company Law Administration, has been created within the Ministry of Finance, Government of India, with a full-fledged Secretary in charge and directly responsible to the Minister concerned. The Department is to have the requisite complement of senior and junior officers, some of whom would be specially versed in company management and finance. A separate Research and Statistics Division has also been created within the Department and it has shown commendable alertness by issuing, within a few weeks of the launching of the Department, a comprehensive Report on the Progress of Joint-Stock Companies in India. The necessary regional organisation has also been brought into existence.

The Future

Now that the controversy over a Central Department v. a Statutory Commision is over, the question is whether the new type of authority set up will be able to discharge its duties and responsibilities as efficiently as was expected of the proposed Central Authority by the Company Law Committee. It would be dangerous to prophesy, but here also we may make a few general observations. A lot will depend on how the department is manned. Regret has been expressed in some quarters that business and banking talent has not been harnessed in recruiting personnel for the department, but it is too early to say that such talent will be left out. Much will, however, depend on the spirit in which the law is administered. The best law can become an engine for the worst form of bureaucratic dilatoriness, tyranny and even corruption, if its administration is left with persons who lack imagination, initiative and integrity of character. About a quarter century ago, a distinguished

[1] *Statesman*, Calcutta and New Delhi, 1 August 1955.

English jurist pointedly referred to the 'despotism' of those in authority, of persons who had been armed with a wide range of powers under Acts of Parliament and the rules framed thereunder. If it is possible to think of 'despotism' in a country like the United Kingdom, where public opinion and the forces of democracy are so strong, how very much more likely are they in a country like India where public opinion is still amorphous and unorganised, and the shareholder is no better than a helpless onlooker. The 'little bureaucrats' who are invested with large powers are not always guided by the lofty motives of social purpose which animate those who confer such powers on them. As a result, they often cause innumerable difficulties and hardships to the general public —not necessarily from selfish or personal motives, but because power always corrupts and makes one act and behave in a loftier and more grandiose manner than one should.

We should also bear in mind that no law, howsoever meticulously drawn up, can be fool-proof. 'It is not beyond the wit of man to circumvent the law.' When the Amending Act of 1936 was passed, the hope had been expressed that many of the glaring abuses and malpractices which had become a common feature of company management in this country, would gradually disappear. But this hope not only did not materialise, but some of the abuses and malpractices became more widespread while others reappeared in a different guise. It is not inconceivable that a similar trend may recur even after the passing of the present Act, if those in charge of administration are not vigilant. Already, a few companies have been studying the new Act with a view to finding possible loopholes in it and the services of some of the best lawyers and financiers are being engaged for the purpose of finding out how far, and to what extent, the rigorous provisions of the Act can be circumvented. Well has it been said that the new Companies Act has been a godsend to lawyers and accountants: their services will now be in greater demand than ever before, not merely for the purpose of securing advice on how to comply with the provisions of the law but also as to how

1914-15 that information became available on new registrations and liquidations of companies registered in India as also in regard to companies registered elsewhere than in India, but working in India. A few years later, i.e., in 1920-21, the industrial classification was made more exhaustive, giving details for 59 industrial groups instead of 28. About the same time, figures relating to many Indian States also came to be incorporated in the annual publication. The annual publication was further strengthened, some time in 1935-36, by a monthly publication on joint-stock companies which gave data regarding the new registrations, liquidations, and changes in the capital structure of existing companies, during each month.

At the beginning of the present century, there were 1,340 companies at work with a total paid-up capital of Rs 34·7 crores, as compared with 505 companies with a total paid-up capital of Rs 15·7 crores in 1882 and 950 companies with a total paid-up capital of Rs 26·6 crores in 1892. Between 1882 and 1900, therefore, the number of companies as well as their paid-up capital had more than doubled: the growth was particularly significant in the sphere of 'mills and presses' and 'trading companies'. The companies were concentrated primarily in Bengal, Bombay and Madras: their shares of paid-up capital, during 1899-1900, came to 92·9 per cent of the total for the whole country.[1] On the average, during the nineties of the last century, 150 companies were set on foot every year whereas there were 61 liquidations in a year.

Progress during the Twentieth Century

The number of joint-stock companies increased steadily from the beginning of the present century, particularly after the Swadeshi Movement of 1905. In 1905, the number of companies was 1,550 with a paid-up capital of Rs 40·3 crores. This had increased, on the eve of World War I, to 2,744 with a paid-up capital of Rs 76·6 crores. During the first 15 years of the present century, therefore, the number of companies as well as their capital had more than doubled.

[1] The distribution was as follows: Bengal, 43·2 per cent, Bombay, 42·3 per cent, Madras, 7·4 per cent, the rest of India 7·1 per cent.

Then came World War I and the post-war period of increased industrial activity. At the end of 1922, the number of companies had risen to 5,189 with a total paid-up capital of Rs 230·5 crores.

The next ten years, however, did not witness any spectacular rise in the number and paid-up capital of joint-stock companies. As against a three-fold increase in the paid-up capital during 1913-22 (i.e., from Rs 72·1 crores to Rs 230·5 crores), the rise during the following decade ending March 1932, was only to the extent of Rs 55·4 crores (i.e. from Rs 230·5 crores to 285·9 crores). The last four years of this decade were characterised by a severe trade depression which reflected itself in the liquidation of a number of joint-stock companies.

Between 1932 and 1939, an outstanding event was the separation of Burma in 1937 which reduced the number of companies working in India and their paid-up capital by 278 and Rs 25·7 crores respectively. Even so, the number of companies in 1939, i.e., at the beginning of World War II was 11,114 with a total paid-up capital of Rs 290·4 crores.

During the period of World War II, i.e., between 1939 and 1945, the number of companies rose to 14,859 with a total paid-up capital of Rs. 389 crores, i.e., nearly Rs 100 crores more than at the beginning of World War II. The termination of the War gave a new fillip to company promotion in the country and there was an unprecedented growth in the number of companies, accompanied by a sizeable increase in their capital resources. On the eve of the partition of the country, the number of companies stood at 21,853 with a paid-up capital of Rs 487·7 crores.

Despite the fact that as a result of partition, 2,000 companies with a total paid-up capital of Rs 18 crores were 'lost' to India, the number of companies as well as the paid-up capital thereof registered an increase in the following year. Since then, the upward movement has been steadily maintained and at the end of March 1955, the number of companies stood at 29,779 with a total paid-up capital of Rs 983·1 crores.

Trends in Principal Industrial Groups

During the last fifty years, the base of industrial activities of joint-stock companies has considerably widened. As we have seen already, before World War I, India depended very largely on imports from other countries—even in regard to her textiles and other consumer goods. But in subsequent years, especially from about the late thirties, she met her domestic needs mostly from indigenous production. Some of these industries expanded under the shelter of protection. Capital also became less shy and a sound banking system began to develop—particularly after the setting up of the Reserve Bank of India in 1936. The post-World War II period witnessed a further diversification of industrial development and the process was considerably accelerated after the attainment of independence in 1947.

A study of the trends of growth of joint-stock companies in the major industrial groups shows that there was a general increase in the number of joint-stock banks and insurance companies right up to the beginning of World War II. But since 1939, the number of companies in these two groups has shown a marked fall. The amount of paid-up capital has, however, more than doubled: it increased from Rs 30·32 crores in 1939 to Rs 62·43 crores in 1955. In other words, the smaller banks and insurance companies have been gradually weeded out, while the bigger ones have emerged with greater resources and strength.

Among the other groups, cotton, jute, woollens and silk, tea, coffee, breweries and sugar witnessed an increase both in number and in paid-up capital. In the group of chemicals, engineering industries, glass industries and agencies (this includes managing agencies), there was a considerable rise both in number and in paid-up capital, particularly since the end of World War II.

Statewise Distribution of Joint-Stock Companies

At the beginning of the present century, the three provinces of Bengal, Bombay and Madras accounted for 86 per cent of the total paid-up capital of all the companies in the country. Although these three States still continue to have

the major share, it fell to 75 per cent in 1955. In other words, the policy of Government in regard to the dispersal of industries in the underdeveloped States of India has begun to bear fruit.

Recent Trends

The recent trend is towards the floatation of companies with bigger authorised and paid-up capital. The days of launching under-capitalised concerns are gone, as entrepreneurs have realised that in the highly competitive world market, economies of production can be secured only in large units. From the frequency distribution of newly registered companies during the period 1951-55, it appears that no less than 34 companies were floated with an authorised capital of Rs 2 crores and above.[1] Among these, Sindri Fertilisers and Chemicals, Hindusthan Shipyards, Burma-Shell Refineries, Hindusthan Machine Tools, Hindusthan Steel, Durgapur Iron and Steel Works and Bharat Electronics have an authorised capital of Rs 10 crores and above. It is interesting to note that excepting the Burma Shell Refineries and the Durgapur Iron and Steel Works, all the others happen to be Government companies.

Another interesting fact, which points to the same trend, is that, during 1951-55, as many as 56 companies with a paid-up capital of Rs 50 lakhs and above increased their paid-up capital by Rs 10 lakhs and above. As against this, only 13 companies with a paid-up capital of Rs 50 lakhs and above decreased their paid-up capital by Rs 1 lakh and above.

The same conclusion is reached if we consider the *average* paid-up capital of joint-stock companies since 1923.[2] The average paid-up capital registered a steady decrease from 1923 till 1947 (it fell from Rs 5·01 lakhs in 1923 to Rs 2·19 lakhs in 1947), but from 1948 onwards it again showed an increase and at the end of March 1955, the figure stood at Rs 3·3 lakhs. If we exclude from the list of companies the giant Government companies which have been floated during the past few years, the average paid-up

[1] Vide Appendix V.
[2] Vide Appendix I.

capital in the private sector would be much higher than Rs 3·3 lakhs.

Concentration of Control

A disquieting feature of recent times is the tendency towards concentration of control in a few hands. While this has been facilitated largely by the managing agency system, it would be a mistake to hold only the latter responsible for the present state of affairs. As in Europe and America, the concentration of control in this country has been the direct consequence of modern industrial enterprise: industry nowadays requires huge capital, considerable enterprise and resourcefulness plus a high degree of technical know-how. These cannot be procured by the small entrepreneur. Secondly, in the competitive buyers' market which is the normal feature of modern capitalism, none but the most efficient units can survive. Efficiency, however, demands that the size of the business should be such as to yield the maximum production at the minimum cost. This is generally beyond the resources of the small entrepreneur.

Let us take a few instances. On the eve of World War II, 53 jute mills with a capital of Rs 18 crores, out of a total of 100 mills with Rs 23 crores, were controlled by 17 managing agents. Four of them controlled as many as 30 mills. Out of a total of 247 coal companies with a capital of Rs 10 crores, 60 companies with a capital of Rs 6¼ crores were controlled by 18 firms. Four of them controlled, between themselves, 31 companies. In tea, 117 companies were controlled by 17 firms, and five of them controlled 74 companies. Similar concentration of control existed in sugar and other industries. In the cement industry, the Associated Cement Company took over the business of 11 different companies. The British India Corporation, formed in 1920, had a capital of Rs 1¼ crores with a single Board of Directors and controlled two woollen mills, one cotton mill, the biggest boot manufacturing company in the country and a company dealing in automobiles. In Western India, the Tatas alone controlled 22 concerns with a capital of roughly Rs 30 crores. These included four cotton mills, four

power companies, an oil mill, an iron and steel factory, hotels, airways, chemical, and insurance companies—with total assets exceeding Rs 100 crores. Andrew Yule & Co. of Calcutta controlled 52 concerns with a capital of Rs 7 crores. 34 British Trusts controlled about 400 concerns with an approximate capital of Rs 75·5 crores, while half a dozen Indian Trusts controlled some 50 concerns with Rs 37·5 crores of capital.[1]

The above control was ultimately exercised, not by a few firms, but by a few individuals. In the jute industry, 132 persons were directors in 271 concerns. According to an unofficial survey, 500 important industrial companies were managed by 2,000 directors. At the apex of the pyramid stood 10 men holding 300 directorships.[2] These firms have maintained close connexion with banks and other financial institutions by the simple method of common directorships.

The tendency towards the process of concentration has further accelerated after World War II. The following figures are interesting:

Number of companies managed by 6 managing agents in selected industries[3]

	1911	*1931*	*1951*	*1955*
Jute ...	22	31	38	40
Cotton ...	24	27	36	39
Sugar ...	6	9	30	32
Tea ...	58	84	96	100
Engineering ...	6	15	21	34

The true extent of the concentration of control can be gauged by the number of directorships enjoyed by a single individual. An analysis of the distribution of directorships reveals that a large number of directorships are held by a minority of influential persons. In the coal industry, out of 56 companies, 51 companies with 247 directorships

[1] Reserve Bank of India: *Census of India's Foreign Liabilities and Assets*, Bombay, 1950.

[2] The unofficial survey was carried out by Mr. Asoka Mehta of the Praja Socialist Party. Vide also P. A. Wadia and K. T. Merchant: *Our Economic Problem*, Bombay, 1954.

[3] These figures have been compiled from the relevant editions of the *Investors' India Year Book* published by Messrs. Place, Siddons & Gough of Calcutta.

are controlled by 28 persons, 7 of whom hold 64 directorships. In jute, 267 directorships are held by 130 persons, 4 of whom have 82 directorships. In the joint-stock companies surveyed by Mr. Asoka Mehta, there were 3,728 directorships distributed among 1,103 persons: 61 of these persons held 1,038 directorships, (an average of 16 per person), while 20 of them held 805 directorships (an average of 40 !)[1]

Industrial enterprise in India to-day thus appears to be concentrated more and more in a few groups or individuals. The Tatas now control 32 companies, the House of Birlas over 125 companies, the J. K. Industries group some 50 companies and the Dalmias, over 40 companies.

According to some, this development is not to the ultimate good of the country. 'Control is now passing into the hands of a few combines which, with their immense resources and connexions, can virtually dictate policy to Government. This tendency must be checked by Government before it is too late. If the private sector of the economy is to function within the framework of a socialistic pattern of society, private monopolistic capitalism must not be allowed to develop.' There does not exist in India to-day (and this state of affairs is likely to continue for a long time to come) those 'countervailing powers' of a strong trade unionism or of buyers' groups which serve to regulate and moderate an economy like that of the U.S.A. It is, therefore, all the more necessary that the State should fill in the gap and act as a bulwark against the 'original power' of monopolistic capitalism. The development of 'countervailing power' requires a certain minimum opportunity and capacity for an organisation, corporate or otherwise, amongst those who are the victims of 'original power': in India, neither the shareholders nor the consumers have the necessary opportunity or capacity.[2]

These are harsh words. It would be wise not to be led away by catchwords and shibboleths, but to look at the

[1] Vide also Appendix VI.

[2] For a brilliant exposition of the concept of 'countervailing power' in the economic system, the reader is referred to John Kenneth Galbraith, *American Capitalism*. New York, 1952.

problem objectively and dispassionately. That there has been a tendency towards concentration of control is an undisputed fact, but is this not inevitable in the modern world? Leaving aside the U.S.A., land of giant combines and trusts, do we not find the same trend in the U.K., France, Germany, Italy and even in the U.S.S.R.? In a world in which the traditional sources of power bid fair to be replaced by atomic energy, in which automation is gradually percolating into most manufacturing industries, it would be foolish to deplore the emergence of big industrial units. The really important question is whether these big units can be made to serve the interests of the common people. With a vigilant Government, clinging firmly to the objective of a socialistic pattern of society, there appears to be no doubt that this can be done: but there will be need for constant vigilance, and perhaps still greater vigilance, on the part of the State.

CHAPTER IX

SOME ANCILLARY FACETS OF INDUSTRIAL ENTERPRISE IN INDIA

Growth of Private Limited Companies[1]

AN INTERESTING FEATURE in the development of industrial enterprise in India is the rapid growth of private limited companies (as distinguished from public limited ones). Historically, the distinction between a private limited company and a public limited company arose as follows. As corporate enterprise was increasingly utilised in the field of medium and small-scale business, the need was felt for some relaxation in the legal requirements applicable to the formation and management of companies. The initiative was taken by Germany in 1892 in relaxing the provisions applicable to private companies by dispensing with the issue of share certificates. Also, a simpler method of management was provided and the filing of, and publicity for, accounts were dispensed with. This mode of distinction was adopted by a number of countries on the Continent. In the U.K., however, it was the Companies Act of 1907 which for the first time made a distinction between private and public companies by exempting private companies from filing balance sheets with the Registrar of Companies. It also imposed certain conditions as to memberships and restrictions on transfer, and the inviting of public subscription for their shares was forbidden.

Under the Indian Companies Act of 1913, a company was deemed to be a private company if, in its articles, it (*a*) restricted the right of its shares, (*b*) limited the number

[1] The author is grateful to the *Eastern Economist* of New Delhi for permission to make liberal use of the material contained in an article entitled 'The Rôle of Private Companies' published in the Indian Company Law Supplement of that journal, 29 July 1955.

of its members to fifty only, and (*c*) prohibited any invitation to the public to subscribe for any shares or debentures of the Company. These restrictions, limitations and prohibitions must be continued to be observed by a private company during its existence.

A private company thus enjoyed certain privileges and exemptions, the most essential and valuable of which was the one relating to the exemption from the filing of the balance sheet and the profit and loss account with the Registrar. This concession by itself was responsible for the promotion of numerous private companies in the U.K. and, in that country, private companies now outnumber public companies by more than twenty to one.

Although the proportion of private to public companies in India is nowhere like what it is in the U.K., there has been a rapid growth in the number of private companies since 1919-20.[1] During this year, the percentage of private to all companies (public as well as private) was 18·2. This gradually increased to 47·3 in 1938-39 and the figure in 1954-55 was 66·5. As a matter of fact, more private than public companies have been functioning in this country since the end of World War II.

As regards paid-up capital, although the total paid-up capital of private companies is still less than the total paid-up capital of public companies, there has been a progressive increase in the relative percentage of the paid-up capital of private and public companies. While in 1919-20, the paid-up capital of private companies constituted only 15 per cent of the total paid-up capital of all companies the corresponding figure in 1954-55 was 33·3 per cent.[2]

As has been stated already, the rapid growth of private companies has been largely due, both in the U.K. and India, to the privileges and exemptions which they enjoy under the law. A private company offers a unique facility for converting a proprietary business into the joint-stock form of organisation so that all the advantages of company

[1] Vide Appendix VII.

[2] In the U.K. also, the total paid-up capital of private companies in 1952 was £2,330 millions as against a total paid-up capital of £3,970 for public companies.

incorporation may be derived. These are (*a*) limited liability for the members, (*b*) legal entity for the business, (*c*) continuity of existence as distinct from the shareholders and (*d*) division of financial ownership into two or more classes of shareholders with different rights as to profits, voting powers, etc. In the U.K., the very large number of private companies has been due to the conversion of many 'family businesses' into the joint-stock form of organisation. It may also be added that private companies continue to grow because of certain characteristics of human nature. There are many people who want to manage their own concerns themselves and at the same time require the assistance of a few outsiders to get the requisite capital: the obvious course for such people is to form a private company.

What is striking in the case of India is not the large relative proportion of private companies to all joint-stock companies, but the *rate* of increase of this proportion. Notwithstanding the need for larger capital in the floatation of industry, the number of private companies has been increasing faster than the number of public companies. Apart from the general reasons, there have been three special factors favouring the growth of private companies in India. Firstly, managing agency concerns which are composed of persons who are either relatives or close business associates have found it convenient, from many points of view, to convert their proprietary business into private limited companies. Secondly, until lately, the investment market was more or less unresponsive to a general appeal for the public subscription of shares. Hence entrepreneurs have often preferred to start their businesses as private companies, especially as they knew that it was always possible to convert a private company into a public one. Finally, the restrictions imposed by the Amending Act of 1936 on all public companies (private companies were exempted from many of them) induced many a shrewd entrepreneur to organise his business as a private company rather than as a public one.

An interesting feature of the private companies operating in India is that a large number of shareholders hold

50 per cent or more of shares. This was revealed in a sample analysis carried out by the Taxation Enquiry Commission, on data supplied by the Income Tax Department of the Government of India.[1]

The distinction in the nature of the duties and obligations to be discharged by public and private companies has been maintained in the new Companies Act, but it has been provided that the balance sheet and the profit and loss account of a private limited company should also be audited by qualified auditors and that copies of the balance sheets, certified as true copies by the Company's auditors, together with the auditor's report, should be filed with the Registrar. These two departures from the U.K. practice have been criticised in many quarters on the grounds that (*a*) qualified auditors are not easily available in small towns where many private companies have their registered offices and that as such they may have to pay high fees for the services of such auditors—a luxury which many of them cannot afford, and (*b*) the filing of accounts with its attendant publicity would give valuable information to their rivals, especially to powerful competitors, who could easily drive them out of business. On the other hand, the sharp growth of private companies since 1935-36 seems to indicate that some persons start private companies (in preference to public ones) mainly with a view to avoiding scrutiny of their accounts and, in the public interest, it would be desirable to impose a few minimum restrictions on these companies as well.

Company Failures

Although the number of joint-stock companies has increased steadily since the beginning of the present century, it is interesting to note that, between 1921 and 1935, the paid-up capital did not register much of an increase. This was due to the fact that during this period there occurred a very large number of company failures, with the result that the Indian investor, habitually shy, became shyer still. As a matter of fact, up-to-date, the 'loss' due to the liquidation or winding up of companies has been much

[1] Vide Appendices VIII and IX.

more than the 'gain' ensuing from new registrations, but the position is not as serious as it might appear. In addition to *new* registrations, considerable addition to the quantum of capital has been made by *existing* companies. Although during the period 1948-55, there was a net 'loss' of Rs 2·4 crores of capital per annum (Rs 9 crores —Rs 6·6 crores), there has been an average increase of Rs 49 crores in the paid-up capital of other companies at work.

The position is, however, alarming enough to bear close scrutiny. Why is it that such a large number of companies still continue to fail in our country?

According to a famous writer on business management, the causes of joint-stock company failures can be broadly divided into two classes: (*a*) those operating from outside and (*b*) those operating from inside. To the former class belong such causes as competition, change in the demand for the products of the company, operation of the business cycle and normal casualties. In the latter class lie such causes as archaic methods of production, slowness of collections, unwise distribution of cash dividends, incompetent sales organization, high operating expenses, over-capitalization, excessive floating debt, failure to make adequate provision for depreciation, and fraud. According to the same writer, all these causes are ultimately due to 'incompetence': inside causes are, of course, obviously signs of 'incompetence', but even outside causes may be said to be due to 'incompetence', because, with good management, the evil effects of most of those causes can be modified even if the causes themselves cannot be humanly avoided.[1]

Now, in India, owing to the fact that for a long time industrial and economic policy was not completely in the hands of ministers responsible to the legislature, there was a tendency to exaggerate the outside causes and to minimize the inside ones. An impartial study of some of these industrial failures would, however, show that in the majority of cases they were what Gerstenberg would call the 'results of incompetence and fraud'. In recent years, the floatation

[1] C. W. Gerstenberg, *Financial Organization and Management*, New York, 1924.

by numerous adventurers of companies which were inevitably closed down within a few years of their inception have not only entailed a loss involving crores of rupees to the unwary investors, but also acted as a definite hindrance to the commercial and industrial development of the country by joint-stock enterprise. To put it bluntly, in India depraved business morality perhaps accounts for the largest number of company failures. The old Company law left several loopholes for unscrupulous promoters, and the shareholders had no protection against their actions unless these were found to be within the orbit of criminal breach of trust.

Next to fraud, the most important cause of failures has been incompetence or inefficiency in the strict sense of the term. Very often, bona fide floatations launched with the best intentions and enthusiasm have come to grief because their prospects and possibilities had not been carefully scrutinized. In one way in particular, the law connived at this form of incompetence, at least till 1936. The law left the determination of the minimum capital with which to start business practically to the discretion of the promoters, subject only to the condition that the certificate for commencement of business should be issued only on prior realization of 5 per cent of the subscribed capital as the application money. But as this percentage very often proved far too short of the capital required even for the acquisition of lands and the construction of buildings and factory, the provision failed to afford any assurance that the company had attained the actual working stage. Numerous cases occurred in which, despite serious efforts to procure sufficient funds by disposing of its shares, a company failed to secure any substantial amount in excess of the statutory minimum, with the result that the company had to be closed down after the little money it had procured from its sale of shares had been spent in sundry preliminary expenses.

The Amending Act of 1936 introduced a number of safeguards to deal with mushroom and fraudulent companies. For example, it required that the minimum subscription (on which alone certificates of commencement

of business could be obtained from the Registrar of Joint-Stock Companies) should be fixed by the directors upon a certain specified basis. The directors were to provide for (*a*) the purchase price of any property to be purchased out of the proceeds of the issue of shares, (*b*) the preliminary expenses, (*c*) commission for procuring shares, (*d*) moneys borrowed by the company in respect of the preceding matters, and (*e*) working capital, all of which meant that the minimum subscription had to be such as to provide not only for the acquisition of the necessities for the business to be carried on by the company, but also for the working capital. Again, while under the old Act there was nothing to prevent a company from utilizing moneys received from prospective shareholders even before shares were allotted to them, it was no longer possible under the Amending Act to do so. All such moneys were to be kept away from the reach of the company and its promoters, and to be kept deposited in a scheduled bank until a certificate of commencement of business had been obtained.

In the matter of fraudulent companies, until 1936, apart from the ordinary remedy available under the Indian criminal law, there was really no provision for the investigation and detection of frauds practised by some of the companies on the public. The Amending Act removed this omission and authorized the Registrar of Joint-Stock Companies to investigate cases of fraud brought to his notice. He could make an enquiry and report to the local Government which might, at the cost of the State, order the prosecution of persons who were believed to be guilty of an offence in relation to the company. Any officer or director of the company who was convicted as a result of such prosecution was debarred, unless permitted by the court, from directly or indirectly taking part in the management of a company for a period of five years.

As we have seen, even these safeguards were not able to bring down the number of company failures in this country. It is not known how many of these failures in recent years have been caused by deliberate fraud and how many by inefficiency or incompetence, but the fact remains that considerable sums of money which could and should have been

profitably utilised for development, have been lost to the country. The various safeguards provided under the new Act (many of these have already been reviewed in Chapters V and VI) will, it is hoped, put a brake on the admittedly unsatisfactory state of affairs that prevails in a section of the private sector to-day.

Company Profits

In recent years, a good deal of criticism has been levelled at the alleged usurpation of huge profits by most companies—to the detriment of the long-term interests of industry. The Planning Commission, for instance, referred in their First Five-Year Plan to the 'arrears in replacements' which had been accumulating over a number of years and said that 'the scope for encouraging, through fiscal and other measures, the practice of ploughing back of profits for replacements or other capital expenditure, should be examined as early as possible.' The Taxation Enquiry Commission also has said that although the situation had improved in recent years, there was still a good deal of leeway to be made up by industrial enterprise in India.

The above view has been contested by many businessmen. According to them, industry has not been able to carry out replacements, because there was difficulty in getting the capital goods from foreign countries and not because it was unwilling to plough back profits into the undertaking. According to a survey carried out by the Employers' Association, Calcutta, the total assets of 138 selected companies increased, during the period 1946-50, from Rs 335·3 crores to Rs 422·8 crores (an increase of Rs 87·5 crores) and, of this, Rs 26·5 crores was in respect of depreciation provisions and Rs 16·7 crores due to the ploughing back of profits. Actually, expenditure on block capital was even more: as much as Rs 47·0 crores was spent on this item. On the assumption that the sample survey represented 20 per cent of the whole private sector, according to this Association, the expenditure incurred on block capital during the above four-year period was in the neighbourhood of Rs 235 crores—not an inconsiderable

figure when viewed against the fact that the total paid-up capital of the sector in 1946-47 was about Rs 400 crores.[1] It was, therefore, argued that, if there was a leeway still to be made up, the same should be done by Government. 'In the interest of maintaining progress and improving general efficiency, industry should be asked to bear only half the net differential cost, while Government should agree to grant additional depreciation allowances, on a tax-free basis, for the remainder.'

All this is based on the argument that industrial profits have not been adequate. Now, whether profits are adequate or not is largely a matter of opinion. Industry naturally argues that, unless profits are on a given scale, capital and enterprise would not be attracted to business: others (i.e., the Government and the public) may hold a contrary view and say that, while there is scope for certain further facilities being granted by Government, the scale of profits is unduly high—especially in the context of a 'socialistic pattern of society'.

Data in regard to trends in company profits and their allocations are, however, rather inadequate in this country. Until 1951, the index of profits was compiled by the Office of the Economic Adviser, Ministry of Commerce and Industry, Government of India, and thereafter it is collected by the Ministry of Finance of the Central Government. According to the figures compiled by Government (with 1939 base = 100), profits have never been below 181 during the period 1941-53 and were as high as 310·5 in one year (1951).[2] It cannot, therefore, be argued that profits were 'inadequate' at any time till 1953.

The next question is how the profits which have accrued are being allocated. Here also, the information available is inadequate. Information in some detail with regard to the allocation of profits is available in the Report of the Taxation Enquiry Commission for a sample of 496 public companies for the period 1946-51 and in a survey made by the Reserve Bank of India for a sample of 746 public

[1] *Depreciation Allowances and Replacement Costs*, issued by the Employers' Association, Calcutta, December 1952.
[2] Vide Appendix X.

companies for 1950-52.[1] These two samples comprise companies having a paid-up capital of Rs 5 lakhs and above, and cover 19 major industrial groups. According to the Taxation Enquiry Commission's analysis, during the period 1946-51, tax provision, distributed profits, and retained profits, as percentages, of profit before tax, constituted 44 per cent, 32 per cent and 23 per cent respectively. During 1946-51, the corresponding percentages were 41 per cent, 37 per cent and 22 per cent respectively.[2] The corresponding figures in the U.S.A. during 1949 were 40 per cent, 28 per cent and 32 per cent.[3]

No definite conclusion, either for or against the charge of dissipation of profit resources can, therefore, be drawn from the figures given above. It appears from the Taxation Enquiry Commission's study, however, that 20 per cent of the funds for financing gross capital formation came from the increase in paid-up capital including the capitalised reserves, 45·4 per cent came from various other reserves and 26·4 per cent were raised through borrowings by the companies. The corresponding figures in the survey carried out by the Reserve Bank of India also reveal more or less the same trend.

The point which may be urged here is that industrial enterprises in India must be prepared to plough back more of their profits into industry than they have done so far. In the U.K. and the U.S.A., as in other capitalistic countries of Europe, this has been the most important single method, in recent years, of promoting industrial enterprise. There is no reason why the same pattern should not be followed in a country where there are the additional arguments of (*a*) reduction in the inequality of incomes and (*b*) need for increased capitalisation in the quickest possible time. Even in the sphere of obtaining capital from the open market, the trend in the U.K. and the U.S.A. is for institutional investors participating in new capital issues. For example, in the U.K. insurance companies held ordinary stocks and

[1] Vide *Company Finances in India, 1950-52*, published in the Reserve Bank of India Bulletin, July 1955.
[2] Vide Appendix XI.
[3] Quoted in *Depreciation Allowances and Replacement Costs* issued by the Employers' Association, Calcutta.

shares to the extent of only 3·4 per cent of their investment in 1927. In 1953, it was 12·5 per cent and in 1954 about 14·1 per cent. In addition, another 20·6 per cent was invested in debentures, and preference and guaranteed shares. These investments have helped the wheels of British Industry.[1] In India, we do not find a similar trend, not because insurance companies here are loath to invest in equities but because, in the interest of insurers themselves, Government have found it desirable to impose a ceiling on the extent of such investments. This gives additional urgency to the need for conservation of capital through the system of ploughing back profits.

Future of Profits

A good deal of speculation has taken place in recent years about the future of profits in the private sector. While production has been steadily on the increase,[2] it has been urged by some that this tempo cannot be maintained indefinitely, because (*a*) productivity (as opposed to production) is not rising and (*b*) the quantum of profits is decreasing. Now, neither of these two statements stands the test of scrutiny. In so far as productivity is concerned, contrary to popular belief, it has risen appreciably over the past few years. Apart from the fact that average productivity does not depend on the performance of labour alone (it is a function of the combined input of a number of other factors which are almost as important—equipment, resources, organisation and management)[3], even in terms of output per man-hour or per wage-earner, there has been a rise in at least three major industries—cotton textiles, steel and cement. In the case of cotton textiles, output per man-hour moved up from 1946 to 1951 by 22·6 per cent, per wage-earner by 18·7 per cent. In the case of steel, the increase was 26 per cent per man-hour and 24 per cent per wage-earner, and in cement the increases per man-hour and

[1] Article on 'Investment Pattern of British Insurance Offices' in *Commerce*, Bombay, 10 September 1955.
[2] Vide Appendix XII.
[3] I.L.O.: *Higher Productivity in Manufacturing Industries*, Geneva, 1954.

per wage-earner were 80 and 75 per cent respectively.[1] Figures later than 1951 are not available, but the steep rise in industrial production since 1952, without a proportionate rise in the number of factory workers, raises the presumption that the trend has been maintained. Although the real wages of labour have also moved forward, the moral, in so far as industrial enterprise as a whole is concerned, is that the factor of productivity should not be held to have acted as a damper.

As regards the quantum of profits, while it is true that gross profits (this includes managing agents' remuneration, interest charges and provision for taxation, but excludes depreciation) have shown a decline since 1951, the estimated profits in 1954 were as high as those in 1948 and higher than the figure in 1947. According to calculations made by the Indian Institute of Public Opinion of New Delhi, with 1946 base = 100, the index number of industrial profits stood at 113·3 in 1948 and 112·2 and 113·9 respectively in 1953 and 1954.[2] It is true that, in a few industries, profits have declined substantially, but it is also true that profits have increased considerably in others, and, taking industry *as a whole,* the situation is by no means as gloomy as is generally made out. It will perhaps be said that the entrepreneur (or the investor) is not interested in gross profits, but in net profits, but even if we exclude interest charges and provision for taxation, the position is not unsatisfactory —particularly in the context of the fact that net profits are on the decline in all countries of the world, except perhaps in the U.S.A.

The point to be remembered in this connexion is that *total* profits have not gone down, but are slightly on the increase. There has been a tremendous expansion of the market during the past few years and, except in a few industries like paints and varnishes, jute manufactures and woollen manufactures, industrial sales were much higher in 1954 than in 1950. Thus, with 1950 base = 100, we find that in 1954

[1] Vide article on 'A Study in Productivity' in the *Quarterly Economic Report* of the Indian Institute of Public Opinion, New Delhi, April 1955. Vide also Appendix XIII.

[2] Vide Appendix XIV.

the index of industrial sales in cement was 159·4, in chemicals 161·2, in engineering 197·1, in iron and steel 111·6, in cotton textiles 113·2, in tea 155·5 and in paper 163·5.[1] Some consumers' goods industries like sewing machines, bicycles, electric lamps and fans have shown spectacular rises in sales. In other words, the slight fall in net profits has been more than made up by increased sales.[2]

[1] Vide Appendix XV.

[2] Vide article on 'The Character of Indian Economic Dynamism' in the *Quarterly Economic Report* of the Indian Institute of Public Opinion, New Delhi, August 1955.

CHAPTER X

INDUSTRIAL ENTERPRISE AND THE PUBLIC SECTOR

The Evolution of the Public Sector

THE STORY OF THE EVOLUTION of the public sector in the economy and polity of India is a very recent one: unlike in Western countries like the U.K., France, Germany, Sweden and Italy, its history in India can be compressed within the last decade, or, to be more precise, within the period following the attainment of independence by India in 1947.[1]

Although planning has been the topic in India since the Congress Party assumed power in the Provinces existing in 1937, the idea that development should be promoted by the State actually managing industrial concerns did not take root until well after 1947.[2] As we have seen already, it was only after a Constitution had been framed laying down the 'Directive Principles' of State policy that the matter assumed importance. The issue received its final imprimatur or seal of approval in the Report of the Planning Commission dated 7 December 1952. There was a definite acceptance of the principle of nationalisation, together with the general caveat that even those undertakings which would operate in the private sector might have to be subjected to State regulation and guidance.

[1] Prior to 1947, there was virtually no 'public sector' in the Indian economy. The only instances worthy of mention were (*a*) the Railways, (*b*) the Posts & Telegraphs Dept., (*c*) the Port Trusts, (*d*) the Reserve Bank of India, (*e*) the Ordnance and Aircraft factories and (*f*) a few State-managed undertakings like the Government salt factories, quinine factories, etc.

[2] Even the Report of the National Planning Committee, set up under the auspices of the Indian National Congress, did not envisage the setting up of large industries to be owned by the State. It spoke more of control and regulation of economic activities by the State in the national interest rather than of actually taking part in such activities.

The specific projects and enterprises which have been initiated in the public sector since 1947, may be classified under five broad heads: (*a*) defence and strategic establishments; (*b*) public utility undertakings; (*c*) shipping; (*d*) industries proper; (*e*) other projects.[1]

We are concerned here with industries and other projects only. Of these, the most important are the Sindri Fertilisers and Chemicals, Ltd., the Hindusthan Machine Tools, Ltd., the National Instruments Factory, the Government Housing Factory, the Indian Rare Earths, Ltd., the Penicillin Factory, the D.D.T. Factory, the Bharat Electronics Co., Ltd., the Hindusthan Cables, Ltd., the Chittaranjan Locomotive Works, the Integral Coach Factory, the Machine Tools Factory, and the three steel plants to be set up at Rourkeila, Bhilai and Durgapur respectively. In addition to these which have been sponsored by the Central Government, there are projects sponsored by the Governments of the constituent States: the most important of these are the U.P. Government cement factory, the NEPA mills (newsprint factory) in Madhya Pradesh, the Superphosphate Factory of the Bihar Government, the Sirsilk, Ltd., in Hyderabad (producing artificial silk), the Sirpur Paper Mills and the Coke Oven cum Gas Grid Project in Durgapur, West Bengal.

An idea of the relative importance of the public and private sectors in the country today may be gauged from the fact that the book value of gross fixed assets owned by the Central and State Governments, together with the working capital in the enterprises concerned, amounted to Rs 1,236 crores at the end of 1950-51 as compared to Rs 875 crores at the end of 1947-48.[2] Of the former, Railways alone (including Railway industries like the Chittaranjan Locomotive Factory) accounted for Rs 837 crores and industries proper, Rs 44 crores.

According to the Taxation Enquiry Commission, the book value of gross fixed assets owned by the Central and

[1] For details, see N. Das, *The Public Sector*, New Delhi, 1955, Ch. III.

[2] As against this, the value of the productive assets in the private sector (excluding agriculture, small-scale industry, transport and residential housing) in 1950 was estimated at Rs 1,472 crores. Vide *The First Five-*

State Governments, together with the working capital in the enterprises concerned, had nearly doubled at the end of 1953-54, as compared to the position obtaining in 1950-51. Taking the latest year (1953-54), the Commission observed that investment in the corporate sector of industry was about Rs 55 crores, although it added the qualification that this estimate 'was highly tentative and, owing to lack of necessary primary data, was in the realm of informal conjecture rather than scientific discussion.'[1] A report issued by the Department of Company Law Administration, Government of India, says that, out of the total authorised capital of all the newly registered companies during the period 1951-54, the share of Government companies alone is about 26 per cent.

In the Second Five-Year Plan, it is proposed to have a much larger actual expenditure in the public sector for industrial and mineral development than in the First Plan —Rs 1,100 crores as against Rs 178 crores. The relative proportion is also much higher (26 per cent of total development expenditure in the Second Plan against 8 per cent in the First Plan). According to another estimate, this expenditure is likely to be of the order of Rs 1,400 crores.[2] Whatever the figure, the basic idea is that there would be considerable expansion of the direct activities of the State in the industrial field during the Second Five-Year Plan period.

Problems caused by the Public Sector

The assumption of direct responsibility for industrial development by the State raises problems of various kinds—both internal and external. The internal problems are those relating to (*a*) organisation, (*b*) price-fixing and (*c*) labour relations. As regards external problems, the very fact that a considerable proportion of the capital and enterprise of the country flows into the public sector has its

[1] *Report of the Taxation Enquiry Commission*, New Delhi, 1955.

[2] *Second Five-Year Plan : The Framework*, New Delhi, 1955. It should be mentioned, however, that these sums include other items besides investment in the State industrial undertakings, e.g. expenditure on research and survey, on assistance to be granted to small and cottage industries, etc. etc.

impact on the flow of capital and enterprise into the private sector.[1]

Let us consider the internal problems first. The most important of the internal problems is that of organisation, i.e., how the socialised industries should be managed so as to yield the highest production at the least cost. While no uniform rule can be laid down regarding the form of organisation in a nationalised undertaking, the general pattern in almost all countries is that such undertakings are managed by quasi-independent corporations. The success or failure of such a corporation depends largely on the quality of the Board directing it, as it is the Board which takes most decisions on policy and all decisions on administration. Unlike that of a private company the Board of a State undertaking has a special responsibility to the consumers, the employees, the Government and indeed to the entire nation. The composition of the Board and the manner in which the members thereof are selected are, therefore, very important from more than one point of view. While there cannot be any rigid rule about the size of such a Board, it is obvious that selection should be confined to persons who have wide experience in the appropriate field of activity.

What should be the powers and responsibilities of such a Board? In a private undertaking, the Board of Directors is responsible only to the shareholders, but the very concept of a State undertaking implies a certain degree of control of policy by Government. At the same time, efficiency can be secured only by decentralisation of management. The question is how to strike a balance between these two conflicting principles. This, however, is an exceedingly delicate and difficult task. Excessive use of parliamentary control may diminish the autonomy of the Board and undermine its ability to make quick decisions and secure efficient management.[2]

The other two internal problems are those of price-fixing and labour relations. As regards the former, intricate social and other considerations complicate the issue. While

[1] The 'external' problems have been examined in Chs. XI and XII.
[2] Ernest Davies, *National Enterprise*, London, 1946.

private industry must, in the long run, receive prices which cover total costs (including taxes) and provide sufficient net return to attract venture capital, Government may allow extra-commercial considerations to enter into the determination of its supply prices. 'The interests of Government are inevitably broader than those of private enterprise. The consequence to cost calculation of broader public interest is that almost every Government-produced good is more than one good—it is a good providing individual utility to the buyer, while at the same time providing utility to the community in terms of more general welfare. Hence the operaton of some public industries at less than cost (the remainder to be made up from the general revenues) can be justified.'[1] There is, however, a danger that in those public undertakings which partake of the character of 'insulated' monopolies, prices may be fixed not at less-than-cost, but even at well above cost. In a private enterprise, competition provides the 'natural safeguard' for the consumer: although the primary aim is to maximise profits, the service rendered to the consumer being only an incidental consequence, the forces of competition help to bring the prices to the level of actual costs. In a public undertaking, on the other hand, the 'take-it-or-leave-it' attitude is likely to dominate and make it extremely difficult for the consumer to influence price policy.

Labour relations also take on a special character in a State-managed undertaking. With the advantage of being able to work under insulated and often non-competitive conditions, labour wants to make its influence felt in two ways—(*a*) by demanding representation on the executive boards or on bodies associated with such boards and (*b*) by securing special benefits (e.g. higher wages, security of service, better housing and other amenities) for itself. The former demand impinges on the managerial organisation while the latter affects prices. And this has its repercussions on the private sector as well. It is not possible to isolate the workers in the public sector from those in private undertakings: so, when the former demand a 'correct' or 'scientific' wage, the question arises whether such a wage

[1] Philip E.Taylor, *The Economics of Public Finance*, New York, 1952.

can be granted without causing repercussions on costs and also on the general wage level in the country as a whole.[1]

The Organisational Set-up in India

In India, the joint-stock form of organisation has been attempted in most of the industrial undertakings in the public sector. The capital of these joint-stock companies is fully contributed by Government and is held in the name of the President (or the Governor) except that a few shares are held in the name of one or two officials, because the establishment of a private limited company requires at least two shareholders. In form, these companies are like any other companies: they have an elaborate memorandum and articles of association; these latter provide for share transfers, general meetings and all the other paraphernalia of a joint-stock company. But in actual practice this is all on paper, because generally a single Government (sometimes two Governments) are shareholders. The Boards of Directors of these companies are all nominated by the controlling Government and they follow a general pattern. There is a Chairman who is generally the Secretary of the Ministry in charge of the particular enterprise. There is invariably one officer, generally from the Finance Ministry, of the rank of Joint Secretary. There are officials of one or two other Ministries who have close connection with the working of the particular enterprise. All these Directors are nominated ex officio and, therefore, any transfer in their postings means a change in the composition of the Board of Directors. In most of these Boards, there is also a sprinkling of a few non-officials—one or two businessmen and sometimes a labour leader.

As regards concerns which are not fully, but only partly, owned by Government, the Government reserve the right to nominate a certain proportion of the Directors. Their number varies with the proportion of the Government's shareholding and the relationship of Government with that particular concern. A large number of the Directors nominated by Government are officials who are connected

[1] United Nations, *Some Problems in the Organisation and Administration of Public Enterprises in the Industrial Field,* New York, 1954.

with the particular activity and the rest are non-officials who are considered to be experienced in that particular line. In most of these concerns, Government reserve certain special rights: for example, Government's approval has to be obtained for the raising of new capital, for large expenditure on certain items and in the appointment of top officers.

The organisational set-up of industrial undertakings in the public sector has evoked a good deal of criticism in recent months. Although the joint-stock form of organisation is now the rule rather than the exception,[1] in actual practice the advantages of elasticity and efficient management have not been fully secured. 'The lack of definite rules laying down their relationship with the controlling Government, the legislature, the labour employed, the consumer and the general public, has meant in many cases lack of proper accountability which has led to its being described as a "fraud on the constitution".'[2]

In the new Companies Act, Government companies have been assigned a special position. A Government company is defined as one in which the Central and State Governments alone or together hold at least 51 per cent of the share capital. In such cases, Government has the power to determine which provisions of the Act should apply.[3] This provision has been criticised in many quarters on two principal grounds: (*a*) the provision is discriminatory against companies in the private sector and (*b*) it takes out Government companies from the general orbit of State control and regulation. 'When the public hold almost an equal share with the Government, there is no justification for discriminatory provisions. It cannot be argued that either at the bureaucratic or political levels, the amount of incompetence and corruption is less than is common among the less well-managed companies in the private sector. Where an enterprise is run entirely as a departmental responsibility, there is the usual control of

[1] At a certain stage, Government held the view that a statutory semi-autonomous corporation was better than a joint-stock company, but this view no longer finds acceptance.

[2] *The Indian Economic Journal*, Bombay, October 1954.

[3] The original Bill had defined a 'Government Company' as one in which the total Government holding was at least 80 per cent.

Parliament ; where it is not so and Government chooses to adopt the company method, there is no reason why it should not subject itself to its disabilities as well, when it seeks the privileges of the corporate structure.'[1]

The same view was expressed by a number of members of Parliament at the time the Companies Bill was debated on the floor of the House. 'These provisions would enable Government to exempt so-called Government companies from the control of both the Parliament and the Act.' 'All real power is taken in the hands of the executive and would be liable to the vagaries of executive discretion without any real control by Parliament.'

On behalf of Government, it was argued that Government companies, owing to the very fact that they represent public interest and not the interests of groups of shareholders, should stand on a different footing from companies in the private sector. It was pointed out, for example, that the provisions requiring the supply of information to shareholders and the submission of returns, as also the power given to the Auditor General to direct the manner in which audit should take place, to conduct supplementary and test audits, and to comment on the audit report (the comments of the Auditor General are required to be placed before the general body meeting) provide adequate safeguards against executive tyranny.

It is very difficult to say at this stage whether this according of a special position to Government companies, as defined in the Act, would ultimately be in the national interest. In this matter, a compromise has been attempted between two conflicting considerations. On the one hand, it has been felt that State undertakings, which have as their objective the promotion of something above and beyond the interests of private shareholders must have a certain amount of freedom which cannot be accorded to enterprises operating within the private sector. Control of State undertakings should, therefore, be exercised through a different set of rules and practices and the State must be the ultimate authority in deciding what these rules and practices should be. On the other hand, there is no

[1] *The Eastern Economist*, New Delhi, 29 July 1955.

case for autonomous Statutory Corporations, as such institutions tend to operate as independent bodies with objectives and policies often at variance with the general economic policy of the Government of the day. In the new Act, a golden mean has been attempted between autonomy and control.

The problem of management of State industries has also been discussed in the recent reports of the Estimates Committee of the Parliament. In its sixteenth Report, the Committee has pronounced a categorical disapproval of industries run on a departmental basis—which it considers unsuitable for any public or commercial activity except for Posts and Telegraphs and, to some extent, the Railways. The Committee then remarks that the setting up of undertakings as public limited companies has not also improved matters. 'For all practical purposes, they have functioned like private limited companies and, in spite of the safeguards which Parliament recently provided in giving a special position to Government companies under the new company law, it is unlikely that this would change matters.' This, however, runs counter to the other point made by the Committee, viz., that the Directors of the Boards of various public undertakings, being mostly nominated officials of Government with no experience of business management, have not contributed to the efficient functioning of industry. The Committee has, therefore, recommended the abolition of the present system of nomination and its substitution by a Board of Managing Directors consisting of men of wide experience, preferably from private business or those who have some knowledge of financial and technical matters. 'This Board must be given the freedom to which they have been accustomed in their own particular fields of activity and a new system of relationship should be found between the Minister and the Board which would terminate the existing departmental status of public undertakings.'[1]

These and other suggestions of the Estimates Committee have been criticised on the ground that the Committee has gone far beyond the scope of its duties and functions and

[1] *Sixteenth Report of the Estimates Committee of Parliament*, New Delhi, 1955.

encroached on the sphere of policy-making which is normally the purview of Government. While this may be true, it would be unwise to reject the suggestions of the Committee merely on this ground. The fact is that the ideal organisation for industrial undertakings in the public sector has not been evolved yet and we may have to modify many of our rules, procedures, and policies in the background of actual experience and also of the general economic framework. 'While every effort should be made to secure the best and most reliable men for management, they must have defined discretionary powers which will not be questioned—even by audit—so long as they are exercised bona fide and in the normal course, even if subsequent developments reveal miscalculations or errors of judgment. The tendency to judge by results can often discourage experienced men from offering their services . . . . There is no escape from the fact that discretion must be real if the evil of departmentalism is to be checked.'[1]

In conclusion, it should be remembered that nationalisation is not an end in itself, but a means to an end. The goal is socialisation. Nationalisation by itself may mean no more than the fact that the proprietary interest vests in the State and that the profit-making motive has been abolished. But if the social implications of public ownership and operation are to be realised, there should, firstly, be full recognition of the consumer's right to the most ample service or supplies at the lowest possible price. Secondly, socialisation implies the full acceptance, both by the management and Government, of the principle of a social objective, viz., that of serving the public good. All this would require a much greater degree of fairness, objectivity and mutual respect on the part of both the management and Government than has been displayed so far.

[1] *The Eastern Economist*, New Delhi, 21 October 1955.

Chapter XI

SAVINGS, INVESTMENT AND CAPITAL FORMATION

India's Potential Financial Resources

WE HAVE SEEN in an earlier chapter that, until recently, the flow of enterprise into industrial undertakings was governed, to a considerable extent, by the availability of finance. Although the situation has altered considerably during the past two decades or so, finance, in the sense of the ultimate financial resources of the country, has not ceased to be important. The emphasis has, however, shifted from its quantitative aspect to the aspect of its mobility and quality, from the 'mechanics' of finance to its 'physics'.

Even a rough estimate of the 'total financial resources' available in the country is difficult because it includes such indeterminate items as (*a*) the resources of moneylenders and indigenous bankers and (*b*) the hoards. We know more or less accurately the total paid-up capital, reserves and deposits of agencies like the joint-stock banks, exchange banks, co-operative banks, insurance companies and post office savings banks, but we have no exact information about the quantum of capital handled by the indigenous shroffs. It is true that in their evidence before the Committee on Finance for the Private Sector, the Bombay Shroffs' Association stated that the annual turnover of their members was about Rs 100 crores, but they could not furnish any figures regarding the amount of finance lent by them to small and medium-scale industries to meet their requirements of working capital. Similarly, the claim of the Shikarpuri Shroffs' Association that they had outstandings of about Rs 20 crores at any time could not also be substantiated nor could the Association say with

any exactitude how much of this represented industrial advances.[1]

As regards hoards, we are still more in the dark. Many conflicting statements have been made in the past regarding the amount of hoards in existence, but this has been due mainly to the fact that the word 'hoarding' was used very loosely. What is injurious from the standpoint of economic development is the locking up of surpluses in gold or silver bullion or coin, and not the industrial or social use of the precious metals. Now, whatever might have been the situation half a century, or even a quarter of a century ago, nobody would now seriously contend that there are enormous 'hoards' in the country. Firstly, the psychology of the people has undergone a tremendous change and the hoarding habit has virtually disappeared. Secondly, the people have become so poor as the result of exploitation by an alien Government and the impact of a number of economic calamities, such as the high cost of living, that they have been compelled to disgorge whatever hoards they or their forefathers might have had. In these circumstances, the accumulation of fresh hoards becomes highly improbable, if not impossible. In other words, the 'enormous' hoards over which economists of a generation ago used to lament have shrunk considerably in the India of today. If, therefore, the country still continues to absorb a large quantity of gold and silver, the explanation is that part of it is put to industrial and social use (the use of gold and silver for feminine adornment does not amount to hoarding as long as this is not done with a view to locking up money in a convenient and safe form) and only a part perhaps finds its way into hoards as such.

The cry is, however, still heard that funds are not forthcoming for industrial enterprise—particularly in the private sector.[2] The Planning Commission had estimated the total financial requirements of industry in the private sector

[1] *Report of the Committee on the Private Sector,* Bombay, 1954.

[2] As a matter of fact, the Committee on Finance for the Private Sector was set up, as late as October 1953, to examine why investment in the private sector had not reached the level envisaged in the First Five-Year Plan and how increased finance could be made available to this sector.

for the First Five-Year Plan period at Rs 613 crores. Out of this, Rs 200 crores was to have come from savings of corporate enterprise in the industrial sector, Rs 90 crores from new issues, Rs 60 crores from refunds of excess profits tax deposits, Rs 158 crores from banks and other sources of short-term finance, and the balance from the Industrial Finance Corporation and foreign investment. Unfortunately, however, these expectations did not materialise fully—particularly those relating to *new* investment.

Factors Inhibiting Investment in the Private Sector

What were the reasons for the above state of affairs? Now, private investment is governed by two principal factors. The willingness to invest may be reduced by economic, political or psychological uncertainties. Then again, the ability to invest may be diminished by contraction of the savings available to the private sector. Both these factors have been at work in India.

As has been pointed out by the Committee on Finance for the Private Sector, the willingness to invest has been affected by (*a*) the threat of nationalisation, (*b*) procedural uncertainties and difficulties, (*c*) Government's labour policy and labour legislation and (*d*) various forms of control and regulation.[1] Let us consider these factors one by one.

Firstly, we may consider the threat of nationalisation. 'There is, in the country, a widespread feeling that, despite the importance given to private investment in the Five-Year Plan, private enterprise is in practice tolerated rather than accepted as an instrument of development.' This feeling has been reinforced by the series of legislative measures undertaken in recent years to regulate the private sector and also by the amendment of the Constitution making the fairness of compensation, in the event of nationalisation, a non-justiciable issue. Frequent references to the statutory power of nationalisation by Government spokesmen have increased rather than allayed the fears of potential investors and entrepreneurs.

[1] *Report of the Committee on Finance for the Private Sector*, Bombay, 1954, Ch. III.'

The second inhibiting factor consists in the procedural uncertainties and difficulties in starting a new enterprise or expanding an existing enterprise. These have been caused directly by the regulative powers assumed by the State. Firstly, any party wishing to establish a new unit or substantially to expand an existing unit in a 'scheduled' industry, must take out a licence under the Industries (Development and Regulation) Act. This usually takes at least three to six months from the date of application. Secondly, if financing such a project involves floatation of new issues on the capital market, sanction for the issue must also be obtained from the Controller of Capital Issues. And if the project requires the importation of machinery or other material, import licences and foreign exchange must be secured. All these steps have to be taken by any promoter of a new unit, in addition to compliance with the normal procedure laid down in the Indian Companies Act. 'While these regulations have the legitimate purpose of conserving domestic and foreign capital and canalising them into desired channels of activity, they have also the effect of delaying and retarding private investment.' The inevitable bureaucratic delay in dealing with applications is also an important inhibiting factor.

The third cause which is said to have had a considerable adverse repercussion on private investment is Government's labour policy and labour legislation. With the increase in the cost of living in the war and post-war years, a variety of additional obligations to compensate labour has been imposed by legislative measures adopted by the Central and State Governments and by the Awards of Industrial Tribunals. Apart from the effect of these measures on the costs of labour to industry, they have greatly reduced the freedom of employers to adjust the labour complement or to enforce disciplinary measures or to rationalise in order to step up productivity. Ultimately, they have adversely affected initiative and the flow of venture capital, with deleterious consequences on expansion and modernisation. The uncertainties regarding the trend and implications of labour legislation are said to have made the situation worse still.

Finally, there are some industries which are subject to special regulations in regard to price, production or distribution. In the coal, cement and iron and steel industries, for example, prices are fixed and distribution of the product regulated by Government. Price or distribution controls or both are also operative in respect of the products of a number of other industries, under the Supply and Prices Goods Act, 1950. All these are said to have hindered the maximum mobilisation of internal resources for the expansion or rehabilitation of industry. 'In the case of steel and electricity undertakings in particular, the restrictions imposed by Government have not only limited the internal resources of these industries, but have rendered difficult the attraction of new capital, because of the low rate of return on investment.'

As regards diminution of the *ability* to invest, the following facts are relevant. Such factors as increased labour costs and restrictions on prices have not only affected the *willingness* to invest but have also reduced the quantum of resources that could be utilised for reinvestment. Secondly, the price rises in the war and post-war years, along with increased taxation, have reduced the capacity of fixed income earners to save.[1] Again, as a result of the social and political changes which have occurred in the past few years, some of the traditional investing classes like the princes and the zamindars have ceased to be substantial supporters of the investment market. Although the upward shift in the prices of agricultural products and the large outlay by Governments in the rural areas have added to the incomes of the agriculturists, this has not helped investment as they have a lower propensity to save. As a result, floatation of issues on the market has had to depend largely on institutional investors.

The heavy borrowings by Government have also had their repercussions on private investment in the industrial sector. Since 1951-52, borrowings by Governments in the

[1] Before World War II, shares in joint-stock companies were a common form of investment by middle-class families. Since the end of World War II, the number of such investors has gone down considerably.

organised capital market have been substantial.[1] There has been a considerable diverson of voluntary savings into Government Securities and correspondingly the resources available for investment in industrial shares and debentures have been reduced. The violent fluctuations in the prices of industrial securities which have occurred in recent years and the reduced confidence in industrial management as a result of malpractices by some sections of the entrepreneurial community have also contributed to this preference for Government Securities. 'There have been several weaknesses within the private sector itself which have tended to make the investors shy of subscribing to industrial shares and debentures.'

To what extent are these various factors outlined above likely to act as a permanent brake on the flow of private capital and enterprise into industry? Here also, one need not take a very pessimistic view of the situation. Notwithstanding what has been stated above, private capital and enterprise have shown a remarkable resilience and adaptability which have confounded even the most confirmed sceptics. It is true that businessmen still complain loudly about these various inhibiting factors, but even a cursory glance at the licences granted for starting new industrial undertakings or substantially expanding existing units, shows that private enterprise has not been overwhelmed by the so-called 'adverse' climate in which it now has to function.

Scope for Mobilisation of Untapped Resources

There are many people who believe that the sources of capital have not dried up, but that instead they have merely shifted from the urban to the rural sector. According to this school of thought, what is needed is intensive propaganda among the new class of 'potential' investors and the creation of 'facilities' for the mobilisation of such savings.[2] There has been tremendous increase in

[1] Vide Appendices XVI and XVII.

[2] This view has been expressed by the Committee of Direction of the Reserve Bank of India in their *General Report on All-India Rural Credit*

agricultural production in rural areas, and cottage and village industries have also received a new fillip as a result of the more positive policies pursued by the State. According to the First Five-Year Plan, the largest addition to national output was to have come from the agricultural sector and, in due course, agriculture and cottage and hand industries (mostly distributed in rural areas and small towns) are expected to make as much contribution to the national output as all the other sectors put together. These expectations have largely materialised. In their Final Report, published in 1954, the National Income Committee estimated that, of the total net national product of India in 1950-51 amounting to Rs 9,550 crores, as much as Rs 4,780 crores or 50 per cent was contributed by agriculture, animal husbandry and allied activities.[1] Speaking in terms of national income, in 1948-49, agriculture accounted for Rs 4,250 crores (49 per cent) of the total national income of Rs 8,650 crores: in 1953-54, the corresponding figures were Rs 5,400 crores (50 per cent) and Rs 1,06,00 crores respectively.

In other words, the national income has been increasing in the rural areas at a much faster rate than ever before. It is true that part of the increase is being used up in consumption, but as has been pointed out in the *General Report on All-India Rural Credit Survey,* a good slice of the increased purchasing power in the rural areas can be mobilised into productive channels if proper investment facilities are provided in those areas. The private credit agencies (i.e., the commercial banks and indigenous bankers and moneylenders) operating in these areas have not been able to tap these increased earnings in any satisfactory measure, this having been due largely to factors inherent in the operation of these agencies. On the other hand, the records of Post Office Savings Banks, Co-operative Credit Agencies and the Small Savings Scheme show conclusively that, with proper publicity and propaganda coupled with the provision of necessary facilities, a good deal of so-called 'idle' resources can be transformed into

[1] *Final Report of the National Income Committee,* New Delhi, 1954.

'active' investible funds.[1] The integrated scheme of rural credit which has been drawn up by the Committee of Direction of the Reserve Bank of India will not only facilitate agricultural and other rural operations, but also make more funds available for investment in other sectors.[2] The setting up of the State Bank of India, with the avowed objective of bringing banking facilities within the reach of the remotest village or small town, is also expected to facilitate the mobilisation of untapped savings.

The above viewpoint has also been stressed in the survey on the 'Mobilisation of Domestic Capital in certain countries of Asia and the Far East' issued by ECAFE. Starting with the thesis that agriculture must provide a substantial part of the domestic resources necessary for economic development, the ECAFE report says that 'until the peasant can be assured of access to working finance on reasonable terms, he is not likely to be able to make any substantial contribution to the growth of development capital.' 'There do exist pockets of sizeable surpluses of income over expenditure. Potential savings are waiting to be garnered and it is up to Government to offer the necessary inducements and facilities to smoothen the process of mobilisation.'[3] The latest annual report of ECAFE also speaks in optimistic terms about the possibilities of harnessing such capital for economic development.[4]

The General Problem of Savings, Investment and Capital Formation

The fact is that, notwithstanding pessimistic prophecies to the contrary, the *per capita* real national income of the people shows an increase, as evident from the following table:

[1] Vide Appendices XVIII and XIX.

[2] It is important to recognise in this connexion that there is greater need to make rural savings *possible* (e.g., by economic development and credit extension) than to render rural savings *available* (by 'mobilisation' of different kinds).

[3] ECAFE, *Mobilisation of Domestic Capital in certain countries of Asia and the Far East*, Bangkok, 1951. This view has been disputed by Mr.G. W. Tyson—vide his article in 'Savings and Planning in Asia' in the *Lloyds Bank Review*, October 1953.

[4] ECAFE, *Economic Survey of Asia and the Far East*, 1954, Bangkok, 1955.

ESTIMATES OF PER CAPITA REAL NATIONAL INCOME[1]

(Rupees at 1948/49 prices)

Year.	*Per Capita Income.*	*Index.*	*Target in the First Five-Year Plan.*
1950-51 ...	246	100	100
1951-52 ...	252	102	101
1952-53 ...	261	106	102
1953-54 ...	276	112	103
1954-55 ...	—	—	104
1955-56 ...	—	—	105

The question is whether the increase in the *per capita* real national income is finding its way into productive channels. We have no accurate statistics on this point, but all the various economic activities in India to-day, both in the public and private sectors, seem to indicate that a substantial portion of it is being utilised in actual savings and investment. In other words, capital formation is indeed proceeding—maybe rather slowly, but none the less surely. It has been estimated by the Panel of Economists set up by the Planning Commission to draw up the draft of a Second Five-Year Plan (for the period 1956-61) that investment has been going on at the rate of 5 per cent of the national income per annum during the First Five-Year Plan period and that in the Second Plan period it would be possible to step it up to 12½ per cent per annum.[2] According to some writers, the current rate of investment has been underestimated: it should be of the order of 7½ per cent, if we take into account the increase in stocks and investment in small industries. Similarly, we could easily plan for the Second Five-Year period on the basis of a capital formation rate of the order of 15 per cent.[3]

The conclusion is thus inescapable that savings, investment and capital formation are proceeding 'well according to plan'. This does not mean that capital formation is uniform in all sectors. The savings effort of the monetised

[1] Ibid, p. 116.

[2] *Second Five-Year Plan : The Framework*, New Delhi, 1955.

[3] Article entitled 'Some Comments on the Second Plan' by Dr. J. D. Mehta in *Commerce*, Bombay, 8 October 1955. See also the *Quarterly Economic Report*, August 1955 issued by the Institute of Public Opinion, New Delhi.

sector for example, is already high—more than 9 per cent, which perhaps implies that the scope for greater effort will be smaller in this sector in future. Nevertheless, the progress so far has been so satisfactory—in spite of gloomy prognostications to the contrary—that one need not complain overmuch even if the rate remains more or less stationary in the second quinquennium. The recent study made by the Reserve Bank of India, with a 44 per cent coverage of the aggregate paid-up capital of all public limited companies, reveals that gross profits, inclusive of depreciation, reached Rs 62·9 crores in 1951. If these figures are compared with the target annual rate of gross corporate savings of Rs 40 crores, corporate savings can hardly be treated as such a bottleneck as they are often claimed to be. Other studies show that the net increase in paid-up capital of manufacturing (joint-stock) companies during the three years 1951-52 to 1953-54 amounted to Rs 70·6 crores, exclusive of bonus share issues. This gives an annual rate of Rs 23·5 crores which compares quite favourably with the target annual rate of Rs 18 crores. In other words, there is hardly any inherent lack of investible funds for expanding private industries to-day. Difficulties, if any, seem to lie more in *mobilising* the capital in risky ventures.[1]

Indian Taxation Policy and Private Investment

A good deal of controversy has raged in recent months over the effects of taxation policy on private investment. Businessmen and entrepreneurs have been complaining that the taxation policy of Government sucks them dry and leaves little room for initiative, enterprise and investment. We have already mentioned in an earlier chapter the difficulties experienced by the business community in regard to replacement and modernisation on account of the taxation measures adopted by Government. 'Statistics' have been put forward by the Employers' Association, Calcutta, that 'capital' is disappearing from the private sector and that the policy of 'dividend slash' is having a

[1] ECAFE, *Economic Survey of Asia and the Far East*, 1954, Bangkok, 1955.

distinctly harmful effect on future investment.[1] We have seen, however, that *actual* investment in the private sector has not diminished, but rather increased, both in quantity and quality, during all these years.

In a recent study made by Mr.N.K.Chowdhury of the International Bank for Reconstruction and Development, Washington, for the period 1946-51, it has been shown that although there was a fall in the volume of annual capital issues between these two years (1946 and 1951), the fall could not be attributed to taxation policy. As a matter of fact, Government had made a number of tax concessions during the closing years of the period under review, but these did not increase investment in the private industrial sector. On the other hand, the position does not appear to have been as gloomy as is made out in certain quarters. Industrial investments, as a percentage of total investments, increased from 45·78 per cent in 1948-49 to 79·84 per cent in 1950 and 73·89 per cent in 1951. What had happened was that the percentage of *long-range* investments had declined—more perhaps on account of other inhibiting factors than to actual taxation policy.[2] Although comparable data subsequent to 1951 are not available, there are indications that the situation has not deteriorated.

There are one or two important points which should be borne in mind in this connexion. All Governments nowadays require an increasing volume of public revenue and, more so, when the avowed objective is the establishment of a Welfare State. No doubt, there is a limit to taxable capacity and the limiting factor is generally taken to be the estimated wealth of a country. Ordinarily, this is taken to be the overall national product, but this limit refers only to a point of time. The capacity to pay (i.e. taxable capacity) is never constant—on the contrary it is ever changing, except when the employable resources have

[1] Vide arguments adduced in two pamphlets, 'Where is Capital gone?' and 'Whither leads a Dividend Slash?', issued by the Employers' Association, Calcutta, 1949.

[2] Article entitled 'Indian Taxation Policy, 1946-51, and Private Investment' in the *Indian Economic Journal*, Bombay, July 1955. The percentage distribution in the 'immediate' and 'long-range' group schemes was 67·62 and 37·38 in 1947-48, and 75 and 25 in 1951.

been fully exploited and the economy has reached a full employment level. 'In a developing economy, the capacity is not inflexible. The limits to taxation in such an economy are more psychological than physical. The quality of public administration, the degree of public consciousness and the extent of confidence in the Government's expenditure policy on the part of those who are called upon to pay the taxes are the deciding factors in this psychological limit.' In other words, as long as the tax proceeds are properly utilised for developmental purposes, adding progressively to the size of the national income, there can be no real limit to taxation. 'If there are visible symptoms of taxable capacity being exhausted in such an economy, it will be the result of a *psychological* crisis and not of a real *physical* crisis in the economy.' In India, too, taxable capacity should be viewed from this broad and dynamic angle and not from the static, physical angle.

Even so, there is an upper safe limit to taxation. According to Colin Clark, the safe limit is 25 per cent of the national production.[1] Although this precise figure has been contested by a number of economists,[2] we may accept this as a working formula for the purpose of examining the present and foreseeable burden of taxation in our country. In India, this upper limit has not been reached yet and is not likely to be reached even under the scheme of development proposed in the draft Second Five-Year Plan. As a matter of fact, if the trend of events is any guide, businessmen are working as hard under high tax-rates as they would have done under low tax-rates.

The other point to be remembered is that taxable capacity depends also on the length and nature of the goods and services supplied by Government. It is greater if the supply is mainly of consumers' essential goods and services and at fixed prices or free. Secondly, the expenditure policy of Government must be fully endorsed by the

[1] Colin Clark has proved this 'limit' by making close studies of the price-index, tax-level and its relation to the national income in a number of countries.

[2] E.g., Benjamin Higgins, Joseph A. Pechman and Thomas Mayor. Colin Clark's analysis has been attempted with a purpose: with statistics, any conclusion can be shown to be valid.

people: 'taxable capacity is what the majority of the people think it to be.'

Finally, tax is paid ultimately by individuals and not by groups. Even in the same income-bracket, the capacity of any two individuals to bear the tax load is not identical. Taxes evoke reactions individually and sometimes the most vociferous are those who are the best organised, but not necessarily the hardest hit.

The Taxation Enquiry Commission which reported in February 1955, has examined the taxable capacity of the people in great detail—with particular reference to the income inequalities prevalent in the country. Starting with the premise that such disparities must be narrowed down to a reasonable minimum, the Commission has outlined certain proposals for the financing of the future development of the country. These have been characterised by the business community (who, by the way, are most vocal in this respect) as 'unfair, harsh and against the best interests of the country.' In the opinion of the present author, however, although the projected taxation measures may operate harshly on particular individuals or groups, they are neither beyond the taxable capacity of the people nor are they likely to act as deterrents to investment, if the process is gradual and is accompanied by a dynamic programme of development.

Chapter XII

THE FUTURE OF INDUSTRIAL ENTERPRISE IN INDIA

The Gloomy Prophets

EVER SINCE Government announced their policy of fostering a 'mixed economy' (i.e. the co-existence of public and private sectors) in the country, all kinds of doubts and misgivings have been expressed, not merely by businessmen and industrialists, but by responsible economists and 'neutral' members of the public. Measures adopted to 'control, regulate and direct' industry have been criticised—sometimes in violent terms—and the fear has been expressed that Government's policy was leading the country to the verge of bankruptcy. In particular, it has been asserted that the assumption of greater and still greater responsibilities by the State would be too much for the administration to bear and whispers have been gleefully exchanged that one day Government would be compelled, by the sheer logic of events and circumstances, to retrace its steps. But, to-day, at the close of the First Five-Year Plan period, Government's plans and policies stand vindicated in more than ample measure. Not only has there been no fall in production, but there have been spectacular rises—both in the agricultural and industrial sectors. Even in terms of productivity per wage-earner or man-hour, there has been a distinct improvement, though one might wish that it could have been better still. As regards the flow of investment and enterprise into the private sector, notwithstanding the so-called irritating and irksome restrictions, flowing directly from the economic and fiscal policies pursued by Government, there has been no diminution in activity. Even some of the worst critics of Government have at last been compelled to admit that they had made a

mistake in jumping to premature conclusions and that they should have awaited the march of events before pronouncing a verdict.

An Objective Analysis of Pitfalls and Dangers

The fact that India has made progress should not, however, make us feel complacent. 'India continues to make progress, but she should be making, and has the capacity to make, far greater progress than she has done so far.'[1] There will be no obstacles in the sector of financial resources: the obstacles, if any, are likely to arise in the sector of 'incentives'. A Government does not need incentives: it is driven as much by the spur of the people's displeasure as by the personal ambition or sense of public service of individual members. But the private sector would still need 'incentives'. Would the necessary 'incentives' be there in the years ahead?

It can be stated categorically and at the very outset that the kind of 'incentives' to which industrial enterprise in the private sector has been accustomed for so long will decrease both in quantity and in quality. The old motive of making huge profits will have to be replaced by a new motive of serving the country and its people, with only limited profits. Workers will have to be treated as partners in industry and not as mere producers of goods. There should arise the awareness of a social purpose in even the most private undertaking. If the mental outlook can be adjusted in this fashion, business enterprise will be inspired by new kinds of 'incentives', the 'incentives' of service and of promoting the general welfare.

This adjustment will naturally take some time. As, however, economic development is being furthered in this country through a democratic process and not as an imposition from the top (it is a unique experiment and has probably no parallel in any other country of the world), there are reasons for cherishing the hope that the adjustment will ultimately take place. Echoes of this adjustment are to be found in the offer made by certain leading industrialists

[1] *The Eastern Economist*, New Delhi, Special Budget Number, 1954-55, ; March 1954.

to serve Government in the public sector on terms and conditions to be laid down by the latter. Even those who have not volunteered in this fashion, have taken note of the new ideology and have publicly expressed their readiness to fall in line with Government. For example, addressing the shareholders of the Tata Iron and Steel Co., Ltd., at the Eighth Annual General Meeting held on 25 August 1955, Mr. J. R. D. Tata said: 'Bold planning and determined execution of large schemes of development are essential if we are to raise living standards, relieve unemployment, give opportunities to all and ensure a reasonable degree of social justice. . . . I welcome the policy of creating a Mixed Economy in which both State Enterprise and Free Enterprise will, side by side, play their important rôles. . . . We should not close our eyes to the enormous changes which have occurred in the capitalistic countries throughout the world. Modern capitalism has changed beyond recognition from what it was a century ago. It has shown a remarkable capacity to fit into the most modern concepts of the Welfare State.' Those who have read the appeals made to businessmen by the Company Law Committee and the Committee on Finance for the Private Sector, requesting the latter to make adjustments in their outlook, must be smiling with satisfaction that the appeal has borne fruit—at least in some sections of the business community.

The danger, however, lies not so much in the attitude of the private sector as in the fact that maintenance of consumption is largely a matter of price. India's production is no longer inexpensive: will the high-cost economy prove a serious impediment to the pattern of consumption and adversely affect production and economic development? Also, will the industrial undertakings which are operating in the public sector be able to 'deliver the goods' in reasonable quantities, and at a price which the consumer can afford?

The other pitfall, to which a reference has been made already, lies in bureaucratic red-tape and formalism. On the one hand, various controls and regulations have vested enormous powers in the hands of Government officials

and the private sector as well as the general public are often put to needless harassment, inconvenience and delay by the 'little bureaucrats'. The arguments put forward by Mr. N. C. Chatterji in his dissenting minute on the Report of the Select Committee on the Companies Bill are well worth quoting in this context: 'It is one thing to prescribe restrictions, limitations or fetters sitting in a Select Committee or discussing a Bill in the placid atmosphere of a legislative chamber. Yet the sum total may create an impracticable situation from the point of view of company formation or the practical working of a business concern. It is not wise to drive the private sector to the tender mercies of a bureaucracy, as this may lead to jobbery and corruption.'

There is the possibility of bureaucratic red-tape and formalism exhibiting itself in the management of industrial undertakings in the public sector as well. Although strenuous efforts have been, and are being, made to entrust the management of such undertakings to the same type of Board as obtains in the private sector, with adequate scope for initiative and enterprise, old practices and prejudices die hard. It is to be hoped that authority will have the imagination and boldness to permit the unfettered use of discretion within a fairly large orbit of operation.

Finally, there is the pitfall inherent in the lack of adequate entrepreneurial ability within the ambit of Government officialdom. Recruited to discharge an entirely different type of responsibility, unacquainted with the needs of business and industry, unfamiliar with practices and procedures which have resulted in a high level of efficiency and productivity in the private sector, Government officials, barring a few notable exceptions, are hardly equal to the new tasks and responsibilities which have been assigned to them. It is true that some of them are learning the technique of business administration through trial and error, but this is a costly method of acquiring experience and, in the process, incalculable harm may be caused to programmes and plans of development. The recent disparaging account by a British machine-tool expert of Government's venture into the machine-tool industry may

have been exaggerated, and it may also be uncharitable to hold one company's misdemeanour as proof enough to indict all managements in the public sector, but the public sector ought not to expect, as a matter of right, that the maximum allowance should be made for its shortcomings or that it should be judged by its good intentions rather than by its good performance.[1]

It should not also be forgotten that in modern industrial undertakings, the scope of functions of the management has expanded both in volume and in complexity. 'While the volume of work increases in arithmetical progression, the complexity of functions and their relationships increase in geometrical progression.'[2] The task of a successful organisation is to co-ordinate the different factors of production in such a way that the maximum possible output is secured at the least possible cost, without undermining the required quality standard of the product. This is as true of the public as of the private sector.

The Second Five-Year Plan

It would be appropriate at this stage to consider the pattern of development envisaged in the Second Five-Year Plan period, as this must inevitably affect industrial enterprise for the next five years. The objectives in view, in the words of Prof. P. C. Mahalanobis, are (*a*) to attain a rapid growth of the national economy by increasing the scope and importance of the public sector and in this way to advance to a socialistic pattern of society, (*b*) to develop basic heavy industries for the manufacture of producer goods to strengthen the foundations of economic independence, (*c*) to increase production of consumer goods as much as possible through household or hand industries and to provide an adequate market for these products, (*d*) to develop factory production of consumer goods in a way not competitive with hand industries, (*e*) to increase productivity in agriculture and to speed up agrarian reforms with an equitable distribution of land to peasant cultivators,

[1] Vide article entitled 'The Private Life of the Public Sector' in the *Eastern Economist*, New Delhi, 19 August 1955.

[2] R. C. Davis, *Industrial Organisation and Management*, New York, 1940.

so as to stimulate the increase of agricultural production and of purchasing power in rural areas, (*f*) to provide better housing, more health services and greater opportunities for education, especially for the poorer sections of the population, (*g*) to liquidate unemployment as quickly as possible and within a period of not less than ten years, and (*h*) as a result of such measures, to increase national income by about 25 per cent over the plan period, and achieve a more equitable distribution of income.[1]

This is an ambitious programme, but it will give an idea of the policies and measures that are likely to be adopted by Government during the next five years in furtherance of the objectives laid down. 'The basic strategy would be to increase purchasing power through investments in heavy industries in the public sector and through expenditure on health, education, and social services; and to meet the increasing demand for consumer goods by a planned supply of such goods so that there would be no undesirable inflationary pressures. Planning would thus be essentially a feed-back process of matching a continuously increasing (planned) demand by a continuously increasing (planned) production, giving rise to a steadily expanding economy.' The allocation of investment (or net capital formation) would be Rs 3,400 crores in the public sector and Rs 2,200 crores in the private sector:[2] of this, the allocation under 'industry' is envisaged to be of the order of Rs 1,500 crores (25 per cent of the total investment), split up between the public and private sectors at Rs 1,000 crores and Rs 500 crores respectively. Investment of another Rs 400 crores is envisaged as working capital in private industry and trades.[3]

The framers of the Second Five-Year Plan recognise that 'administrative difficulties inherent in the existing Government machinery are likely to prove the greatest obstacle to

[1] *The Second Five-Year Plan: The Framework*, New Delhi, 1955.

[2] In addition, there would be further developmental expenditure of Rs 1,000 crores in the public sector on certain current items to be carried forward from the First Five-Year Plan.

[3] It has been pointed out by a recent writer (Dr. S. D. Mehta in *Commerce*, Bombay, 22 October 1955) that the figure of Rs 400 crores as working capital required for private industry and trade is a gross underestimate: it should be at least twice this amount.

efficient planning.' 'To overcome such difficulties,' they observe that 'large organisational and even constitutional changes may become necessary.'[1] At the same time, they emphasise that 'the major effort in the development of basic capital goods industries must come from the public sector,' although they concede that the private sector should also be encouraged to invest predominantly in the producer goods industries. The strategy would also require all-out efforts for the maximum utilisation of capacity in existing industries. While in the sphere of production of consumer goods, the emphasis is laid on the 'extensive development of small-scale industries,' the hope is expressed that 'once the economy gets going and investible surpluses increase, it would be possible, nay desirable, to introduce more efficient methods of production in the consumer-goods industries as well.'

We thus see that the public sector is going to become more and more important as the years roll by. This does not, however, mean that the private sector will have no important part to play. It has been tacitly admitted by the framers of the draft Plan for the Second Five-Year period, in more places than one, that 'lack of trained personnel and of suitable organisations' may raise insuperable difficulties in the implementation of the Plan. This is likely to be as pronounced in the industrial sector as in other sectors. Whatever, therefore, may be the objectives and targets, there is likely to be scope for further activity by industrial entrepreneurs even in spheres now assigned to the public sector—in addition of course to spheres which are already open to them.

The Future

It would, therefore, be a mistake to conclude that industrial enterprise in the private sector is on its 'last legs'. We have already referred to the mental readjustment which is being made by the business community in the background of the new values which have been enunciated and the

[1] It is rather unfortunate that this point has not been elaborated further. Only a naïve remark has been made that 'the problem is urgent and requires immediate and serious attention.'

new policies which have been laid down. Part of this re-adjustment is genuine, but part may also be a fake. In the history of business enterprise in this country, we have seen innumerable instances of persons trying to outwit Government and to get round all kinds of restrictive laws and regulations. It is not inconceivable that some such persons are thinking on the old lines, viz., that, with their astuteness and command of wealth, they will be able to evade many of the new restrictions which have been, or are likely to be, placed on the promotion and management of industry in the private sector. Such persons would not feel unduly worried over the shape of things to come, particularly as the process of socialisation and State control is being operated within a democratic framework which respects the rights and liberties of all individuals, including those of businessmen.[1]

There are two important facts inherent in the economic situation which afford cogent reasons for cherishing the hope that enterprise in the private sector will continue to flourish. The first is that consumer demand has been considerably stimulated by the impact of heavy developmental expenditure undertaken by the State. This demand will increase still further as more money is injected into the economic system. Secondly, every outlay in the public sector directly generates demand for goods and services in the private sector. When the State decides to set up a steel plant or a fertiliser factory in the public sector, it is not in a position to undertake by itself all the operations connected with the setting up of the plant or factory. It has to fall back upon persons or firms in the private sector for the supply of relevant goods and services. These two factors give the Indian economic situation a 'dynamism' which should become more pronounced as the Second Five-Year Plan comes into operation.

[1] It would be interesting to note in this connexion that the Gallup polls conducted by the Institute of Public Opinion, New Delhi, over a period of 18 months during 1954 and 1955 showed that businessmen were not as perturbed over 'the shape of things to come' as one would have imagined them to have been, from a cursory glance at the bulletins and memoranda published or issued by the various Chambers of Commerce and Trades Associatiens.

The main reason for saying that industrial enterprise has still a large and important part to play in this country is that India's approach towards the socialistic pattern of society is not doctrinaire, but pragmatic. Notwithstanding the occasional outbursts of certain political leaders, the fact remains that the Prime Minister of India and his colleagues in the Cabinet do not want socialism for its own sake. It is significant that the official parlance is the 'socialistic *pattern* of society' and not 'socialism'. In other words, if private industrial enterprise can attune itself to the new outlook, the need for expropriation or nationalisation of *existing* undertakings may never arise. Not only that: industrial enterprise in the private sector may find that it has an honourable place in society and is not being just tolerated. Its future, therefore, lies with itself and it is earnestly to be hoped that it will rise to the occasion and help in building up an India in which the people have not merely political freedom but economic freedom in the true sense of the term—freedom from want, freedom to mould their destiny as they deem best, and freedom to make use of all the opportunities that independence has brought to their doorsteps.

APPENDIX I

JOINT-STOCK COMPANIES REGISTERED IN INDIA AND AT WORK

(Number, paid-up capital and average paid-up capital)

Year	*No.*	*Paid-up Capital (In crores of rupees)*	*Average paid-up capital of each company. (In lakhs of rupees)*
1923 ...	5,190	259·8	5·01
1925 ...	5,204	275·5	5·48
1927 ...	5,526	276·9	5·01
1929 ...	6,330	279·3	4·41
1931 ...	7,328	282·7	3·86
1933 ...	8,715	286·5	3·29
1935 ...	9,842	304·0	3·09
1937 ...	11,229	311·5	2·78
1939 ...	11,114	290·4	2·61
1941 ...	11,638	309·6	2·66
1943 ...	12,770	336·1	2·63
1945 ...	14,859	389·0	2·62
1947 ...	21,853	478·7	2·19
1948 ...	22,675	569·6	2·51
1949 ...	25,340	628·3	2·48
1950 ...	27,558	723·9	2·63
1951 ...	28,532	775·4	2·72
1952 ...	29,223	855·8	2·93
1953 ...	29,312	897·6	3·06
1954 ...	29,528	944·9	3·20
1955 ...	29,779	983·1	3·30

Source: *Annual Reports on the Working of Joint-Stock Companies in India*

APPENDIX II

SHARE AND DEBENTURE CAPITAL ISSUED BY THE MAJOR INDUSTRIES IN INDIA

(Position as on 31 March 1955)

Name of Industry	*No. of Companies*	*Paid-up Share Capital (In lakhs of rupees)*				*Debenture capital (In lakhs of rupees)*	*Percentage of total*	*Total (In lakhs of rupees)*
		Ordinary	*Percentage of total*	*Preference*	*Percentage of total*			
Cotton ...	63	3,619·2	85·9%	546·2	12·9%	48·7	1·2%	4,214·1
Tea ...	128	773·2	90·0%	83·3	9·7%	2·5	0·3%	859·0
Jute ...	60	2,131·0	67·8%	712·8	22·7%	229·8	9·5%	3,143·6
Sugar ...	26	479·3	77·2%	130·5	21·0%	11·0	1·3%	620·8
Coal ...	51	818·0	77·2%	124·8	11·8%	117·0	11·0%	1,059·8

Source: *The Investors' India Year Book, 1955*, compiled by Place, Siddons & Gough, Calcutta.

APPENDIX III

ADVANCES OF SCHEDULED BANKS BY PURPOSE

(In crores of rupees)

At the end of:

	June 1952	*June 1953*	*June 1954*	*June 1955*
Industry ...	210·5 (37·4)	189 (34·7)	193 (34·2)	241 (38·6)
Commerce ...	263·5 (46·7)	263 (48·2)	274·5 (48·7)	292·5 (46·7)
Agriculture ...	23 (4·0)	23 (4·2)	16 (2·8)	12 (2·0)
Personal & professional ...	41 (7·2)	41 (7·5)	45 (8·0)	55 (8·8)
All others ...	26 (4·6)	29 (5·4)	35·5 (6·3)	25·5 (4·0)
TOTAL ...	564 (100)	545 (100)	564 (100)	626 (100)

N.B.: The figures within brackets represent percentages of the total advances by these banks.

Source: *Reserve Bank of India Bulletin*, Bombay.

APPENDIX IV

REMUNERATION OF MANAGING AGENTS

Industry	*No. of companies*	*Average from 1946-51 (In lakhs of rupees)*	*As percentage of profits*
Cotton textiles ...	96	3·18	16·4
Jute textiles ...	47	1·50	20·3
Other textiles ...	12	6	13·8
Iron & steel ...	3	48	7·3
Engineering ...	52	32	12·0
Sugar ...	22	28	15·8
Chemicals ...	29	10	14·8
Paper ...	7	18	11·2
Vegetable oil ...	7	5	13·1
Matches ...	4	18	15·4
Cement ...	8	29	·3
Tea plantations ...	76	33	12·0
Other plantations ...	11	2	13·0
Coal ...	17	29	16·7
Electricity ...	22	30	18·1
Shipping ...	11	27	21·4
Others ...	55	31	5·5
TOTAL ...	479	8·14	13·7

N.B.—Profits include Managing Agency commission and provision for taxation, but exclude depreciation and interest charges.

Source: *Report of the Taxation Enquiry Commission, 1955.*

APPENDIX V

GIANT FLOATATIONS DURING 1951-55

Name of Company	*Class of Company*	*Industrial Group*	*State*	*Authorised capital (In lakhs of rupees)*
		1951-52		
1. Sindri Fertilizers & Chemicals ...	Private.	Manufacturing of Chemical preparations.	Bihar.	30,00
2. Hindusthan Shipyards ...	Public.	Shipbuilding.	Delhi.	10,00
3. Dalmia Cement (Bharat) ...	,,	Cement manufacturing.	Madras.	5,00
4. Mamata Films	,,	Producers and Distributors of Cinematographs.	West Bengal.	5,00
5. Everest Filmland (International)	,,	Film Exhibitors & Distributors.	New Delhi.	5,00
6. Remington Rand of India ...	,,	Business of typewriters.	West Bengal.	3,00
7. Kaling Tractors Corporation ...	,,	Miscellaneous Manufacturing and Trading.	Orissa.	2,00
8. Reckitt and Colman of India ...	,,	Manufacturing and dealing in Chemicals.	West Bengal.	2,00
		1952-53		
1. Burmah Shell Refineries ...	Private.	Oil Refining.	Bombay.	25,00
2. Hindusthan Machine Tools ...	,,	Dealers and Manufacturers of all types of machine tools.	Mysore.	12,00
3. Hindusthan Cables ...	,,	Dealers in cables, wires and other insulating materials.	West Bengal.	3,00
4. Standard-Vacuum Refining Company of India	,,	Dealers in Petroleum.	Bombay.	3,00
5. Challapalli Sugars	,,	Sugar manufacturing.	Madras.	2,00

Name of Company	*Class of Company*	*Industrial Group*	*State*	*Authorised capital (In lakhs of rupees)*
		1953-54		
1. Hindusthan Steel	Private.	Iron and Steel.	Delhi.	1,00,00
2. Indian Explosives	Public.	Manufacturing and dealing in explosives and ammunitions.	West Bengal.	4,00
3. Hyderabad (Sind) Electric Supply Co.	,,	Supply of Electric Power.	Bombay.	3,10
		1954-55		
1. Durgapur Iron & Steel Works ...	Public.	Iron masters, Steel makers etc.	West Bengal.	50,00
2. Industrial Credit and Investment Corporation of India ...	,,	Investors.	Bombay.	25,00
3. Bharat Electronics ...	Private.	Manufacturing and dealing in electric instruments.	Mysore.	10,00
4. Indian Tube Company (1953) ...	Public.	Manufacturing and dealing in Iron and Steel.	West Bengal.	7,00
5. Caltex Oil Refining (India) ...	,,	Refining of Oil, Petroleum, etc.	Bombay.	5,00
6. Bengal Line	,,	To purchase, hire and build steamships.	West Bengal.	5,00
7. Bharat Development ...	,,	Dealers in Cement.	P.E.P.S.U.	5,00
8. Jay Somnath Steam Navigation Co.	,,	Navigation.	Bombay.	5,00
9. Rajasthan Udyog	Private.	Manufacturing and dealing in building materials.	Rajasthan.	5,00
10. Sahu Chemicals	,,	Manufacturing Chemicals.	West Bengal.	5,00
11. Sahu Rayons ...	Public.	Manufacturing and dealing in rayon yarn.	West Bengal.	5,00
12. Saurashtra Chemicals ...	,,	Dealers in Chemicals.	Bombay.	5,00
13. Voltas	,,	General Merchants.	Bombay.	5,00
14. West Coast Paper Mills ...	,,	Paper Mills.	Bombay.	5,00
15. Hind Cement	,,	Dealers in Cement.	West Bengal.	4,00
16. Ashoka Cement	,,	Dealers in Cement.	Bihar.	2,50
17. Nilgiri Plantations	,,	Cultivation of Tea, Coffee, Cinchona.	West Bengal.	2,00
18. Thiru Arooran Sugars ...	,,	Manufacturing of Sugar.	Madras.	2,00

Source: *Progress of Joint-Stock Companies in India,* New Delhi, 1955.

APPENDIX VI

MULTIPLE DIRECTORSHIPS IN INDIAN COMPANIES REGISTERED IN WEST BENGAL, ASSAM, BIHAR & ORISSA

(As in 1955)

Name of Director	*No. of companies in which the directorship is held*
Mr. C. L. Bajoria	32
Mr. W. A. Russell	28
Mr. G. T. Routledge	27
Mr. K. L. Jatia	26
Sir B. P. Singh Roy	24
Mr. D. F. Macmillan	21
Mr. T. Leslie Martin	20
Maharaja Udaychand Mahtab of Burdwan	20
Mr. N. Stenhouse	19
Mr. R. H. Duguid	17
Mr. C. C. Sandys-Lumsdaine	17
Mr. A. T. Doig	16
Dr. S. C. Law	14
Mr. W. H. S. Michelmore	13
Mr. D. C. B. Pilkington	11

Source: *Investors' India Year Book, 1955*, Calcutta.

APPENDIX VII

PRIVATE COMPANIES REGISTERED IN INDIA AND AT WORK

(Capital in crores of rupees)

Year	*All Companies*		*Private companies*		*Percentage of private companies to all companies*	
	No.	*Paid-up capital*	*No.*	*Paid-up capital*	*No.*	*Paid-up capital*
1919-27 ...	3,668	123·2	668	18·5	18·2	15·0
1927-28 ...	5,830	276·4	1,722	71·5	29·5	25·5
1933-34 ...	9,434	300·8	3,698	98·7	39·2	32·8
1938-39 ...	11,114	290·0	5,255	77·0	47·3	26·6
1945-46 ...	17,343	424·0	7,214	101·0	42·2	24·1
1950-51 ...	28,532	775·4	15,964	208·9	55·9	26·9
1951-52 ...	29,223	855·8	16,810	248·9	57·5	29·0
1952-53 ...	29,312	897·6	17,257	268·8	57·5	29·9
1953-54 ...	29,528	944·9	19,280	313·6	65·3	33·2
1954-55 ...	29,779	983·1	19,720	327·1	66·5	33·3

Source: *Progress of Joint-Stock Companies in India*, New Delhi, 1955.

Appendix VIII

ANALYSIS OF PRIVATE LIMITED COMPANIES ACCORDING TO NUMBER OF SHAREHOLDERS EXERCISING CONTROL

Number of Companies with paid-up capital.

Minimum No. of share holders who account for 50% or more shares	*Not more than Rs 1 lakh*	*More than Rs 1 lakh but not more than Rs 5 lakhs*	*More than Rs 5 lakhs but not more than Rs 10 lakhs*	*More than Rs 10 lakhs but not more than Rs 50 lakhs*	*More than Rs 50 lakhs but not more than Rs 100 lakhs*	*More than Rs 100 lakhs*	*Total*
1	611	230	53	32	12	6	944
2	616	255	34	31	—	1	937
3	293	134	19	13	1	—	460
4	135	91	10	11	1	—	248
5	75	48	9	5	—	—	137
6	49	25	1	2	—	—	77
7	14	25	2	4	—	—	45
8	21	15	—	2	—	—	38
9	17	9	3	1	—	—	30
10	10	12	—	—	—	1	22
More than 10	32	31	3	—	—	—	67
TOTAL	1,873	875	134	101	14	8	3,005

Source: *Report of the Taxation Enquiry Commission*, New Delhi, 1955.

Appendix IX

ANALYSIS OF PRIVATE LIMITED COMPANIES ACCORDING TO PERCENTAGE OF SHARES HELD BY THE LARGEST SHAREHOLDER

Paid-up Capital	*Number of Companies in which the percentage of shares held by the largest shareholder is:*					
	1-10	*11-25*	*26-50*	*51-75*	*76 or more*	*Total.*
More than Rs 1 lakh but not more than Rs 5 lakhs	18	47	45	17	16	143
More than Rs 5 lakhs but not more than Rs 10 lakhs	8	33	33	19	19	112
More than Rs 10 lakhs but not more than Rs 50 lakhs	5	41	24	12	17	99
More than Rs 50 lakhs but not more than Rs 100 lakhs	1	1	—	4	6	12
More than Rs 100 lakhs	—	—	2	2	2	6
TOTAL ...	32	122	104	54	60	372

Source: *Report of the Taxation Enquiry Commission,* New Delhi, 1955.

APPENDIX X

INDEX OF PROFITS

(1939 Base = 100)

Coverage (in terms of paid-up capital)	*All Industries*	*Jute*	*Cotton*	*Tea*	*Sugar*	*Paper*	*Iron & Steel*	*Coal*	*Cement*
	25·0%	92·7%	46·5%	40·6%	34·6%	98·0%	72·2%	63·7%	80·4%
Year.									
1940 ...	138·0	359·1	142·5	99·1	100·3	236·3	103·8	100·8	102·8
1941 ...	187·0	344·1	316·6	146·8	137·8	284·7	133·7	82·6	128·8
1942 ...	221·8	351·1	491·3	228·1	126·7	321·7	110·1	80·5	169·1
1943 ...	245·0	376·3	640·0	142·3	157·8	352·8	111·8	95·6	147·9
1944 ...	238·9	310·6	492·1	110·5	133·5	271·5	117·8	237·0	214·4
1945 ...	233·6	327·6	423·3	150·7	108·9	279·5	120·2	258·3	211·6
1946 ...	229·2	415·4	408·9	198·8	122·4	266·4	101·3	198·5	194·1
1947 ...	191·6	313·2	317·7	216·3	171·5	167·6	86·1	171·8	142·5
1948 ...	259·9	361·2	548·1	127·9	381·3	257·0	96·3	201·0	252·6
1949 ...	181·5	89·3	192·0	138·4	216·4	316·7	116·0	287·2	295·0
1950 ...	246·6	456·9	356·6	271·2	262·4	479·0	134·2	209·2	333·4
1951 ...	310·5	679·1	551·1	103·9	420·8	604·1	157·7	178·4	419·7
1952 ...	190·6	183·4	262·8	88·8	409·1	566·8	162·6	220·4	293·4
*1953 ...	261·2	326·2	379·4	391·4	419·8	512·7	179·4	145·5	179·4

N.B.: *Definition of Profits* :—Profits of manufactures less provision made for taxes, interest, commission and other miscellaneous items. The contributions made towards depreciation and reserves are not deducted from this amount, but allowance is made for the transfer of money towards the profit account from the contingencies and capital or reserve funds from sale of Government loans or from charges foregone by managing agents, directors, debenture holders etc.

Source: *Progress of Joint-Stock Companies in India,* New Delhi, 1955.

APPENDIX XI

ALLOCATION OF PROFITS DURING 1946-51 AND 1950-52 RESPECTIVELY

ALL INDUSTRIES

Tax Provisions		*% of Profits before Tax*		*% of Profits after Tax*		*% of Paid-up Capital*	
		Profits distributed	*Profits retained*	*Profits distributed*	*Profits retained*	*Net profits*	*Profits distributed*
(A) TEC Sample of 492 Companies							
1946	50·0	28·0	19·0	55·8	38·8	16·6	9·1
1947	46·0	33·0	19·0	62·0	35·1	13·8	8·1
1948	46·0	26·0	27·0	48·8	50·2	16·7	7·2
1949	43·0	44·0	12·0	77·0	21·6	10·1	6·7
1950	38·0	37·0	25·0	58·9	39·9	15·1	7·5
1951	39·0	32·0	28·0	52·8	46·0	18·8	8·5
1946-51	44·0	32·0	23·0	57·7	40·1	15·2	7·7
(B) RBI Sample of 746 Companies							
1950	40·0	38·0	23·0	62·0	38·0	11·5	7·2
1951	39·0	32·0	29·0	52·0	48·0	15·0	7·9
1952	45·0	44·0	11·0	80·0	20·0	9·0	6·9
1950-52	40·9	36·8	22·3	62·3	37·7	11·8	7·3

Note : For the definition of 'Profits', see Appendix X.

Sources: *Report of the Taxation Enquiry Commission,* 1955 and *Reserve Bank of India Bulletin,* July 1955.

Appendix XII

INDEX OF INDUSTRIAL PRODUCTION IN INDIA

(Base: 1946 = 100)

Period	*General index*	*Cotton textiles*	*Jute*	*Coal*	*Sugar*	*Cement*	*Paper*	*Matches*	*Sulphuric acids*	*Steel ingots & metal for castings*
1947	97·2	95·8	96·6	103·9	97·6	93·9	87·8	113·0	100·0	97·1
1948	108·4	109·0	100·2	103·2	116·5	100·7	92·4	129·4	133·3	97·1
1949	105·7	99·7	84·8	108·9	108·5	136·3	97·4	127·8	165·8	104·6
1950	105·0	91·1	76·8	110·8	105·8	169·5	102·7	127·0	170·8	111·2
1951	117·2	101·3	80·4	118·8	120·8	207·2	124·4	140·3	178·2	116·0
1952	128·9	113·8	87·4	125·4	161·9	229·3	129·7	150·1	160·1	122·0
1953	135·3	119·9	79·8	124·1	139·9	245·1	131·8	150·0	181·8	116·5
1954	146·3	123·3	85·2	127·3	109·2	285·1	146·5	128·4	251·5	130·2

Source: *Journal of Indian Industry & Trade*, New Delhi.

APPENDIX XIII

PRODUCTIVITY INDICES

	Cotton Textiles		*Iron & Steel*		*Cement*	
	(*a*)	(*b*)	(*a*)	(*b*)	(*a*)	(*b*)
1946	100·0	100·0	100·2	100·0	100·0	100·0
1947	109·8	105·6	90·2	93·4	92·6	94·9
1948	124·2	118·6	95·9	104·0	103·0	102·2
1949	116·3	110·6	101·3	109·6	126·7	121·7
1950	117·5	107·1	118·2	129·0	165·9	171·5
1951	122·6	118·7	124·1	126·0	180·3	174·7

(*a*) = Product per man-hour. (*b*) = Product per wage-earner.

Source: *Quarterly Economic Report of the Indian Institute of Public Opinion,* New Delhi, April 1955.

APPENDIX XIV

INDEX NUMBERS OF INDUSTRIAL PROFITS

(1946 = 100)

ALL INDUSTRIES

1947	1948	1949	1950	1951	1952	1953*	1954*
83·6	113·3	82·5	107·6	135·5	83.2	112·2	113·9

* Provisional.

Source: *Quarterly Economic Report of the Indian Institute of Public Opinion,* New Delhi, August 1955.

APPENDIX XV

INDEX NUMBER OF INDUSTRIAL SALES

(Base: 1950 = 100)

Industry		*1951*	*1952*	*1953*	*1954*
Coal	...	137·5	152·4	110·6	105·0
Cement	...	111·5	137·4	141·4	159·4
Chemicals	...	120·4	157·9	178·4	161·2
Engineering	...	121·1	155·6	153·6	197·1
Iron & Steel	...	103·9	113·2	113·7	111·6
Jute	...	144·6	134·8	79·3	98·0
Cotton Textiles	...	128·2	114·4	108·2	113·2
Tea	...	103·7	82·0	108·4	155·5
Paper	...	141·3	156·3	154·6	163·5
Sugar	...	116·0	95·3	131·4	109·2

Source: *Quarterly Economic Report of the Indian Institute of Public Opinion,* New Delhi, August 1955.

APPENDIX XVI

DEBT POSITION OF THE GOVERNMENT OF INDIA

RUPEE DEBT (In crores of rupees)

End of March	*Undated*	*Over 10 years*	*Between 5 & 10 years*	*Under 5 years*
1947	257·47	752·62	117·09	343·18
1948	257·74	682·42	285·62	267·23
1949	257·85	711·59	196·90	309·80
1950	257·86	597·93	303·08	291·08
1951	257·85	519·33	342·51	318·77
1952	257·85	463·47	450·14	232·05
1953	257·85	387·60	411·67	346·46
1954	257·85	271·43	546·93	288·06
1955	257·85	241·14	621·70	353·70

N.B.: Treasury Bills and small savings are excluded; so also is external debt.

Source: *Reports on Currency and Finance in India,* Reserve Bank of India, Bombay.

APPENDIX XVII

PERMANENT DEBT POSITION IN PART 'A' STATES

(In crores of rupees)

At the end of			*Permanent debt*
1947-48	...	...	44·17
1948-49	...	...	45·94
1949-50	...	...	50·41
1950-51	...	...	58·07
1951-52	...	...	69·11
1952-53	...	...	80·44
1953-54	...	...	105·37
1954-55	...	...	118·60

N.B.: Floating debt and unfunded debt are excluded.

Source: *Reports on Currency and Finance in India,* Reserve Bank of India, Bombay.

APPENDIX XVIII

PAID-UP CAPITAL AND RESERVES OF CO-OPERATIVE BANKS IN INDIA

State & Central Co-operative Banks and registered non-agricultural (urban) Co-operative Credit Societies—having Capital & Reserves of Rs 1 lakh and above

(In crores of rupees)

Year	*Paid-up capital*	*Reserves*	*Total deposits*
1947-48	6·04	7·03	72·04
1948-49	7·08	7·71	87·85
1949-50	8·06	8·51	90·43
1950-51	9·20	9·29	100·99
1951-52	10·55	10·29	105·80
1952-53	12·37	12·01	115·37
1953-54	14·38	12·51	128·57

Source: *Statistical Tables relating to Banks in India, 1954.*

Appendix XIX

NET RECEIPTS OF PRINCIPAL ITEMS OF SMALL SAVINGS

(In crores of rupees)

Year.	*Post Office Savings Bank Deposit*	*National Savings Certificates (a)*	*Treasury Savings Deposit Certificates*	*Post Office Cash Certificates, Defence Savings Bank Deposits & Defence Savings Certificates*	*Other small savings (b)*	*Total net receipts*
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1950-51 ...	16·27	17·34	5·31	−5·48	—	33·44
1951-52 ...	12·83	17·86	13·08	−5·23	—	38·54
1952-53 ...	17·83	18·49	7·25	−3·52	—	40·05
1953-54 ...	14·26	20·29	6·47	−3·12	—	37·90
1954-55 ...	21·06	19·80	5·04	−2·13	8·92	51·67

Note : (*a*) Include 12-year, 7-year and 5-year National Savings Certificates, the last having been discontinued with effect from 1 July 1953.

(*b*) Include 10-year National Plan Certificates and 15-year Annuity Certificates. Ten-year National Plan Certificates are being issued since 10 May 1954. Fifteen-year Annuity Certificates are being issued since 15 August 1947.

Source *Report on Currency and Finance for the year 1954-55,* Reserve Bank of India, Bombay.

APPENDIX XX

SAVINGS DEPOSITS OF INDIAN JOINT-STOCK BANKS

(Both scheduled and non-scheduled)

Year	*Deposit (In crores of rupees)*
1950	145·04
1951	146·72
1952	145·42
1953	147·26
1954	155·59

Source: *Statistical Tables relating to Banks in India.*

APPENDIX XXI

COMPANY FAILURES IN INDIA

TABLE I

Quinquennial averages	*New registrations*		*Liquidations.*	
	No.	*Paid-up* capital (In crores of rupees)*	*No.*	*Paid-up capital (In crores of rupees)*
1915-19 ...	199	0·5	189	1 3
1920-24 ...	726	1·8	285	6·4
1925-29 ...	553	0·7	335	6·6
1930-34 ...	891	0·9	382	6·7
1935-39 ...	1,054	1·2	634	5·5
1940-44 ...	1,182	1·4	648	3·6
1948-55 (average for post-independence period) ...	2,082	6·6	975	9·0

* These figures do not, however, include the additions to capital structure made by existing companies.

TABLE II

	New registrations.		*Liquidations.*	
	No.	*Authorised capital (In crores of rupees)*	*No.*	*Paid-up capital (In crores of rupees)*
1947-48 ...	3,267	283·9	628	9·0
1950-51 ...	2,104	120·7	830	9·1
1951-52 ...	1,866	152·2	1,244	9·2
1952-53 ...	1,333	96·4	1,244	11·3
1953-54 ...	1,211	153·0	927	8·8
1954-55 ...	1,203	226·0	952	8·0

Source: *Progress of Joint-Stock Companies in India,'* New Delhi, 1955.

APPENDIX XXII

NATIONAL INCOME OF INDIA BY SECTORS

(In hundred crores of rupees)

Sector	*1948-49*	*1949-50*	*1950-51*	*1951-52*	*1952-53*	*1953-54*
Agriculture, animal husbandry etc. ...	(*a*) 42·5	(*a*) 44·9	(*a*) 48·9	(*a*) 49·9	(*a*) 47·9	(*a*) 54·0
	(*b*) 42·5	(*b*) 43·6	(*b*) 43·4	(*b*) 44·4	(*b*) 46·0	(*b*) 48·9
Commerce, transport and communications ...	(*a*) 16·0	(*a*) 16·6	(*a*) 16·9	(*a*) 17·9	(*a*) 17·8	(*a*) 18·0
	(*b*) 16·0	(*b*) 16·4	(*b*) 16·6	(*b*) 17·3	(*b*) 17·9	(*b*) 18·6
Mines, manufacturing and hand trade ...	(*a*) 14·8	(*a*) 15·0	(*a*) 15·3	(*a*) 17·3	(*a*) 17·6	(*a*) 18·0
	(*b*) 14·8	(*b*) 14·6	(*b*) 14·8	(*b*) 15·8	(*b*) 16·4	(*b*) 16·7
Other services ...	(*a*) 13·4	(*a*) 13·8	(*a*) 14·4	(*a*) 15·0	(*a*) 15·4	(*a*) 16·1
	(*b*) 13·4	(*b*) 13·8	(*b*) 13·9	(*b*) 14·3	(*b*) 15·0	(*b*) 15·4
Net earned income from abroad ...	(*a*) 0·2	(*a*) 0·2	(*a*) 0·2	(*a*) 0·1	(*a*) 0·1	(*a*) 0·1
	(*b*) 0·2	(*b*) 0·2	(*b*) 0·2	(*b*) 0·2	(*b*) 0·1	(*b*) 0·1
TOTAL ...	(*a*) 86·5	(*a*) 90·1	(*a*) 95·3	(*a*) 99·9	(*a*) 98·6	(*a*) 106·0
	(*b*) 86·5	(*b*) 88·2	(*b*) 88·5	(*b*) 91·6	(*b*) 95·2	(*b*) 99·5

Note :—(*a*) At current prices.
(*b*) At 1948-49 prices.

Source: *Final Report of the National Income Committee 1954, and Ministry of Finance,* Department of Economic Affairs.

APPENDIX XXIII

NET DOMESTIC CAPITAL FORMATION IN INDIA

	(1) *Net domestic capital formation (In crores of rupees)*	(2) *National income (In crores of rupees)*	(3) *Percentage of (1) to (2)*
1948-49 ...	446	8,580	5·2
1949-50 ...	524	9,000	5·8
1950-51 ...	589	9,500	6·2
1951-52 ...	672	10,000	6·7
1952-53 ...	659	9,800	6·7
1953-54 ...	719	10,500	6·8

Source: *Second Five-Year Plan : The Framework*, New Delhi, 1955—Note of dissent by Prof. B. R. Sheony.

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