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CORPORATE MANAGEMENT
AND
ACCOUNTABILITY

CORPORATE MANAGEMENT AND ACCOUNTABILITY

TOWARDS A JOINT SECTOR

L. C. GUPTA

Director of Research,
Institute for Financial Management & Research, Madras

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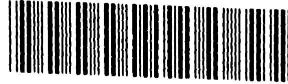

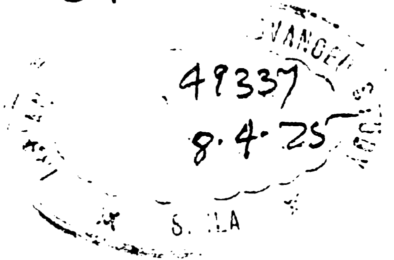

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Foreword

An important function of our Institute is to conduct research on current problems of the national and international economy in the broad area of finance and publish the results both to stimulate discussion and to be of help to the policy makers, whether in the Government or elsewhere, including in particular business corporations. About two years ago the subject of the 'Joint Sector' form of business organisation was very much under debate and an esteemed member of our Board of Governors suggested to me that the Institute might take up a comprehensive study of the various aspects of this so-called novel form of business organisation with a view to having a background paper for discussion in a Seminar to be organised by the Institute. I agreed that the joint sector arrangement posed complex problems which needed to be sorted out and although the subject raised many non-financial issues, I felt we should do a preliminary study.

This study is not primarily an examination of the rationale of the joint sector, nor of the many practical problems that arise in implementing joint sector proposals. Rather, it reviews in some detail the present working of the private corporate sector in India in order to provide guidance to the joint sector arrangements.

Part One of the book is likely to provoke much controversy. One view may be that the account that is given in the section is too familiar to need the kind of elaborate quoting, especially from American books, that has been done. The other view may be that the account is very much an exaggerated one, in the present Indian context when Government has vast powers of direct and indirect regulation of the private sector business units.

Undoubtedly, private sector industrial and business units, especially the large ones—and those which constitute a group—enjoy a lot of power, not all of which, like the iceberg, is visible. But the fact is that this state of affairs is not something deliberately planned. In the first 10-15 years after Independence, the Government naturally concentrated on industrial growth, though socio-political aspects of the growth were not overlooked and indeed some steps were taken in the direction of what one may broadly call 'Social Control' of industry. In this connection, it will be widely agreed that the private sector has done an excellent job, of course receiving valuable help from Government in a variety of ways. The next stage was naturally one where a democratic Government wedded to socio-economic reform of the society had to take stock of the actual and potential political power which the private sector came to acquire and think of appropriate steps to keep it under check.

So, if intellectuals talk of growing power of the private sector, one should not dismiss it as academic hallucination. Nor should the range and depth of the power be exaggerated, creating a wrong impression in India and abroad that

the Central and State Cabinets and legislatures are wholly under the vicious influence of private sector merchants and manufacturers. The situation undoubtedly needs watching by a vigilant community. It is in this spirit that I would invite readers to view the first part of the book. A democratic society has to balance the need for growth and efficiency—in fact, if not in theory, the private sector has so far been generally much more efficient than the public sector— on the one hand and curbing concentration of economic and political power on the other hand.

Part Two of the study on the subject of *Corporate Ownership and Control* is illuminating. Dr. Gupta has collected a lot of material and presented it admirably. Part Three is also both a factual and interpretive portion on the top management structure of Indian joint-stock companies in the private sector.

Naturally, the concluding section of Dr. Gupta's book is the most interesting and provocative portion of the book. He has made a number of suggestions for reforming the management structure of the corporate sector with a view to achieving the objectives of public accountability and efficiency. Thus, he favours the German system of two-tier boards, namely a board of full-time executives and another of non-executives or a supervisory board. I am not sure whether this formal arrangement is necessary. In fact, this practice is rare outside Europe and even in Europe does not appear to be very common outside Germany. In the UK this matter has been considered very carefully and there does not appear to be a general support for a two-tier arrangement. What is, however, important is to adopt the spirit of the two-tier system. This can be achieved by having a board that comprises both whole-time executive directors and non-executive directors, the latter representing not so much family connections as expertise in various branches of management. Even very eminent industrial houses are not free from the evil of filling top managerial positions on the basis of caste and community. This should certainly change.

Another very important suggestion which Dr. Gupta has made, and which is not new, is that there must be proportional representation in regard to the selection of company directors. There may be practical difficulties in following this practice in a formal way. Fears have also been expressed that the principle of proportional representation might destroy the sense of homogenity that should prevail in any board. Here again, my view is that what is important is to accept the spirit of proportional representation so that the board comprises directors representing various shareholding interests. In the name of complete homogenity, boards of directors should not become rubber stamps of what the managing or the executive director says or does. With a Chairman, possessing both ability and integrity, it should not be difficult to produce homogeneity and at the same time get the benefit of the different points of view on the functioning of an industrial unit and plans for its expansion and diversification. Having said this, I should add that perhaps Dr. Gupta has given the impression that if only the system of proportional representation is followed all the evils of corporate management will disappear. I do not think he really means it. The situation in this regard has undergone a marked change what

with substantial shareholding by institutional investors and the increasing interest they are evincing in the day to day functioning of industrial units assisted by them or in which they have invested. Naturally, representation of these institutional shareholders will become increasingly common and that should go far in meeting the suggestion of proportional representation made by Dr. Gupta.

Dr. Gupta has also valuable comments on some other aspects of the functioning of the corporate sector, especially in regard to control over private sector management by public sector institutions. He is not in favour of the Dutt Committee's suggestion for the creation of a ' well trained managerial cadre of full time Public Directors who will represent the state on the joint sector industrial concerns '. Dr. Gupta is also not in favour of establishing a holding company to which is to be transferred the shareholding of public sector financial institutions. I am in entire agreement with Dr. Gupta.

In regard to the joint sector arrangement, Dr. Gupta's view is, rightly, that it must be a genuine partnership between private parties and the Government, with equal sharing of power and responsibility. In my view this is an ideal arrangement very much to be wished for but in practice it is unlikely to work, except perhaps for short periods. All said and done, as in the case of Government generally, there has to be a great deal of centralisation of authority and direction. An arithmetically equal division of responsibilities between the private entrepreneur and the Government is unlikely to work. Much also depends upon the personalities so far as the Government is concerned. There is a danger of the Government representatives wanting to consult, at every stage, the numerous departmental officials and the Ministers, thereby delaying decisions. Ultimately, either the Government representative or the private entrepreneur would have to be entrusted with the decision-making authority.

In other words, in my view the joint sector cannot function in a formal way. The joint sector is thought of primarily as an interim arrangement; the ideal arrangement is considered to be State-ownership and direction of large establishments. The view appears to be that the joint sector arrangement will combine the best of private sector and public sector managements, namely efficiency and public accountability. One cannot be sure whether it will not have the worst of both, namely, inefficiency, bureaucracy, corruption and stagnation. If things go wrong the private entrepreneur will blame the Governmental representatives who in turn will try to put the blame on the shoulders of their private partners. I doubt whether any private entrepreneur would like to put in large sums of money in an industrial unit in the running of which he does not have a major say. In other words, before long there will be no such thing as a joint sector organisation.

The question will still remain as to what control the financial institutions must exercise over the working of industrial units, the major portion of the funds of which are supplied by financial institutions, development banks and commercial banks, nearly all of which are in the public sector. There should not be much difficulty in working satisfactory arrangements in this behalf. Nomi-

nation of directors by the financial institutions and the calling of periodical data and inspection by the representatives of the financial institutions, supplemented by Governmental authority under statutes such as the Industries (Development and Regulation) Act, the Monopolies and Restrictive Trade Practices Act and enormous powers possessed by the Reserve Bank under the Banking Regulation Act, which should be adequate for the purpose. Such an arrangement would give operational freedom to the private entrepreneur and at the same time he will have to bear the responsibility for his acts. If there are signs of mismanagement, there are enough powers to throw him out and substitute good management.

Simultaneously, efforts should also be made to improve efficiency of public sector units. So far as the Central Government industrial units are concerned, latterly there would appear to have been a marked improvement of performance; a lot of credit for this should go to the Minister for Heavy Industry. There should be no objection to the public sector constituting a substantial portion of the industrial sector so long as it is efficiently run. As already mentioned, the indications are that this is taking place.

In other words, what we require is not so much a formal joint sector as a reformed and an even more efficient private sector, operating under the broad vigilance of the Government and the financial institutions and a growing and efficient public sector. In the running of public sector units the assistance of private entrepreneurs should be mobilised. What is standing in the way of this being done is a lot of suspicion on the part of the Government regarding the bonafides of the private entrepreneurs. There are a lot of able and honest entrepreneurs who are ready to make their services available to the Government on an honorary basis.

As regards the regulation of the private sector, the trouble in the country is not lack of legislative authority but unwillingness and incapacity to administer the laws. But the private sector must reform itself in a spirit of enlightened self-interest. A sense of trusteeship should prevail in private sector management, which must also make profits on the basis of efficiency, rather than monopolistic and unfair practices. There is ample evidence to prove that private benefit and public good can be harmonised. From the modest contacts which I have had with private sector management, I should say that while the initial reaction of management to any proposal for reform is not quite favourable, there is a gradual willingness to improve. This process can be speeded up by independent directors, with academic and professional background. In this connection, the Government should consider seriously appointing, as a normal routine, a director or two on large-sized companies, measured by assets/turnover. These directors should, as far as possible, be experts.

In conclusion, regardless of the extent to which there will be general support to Dr. Gupta's views and recommendations, I am sure there will be no disagreement regarding this being a stimulating and an eminently readable book. The function of the Institute is to focus public attention on key areas of financial and general management and provide all the relevant data for understanding the problems and reaching conclusions and decisions. It is with this object

that we undertook the publication. I should like to add that the views expressed in the book are Dr. Gupta's and not those of the Institute; the disclaimer also applies to such views as I have expressed in this Foreword.

S. L. N. SIMHA
Director

Institute for Financial Management and Research,
Kothari Road, Madras-34.

June 8, 1974.

Preface

The 'joint sector' represents, in a sense, a new institution of property and a new ideology of economic management which, if adopted, will produce in due course a new economic system, different in fundamental respects from the mixed economy of today. Implicit in that concept is a recognition that the large business corporation of today is not a 'private' but a 'social' institution, holding and managing productive property for the benefit of the society at large. It is undoubtedly an idea with a revolutionary potential and needs to be studied in depth. The present study represents a modest attempt in that direction.

The significance of the 'joint sector' concept, its underlying purpose, and its problems and prospects can be appreciated only if the concept is considered against a broad canvas of socio-political organisation and development. The concept is a product of certain evolutionary forces, of which two seem to be the most relevant: first, a sweeping change in the promotion, financing and ownership of big private industry in India as a result of state-owned financial institutions acquiring a dominant role; and second, an increasingly insistent popular demand to 'socialise' big business in order to curb economic power in private hands.

Governmental financial assistance to private industry began in India on a significant scale only after Independence for purely pragmatic reasons of assisting industrial development and in response to a long-standing demand from private industry. A combination of planning requirements and ideological trends has led to a gradual transformation of the character of financial institutions, from purely financing agencies into instruments of controlling and guiding industrial development as also of bringing about desired social changes.

The remarkable expansion of financing of private industry through state institutions and the accumulation of equity holdings of private enterprises in the hands of these institutions had at first no significant impact on private control of industry, the basic structure of corporate control remaining, more or less, undisturbed by these changes almost till 1971. With a marked increase in the role of state-owned financial institutions and a corresponding reduction in the financial contribution of private controlling groups, the financial institutions' traditional attitude of remaining aloof from control began to look somewhat illogical. The Government had also before it the political aim of reducing the power of established business groups. The institutions were, therefore, compelled to adopt a more interventionist philosophy towards corporate managements assisted by them and to take specific measures in this direction, such as reserving a right to convert a part of their lending into equity securing representation on Boards and participating more actively in the managerial affairs of the industrial concerns.

It is not as yet fully appreciated that the joint sector enterprises demand a new managerial style. The success of the joint sector experiments will depend

much on evolving a proper structure of top-management for such enterprises and on developing appropriate conventions, specially with regard to the role of the Board of Directors vis-a-vis the Executive. Unfortunately, in the din and noise created by the controversy about the joint sector, this problem has not received adequate attention. A good deal of the confusion which still prevails in many minds about many aspects of the joint sector is directly the result of this. We, therefore, made it a point to examine at some length the top management structure and functions in the large corporation.

If the adoption of the joint sector for most of large scale industry achieves the aim of 'socialising' business without 'nationalising' it, much of the present administrative and discretionary controls over the private organised sector would become unnecessary, excepting those required for purposes of planning and coordination. It is suggested that a comprehensive review of all such controls be commissioned by the Government through an expert team composed of both officials and non-officials.

The evolution of a joint sector may well prove to be a decisive influence on India's future economic system. The joint sector can be used not only for reforming the system of control and management of big private corporations in order to introduce effective social accountability, but also to transform the management of public sector enterprises with a view to achieving greater efficiency.

I am greatly indebted to Shri S. L. N. Simha, Director of the Institute for Financial Management and Research, and to Shri H. T. Parekh, Chairman of the ICICI, for constant guidance, advice and encouragement throughout the study. The study would have been impossible but for the most willing cooperation extended by the Madras Stock Exchange in making available their records. In particular, their Executive Director, Shri E. R. Krishnamurti, gave freely of his time for discussions and advice to considerable personal inconvenience. I am also grateful to all those senior company executives and the heads of several financial institutions who gave me opportunity for a personal exchange of opinion. A large number of company managements have provided valuable data by responding generously to our time-consuming enquiries and questionnaires.

The collection and analysis of statistical data for this study was handled almost single-handed by Miss D. Hemalatha who did a very competent job. Shri K. Natarajan provided good stenographic as well as secretarial support.

It is impossible to put in words the strong moral support provided by my wife who, along with my daughters, agreed to forego the whole of a summer vacation to see early completion of this study.

The responsibility for the facts, interpretations, and views offered in this study is entirely that of the author and not of the employing organisation, nor of any other individuals.

Institute for Financial Management and Research, Madras. L. C. Gupta

March, 12, 1974.

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1

Introduction

The Object and Scope of Study

In this study, the joint sector idea is examined mainly as a measure of reform directed towards solving the problems of power and accountability in the private corporate system. The study has been carried out in the specific Indian context, a unique feature of which is the state ownership of all the important financial institutions, and, through their intermediation, of a sizable part of the equity of private corporations, particularly the bigger ones. The study proceeds on the premise that the prevailing structure of control and management within private corporations is at the root of the problem of economic power at the national level. Hence an examination of this structure is a necessary part of the background against which the joint sector idea will be considered. Thus, the study attempts to cover a fairly wide ground, including investigation into the ownership, control and top-management patterns of private corporate undertakings, as also into the socio-political problems resulting from the concentration of economic power.

A good deal of the data presented in this study is original. This applies particularly to our data on the ownership of corporate equity by the public institutions in the aggregate. The data on the composition of company boards, specially on the extent of institutional representation, are also new. Our attempt to examine the problem of concentration of power in all its aspects on a non-ideological plane and against the broad sweep of socio-political history, breaks at least some new ground and should help to clarify thinking.

The Meaning of 'Joint Sector'

The term 'joint sector' is applied to an undertaking when both its ownership and control (which should be distinguished from day-to-day management) are effectively shared between public sector agencies on the one hand and a private group on the other. It is a total misconception to suppose that the joint sector idea implies a combination of *public* ownership and *private* management. The basic idea underlying the concept is a combination of joint ownership, joint control and professional management.[1]

Hitherto, industrial enterprises in India were ordinarily classified as belonging either to the public or to the private sector,[2] the managerial responsibility

[1] See Chapters 7 and 9 below.

[2] Leaving aside some isolated cases of 'joint' enterprises and the cooperative sector.

and power being located squarely in one of the two only. The joint sector represents a departure from this pattern as it involves a sharing of managerial power between the public and the private sectors at the level of individual undertakings.

Theoretically speaking, the joint sector can be thought of as an alternative to either of the other two sectors. Presently, it is being conceived to replace the big private industry. The joint sector idea was strongly advocated by the Industrial Licensing Policy Inquiry Committee (popularly known as the Dutt Committee) in the following words:

> Where a very large proportion of the cost of a new project is going to be met by public financial institutions either directly or through their support, normally these projects should be set up in the public sector......private interests—and in the case of large projects these are likely to belong to the Large Industrial Sector—would thus not be permitted to build up huge industrial empires and obtain the benefits accruing from them while essentially using in large part public funds and support for such development......
>
> It may be that *for some time to come* Government might decide to permit projects with significant proportions of public financial assistance to remain in the private sector. In that case, however, we would like to emphasize that they should be clearly treated as belonging to the 'joint sector' and not to the private sector. *The 'joint sector' would, in our view, include units in which both public and private investment has taken place and where the State takes an active part in direction and control.*[1] (Emphasis added)

The remarks cited above unmistakably indicate that the Dutt Committee put forth the idea of the joint sector, not as something to be commended in its own right, but as a kind of 'apology' for the public sector, purely as an intermediate stage in our journey towards the destined goal of wholly state-owned enterprise. In the Committee's definite view, the ideal thing was the public sector and not the joint sector. The Committee had never the slightest thought that the joint sector could possibly be superior not only to the private corporate system, but also to direct state-ownership of industry.

Alongside recommending that new large projects should be started in the future as joint sector enterprises only, the Dutt Committee also recommended that the equity holdings of the public financial institutions 'should be effectively used for enlarging the role of the state in the management of private sector industry',[2] and emphasized that 'the idea that financial assistance and even equity-holdings should not be normally used by the state and the public financial institutions for appropriate participation in the private sector concerns so assisted needs to be firmly set aside.'[3]

In order to implement the Dutt Committee's recommendations, the Government of India initially toyed with the idea of demarcating the whole industrial

[1]See the Committee's *Main Report* (New Delhi, 1969), p. 186.
[2]Ibid., p. 187.
[3]Ibid.

field into three sectors—the public, the private and the joint—instead of two, as hitherto. This seems to have been found impracticable, and the final policy announcement made in February 1973 gave up attempting the three-fold demarcation. Instead, the announcement cryptically stated that 'each proposal for establishing a joint sector unit of this nature will have to be judged and decided on its merits in the light of Government's social and economic objectives.'[1]

From the above discussion, it is clear that in the Government of India's thinking, the 'joint sector', as a formal concept, applies to new projects only. An arbitrary formula has also been laid down prescribing the respective percentages of equity capital to be held by each of the parties to a joint sector unit, the formula being: 26 per cent to be held by the Government or its agencies (generally the state industrial development corporations), 25 per cent by the private collaborating group, and 49 per cent by the public. The percentage shares are, however, regarded as flexible.

Parallel to the policy of setting up new projects as joint sector units, and standing somewhat in isolation from it, is the policy of making all public financial institutions participate actively in the control and management of concerns assisted by them. In order to further such participation, a general policy has been adopted under which lending institutions must reserve an option to convert a part of their loans into equity shares.[2]

The two ideas—the 'joint sector' and institutional participation in managerial control—have a common element and a common aim, and should, therefore, be viewed together. The official thinking on the problem has remained somewhat piecemeal and the two ideas have not been properly integrated into a coherent official policy. Further, there is no clear appreciation of the implications of these policies for operational management, nor is there clarity about the aims to be achieved.

In our opinion the joint sector, as an organisational form for the large business enterprises, can be considered as much a substitute for the public sector as for the private corporate system. The arguments in support of such substitution are, of course, not the same in the two cases. While the justification for the joint sector vis-a-vis the private sector is derived basically from the problem of economic power and accountability, the case for the joint sector vis-a-vis the public sector rests mainly on the need to secure profitable operation. In our opinion, the conversion of public sector enterprises into joint sector ones does offer promising possibilities but the case for such conversion and the practical problems will need a detailed examination. The point will be only briefly touched in the present study with a view to keeping its size within manageable limits.

[1]See the press note on the Government of India's industrial policy, *The Hindu*, February 3, 1973.

[2]This is more or less compulsorily required if the amount lent by the public financial institutions, taken together, exceeds Rs. 50 lakh but is left to the discretion of the institutions if the amount lies between Rs. 25–50 lakh.

Sources of Data

Almost the whole of the statistical data presented in this study was collected from primary sources. The most important among these sources were the records available with the Madras Stock Exchange relating to the Distribution Schedule required to be periodically filed by the listed companies. The data on the composition of company boards were collected directly from the companies through a questionnaire. The published annual reports and prospectuses of companies were used as supplementary sources, mainly for purposes of verification. Personal interviews and correspondence with the top officials of financial institutions and corporate enterprises were used to elicit views on the conceptual, practical and operational aspects of the joint sector and on the related problem of concentration of economic power.

The Plan of the Study

The study has been divided into four parts. Part One comprises two chapters respectively dealing with the problems of accountability and economic power, which are closely interlinked. The basic questions covered in the first of these are: how effective is the present system of managerial accountability to shareholders, whether it needs to be replaced by the broader concept of social accountability, and if so, what practical problems are involved. The second problem, viz., economic power, is a complex social issue with an ideological overtone. It will, however, be shown that the problem is not wholly ideological. We shall attempt to examine the problem in all its aspects, including the relation between big business and politics in the specific Indian context.

Part Two is concerned with an examination of the potential control exercisable by public institutions over corporate enterprises by virtue of their equityholdings. The discussion is divided into three chapters. The first of these attempts to show how the institutional attitudes have changed and the factors underyling such change. The deeper impact of this change on the evolution of the corporate system is also analysed. The next two chapters present the results of a detailed survey of equityholding by public institutions in private enterprises. The survey covers two points of time, viz., 1959–60 and 1971–72, and brings out how the ownership of the private corporate sector is tending to get increasingly concentrated in the hands of public institutions. We first examine the equityholding by all the public institutions taken together, and then proceed to study the differences in attitudes and policies among the individual institutions. The survey not only presents the statistical data but also attempts to uncover in some depth the forces underlying the changes so that the future trends can be better understood.

Part Three deals with the organisation of top-management in corporate enterprises. Unfortunately this problem has not received adequate attention in the discussions about the joint sector. In our opinion, the most important operational problem in the joint sector enterprises is going to be their top-

management structure, particularly the relation between the board of directors and the chief executive. Proper conventions will have to be developed in this regard. There is at present wide-spread confusion, in both Government and business circles, about how the control and management should be organised in the joint sector enterprises. We shall, therefore, examine this problem in the light of fundamental principles. The first chapter of Part Three raises basic questions of concept and principle about the functions and structure of company boards and the relation between the board and the executive management. The next chapter presents the results of a factual survey on the composition of company boards in India with particular reference to the extent of institutional representation. The impact of the recent policy decision about institutional participation in management is also analysed by reference to the extent of control reserved by institutions in the new companies being formed.

Part Four is the concluding part and attempts to bring together the more important elements of the picture bearing directly on policy towards the joint sector. It projects the joint sector idea in a historical setting of the evolution of corporate finance and ownership in India, and examines the need for reforming the power structure within companies for solving the problem of economic power at the national level. It explains how the joint sector idea can be a major reform, not only of the private corporate system but also of the administration of public enterprises. Certain suggestions are offered for implementing the joint sector idea, not as a cut and dried formula for sharing ownership in the new enterprises that may come up, but as a general principle having wide applicability, the ultimate aim of which is to make the administration of corporations conform to the accepted values of a democratic society. Three specific proposals that have sometimes been made for implementing the joint sector idea are examined, viz., the adoption of the system of proportional representation on company boards, the creation of a cadre of fulltime ' public ' directors, and, the formation of a ' holding company ' for pooling the votes of all public financial institutions.

Part One

Accountability and Economic Power

2

Corporate Accountability

UNDER THE CORPORATE system of production, the ownership of the means of production gets separated from the control over such means. It is this fact which essentially gives rise to the whole problem of managerial accountability in corporations. Corporate managers are managing property which substantially, if not wholly belongs to others. It follows that they owe a responsibility to those whose interests they are supposed to further.

How effective is the present system of managerial accountability? Is the management's responsibility limited to shareholders or does it extend to interest-groups other than shareholders?[1] How is corporate behaviour influenced by the system and effectiveness of managerial accountability? These are some of the questions with which this chapter will deal. The chapter draws heavily on the existing literature on the subject.

1. THE LEGAL AND THE 'INSTITUTIONAL' CONCEPTS OF A CORPORATION

The concept of accountability itself hinges upon the concept of a corporation. Two concepts can be sharply distinguished here: one, traditional and the other, modern.

According to the traditional concept, which is also the ruling legal concept, a company 'belongs to' its shareholders; all corporate property is held 'in trust' for the shareholders to be used for the ratable benefit of all of them; in short, a company exists for the sole purpose of making profits for its shareholders. Even under this concept, the company is recognised as a distinct legal entity separate from its shareholders, but only in the sense that the existence of the company is not threatened by the mortality of human life and other human frailties, such as incapacity, insanity or insolvency, nor by transfer of interest from one shareholder to another. The accountability concept which immediately follows from this is that the corporate management is accountable to shareholders and to shareholders alone.

The second and more modern concept of a corporation views it as a social

[1]Of particular interest in this connection is an empirical study by Barbara Shenfield, *Company Boards: Their Responsibilities to Shareholders, Employees and the Community* (London, 1971). For a survey of the problem in different countries, see Charles De Hoghton (ed.), *The Company: Law, Structure and Reform in Eleven Countries* (London, 1970). This collection of papers gives a good indication of the debate on reform of company law that has been going on in most industrial countries for more than a decade.

' institution '. This concept has evolved slowly over the past few decades as a result of certain developments which have tended to sharpen the divorce of corporate ownership from corporate management. This is by now widely recognised. Among the developments referred to above are the progressive professionalisation of company management, the diffusion of shareownership, the growth of institutional shareholding, and the increasing size of corporate units. Under these conditions, the old concept, which treated the shareholders and the company as one, is regarded as out-of-date. The modern concept of a corporate enterprise is indicated by the following extract from a recent work:

> The business enterprise may therefore be pictured as a production unit, controlled and coordinated by ' professional ' management, owned by the holders of its equity stock and employing two factors of production: labour and capital ...
>
> The capital stock of the firm is initially obtained in part from the owners and in part from the company's creditors (bond and debenture holders)...
>
> The decision-taking authority lies in the hands of a professional management whose role is to reconcile the opposing interests of the various pressure groups which together form the company.[1]

According to this modern concept, then, the business enterprise is viewed as a complex organisation of ' pressure groups ', including workers and managers, consumers of products and suppliers of materials, shareholders and creditors, as also the general public. In this view, the corporation does *not* belong to the shareholders but represents a ' community of interests ', and ' the shareholder is someone who simply provides capital in a particular form to an enterprise which is a distinct collection of interests in its own right '[2]; he is only a special kind of creditor. From this view emerges a distinctive corporate personality to which Galbraith has given the name of ' The Technostructure '. The technostructure may have goals of its own which may, and often will, conflict with the achievement of the maximum value for the equityholders.[3]

A related development which has been particularly helpful in gaining recognition for the corporation as an entity in its own right, is the growing independence of corporate enterprise from the individual saver for the supply of capital. The bulk of the new capital devoted to corporate expansion is now internally generated, or, as Berle and Means say, ' more accurately, " price-generated " because it is collected from the customers.'[4] The corporation, so to say, ' runs on its own economic steam.'[5] In India, over the last two decades,

[1]Edward Townsend, *Investment and Uncertainty* (Edinburgh, 1969), pp. 12–13.

[2]N. J. Cunningham, ' Capital Investment and the Cost of Capital,' in A. M. Bourn (ed.), *Studies in Accounting for Management Decision* (London, 1969), p. 190.

[3]A still wider view sees a corporation in its triple role of economic unit, social environment, and cultural vehicle. See Preface to Hoghton (ed.), *The Company*, p. 8.

[4]Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (Rev. ed., New York, 1968), p. xv.

[5]Ibid.

about 50–60 per cent of gross corporate investment has been internally financed. Another about 25–30 per cent is supplied by commercial banks, development banks and savings institutions. The individual saver directly provides only 10–20 per cent of the funds for financing corporate expansion.

It is also interesting to note that the modern concept of a corporation has evolved parallel to the evolution of public opinion about private property in general. Today, public opinion is acutely conscious of the fact that the use of private property is affected with public interest.[1] Implicit in the modern institutional concept of a corporation is some kind of social accountability of corporate managements.

2. Accountability to Shareholders in Practice

It is by now an accepted fact that the shareholders in general have no control over company managements, in any case, so far as the widely-held companies are concerned. This is true the world over, and is attributable to the dispersal, apathy and ignorance of the shareholders.[2] This phenomenon led Galbraith to remark sarcastically that 'corporate size, the passage of time and the dispersion of stock ownership do not disenfranchise the stockholder. Rather he can vote but his vote is valueless'[3]; and that 'the annual meeting of the large American corporation is, perhaps, our most elaborate exercise in popular illusion.'[4] Most writers now generally concede that the electoral process in widely-held companies is an empty ritual.

In many western countries, and specially in the United States, the shareholding in the bigger companies generally has become so widely dispersed with passage of time that all substantial ownership interests have disappeared and control vests in a self-perpetuating endocratic group of professional managers who are usually not significant shareholders. Thus, according to one recent study, 85 per cent of the 200 largest non-financial corporations in 1963 were under 'management-control' in the sense that there were no ownership

[1]cf. Adolf A. Berle's following observation:

> It is merely misleading to present the vast operations of corporate concentrate as 'private' —except in the sense that they are not statist, and even that is subject to some qualification as will later appear. *The 20th Century Capitalist Revolution* (New York, 1954), p. 12.

[2]This is sometimes compared to the situation in a system of parliamentary democracy. There is, however, a very important difference: while the electorate in a parliamentary democracy may seem powerless against the party in power for a time, the Indian elections do furnish clear evidence that mass dissatisfaction leads to overthrow of parties in power.

[3]J. K. Galbraith, *The New Industrial State*, (London, 1967), p. 80.

[4]Ibid., p. 84. Witness also the following observation of another writer:

> "The election of the legislature in the corporate political system is practised every year, however, with farcical solemnity. The annual stockholders' meeting is held, the managers are bright and brisk with the agenda, the newspapers get the usual laugh out of the usual crank who wants to protest, the business of the meeting is conducted with slick efficiency, and the winning slate wins as predictably as it does in a rigged election in a gangster-ridden union." See Earl Latham, 'The body politic of the corporation', in Edward S. Mason (ed.), *The Corporation in Modern Society* (Cambridge, Mass, 1959), p. 84.

interests large enough to exercise any control over management.[1]

In India, on the other hand, control of even the large companies, is still generally associated with the holding of a substantial block of shares, usually referred to as the ' controlling block '. This has given rise to the phenomenon of a few family groups dominating the private industrial sector, a phenomenon which has attracted much comment in recent years. The size of controlling blocks in individual companies varies widely, and in most cases the blocks represent a significant minority ownership only, the minority control being made possible as a result of the dispersal of the remaining shareholders who together own the bulk of the equity.[2] The increasing frequency, in recent years, of attempted take-overs of large companies through clandestine cornering of their shares, and the proposed amendments to company law for regulating such take-overs, seem to indicate that the controlling blocks are tending to become smaller in India.[3] A controlling group's percentage share in the total financing of an enterprise will be much smaller than its percentage share in the equity capital because most companies nowadays use massive amounts of debt financing.

Whatever be the method by which a management acquires and maintains its control over a company, it is generally true that the shareholders, even when grossly dissatisfied with the management, are invariably unable to dislodge it. This is as much a fact today as it was in the heyday of the managing agency system in India.[4]

It is only when a proxy fight takes place in a company that the shareholder seems to come into his own. Such occasions are, however, rare, though by no means unknown; in any case, they do not give to shareholders any lasting power of control over managements.

The normal recourse for a dissatifised shareholder is to shift his investment from one company to another rather than ' to engage in lengthy and dubious battles for remedying managerial shortcomings. It is better business for them, they conclude, to shift capital to a profitable company than to conduct a quixotic struggle against the inherently powerful and entrenched position of the management.'[5]

[1]Robert J. Larner, ' Ownership and Control in the 200 Largest Non-financial Corporations, 1929 and 1963,' *The American Economic Review*, September 1966, cited by Berle and Means, op. cit., p. 358. The study takes 10 per cent stock interest as the dividing line between minority control and management control.

[2]For details, See R. K. Hazari, *The Corporate Private Sector: Concentration, Ownership and Control* (New Delhi, 1966).

[3]Companies (Amendment) Bill, 1972, presently before Parliament, contemplates several restrictions on the acquisition and transfer of large blocks of shares by any groups and proposes to empower the Central Government to prevent changes in management in appropriate cases. See, in particular, Clause 10 of the Bill.

[4]Cf. the following observation:

> In the public government, the party system exists as a regular method by which the government can be changed......The two-party system in the corporate commonwealth, however, is not a permanent institution. The corporate state normally is a one-party state, in the hands of the managers. (Latham, op. cit., pp. 225–6).

[5]Eugene V. Rostov, ' To whom and for what is corporate management responsible?' in Mason (ed.), *The Corporation in Modern Society*, p. 54.

There have been suggestions to make shareholders' control over corporate management real and effective. One of these, to which a great deal of lip service has been paid in India, is to organise shareholders' associations which could put pressure on individual managements and make their accountability more effective. In actual practice, such associations have been able to achieve precious little in correcting the erring managements. They have at best served as forums for a public discussion of certain problems and have not always been completely independent of the influence of large shareholders and brokerage houses which have ties with corporate managements. They have never been able to secure representation for the small shareholders on company boards. In fact, the experience in all countries indicates that there is little chance of making a shareholders' democracy work.

However, there is a paradox here. On the one hand, the Government authorities have generally lamented the apathy of the shareholders; on the other, they seem also to frown on any attempt to change the existing management of a company by activating the shareholders through a proxy fight. Honest and fairly conducted take-over bids should not be obstructed as they serve a useful economic purpose.[1] It has even been suggested that a competition between management teams should be stimulated by freely allowing take-over bids. Preventive action need be applied only in the case of ' raiding ' by patently unscrupulous persons. Undue restrictions on take-overs would harm the shareholders' interests. The regulation of take-overs must safeguard the shareholders' long-term interests and should not shield inefficient managements.

From the viewpoint of shareholders' control, a peculiar development of great significance in India has been the trend towards substantial concentration of equity holdings in the hands of public institutions, opening up the possibility of their effectively intervening in the control of companies. How large such institutional holdings have become, and what are the possibilities of institutional control arising from them, will be examined at length in a later chapter.

3. Social Responsibility of Business: Some Practical Issues

The subject of social responsibilities of business has been talked about a great deal for many years and it has become almost customary for company chairmen nowadays to show their obeisance to it in their annual speeches. It is widely accepted that the shareholders' control, even supposing that it would be made effective, is too narrow a concept of accountability for today's society, and that there is no reason why the shareholders' interests should take precedence over all other interests—employees, creditors, customers, suppliers and the general public.[2]

Thus, the constituency with which a corporation has to deal comprises not only its shareholders but also several other sections of society, in particular, labour, consumers, and suppliers; and, as one can see it happening frequently

[1]See *Report of the Jenkin's Committee* (London, 1962) pp. 98–99.

[2]See Barbara Shenfield, op. cit., esp. p. 20.

both in India and other countries, if any of these constituents are dissatisfied with the conduct of the corporation, they would induce the political state to interfere.[1] The disregard of public opinion by business invites direct Government action, for the force of public opinion will translate itself into political action in due course, specially under adult franchise.

The social responsibility of business is now generally accepted as a fact of present-day life even by business opinion. However, it has not been possible so far to give legal effect to this idea, mainly because no legal substitute has yet been discovered for the shareholders as the focus of company's responsibility; and we cannot abandon the present legal rule unless we can offer ' a clear and reasonably enforceable scheme of responsibilities to someone else '.[2] The social dilemma is very well posed in the following words:

> If the trusteeship for absentee investors, in addition to being an ideal having little emotional appeal to managers, is an ideal that is losing ground in the community generally and if the signs are multiplying that our economic order is evolving away from it, the prospect of its effective enforcement as an interim legal rule is not encouraging. Abandon it, as yet, we dare not—enforce it with more than moderate success, it is to be feared we cannot.[3]

Even if we grant that the managers have the ability and willingness to interpret and implement social responsibility, question is bound to arise in such a situation: By what warrant does the management hold and exercise this power? As Professor Berle puts it most appropriately:

> Whenever there is a question of power there is a question of legitimacy. As things stand now, these instrumentalities of tremendous power (i.e., large corporations) have the slenderest claim of legitimacy. This is probably a transitory period. They must find some claim of legitimacy, which also means finding a field of responsibility and a field of accountability. Legitimacy, responsibility and accountability are essential to any power system if it is to endure.[4]

If we accept the view that corporations have soical obligations to fulfil, there is still the question as to who is to decide about the specific goals in this respect. It has been contended that the acceptance of this view automatically implies ' an increasing power for Governments to direct company policies, since the Government is the only properly constituted authority which can pronounce upon what is or is not in the public interest.'[5]

A practical difficulty in implementing such a concept is that it gives us no unambiguous criterion for business decision-making, nor for judging and

[1]See also A. A. Berle, Jr., *The 20th Century Capitalist Revolution*, p. 56.
[2]Berle, cited by Rostov, op. cit., p. 62.
[3]E. Morrock Dodd, Jr., cited by Rostov, ibid., p. 62
[4]A. A. Berle, Jr., *Economic Power and Free Society* (1958), p. 16.
[5]Barbara Shenfield, op. cit., p. 166.

supervising the performance of managements. For this very reason, it is incapable of being made legally enforceable. In fact, there is some ground for the fear that social responsibility in practice may mean the blurring of responsibility to everybody, as has been the case of Government undertakings. If this happens to private enterprises also, business efficiency will be seriously undermined. This shortcoming of the social accountability concept is regarded by some writers to be so serious that they would like to give it up and opt for a more clearly enforceable test of judging the performance of managements, as provided by profits. Some would even say that the true responsibility of a company management to society lies in achieving this goal to the maximum, consistent with its obligations to labour, consumer and the society at large.

It is true that the social accountability concept does not yield a single practicable test of performance comparable to the traditional test provided by the shareholders' return. However, it would be entirely wrong to assume that the acceptance of social accountability concept means the giving up of the earnings test altogether. That a minimum return on investment should be a necessary ingredient of social responsibility is indicated by the modern view of business goals, as will be shown below.

The enforceablity of such a concept does not depend on the availability of an easy formula. It is more a question of devising a system in which managerial power is less absolute and in which built-in checks and balances prevent excesses in any direction. We shall see later how far the ' Joint sector ' idea can resolve the problem.

4. Towards Managerial Capitalism

The absence of effective shareholders' control over company managements has stimulated extensive research by economists and management specialists into the motivation and behaviour of corporate managements in the modern economies. Their findings, which are revealing, have to a great extent revolutionised our thinking about how the large corporations behave and why. A rather disturbing conclusion to which recent research points is that, under the changed conditions of today, the maximisation of the shareholders' return *is not* the primary goal of a company management. That this cannot be the goal in the realities of today, particularly when executive rewards do not directly vary according to profits, is forcefully brought out by Galbraith in the following words:

> The members of the technostructure do not get the profits that they maximize. They must eschew personal profit-making. Accordingly, if the traditional commitment to profit maximization is to be upheld, they must be willing to do for others, specifically the stockholders, what they are forbidden to do for themselves. It is on such grounds that the doctrine of maximization in the mature corporation now rests. It holds that the will to make profits is, like the will to sexual expression, a fundamental urge. But it holds that this

urge operates not in the first person but the third. It is detached from self and manifested on behalf of unknown, anonymous and powerless persons who do not have the slightest notion of whether their profits are, in fact, being maximized ... Such are the foundations of the maximization doctrine when there is full separation of power from reward.[1]

Modern writers on management generally agree with this conclusion. The traditional all-embracing objective of profit-maximisation for the owners has given way to the concept of 'minimum earnings' as one among many corporate goals, which it is the management's function to balance according to its own conception and judgement.[2]

From a long period of criticism of the traditional theory of entrepreneurial profit-maximization has emerged the so-called managerial theory of the firm based on the wide discretion employed by management in choosing business goals and policy because of the divorce of ownership from control. Influential modern writers have even suggested that the replacement of the traditional capitalism by 'managerialism' represents a fundamental change in our economic system.[3] The greater discretion available to managers implies increased power in their hands. The next chapter will deal with the question of corporate power.

[1]Galbraith, op. cit., p. 117.

[2]Drucker suggests the following eight key areas in which the objectives of performance must be set if the firm is to survive and prosper; (1) market standing (2) innovation (3) productivity (4) physical and financial resources (5) profitability (6) manager performance and development (7) worker performance and attitude and (8) public responsibility.

Galbraith emphasizes four goals for a mature corporate enterprise, goals which would be consistent with the self-interest of the technostructure:

(1) minimum earnings considered necessary for preserving its autonomy and decision-making power;

(2) greatest possible rate of corporate growth which means more power and responsibility, promotion and compensation;

(3) technological virtuosity or innovation; and

(4) rising dividend rate.

The problem of objectives is thus posed as one of balancing the objectives in different key areas. It is also stressed that plurality of goals does not mean that all have the same priority. Rather, a hierarchy of goals is quite plausible and this hierarchy need not be the same for all corporations. Other modern writers have also emphasized the fact that enterprises have multiple objectives and regard it as inadequate to speak of profit as *the* motive of business. See Koontz and O'Donnell, *Principles of Management*, p. 114 and Edward Townsend, op. cit., p. 12.

[3]For a bibliography of important works on the subject, see references given in H. K. Radice, 'Control Type, Profitability and Growth in Large Firms: An Empirical Study', *The Economic Journal*, September, 1971, pp. 547–62.

3

The Problem of Economic Power

THE GROWING DETERMINATION of the Government to assume complete charge over the direction of socio-economic change on the one hand, and the growth of big private business, curiously with Government assistance, on the other, have produced in recent times in India a serious tension of power between the Government and the big private business. This is a question of economic power which has become a pressing socio-political issue of our times. It is also an important input in Government decision-making, specially in the formulation of its policy towards big private firms and towards an extension of the public sector.

The problem is undoubtedly very complex, and its discussion will take us into the realm of politics. It also implicitly raises the most fundamental question of social choice about the kind of economic-political system that we want. The problem of regulating private economic power is not unique to India but is found in all economies, particularly those having a vigorous private sector.

1. NEED FOR A DISPASSIONATE DISCUSSION OF POWER IN ECONOMIC DECISION-MAKING

Economists have always approached the task of decision-making, whether at the micro or the macro-level, from the angle of minimum-maximum criteria. Almost all economic models are conceived in terms of ' optimising ', using the technique of marginal analysis. In fact, the assumption of scarce means, capable of alternative uses, is the basic premise underlying economic science, and the job of the economist is conceived to be to suggest how those scarce means can best be applied to the attainment of *given* social ends. It is this which has excluded the consideration of the problem of power. As a result, economic analysis has tended to be somewhat unreal in situations involving power. Economists have never been able to come to grips with situations like bilateral monopoly, oligopoly, collective bargaining, etc., which imply a play of power; they have treated them as indeterminate problems.

The result of disregarding the problem of economic power is that our understanding of many economic problems and events, or of policies and prescriptions, or of the process of choosing economic goals,[1] remains confused, or at best, incomplete. Even wage theory becomes inapplicable under a system of collective bargaining and ' administered ' prices; the explanation of wage determination

[1]A good recent illustration of this is the much-discussed subject of choice between growth rate and reduction of poverty.

and the recommendation of a wage policy become tasks beyond the competence of a pure economist. It cannot be over-emphasised that an understanding of the part played by power in economic relations is necessary to a better understanding of many economic phenomena and economic processes. The formulation of appropriate policies in several spheres, specially those relating to industry, requires an explicit recognition of the problem of power.

A dispassionate discussion of the problem of economic power is hard to find. The issue is surcharged with emotion and there is tendency to take extreme positions and to exaggerate. This is partly because it is difficult to treat it in wholly pragmatic and non-ideological terms. However, it is a serious mistake to think that the issue is one of pure ideology. No one will accuse the American general public of following the leftist ideology. Yet, the American conscience has been the most troubled about concentration of business power. Big business has been the target of most vehement and widespread criticism in the U.S.A. for almost a century. The U.S. anti-trust legislation has been the most hard hitting among private enterprise economies; and it dates as far back as 1890 when the Sherman Act was enacted. Witness the following extract from a widely used elementary text on American history:

> Trusts did much to develop the industrial resources of the U.S.A. But they also did great harm to American life......They struck at all competitors and smashed small firms......; bribed railroads to give them preferential freight rates; used police......to break the strikes; and bribed politicians, congressmen, senators, and government officials to attain their ends. It soon became clear to Americans that the land of the free was in fact in the hands of a small group of wealthy men, and gradually public opinion began to turn against the trusts. Laws were passed against them ......
>
> It was one thing to pass laws; it was quite another to get them to work. The opponents of trusts came up against two strong forces. The first was the old American belief in private enterprise ......The second was the Supreme Court and its interpretation of the Constitution......
>
> In general the government, instead of stopping the growth of trusts, helped them on their way. The most notable of the methods by which they did so was that of tariffs......In this way the great business magnates protected themselves against foreign competition, and used the laws to benefit themselves at the expense of the citizens of the U.S.A.[1]

The point to note is that the Americans have always been greatly concerned at the rise of private business power despite their almost pathological opposition to the leftist ideology, avowedly for the purpose of preserving liberty, democracy and private enterprise. It is a gross misunderstanding of the inexorable social forces at work to think that concentration of economic power is a purely leftist bogey.

There is also a tendency to misconstrue all criticism of private business as a plea in favour of Government take-over of the business, and similarly to equate

[1]C. P. Hill, *A History of the United States* (London, 1969), pp. 142–43.

criticism of the public sector with plea for private business. This has had most unfortunate results: instead of an objective, constructive and in-depth examination of the various problems involved, and of their possible solutions, we seem to be permanently deadlocked over the never-ending controversy of public verses private sector. Except for drawing and redrawing dividing lines between the public and the private business, we have done little to improve the manner in which businesses are run, whether public or private.

The plain truth that private business must face is that either we make the private devices work in conformity with present-day social needs and values, or the state will take over. As Professor Berle once put it: ' The real guarantee of non-statist industrial organization......is a substantially satisfied public.'[1]

In fact, those who wish to see the Indian democracy succeed and the economy develop, have their reservations both about the big private business and about the public sector.

An attempt will be made below to examine the problem of concentration of power as dispassionately as possible.

2. The Meaning of Economic Power

Economic power is hard to define and even harder to measure. No clear and generally accepted definition of economic power can be found. Since the issues involved can be understood and usefully discussed only if we are first clear about the meaning attached to the term, we shall first attempt to define economic power.

Various terms—economic power, business power, social and political power—have often been used to describe the power enjoyed by business firms. Hence we must first look at the general concept of power.

In general terms, the concept of power refers to the capacity of a subject to induce or require others to carry out his bidding or decision.[2] Two elements may be regarded as essential ingredients before a decision-maker can be said to possess power:

(1) Availability of a Range of Choice

Unless the decision-maker has significant choice open to him, he cannot exert significant power on others.[3] The availability of choice provides room for

[1]A. A. Berle, Jr., *The 20th Century Capitalist Revolution* (New York, 1964), p. 59.

[2]See J. Harsanyi, ' The Dimension and Measurement of Social Power ', in K. W. Rothschild (ed.), *Power in Economics* (Penguin, 1971), pp. 77–78 and J. Pen, ' Bilateral Monopoly, Bargaining and the Concept of Economic Power ', in the same source, p. 105. See also Berle, *The 20th Century Capitalist Revolution*, p. 32.

[3]In fact, Kaysen defines economic power in terms of the ' scope of significant choice '. He illustrates this with the following analogy: ' The disproportionate share of the sun in the total mass of our solar system would not justify the ascription to it of "power" over the planets, since in the fully-determinate gravitational system the sun has no choice among alternative paths of motion which would change the configuration of the whole system. Though the relative weight

manoeuvre. Thus, a tax officer who must assess the amount payable by way of tax strictly in a given manner cannot be said to have any power over the assessee, whatever the amount of tax involved.[1] Similarly, a firm operating under conditions of perfect competition enjoys no economic power: 'If the man in charge of the firm has no power to influence prices, costs, wages or interest, and if even his best output is externally determined and his profits are subject to the levelling effect of competition, one can rightly be unconcerned about his power. He has none.'[2]

(2) Sanctions to ensure Compliance

The decision-maker must be able to use sanctions against those from whom he wants compliance with his direction. These sanctions may take the form of a reward for compliance; or the denial of the reward, or imposition of penalty, for non-compliance.

It is also necessary to understand the 'base' or 'origin' of power. Power may originate in diverse ways: through the possession of economic assets, constitutional prerogatives, administrative authority, kinship with other influential people, popularity and prestige, military forces, unionisation, and capacity to blackmail.

The concept of economic power can be defined as 'power which originates in economic relations or as power which is directed towards economic relations.'[3] The first looks to origin, the second, to the consequence of the exercise of power. Such a definition is not helpful because the power originating in a non-economic source can be exercised in the direction of economic results, and the power having an economic origin can be used as social and political power. In this way, economic power seems to merge with social and political power.

In order that the source of power is not confused with the aim of exercising that power, it is preferable to use the concept of economic power for power originating from control over economic resources. It may also be that the possession of economic power, taken in this sense, may be used to secure political power by influencing legislators or political leaders, and this in turn may be used to secure economic concessions from the state.

However, the extent of economic power must be understood, not in terms of its source but in terms of the type of influence and the scope for its exercise, the effectiveness with which the decision-maker can ensure compliance, and

of the sun is great, its range of choice is nil, and it is the product of the two, so to speak, which measures "power".' See Carl Kaysen, 'The Corporation: How much power? What scope?' in Edward S. Mason (ed.), *The Corporation in Modern Society*, (Cambridge, Mass., 1959), pp. 85 and 88. Thus, no body possesses any economic power in a fully deterministic system.

[1]Unless there is a possibility of his misusing authority illegally, or the lack of clarity in law gives the tax officer a measure of discretion.

[2]Galbraith, op. cit., p. 48. See also Carl Kaysen, 'The Corporation: How much Power? What Scope?' in Mason (ed.). op. cit., pp. 88–89 and M. D. Reagan, *The Managed Economy* (Oxford University Press, 1963), exerpt reproduced in K. W. Rothschild (ed.) *Power in Economics* (Penguin, 1971), p. 142.

[3]Pen, op. cit., p. 106.

the number of people who can be influenced (giving more ' marks ' for power over an important individual, say, a minister, than for power over a less important one).[1] The nature or size of the base of power is only a handle for power; it does not necessarily indicate the extent of power that may be commanded. However, a particular base may normally be associated with considerable economic power.

Galbraith has interestingly traced how economic power, once possessed by the landed aristocracy in the feudal system, passed, as a result of industrial revolution, into the hands of the capitalists, and now, as a result of the managerial revolution, into those of technocrat managers.[2]

The typical structure of industry is tending towards oligopolistic situations in which the choice of corporate managements is not restricted narrowly as under perfect competition. Further, with the atrophy of effective control of management by the shareholders in the widely-held companies, and the substitution of multiple goals in place of the single objective of maximising the owner's return, there is no unambiguous criteria for measuring a management's performance. The result of all this is that corporate managements have acquired great freedom of action. Thus, concentration of power in the hands of corporate managements is the result of two different forces: the growth in the size of individual firms and the freedom of managements from shareholders' control. Both these forces have added to the discretion available to managers in taking business decisions.

The concentration of economic power in all modern economies arises, not so much from the ownership of wealth, as from the concentration of decision-making power in a managerial group, a necessity of modern industrial organization.

Through the instrumentality of the publicly-financed corporate form of organization, the ownership of wealth has been separated from the control of wealth. The ownership is passive, content to receive an income leaving actual control and management of the physical assets to the managers.

To sum up, it is the growing dominance of the corporate form, the increasing decision-making power of corporate management, and the increasingly passive position of shareholders, which have together contributed to an increasing concentration of economic power.

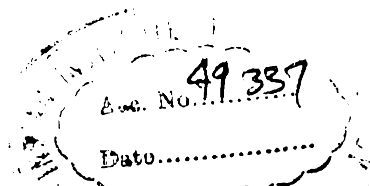
3. Big Private Business and Politics

In India, undoubtedly managerial discretion in important areas, such as size, location, product-mix, price, process, foreign colloboration, etc., etc., is severely restricted by direct Government controls which have been found to be generally inefficient and can be regarded as the principal cause of corruption, both political and individual.

The problem of political corruption is much more intricate than it appears at

[1]See Harsanyi, op. cit., p. 79.

[2]J. K. Galbraith, *The New Industrial State* (London, 1967), Chapter 5.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first sight. The complexity of the problem arises from the fact that, in a democratic system, the political parties attempt to collect huge election funds and an important, albeit disguised, source of such funds is the big business. The corrupting influence of big business on democratic institutions has long been a subject of anxiety in the United States.[1]

In India, before Independence, the problem was not recognised mainly because all political power rested with a foreign Government. However, with the introduction of adult franchise after Independence, every election has made the country more acutely conscious of the money power in politics.

In the initial period of Indian democracy, the charisma of the Indian National Congress was all that mattered and money power was not quite conspicuous. Prominent businessmen sought to join the Congress and influence it from within rather than oppose it from without by their money power. With lapse of time, and perhaps earlier than expected, the charisma wore out and election campaigns became increasingly expensive. In the resulting situation, money power acquired increasing importance. One frequently hears these days of allegations regarding surreptitious business contributions to election funds of political parties.

How to regulate business donations to political parties has raised much debate for some years in India without much success in devising effective controls, both because of the existence of large hoards of black money (again the result of controls and licensing) and the availability of many underhand devices for providing election funds.[2] Professor Dandekar, an astute observer of our social scene, describes the dilemma very aptly as follows:

> It has been rightly said that at the bottom of the present liaison between the big business and the ruling party lies the regulatory and licensing procedures by means of which the government tries to control big business. This offers the meeting ground between the two and the result is that the big money wins and it ends up in big business controlling the government. Hence to break this power of big business over the government, it is suggested that it would be advisable for the government to dismantle the regulatory and licensing machinery and to confine its activities to maintenance of law and order and provision of public utilities, social services and infrastructure. Business and industry should be left to the operations of business and industry. If this is done, big business will concentrate attention on making profits on the market and will have little to do with the government. This may of course break the power of the big business over the government but it will obviously end up in big business establishing its unlimited control over the whole economy.[3]

[1]A good account of the problem can be found in D. Lynch, *The Concentration of Economic Power* (Columbia University Press, 1946), Chapter 10. Reproduced in Rothschild (ed.), op. cit., pp. 158–66.

[2]An amendment of the Companies Act in 1969 prohibited completely the making of any contribution by companies to any political parties or for any political purpose. For reasons mentioned in the text above, the effectiveness of the prohibition is in doubt. See Section 293-A of the Companies Act, 1956.

[3]V. M. Dandekar, 'Next steps on the socialist path,' *Economic and Political Weekly*, Vol. VII, Nos. 31–33 (Special Number 1972), pp. 1557–58.

A related problem is that of newspaper ownership which also represents a vehicle for political power because of the influence of mass media on mass opinion. The press in India, as in most other private enterprise economies, is in private ownership and control. The concentration of ownership of the press has also been a touchy issue in recent years, and the Government has been attempting to devise measures to de-link newspapers from the big business houses. An indirect but important influence of big business firms on newspapers may arise from the substantial dependence of the latter on advertisement revenue received from the former. In recent years, however, public sector agencies have also become a substantial source of advertisement revenue.

The political problem arising from concentration of economic power is a relatively new experience for the young Indian democracy, but it has existed for quite long in the U.S.A. The American experience indicates that it is likely to remain an intractable problem in any democracy. It can be no better summed up than in the words of Berle and Means as follows:

> When these subjects are thought through there will still remain the problem of the relation which the corporation will ultimately bear to the state—whether it will dominate the state or be regulated by the state or whether the the two will coexist with relatively little connection. In other words, as between a political organization of society and an economic organization of society which will be the dominant form? This is a question which must remain unanswered for a long time to come.[1]

4. Economic Impact of Concentrated Managerial Power

(a) General

Individual firms or business groups can be said to possess significant economic power if they are large enough to have appreciable effects on the economy. Their business decisions with respect to prices, output, product character, investment, research, location, employment, markets, etc., then acquire broader significance for the society from many angles, specially growth, stability, distribution and social justice. The significance of its decisions is likely to be greater if the firm produces basic materials, such as oil, electricity, steel, aluminium, copper, chemicals, etc., etc.

There are many areas where the business decisions of the large firms directly affect the Government's economic responsibilities, more so under planning. It has been rightly said that corporate managers, through their business decisions, are in fact administering the nation's resources and their private decisions have sometimes considerable consequences for the public sector too by requiring complementary public facilities.

Big firms in a position to ' administer ' prices can contribute to inflationary pressures. Their locational decisions may affect the character of urban and

[1]Preface to the 1932 edition of *The Modern Corporation and Private Property*.

suburban growth and regional balance. Since a firm's decision is based on the criteria of the firm's welfare, however, conceived, and does not automatically take all the social costs and benefits into account, its choices with respect to products, processes and many other things, may be inefficient from the viewpoint of the economy.[1]

(b) Monopolies and Oligopolies

Traditionally, the type of economic power with which economists have generally concerned themselves is monopoly power in specific commodity markets. A situation of monopoly is universally recognised as meriting state intervention both to control excessive profits and to prevent sub-optimal resources allocation resulting from the monopolist's restriction of supply.

Clear-cut cases of monopoly are those in public utilities where the trend is towards direct public ownership. In the rest of the industrial field generally, the more characteristic situation in modern times is that of oligopoly. Such a market situation is not regarded as deterministic and its consequences on public welfare are by no means clear. The usual aim of public authorities with respect to oligopolies is to maintain competition by preventing any kind of collusion, overt or covert, among such firms.

Competition between two or three dominant units in an industry is not the same thing as competition among hundreds of producers. The results of competition in the two types of situation are quite different for the economy. Competition among a large number of small producers is invariably a price competition; by eliminating abnormal profits and by adjusting supply to demand through the elimination of the least efficient firms, it is likely to produce an optimal result for the economy. On the other hand, competition between a few dominant producers is almost always a nonprice competition; and it leads generally to a political rather than to an economic resolution of events[2] by adjusting supply to demand through some sort of planning for the whole industry and formal or informal understanding between the firms regarding the market share of each.[3]

In India, the industrial licensing system had generally the effect of further restricting competition by restricting the entry of new competitors. The system ruled out the elimination of, or pressure on, the existing inefficient firms by new efficient ones. Further, by not allowing freedom to expand the business, the system also ruled out competitive pressures from the more efficient existing units. Thus, with foreign competition completely shut off by import restrictions and

[1]The reasons are: firstly, the legal and customary obligations of management are to the owners and not to the public; and secondly, the individual firms lack the knowledge of the whole economic system's needs that would be requisite to meshing their own decisions with those needs. See Reagan, op. cit., p. 141.

[2]Berle, *The 20th Century Capitalist Revolution*, p. 48.

[3]Berle interestingly remarks: ' In a school (sic) of herring each herring may compete with the other for the available food supply. But herring do not compete with whales. And competition of whales between themselves is more like war than economics.' *The 20th Century Capitalist Revolution*, p. 51.

with domestic competition severely restricted by the industrial licensing system, Indian industry has worked in an environment of near-monopoly. Even the creation of the Monopolies Commission does not so far seem to have brought about any significant change in the situation.

(c) CONGLOMERATES

The economic effects of conglomerates, which have shown rapid growth in many industrial countries during recent times, have not received the same attention as conventional monopolies in economic literature. A conglomerate, which may be organised as a single company with a number of divisions or as a group of inter-connected companies, characteristically operates in many markets and may, or may not, have monopoly power in one or more of these specific product markets. Whereas the need for Government intervention, even on purely economic grounds, is generally conceded in the case of conventional monopolies—that is, ' product-wise ' concentration, as it is sometimes called—the economic case for restricting the growth of conglomerates—that is, country-wide concentration, as the Monopolies Commission termed it—is not so clear.

From the purely economic standpoint, there are three important consequences which may follow even where conglomerates operate in a competitive situation in their product markets. First, the range of choice available to their managements with respect to any particular market is not quite as restricted as in the case of pure competition: ' Their large absolute size, and the pool of capital at their command, adds something to their power in any particular market which is not explained simply by the structure of that market. In the extreme, the operations of the firm in a particular market can be completely or almost completely insensitive to its economic fortunes in that market, and thus the range of choice of decisions with respect to it may be widened far beyond that possible to any firm confined within its boundaries.[1] This vitiates the competitive situation since the single-product firms would have to face unequal competition from the giant conglomerate. If this happens, it would distort the pattern of production away from the optimal.

A second potential source of economic distortion in the case of a multi-product firm arises from the methods of allocating the overhead costs among the firm's different divisions or products and of pricing the products. Anybody who is familiar with business practice in this regard would at once recognise the arbitrary nature of these decisions leaving much discretionary power in managerial hands. The decisions may not frequently conform to the economic concept of the optimal method. In fact, because of the potential danger of introducing economic distortion as a result of the above, it is doubtful whether conglomerates represent an efficient method of organising economic activity.

Thirdly, on account of the weight that the conglomerate has in the economy by reason of its size, many of its decisions, such as those relating to investment, location, employment, profit retention, research and development, etc., etc.,

[1]Kaysen, ibid., p. 91.

would have substantial impact on the growth, stability and progress of the economy.

There are thus good economic arguments why the growth of conglomerates should be permitted with discriminating care.

(d) The Revised Sequence

Another aspect of the influence of the large firms relates to the impact of business advertising on consumer preferences. The effect of this in moulding the consumer preferences in an era of ' invented commodities '[1] is so important that Galbraith calls it ' the revised sequence ', meaning that instead of the consumers' wants being the starting point for production decisions, the decision process is reversed and the consumer is conditioned by a massive advertising and sales effort to purchase what the firm has planned to produce. It is admitted that there are limits to this malleability of the consumers' tastes but the limits are broad.[2]

(e) Effect on Distribution of Incomes

What one may regard as fair and just is often based on the acceptance of the existing framework of property relationships. Since the institution of property in any of its forms is a human creation the concept of social justice in its fundamental sense takes one into the realm of philosophy. It is ultimately a value problem and evolves with the evolution of social consensus.[3]

A basic implication of social justice, as a workable objective, is that there should be no exploitation of one section of the society by another. Public policy recognises that certain social or economic institutions, like zamindari and monopolies, represent organised instruments of exploitation and should either be controlled or abolished. Similarly, the society has for long recognised the need for protecting the weak against the tyranny of the strong, examples being the regulation of working hours and conditions, the legal support to collective bargaining and trade unionism, the minimum wage legislation, the tenancy reforms, and the miniumm prices payable by sugar mills to sugarcane farmers.

A comparable situation is the relation of a large company to a host of satellite enterprises which become its dependants either as suppliers or as customers. Handloom weavers, fabricators of aluminium or steel and stockists are good examples of such dependent customers whose destinies are in the hands of the

[1]This term is borrowed from Reagan and refers to such things as TV sets, washing machines, tape recorders, airconditioners, as distinguished from ' natural ' commodities such as food, basic clothing and basic shelter. See Reagan, op. cit., p. 146.

[2]Reagan, op. cit., p. 147.

Galbraith has contended that advertising also influences the balance between individual and community goods, such as education, sanitation and other public services.

[3]The controversy surrounding Parliamentary right to abridge fundamental rights, ending finally in the recent Supreme Court decision validating the 24th Amendment to Constitution, which in effect reverses its earlier decision given in the Golaknath case in 1967 and which grants to Parliament the right in question, illustrates this point.

large firm, specially in periods of shortage. Component manufacturers, sub-contractors and packers are typical examples of dependent suppliers. The large company has, in a sense, what amounts to a life-and-death power over them.

The prices paid to suppliers and those charged to customers would affect the income distribution in society. More generally, the price-cost margin on some products may be ' excessive ' indicating ' economic inefficiency ' in the sense of producing too little in relation to consumers' demands.[1]

The income distribution in society is influenced by corporate decisions with regard to the rewards of management. These may sometimes be considered, in the general opinion, to be excessive in relation to social standards, as was the case about managing agents in India. A company might have borrowed its standards from a foreign society and these may be wholly inappropriate to local conditions.[2]

IV. Concluding Remarks

Modern technology requires large concentrations of capital and the trend is towards still larger concentrations. The accumulations of this capital and its proper management is a matter of crucial importance for the progress of society. In the communist countries, this process is carried out through the medium of the state which owns all the plants and is responsible for their management. In a mixed economic system, as in India and most other countries, the process is achieved partly, and increasingly, through the state and to a significant extent, through private corporate enterprise. The ultimate choice between the alternative forms of economic organisation will depend on the evolution of a social consensus. The social issue is essentially concerned with the question: who should have the power to make what decisions?

The political and economic conditions vary a great deal from country to country; so does the relation between the Government and the business. The political opinion in most countries has tended to become less tolerant of concentration of economic power in private hands. This is entirely a matter of political judgement depending on the socio-political conditions of each country.

Enlightened public opinion in India generally concedes that neither the imposition of direct Government controls on private firms, nor the nationalization of such firms, provides a satisfactory solution to the problem of economic power as each of these leads to scandalous corruption and inefficiency. On the efficacy of government control, witness the following observation of Dr. H. K. Paranjape, a member of the Monopolies Commission, in a recent article:

[1]See Kaysen, op. cit., p. 94.

[2]In recent years, the Government of India has directly attempted to control the executive rewards in private firms. Another method of dealing with this problem is through personal taxation. This can be effective only to a limited extent because of increases in executive salaries effected to compensate for higher taxation.

> ' Because of the acute discontent that is caused by the growth of monopoly houses, and to prevent these Houses from exploiting their position to the disadvantage of everybody else, we introduced a number of controls and regulations such as industrial licensing and foreign exchange and trade controls. But with the growth in concentration of economic power in Big Business hands, their capability for manipulating State policies and administration to their advantage also increased. The result has been that the regulations do not always serve the purpose for which they were set up. They lead on the one hand, to a great deal of corruption and on the other to enormous delays which clog the functioning of the whole system.[1]

Lately, Government policy has become more articulate on the question of reducing concentration of economic power and its emphasis is on at least partial embargo on the expansion of ' large ' houses. Given the world-wide technological trend towards larger size of business units, and given the fact that even the ' large ' Indian firms are pigmies by international standards, the soundness of the present official policy of restricting business size in absolute terms is in serious doubt.

A more satisfactory line of approach will be to reform the top management structures of the big companies with a view to providing a built-in system of control over concentrated economic power. The question as to how the top management in large companies should be reorganised in the changed conditions of today has not received adequate attention so far. We shall examine this problem in detail in a later chapter. It may suffice here to state that so long as accountability and economic power go together, there would be little reason for complaint. The basic problem of economic power is, therefore, one of harnessing it with an effective and acceptable system of accountability.

[1]See his article ' Socialism or State Capitalism' in *Economic and Political Weekly*, Annual Number 1973, p. 322.

Part Two

Corporate Ownership and Control

4

The Public Financial Institutions' Attitude towards Control

ALL THE IMPORTANT financial institutions in India now form part of the public sector. The availability of external finance to private business in both short-term and long-term forms has thus come under the close control of Government authorities. At the same time, the new interventionist philosophy, which the institutions are being required to adopt under Government direction, has brought to the fore the question of the relation between the private business groups and the State. The new situation, which is slowly emerging, is yet to be fully analysed and understood.

While public institutions' equityholding is a measurable phenomenon, the quantification of controlling power, flowing from any given share in equity, presents serious difficulty; for there is no necessary and direct connection between the proportion of equity owned and the extent of control exercisable by the owner, except that absolute majority ownership (51 per cent technically) carries with it absolute power of control. We shall attempt to survey in a subsequent chapter, the extent of equity ownership by public financial institutions in India. This chapter is concerned with explaining beforehand what kind of inferences can be drawn about the effect of institutional equity ownership on the power structure within companies.

Although the Government has repeatedly asserted its decision to use public institutions' equityholding in companies for securing a share in control and management, there remains lack of clarity, in official as well as non-official thinking, about many of the pertinent issues involved. Some of the relevant questions are: In what manner, to what extent, and under what circumstances, can public institutions' equityholdings be used in practice for controlling corporate managerial power? What purpose is such control intended to serve—is it to put pressure on managements to increase efficiency, or to safeguard the shareholders' interests in general against managerial abuses, or to further the broader aims of socio-economic policy? Who should exercise the control—in particular, should such control vest directly with the Government, or should it be left to be exercised according to the business judgement of the public institutions either individually or through some kind of a ' voting pool ' among the institutions?[1] What are the risks involved in each of these alternatives,

[1]Mr. Y. B. Chavan, the Finance Minister, recently informed the Lok Sabha that the Central Government is considering a proposal to set up a ' holding company ' for the public financial institutions with a view to facilitating the participation of the Government in the management of companies. See *The Hindu*, April 29, 1973.

specially the dangers of political corruption and misuse of official authority? What kind of safeguards should be adopted to exclude such possibilities?

The above questions are of great importance for the future of Indian society and the answers to them will determine the kind of economic system that we shall evolve for the future. While some attempt will be made to probe these questions in this chapter, we may frankly admit that our discussion is aimed, not so much at providing the answers, as at clarifying the issues involved.

1. The Changing Institutional Attitudes Towards Corporate Intervention

Growing institutional holdings of corporate securities has been a world-wide trend, specially since the 1950s. A number of writers have commented on this development and attempts have been made to assess the impact of this trend on the structure and functioning of the stock market and on the supply of capital to corporate industry. By contrast, very little has been said about the manner in which the accumulation of institutional shareholdings is likely to affect the power structure within the private corporations. For one thing, the structure of institutional investors in the U.S.A., U.K., and other developed economies generally is still decentralised, and shows great diversity, so that, even though all the institutions taken together may represent sizable corporate ownership, each individual institution holds, generally speaking, only a minute fraction of any company's equity and has no direct influence on control. In fact, the divorce between ownership and control remains a marked feature of the corporate enterprise in all the developed economies, despite the growth of institutional shareholding. The institutional shareholders in those countries also generally remain steadfast to the tradition of avoiding involvement in control.

This does not, of course, mean that the institutional investors in the western countries never intervene in corporate management. There have been instances where involvement of the institutions in management became inevitable in order to safeguard their investment. Thus, in the U.K., the Prudential Assurance Company and other big investors in Vickers persuaded their engineering giant's top management to seek a new chief executive because the institutions felt that the company's sub-average return on capital, although showing an increase, was not improving fast enough.[1]

The situation in India in this respect is radically different now as a result of the developments over the last decade and the transformation is still going on. The most spectacular development in India is the growing concentration of shareholding in a few large and monolithic institutions which are all under public ownership. Both the aspects of the change—concentrated shareholding and public ownership—are of great importance from the viewpoint of the emerging economic organisation in India. The social and economic consequences of the change have yet to be fully understood.

[1]See *The Statesman*, April 27, 1970.

The list of financial institutions falling within the ambit of the public sector has expanded impressively since the beginning of the nineteen-sixties both by the creation of powerful new institutions and by nationalisation of the important older ones. Among the new institutions set up during the 1960s are the Unit Trust of India (1964), the Industrial Development Bank of India (1964), and the chain of State Industrial Development Corporations. Fourteen major commercial banks (other than the foreign banks) were nationalised in 1969 (the largest Indian commercial bank, viz., the Imperial Bank of India, had been nationalised and changed into the State Bank of India in 1955). All the general insurance companies were nationalised in 1972[1] (the Life Insurance business had been taken over earlier in 1956).

We may say that the development, which created the Life Insurance Corporation of India, is now approaching a stage of consummation. Commenting on the emergence of LIC, it was noted in an earlier study that:

> The LIC as also company managements, had to reconcile themselves to the holding of substantial proportions of equity by the LIC. Some company managements even seem to take pride in pointing to the shareholdings of the LIC in their companies, such shareholdings being regarded by the public as a measure of management's reputation and quality, a kind of 'status symbol'. It is, however, doubtful whether managements really relish any large equity holding by the LIC. In the initial period of the LIC there were widespread misgivings that the LIC might use its adventitious position to interefere with the management of companies. *There is no evidence so far to show that the LIC has attempted to exercise control.*
>
> The acquisition of substantial equityholdings by the LIC in private enterprises is a peculiar development in the co-existence of private and public enterprise in India and gives a new dimension to public control of private enterprise.[2] (emphasis added)

Until recently, in spite of the very considerable accumulation of equity holdings in the hands of the LIC, UTI and other public financial institutions, all of them stuck to the time-honoured tradition of not intervening in corporate control and management. The entrepreneurs were, presumably, quite willing and happy to have these institutions as sleeping partners in their business. Thus, for a long time after the establishment of the LIC and the UTI, everything went on as before so far as corporate managerial power was concerned.

A radical change is now taking place in the attitude of the public financial institutions towards sharing corporate control. Two factors have been decisive in bringing about this change:

[1]Although general insurance business after nationalisation will utlimately be conducted through four separate companies, the shares of all the nationalised general insurance companies will be held in the hands of a single institution viz., the General Insurance Corporation of India set up after nationalisation as an apex body. See *The Hindu*, January 2, 1973.

[2]L. C. Gupta, *The Changing Structure of Industrial Finance in India* (London, 1969), p. 56.

(1) Firstly, the Government has decided, as a matter of policy, that the public financial institutions will not remain mere spectators and will actively participate in the management of enterprises to the extent possible. Certain measures have been taken to further this development by requiring compulsorily the inclusion of a clause in the loan contracts giving an option to the lending institutions to convert a portion of their long-term loans into equity, and by encouraging a new pattern of corporate enterprise by setting up of 'joint sector' enterprises in which the public-sector partner is expected to be both a financial partner and an active participant in control and management.

(2) A change in the attitude of public financial institutions towards intervention in control was bound to come for yet another reason which does not seem to have received much attention. The traditional attitude of aloofness on the part of shareholding institutions was based on the possibility of shifting shareholdings by market sales and purchases. Such shifting is no longer easy, often impossible, because of the considerably large blocks of shares which institutions have come to hold in many individual companies. The unloading of such blocks on the market raises many practical difficulties. If the option to sell away holdings is not available to the large shareholding institutions, they will have to exercise, willy-nilly, more effective control over managements through their voting power in order to safeguard their investments.[1] A closely related fact is the deep involvement of the public financial institutions in the fortunes of many companies through their lending operations. A perusal of the reports of special institutions in India shows how large is the proportion (ranging frequently between one-third and one-half) that direct medium and long-term loans bear to the total financial requirements of individual borrowing enterprises. In the new situation produced by these changes, the old attitudes had, in any case, become illogical. The initiative for change came from the Government and this has hastened the change.

2. Institutional Shareholders' Potential Controlling Power

The relationship between ownership and control in the case of corporations is not a proportionate one. Even a minority ownership, of whatever magnitude, can, in practice, represent any amount of control—from absolute control at one extreme to no control on the other, depending upon a variety of circumstances. It is known, for instance, that in many widely-held companies in India and elsewhere, the controlling interests are able to exercise absolute controlling power on the basis of a relatively small shareholding. A large number of companies in the United States were classified by Berle and Means as ' manage-

[1]This takes away the liquidity of such investments and reminds one of Keynes' following remark: ' The spectacle of modern investment markets has sometimes moved me towards the conclusion that to make the purchase of an investment permanent and indissoluble, like marriage, except by reason of death or other grave cause, might be useful remedy for our contemporary evils. For this would force the investor to direct his mind to the long term prospects and to those only.' *The General Theory of Employment, Interest and Money* (London, 1936), p. 160.

ment-controlled ' because the entire shareholding was so widely distributed that controlling power got completely dissociated from ownership.[1]

The potential control of shareholding public institutions rests on a number of factors. Two different situations can be clearly distinguished:

(1) *Public institutions' combined equityholding may be large enough to give them absolute control over management*: Where the public institutions' equityholding in a company is so large that the management's tenure in office becomes dependent on the institutions' direct or indirect support (directly by voting in its favour, or indirectly by remaining neutral), controlling power gets effectively separated from the management function. There have been several actual instances in India recently in which the important institutional holders, notably the LIC and the UTI have, by virtue of their voting power, been able to exercise considerable pressure on managements, and even initiated changes in the composition of the board of directors and appointment of the chief executive. The remuneration of the top executives and sole selling agencies now generally receive the critical attention of the institutional shareholders.

How large should the institutions' equityholding be in order to ensure their effective control over a management cannot be stated as some fixed percentage; much would depend on the distribution of equityholding among the other holders, the management's ability or inability to command the other shareholders' general confidence, and other circumstances, such as whether there exist more than one group struggling to secure managerial power. Depending on all these factors, even a relatively small equityholding of, say, 10 per cent, may sometimes give the institutions effective control over the management, while, at other times, a relatively large holding of even 25–30 per cent by the institutions may be insufficient for effective action against an entrenched management.

(2) *The public institutions' combined equityholding in a company may be insufficient to give them absolute controlling power over the management*: This would be the case in the majority of companies even today. A close look into the nature of controlling power indicates that there are degrees of controlling power, even though no ' barometer ' can be devised for its measurement. Answers about the existence of controlling power in the hands of any specific group cannot be put into clear-cut ' yes-no ' categories.

The noteworthy fact is that, with the adoption of a more interventionist attitude by public financial institutions with regard to corporate management, even a small institutional holding can be used to influence and control corporate managements because of the following reasons:

(*a*) Public institutions can campaign against an erring management, or even organise a proxy war. Such campaigns are an expensive affair and can be adopted only in cases of gross managerial abuses and by bodies with large resources. Even though institutional equityholding may be a small percentage of the company's total equity, the absolute amount may be large enough to make the expense of a campaign worthwhile.

[1]Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (Rev. ed., New York, 1967), specially pp. 78–79.

(*b*) Most company managements would need to approach one or more of the public institutions for underwriting, loans, etc., whenever they undertake expansion schemes. Wise managements, therefore, attempt to maintain the general goodwill of the financial institutions.

(*c*) In many cases, some of the public financial institutions may also have advanced medium-term loans to companies or subscribed to debentures. By virtue of the normal contractual arrangements, the institutions are not only entitled to appoint their nominees on the boards of directors but the companies are also required to obtain the institutions' prior approval for certain important categories of managerial decisions. These powers of institutions arising from contractual provisions reinforce the power arising from shareholding which may have been acquired through market purchases.

The actions of the public financial institutions against particular managements are for obvious reasons usually shrouded in mystery and in many cases it may amount to no more than ' moral suasion '. However, a few important cases have come to public light.

A concrete recent instance of public institutions' active intervention in managerial affairs is the Life Insurance Corporation's newspaper campaign, through paid advertisement,[1] advising the shareholders of the Punjab National Bank Limited not to accept the cash option offered by the company management out of the compensation moneys received on account of bank nationalisation. The LIC's complaint is that the cash option is unfairly low and that the company's management has gone for a number of investments which may not be in the best interests of the shareholders. The LIC's own holding in this case consists of 1,24,000 equity shares of Rs. 10 each, being about 6 per cent of the Company's total equity capital of Rs. 2 crores.[2] The LIC's action succeeded in forcing the management to revise its offer.

Active campaigning by the LIC against erring company managements is indicative of the new institutional attitudes. This is in contrast to the earlier attitude of totally *passive* shareholding and of remaining generally neutral by abstaining from voting.[3] It is interesting to recall in this connection the proxy fight that occurred in early 1969 in Synthetics and Chemicals Limited between Firestone (the foreign collaborators) on the one hand, and the Kilachand Devchand group (the Indian promoters) on the other, on the issue of sole selling agency. Both the groups engaged in a wild and expensive newspaper campaign to collect shareholders' proxies.[4] The curious thing is that although the LIC, at the time of voting, voted against the Kilachand Devchand group, it did not attempt to mobilise shareholders' opinion, and did not even make its views public before the voting had taken place. The exercise of the voting right by the

[1]See *The Hindu*, April 7, 1973, p. 4. The advertisement also states that the UTI concurs with the LIC's view on this matter.

[2]*The Hindu*, April 12, 1973, p. 7.

[3]Such neutrality indirectly amounts to support for the present management.

[4]Full-page paid advertisements were inserted by the two warring groups in several newspapers. See, for instance, *The Statesman*, April 14, and April 19, 1969. Abridged advertisements were repeated.

LIC in this case was, by itself, a clear departure from its past practice[1] and seemed to have been decided upon at the last moment.[2]

3. Concluding Observations

The corporate power structure in India is evolving in the direction of an interesting new pattern which is different from that prevailing in the U.S.A. and other capitalist countries. In cases where the public institutions are in a strong position as dominant equity shareholders, the managements can no more be regarded as ' self-perpetuating ', or independent of control by the investor-interest. Rather, they become kinds of tenants-at-will, depending for the continuance of their tenure on their performance as judged by the important institutional equityowners.

The interventionist attitude recently adopted by public financial institutions at the direction of the Government is tending to cause a separation of corporate control from corporate management. *Not only is ownership divorced from control, but control is also divorced from management,* resulting in the creation of the following three distinct groups out of the traditionally recognised two:—

(i) equityowners without significant control;
(ii) institutional equityholders able and willing to exercise effective control; and
(iii) management, usually having a substantial share in equityownership but not enough for giving it absolute controlling power.

We had seen in an earlier chapter, how as a result of the atrophy of shareholders' control over corporate management, the objective of profit-maximisation for owners had been replaced by goals which were more management-oriented than owner-oriented. The new trend is likely to re-assert to some extent the shareholders' interests in the enterprise. This does not, however, signify a wholesale return to an owner-oriented approach. The public institutions are generally expected to keep the broader social interests in view, at the same time operate on business principles. In view of this, the shift of a part of

[1]Synthetics and Chemicals Limited had an equity capital of Rs. 5·75 crores of which Rs. 9,00,000 was held by the LIC and Rs. 4,00,000 by LIC's subsidiaries. See *Economic Times,* April 29, 1969.

[2]This case of proxy fight brings out clearly how expensive are such fights and how uncertain is their result. Firestone, as the technical collaborators of the company, held 25 per cent of the company's equity and the Kilachand Devchand group held 30 per cent. The number of proxies were reported to be 11732 in favour of Firestone and 7789 in favour of Kilachand Devchand group. The results of the poll were declared, long after the poll was held, in favour of Kilachand Devchand group. Firestone alleged irregularities in voting and initiated court action challenging the validity and legality of the appointment of Kilachand Devchand Company as the sole selling agents. The Company Law Board intervened and passed an order on July 6, 1970 abrogating the sole selling agency with effect from October 1, 1968. On September 15, 1970, the Bombay High Court issued a permanent injunction against Kilachand Devchand Company restraining them from acting as selling agents of Synthetics and Chemicals Limited. Thus Firestone ultimately won, but after great expense and litigation. See *The Statesman,* September 17, 1970.

the corporate controlling power from the hands of company management to those of public institutions is unlikely to reverse the trend towards a 'community-of-interests' approach to the setting of corporate goals, already in evidence. The shift in the centre of power in this manner would provide some control over managerial action and performance, thus restoring managerial accountability which had been more or less completely lost earlier.

The adoption of a proportional representation system in place of the present system of voting for directors has been recommended in a later chapter to increase the effectiveness of financial institutions as ' watch-dogs ' on behalf of the shareholders in particular and the society in general.

To the extent that these developments put pressure on company managements to show better performance and greater regard for shareholders' interests, they definitely represent a desirable trend. At the same time, the institutional arrangements should be so devised that they minimise the possibility of political corruption and abuse of authority by officials.

Relevant to the problem of control of industry by public institutions are questions of reform in the top organizational structure of corporate enterprises and the representation of institutional shareholders on company boards on the basis of a proportional representation system. These questions will be examined in later chapters. In the next chapter we turn to a factual analysis of public institutions' equityholdings in individual companies.

5

Public Institutions' Equityholding in Quoted Companies: An Over-all Analysis

THE MAIN OBJECT of this chapter is to show how public institutions' equityholding in quoted companies has grown over the period 1959–72. Our analysis in this chapter will be oriented towards an examination of potential control flowing from equity ownership by public institutions.

That public financial institutions have come to hold large chunks of equity in many individual companies is common knowledge but no precise data are presently available to give an overall picture of how the ownership-pattern of the widely-held companies in general has changed as a result of the growing proportion of shareholding in the hands of public institutions.

1. SCOPE OF ENQUIRY AND SAMPLE

It is only with respect to the widely-held companies, specially the larger ones, that questions of accountability and power, posed in the previous chapters, acquire significance. The unlisted companies, whether private limited or public limited, are more like glorified partnerships. The average paid-up capital of a listed company in 1971 was Rs. 99 lakh whereas the average for an unlisted public limited company was Rs. 4·0 lakh and for a private limited company Rs. 2·0 lakh only. Although the listed companies formed by number just about 5 per cent of all non-Government public limited companies, they accounted for 70 per cent of the paid-up share capital of all non-government companies and 88 per cent of the paid-up share capital of the non-government public limited companies.[1] The problems that we are enquiring into are relevant only to the widely-held companies. For this reason, the scope of our analysis is restricted to companies listed on the stock exchanges.

Our analysis attempts to show the position of equityholding by public institutions at two points of time, viz., 1971–72 and 1959–60 so as to bring out the change that has taken place over this period. The year 1959–60 was selected for purposes of comparison because significant increases in institutional shareholding are known to have occurred mainly after 1959.

The companies that constitute our sample are those listed on the Madras

[1]There were in 1971 a total of 30,098 non-government companies in existence. Of these 6443 were public limited companies and 23655 were private limited companies. See Government of India, *The Fifteenth Annual Report on the Working and Administration of the Companies Act*, 1956 for the year ended March 31, 1971, (New Delhi, 1972), p. 13. Only 1599 of the public limited companies were listed on the stock exchanges.

Stock Exchange. It is arguable that such a sample cannot be regarded, in the statistical sense, as representative of all listed companies. It is our experience that the application of random sampling to company data for many types of enquiries is impracticable in the Indian context. A truly representative random sample must be representative in terms of company size, growth rate, age, industry, region and management groups. Given so many variables and the relatively small number of listed companies in India, random methods will not always secure a representative result.

The sample that we have chosen may be regarded as a purposive sample. The average paid-up capital of companies listed in Madras, which form our sample, was not far different from the average for all stock exchanges in India, the respective figures being Rs. 81 lakh and Rs. 99 lakh for the year 1971. It may also be mentioned that the Madras Stock Exchange has a national, as opposed to a purely regional, character and a number of companies listed in Madras are also listed in Bombay and/or Calcutta. Certain other broad characteristics of shareholding in our sample companies show general agreement with those of listed companies generally. For instance, the top ten equityholders held 62 per cent of the total equity of our sample companies in 1971–72; such holding was 56 per cent in 1968–69 in the case of companies listed in Bombay[1] and must have increased since then, as our data disclose. Our sample covers a wide cross-section of Indian industry. Further, our data have been broken down according to both size-class and age-class of companies so as to facilitate, wherever possible, a comparison of our results with such other data as may be available. There are good reasons to suppose that our general conclusions will hold good for listed companies of comparable size and age. The practical considerations in taking the companies listed in Madras as our sample were the convenience and economy in collecting the data, the excellent cooperation offered by the Madras Stock Exchange, and the desirability of completing the study with reasonable speed.

The sample is restricted to non-financial companies and represents a nearly complete coverage of all such companies listed in Madras. How our sample compares with the 'universe' is indicated by the following figures which relate to 1971–72:

	No. of listed Companies	*Paid-up capital (Rs. crores)*
All Indian stock exchanges[2] (including financial companies)	1599	1581
Madras Stock Exchange[2] (including financial companies)	360	291
Companies covered by our sample (excluding financial companies)	332	284

A break-up of sample companies by size and age is given in Tables 5.1 and 5.2. for 1971–72 and 1959–60, respectively.

[1]See Bombay Stock Exchange, *Profile of Stock Exchange Activity in India* (Bombay, 1970), p. 37.

[2]The data are based on Bombay Stock Exchange, *The Stock Exchange Official Directory*, Vol. 2 (Bombay, 1972).

TABLE 5.1

A BREAK-UP OF SAMPLE COMPANIES BY SIZE AND AGE, 1971–72

Size-classification measured by subscribed equity capital in Rs. lakhs	Age since incorporation							
	Upto 6 years		Over 6 upto 15 years		Over 15 years		All age-classes	
	No.	Subscribed equity (Rs. crores)	No.	Subscribed equity (Rs. crores)	No.	Subscribed equity (Rs. crores)	No.	Subscribed equity (Rs. crores)
Under 10	1	0·09	5	0·32	58	3·40	64	3·82
10 to under 25	6	1·13	23	4·18	77	12·10	106	17·41
25 to under 50	6	2·25	24	7·55	42	14·73	72	24·53
50 to under 100	4	2·33	17	12·43	22	15·18	43	29·94
100 to under 300	Nil	Nil	11	20·56	21	39·29	32	59·85
300 and over	3	36·08	5	25·72	7	62·61	15	124·40
All size-classes	20	41·88	85	70·76	227	147·31	332	259·95

TABLE 5.2

A BREAK-UP OF SAMPLE COMPANIES BY SIZE AND AGE, 1959–60

Size-classification measured by subscribed equity capital in Rs. lakhs	Age since incorporation							
	Upto 6 years		Over 6 upto 15 years		Over 15 years		All age-classes	
	No.	Subscribed equity (Rs. crores)	No.	Subscribed equity (Rs. crores)	No.	Subscribed equity (Rs. crores)	No.	Subscribed equity (Rs. crores)
Under 10	6	0·33	15	0·95	51	2·63	72	3·91
10 to under 25	5	0·68	12	1·86	45	7·25	62	9·79
25 to under 50	3	1·00	8	2·50	14	5·03	25	8·52
50 to under 100	2	1·10	3	2·00	9	5·83	14	8·93
100 to under 300	1	2·70	6	9·94	3	3·32	10	16·45
300 and over	—	—	—	—	2	9·03	2	9·03
All size-classes	17	5·81	44	17·24	124	33·58	185	56·63

2. Our Approach to the Study of Equity Ownership

(a) The Methodology

We shall be approaching the task of analysing equityownership in this chapter mainly from the viewpoint of control; our emphasis will, therefore, be on a disaggregated analysis which is intended to show how public institutions' equityholdings vary between companies of different size and age, as also how such holdings are distributed among individual companies.

The available studies on share ownership in India are all aggregative studies, oriented generally towards capital-market-analysis rather than towards questions of potential control over corporate managements. For this reason, these studies do not carry the analysis down to the level of the individual company. The degree of potential control exercisable by public institutions cannot be analysed without looking into the institutional equityholdings in individual companies.

Since an equityholding will have a potential for control only if the size of the holding is relatively significant, it was not necessary for us to cover the whole ground of equity ownership. As we shall explain below, fairly valid and reliable results can be obtained for our purpose by limiting the analysis, as we have done, to the top ten equity shareholders in a company.

That this short-cut method gives valid results is based on the fact that the present structure of share-ownership in India, unlike that in the United States and in most other advanced countries, shows a very high degree of concentration among the top few shareholders. It was found that, in the majority of companies, the top ten equityholders included, more or less, all those who may possibly be in a position to exercise some potential control over corporate management by virtue of the voting power. In the great majority of companies,

TABLE 5.3

Equityholding of the Tenth Largest Equityholder as Percentage of Equity Capital for Different Size-classes of Companies

Size-class of companies measured by subscribed equity in Rs. lakhs	1971–72	1959–60
Under 10	2·88	1·77
10 to under 25	1·42	1·07
25 to under 50	1·95	1·28
50 to under 100	1·40	0·95
100 to under 300	0·99	1·44
300 and over	0·67	0·76
All size-classes	1·03	1·08
Number of companies examined	332	185

the individual equityholdings below the top ten tended to be of relatively insignificant size from the viewpoint of control. Thus, in respect of the 332 companies covered by our investigation for the year 1971–72, the percentage of a company's equity capital held by the tenth largest equityholder showed an average of only 1·03 per cent[1] of the equity capital of these companies. The corresponding figure for the year 1959–60 was also low, being 1·08 per cent. A break-down of the data by size class of companies for 1971–72 showed that the tenth largest equityholding, in percentage terms, was below 1 per cent in the case of the relatively bigger companies having subscribed equity capital of Rs. 1 crore or more each, and between 1–2 per cent in the case of all other size classes, except the lowest size-class for which the figure was 2·88 per cent. The data for both 1971–72 and 1959–60 are presented in Table 5.3. An examination of frequency distribution of companies according to the size of equityholding of the 10th largest equityholder for both 1971–72 and 1959–60 showed that only in a relatively few cases did this holding exceed 2 per cent of a company's equity capital (See Tables 5.4 and 5.5).[2]

At the same time, we must hasten to add that an analysis of equityholdings, limited to top ten shareholdings, is necessarily incomplete. The individual public institutions may in many companies appear, not among the top ten, but among the lower ranks of equityholders. To this extent, our analysis slightly understates the proportions of equity held by public institutions. However, the fact that the size of the 10th largest equityholding averaged just about one per cent gives us confidence that the error involved is of an insignificant order of magnitude and does not vitiate our main conclusions.

(b) Concentration of Shareholding: The General Trend in India

As a slight digression from our main theme but arising directly from our data, we may note that the data definitely disprove a widely-held belief that shareholding in India is getting more dispersed since the beginning of 1960s. The data reveal a contrary trend towards greater concentration of equityholding among the top 10 holders since 1959–60 (see Table 5.6). Companies in all size-classes, except the largest ones having subscribed equity capital of Rs. 3 crore or more each, share this trend. This is despite the fact that many companies have reported increases in the number of their equityholders over this period. It appears that the increasing number of equityholders in individual companies since 1959 is simply a reflection of the increasing size of companies and increasing population of the country, but, certainly, not of reduced concentration in shareownership. The concentration of shareholding at the top has, if anything, significantly increased between 1959 and 1972.

[1]This percentage has been arrived at by aggregating the shareholding of the tenth top shareholder in all the companies covered by our investigation and comparing it with the total equity capital of this group of companies.

[2]Incidentally, it may be suggested that if the Distribution Schedule required to be filed annually by all listed companies with the stock exchanges could be extended to the top 15 or 20 shareholders, it could reflect, still more completely, all the significant changes in share ownership.

TABLE 5.4

A DISTRIBUTION OF COMPANIES ACCORDING TO THE SIZE OF THE TENTH LARGEST EQUITYHOLDING, 1971–72

Size of tenth largest equityholding as per cent of subscribed equity	Size-classification of companies by subscribed amount of equity in Rs. lakhs						
	Under 10	10 to under 25	25 to under 50	50 to under 100	100 to under 300	300 and over	All size-classes
·01 to under ·20	—	—	4 (5·6)	2 (4·6)	1 (3·1)	2 (13·3)	9 (2·7)
·20 to under ·50	1 (1·6)	11 (10·4)	5 (6·9)	6 (14·0)	6 (18·8)	2 (13·3)	31 (9·3)
·50 to under 1·00	12 (18·8)	20 (18·9)	22 (30·6)	5 (11·6)	11 (34·4)	7 (46·7)	77 (23·2)
1·00 to under 1·50	20 (31·3)	30 (28·3)	22 (30·6)	11 (25·6)	4 (12·5)	3 (20·0)	90 (27·1)
1·50 to under 2·00	12 (18·8)	27 (25·5)	7 (9·7)	8 (18·6)	5 (15·6)	1 (6·7)	60 (18·1)
2·00 to under 2·50	11 (17·2)	8 (7·6)	6 (8·3)	9 (20·9)	3 (9·4)	— —	37 (11·1)
2·50 to under 3·00	4 (6·2)	4 (3·8)	6 (8·3)	1 (2·3)	2 (6·2)	— —	17 (5·1)
3·00 to under 10·00	4 (6·2)	6 (5·7)	— —	1 (2·3)	— —	— —	11 (3·3)
Total	64 (100·0)	106 (100·0)	72 (100·0)	43 (100·0)	32 (100·0)	15 (100·0)	332 (100·0)

Note: Figures within parentheses represent percentage to column totals. Totals may not exactly tally because of rounding off.

TABLE 5.5

A DISTRIBUTION OF COMPANIES ACCORDING TO THE SIZE OF THE TENTH LARGEST EQUITYHOLDING, 1959–60

Size of tenth largest equityholding as per cent of subscribed equity	Size-classification of companies by subscribed amount of equity in Rs. lakhs						
	Under 10	10 to under 25	25 to under 50	50 to under 100	100 to under 300	300 and over	All size-classes
·01 to under ·20	— —	1 (1·6)	— —	— —	— —	2 (100·0)	3 (1·6)
·20 to under ·50	3 (4·2)	4 (6·4)	1 (4·0)	3 (21·4)	— —	— —	11 (5·9)
·50 to under 1·00	11 (15·3)	22 (35·5)	8 (32·0)	6 (42·9)	4 (40·0)	— —	51 (27·6)
1·00 to under 1·50	27 (37·5)	21 (33·9)	8 (32·0)	4 (28·6)	4 (40·0)	— —	64 (34·6)
1·50 to under 2·00	15 (20·8)	9 (14·5)	1 (4·0)	— —	1 (10·0)	— —	26 (14·1)
2·00 to under 2·50	10 (13·9)	4 (6·4)	6 (24·0)	1 (7·1)	— —	— —	21 (11·4)
2·50 to under 3·00	3 (4·2)	1 (1·6)	1 (4·0)	— —	— —	— —	5 (2·7)
3·00 to under 10·00	3 (4·2)	— —	— —	— —	1 (10·0)	— —	4 (2·2)
Total	72 (100·0)	62 (100·0)	25 (100·0)	14 (100·0)	10 (100·0)	2 (100·0)	185 (100·0)

Note: Figures within parentheses represent percentage to column totals. Totals may not exactly tally because of rounding off.

TABLE 5.6

PERCENTAGE OF EQUITY CAPITAL HELD BY THE FIRST LARGEST AND THE TOP TEN EQUITYHOLDERS IN DIFFERENT SIZE-CLASSES OF COMPANIES

	1971–72			1959–60		
Size-class of companies by subscribed amount of equity in Rs. lakhs	Number of sample companies covered	First largest equityholder	Top ten equity-holders	Number of sample companies covered	First largest equityholder	Top ten equity-holders
Under 10	64	20·7	52·1	72	17·1	43·9
10 to under 25	106	20·1	51·0	62	14·3	35·1
25 to under 50	72	19·5	47·6	25	9·8	33·5
50 to under 100	43	20·9	54·7	14	13·2	36·7
100 to under 300	32	21·9	54·4	10	25·2	50·9
300 and over	15	45·5	72·8	2	79·6	85·7
All size-classes	332	32·7	62·3	185	27·2	48·4

(c) Categories of Public Institutions

As pointed out above, the primary data on which the present investigation is based are the data relating to the equityholdings of the top ten equityholders in individual companies, as shown in the Distribution Schedule filed by companies with the stock exchange.[1] The percentage equityholding of each of the top ten equityholders was computed for individual companies in terms of the *subscribed* amount of equity capital.[2] The equityholdings of the public financial institutions, appearing in the list of top ten shareholders in each company, have been analysed in detail. The categories of public financial institutions are not identical for 1959–60 and 1971–72 because of changes resulting from the creation of new public institutions and also from nationalisation measures. The categories included under *public institutions* in 1959–60 were as follows:

(a) Life Insurance Corporation of India
(b) All-India Development Banks
(Industrial Finance Corporation of India and The Industrial Credit & Investment Corporation of India Ltd.)
(c) State-level Development Banks (State Financial Corporations)
(d) Central Government
(e) State Governments
(f) State Bank of India (including subsidiaries)

The additional institutions which came under public institutions in 1971–72 are:

(a) Unit Trust of India
(b) Industrial Development Bank of India
(c) State Industrial Development Corporations
(d) General Insurance Companies
(e) Nationalised Banks
(f) Industrial Reconstruction Corporation of India

The shareholdings of commercial banks have been separated from that of non-bank public institutions for purposes of our analysis for a number of reasons. It is common knowledge that the bulk of the shareholdings appearing in the names of banks in the share registers of companies are nominee holdings, resulting either from the banks' function as executors and trustees or from the banks' holding the shares as security for advances. The banks' own equityholdings are

[1]Certain discrepancies and omissions noticed in the data had to be rectified by obtaining verification from the companies directly. For instance, in a few cases it was found that the shares held by the foreign collaborator were omitted from Distribution Schedule because they were not listed. In some cases, directors' shareholdings were found to have been omitted from the list of top ten holders. Attempt was made to check such omissions as far as possible.

[2]This was done mainly to take care of a problem which arose when a company had both fully-paid and partly-paid shares. The separate Distribution Schedules relating to the fully and partly-paid shares were consolidated in terms of the subscribed amounts, instead of the paid-up amounts, of share capital by finding out the common names in the two schedules and then reconstructing a new schedule.

generally of a relatively insignificant size.[1] Since 1971, in terms of a directive issued by the Reserve Bank to commercial banks, it is required that, in the event of a bank granting or renewing a credit limit of over Rs. 50,000 against the security of shares, not only should the shares so pledged be transferred to its name but the voting rights in respect of those shares should also vest exclusively with the lending bank. It cannot be ascertained from share registers whether a bank holds particular shares as nominee or as beneficiary, and if the shares are held as security for loan, whether the voting right vests with the bank. Hence in our analysis, we have focussed attention on the equity holdings of non-bank public institutions. The equityholdings appearing in the names of the nationalised banks have been examined separately.

3. Major Findings

(a) How Widespread are Public Institutions' Equityholdings?

In the preceding chapter we pointed out how even a relatively small equityholding by public institutions may in certain situations carry some degree of power to control or influence corporate managements. We shall, therefore, begin our analysis by examining how wide is the net cast by the public shareholding institutions over the corporate sector, irrespective of the size of such holdings.

Confining our attention to the non-bank public institutions, for reasons already explained, and taking the sample companies as a whole, we find that these institutions were among top ten equity shareholders in 61·1 per cent of

TABLE 5.7

Percentage of Companies in Each Class in which Non-Bank Public Institutions were Among Top 10 Equity holders: A Break up by Size and Age of Companies, 1971–72

Size by subscribed amount of equity in Rs. lakhs	Age since incorporation			
	Upto 6 Years	Over 6 Upto 15 years	Over 15 years	All age-classes
Under 10	100·0	60·0	24·1	28·1
10 to under 25	83·3	78·3	36·4	48·1
25 to under 50	100·0	83·3	64·3	73·6
50 to under 100	75·0	100·0	68·2	81·4
100 to under 300	†	100·0	95·2	96·9
300 and over	100·0	100·0	100·0	100·0
All size-classes	90·0	87·1	48·9	61·1

†None of the companies analysed fell in this cell.

[1]See L. C.Gupta, *The Changing Structure of Industrial Finance in India* (London, 1969), pp. 150–51.

the companies in 1971–72 (Table 5.7). The corresponding figure for 1959–60 is 35·7 per cent (Table 5.8). This gives a general indication of the sweeping nature of the change that has taken place over the period in question.

TABLE 5.8

PERCENTAGE OF COMPANIES IN EACH CLASS IN WHICH NON-BANK PUBLIC INSTITUTIONS WERE AMONG TOP 10 EQUITY HOLDERS: A BREAK UP BY SIZE AND AGE OF COMPANIES, 1959–60

Size by subscribed amount of equity in Rs. lakhs	Age since incorporation			
	Upto 6 years	Over 6 upto 15 years	Over 15 years	All age-classes
Under 10	16·7	33·3	15·7	19·4
10 to under 25	Nil	41·7	33·3	32·3
25 to under 50	33·3	71·4	53·3	56·0
50 to under 100	100·0	75·0	50·0	64·3
100 to under 300	100·0	83·3	33·3	70·0
300 and over	100·0	100·0	100·0	100·0
All size-classes	29·4	52·3	30·6	35·7

This result has been brought about by two forces: (*a*) an extension of the frontiers of the public sector both through creation of new financial institutions and through nationalisation of the older ones, and (*b*) the rapid growth in operations of all public institutions in the provision of equity finance. Of particular significance in this connection is the spectacular growth in the practice of institutional underwriting of capital issues, since the beginning of the 1960s.[1] Thus, whereas during the latter half of the 1950s, only around one-fourth of the public issues of equity by Indian companies were underwritten, by 1965 underwriting became an almost universal practice in the case of fresh public issues of equity.[2] It is also known that underwriting by public institutions in most cases resulted in their taking up at least some part of the underwritten issue.[3]

There are significant differences with regard to the spread of public institutions' equityholding between companies of different sizes and ages. The institutional equityholding is more common among the larger companies than among the smaller ones (see specially the last column of Tables 5.7 and 5.8). Thus, among companies with equity capitals of Rs. 1 crore or more each, equityholding by public institutions had become almost universal by 1971–72; approximately three-fourths of the companies having equity capital of Rs. 25–100 lakh had public institutions among their top ten equityholders in 1971–72;

[1]For a detailed and critical survey of the growth of underwriting of capital issues in India, see Gupta, op. cit., Chapter VIII.

[2]Ibid., p. 131, specially Table VIII. 2.

[3]Ibid., pp. 124–25.

such holding was much less general, but by no means insignificant, among the small companies having equity capital of below Rs. 25 lakh each.

Our analysis discloses an important operative force which will make public institutions' equityholding even more general in the near future. An indication of this is given by the inverse relationship, observable in the 1971–72 data, between the percentage of companies having public institutions among the top ten equityholders on the one hand and the age of the company on the other (see last row of Table 5.7). This is not the case in 1959–60 (see last row of Table 5.8). The inverse relationship in question in 1971–72 is explained by the growth of underwriting practice after 1959, as already pointed out above. Companies which were 6 years old in 1971–72 must have been floated sometime during 1966–72 and those which were 6-15 years old in 1971–72 must have been floated during 1957–65. The participation in the initial issues of new companies by public institutions, mostly by way of underwriting, and sometimes by way of direct subscription, has been increasing steadily over this period. The result of these developments is a trend towards universality of public institutions' equityholding among the new widely-held companies of all size classes. A careful observation of the data presented in Table 5.7 reveals this trend. Of the oldest companies (those over 15 years old in 1971–72), 48·9 per cent had public institutions among their top ten equity holders, and the percentage shows a systematic difference between different size classes of companies within this age group—being 24·1 per cent for the smallest size-class and rising to 100·0 per cent for the largest size-class. The difference between various size-classes becomes less marked among the medium-aged companies (those 6-15 years old) in 1971–72, and it more or less vanishes among the youngest companies (upto 6 years old) in 1971–72 (see Table 5.7).

The near-universal participation of public institutions in the provision of initial equity of new companies is bound to have the effect of raising in the near future the general proportion of companies having public institutions as dominant partners in the equity capital. A new forceful factor working in the same direction is the policy adopted by lending institutions of reserving an option to convert a part of their loans into equity. The private corporate sector is inexorably slipping under greater ownership of the public financial institutions.

(b) How Big Are Institutional Equityholdings?

As explained earlier, our analysis of public institutions' equityholdings is oriented towards an examination of the potential control by the institutions over company managements by virtue of the voting strength commanded by the institutions. It follows that no possibility of such control exists in the case of companies in which the public institutions are not among the important equityholders.[1] We have already shown, for each size and age-class of companies, the percentage of companies in which the public institutions were among the

[1]We are not considering here the control exercisable by the lending institutions by virtue of loan contracts.

top ten equityholders. We shall now examine what *percentage of equity* is held by the public institutions in the various size and age-classes of companies.

For determining the percentage of equity capital held by the public institutions, we shall take only those companies in which any of the public institutions were among top ten equity holders.[1]

Tables 5.9 and 5.10 show the percentage of equity held by non-bank public institutions in companies belonging to each size and age-group in 1971–72

TABLE 5.9

AVERAGE PERCENTAGE OF EQUITY HELD BY NON-BANK PUBLIC INSTITUTIONS IN THOSE COMPANIES ONLY IN WHICH THEY WERE AMONG TOP TEN EQUITY-HOLDERS, 1971–72

Size-class by subscribed amount of equity in Rs. lakhs	Age since incorporation			
	Up to 6 years	Over 6 upto 15 years	Over 15 years	All age-classes
Under 10	19·4	28·1	11·8	14·9
10 to under 25	42·5	30·4	10·7	21·7
25 to under 50	18·8	22·3	15·6	18·3
50 to under 100	24·4	38·0	20·0	29·3
100 to under 300	—	25·4	24·9	25·0
300 and over	27·0	33·0	40·9	35·3
All size-classes	26·8	30·5	31·2	30·2

TABLE 5.10

AVERAGE PERCENTAGE OF EQUITY HELD BY NON-BANK PUBLIC INSTITUTIONS IN THOSE COMPANIES ONLY IN WHICH THEY WERE AMONG TOP TEN EQUITYHOLDERS, 1959–60

Size-class by subscribed amount of equity in Rs. lakhs	Age since incorporation			
	Upto 6 years	Over 6 upto 15 years	Over 15 years	All age-classes
Under 10	0·8	34·9	14·4	23·1
10 to under 25	†	22·9	10·5	13·4
25 to under 50	5·0	4·1	6·5	5·5
50 to under 100	28·0	11·8	5·9	11·7
100 to under 300	7·4	7·7	6·4	7·4
300 and over	†	†	2·9	2·9
All size-classes	15·2	9·6	5·5	8·0

†There are no observations in these cells.

[1]If we were to examine the problem from the viewpoint of supply of capital, rather than from that of control, we would have related institutional equityholdings, as all, the earlier studies on their-ownership have done, to the total equity capital of *all* companies, including those in which she institutions were not shareholders.

and 1959–60 respectively. A comparison of the two tables shows that the *equity* percentage held by the public financial institutions increased sharply from 8·0 per cent in 1959–60 to 30·2 per cent in 1971–72 for the companies as a whole.

Attention has been drawn earlier to the interesting development, as disclosed by our data, that nearly all new widely-held companies, irrespective of size, are now formed with significant participation by non-bank public institutions in their initial capital. Thus, in the youngest group of companies in 1971–72 18 out of 20 (i.e., 90 per cent of the total) had such participation; and the public institutions held 26·8 per cent of the equity of these 18 companies. In the middle age-group of 6-15 years, 74 out of 85 companies had equity participation by non-bank public institutions to the extent of 30·5 per cent of equity capital.

It has also been pointed out that public institutions' holdings in the new companies seem to have arisen generally out of the underwriting facilities provided by the institutions. As a new company gets established, the LIC and the UTI, tend to pick up more of the existing shares through their market purchases,[1] while the development banks engage in market operations only to unload the existing holdings in order to revolve their funds. The public institutions' shareholdings in the older companies are the net result of these two opposite operations.

The data for 1971–72 show that the percentage equityholding of public institutions is higher for the larger companies than for the smaller ones, but it is worth noting that this relationship is strong only among the oldest group companies (over 15 years old in 1971–72) and not for the other two age-groups. The explanation for this peculiar phenomenon seems to lie again in the growth of underwriting practice. However, an additional operative factor here is the growing volume of market purchases by institutional investors (mainly LIC and UTI). The creation of the UTI in 1964 made a significant addition to the list of such institutional purchasers of shares. A feature of the market purchases of these institutions, more particularly of the UTI, is that they are heavily concentrated on the securities of the large-sized and well-established companies.[2]

By contrast, development banks acquire industrial securities, not through market purchases, but through underwritings and direct subscriptions. What they aim at is to provide a wide general financial service to Indian industry, particularly to the new and smaller companies.[3] The situation revealed by Table 5.9 is likely to remain typical for at least some years to come: while the development banking institutions step up their underwriting operations for all classes of widely-held companies, the savings institutions (LIC, UTI and General Insurers) will continue to accumulate industrial securities of the large and established companies through market purchases.

A comparison of Tables 5.9 and 5.10 indicates that equityholding by non-bank public institutions in 1971–72 had certain features which are quite the opposite of those found in 1959–60. Thus, while in 1971–72, the institutions'

[1]LIC and UTI rarely sell.

[2]For investment policy of the LIC and UTI, see Gupta, op. cit., pp. 56–61 and 76. See also pp. 125–26 for their policy towards underwriting industrial securities.

[3]Ibid., pp.124–25.

percentage equityholding is positively correlated with both company-size and company-age, the data for 1959–60 discloses a negative relationship in this respect. An explanation for these opposing pictures is called for.

The explanation in question seems to lie in the fact that the addition of the UTI and the General Insurers to the list of public institutions has given significantly greater weightage to the group of savings institutions among the shareholding public institutions in 1971–72 as compared to 1959–60. At the same time, the LIC also stepped up the volume of its operations in the equity market over this period, as indicated by a shift towards equity in its investment portfolio.[1] The investment policies of the LIC and the UTI are known to favour the large and established enterprises. The positive correlation of institutional equityholding to company-size and age arises from the massive weight that these institutions have among the shareholding public institutions in 1971–72. The situation in 1959–60 was different in this respect. Added to this is the fact that in 1959–60 some of the State Governments, specially those of Mysore, Kerala and Andhra Pradesh (which are all included under public institutions) held substantial portions of the equity of many small and medium-sized companies which had been set up within the respective states before the 1960s.

To sum up, the average voting strength of all the public institutions together in quoted companies was as high as 30 per cent in 1971–72. It has been tending to increase rapidly over the past fifteen years. The exercise of conversion rights in respect of institutional loans will push up this percentage further in the near future.

(c) Distribution of Institutional Equityholdings Among Individual Companies

The average percentage of public institutions' equity-holdings in the various groups of companies, as presented in Tables 5.9 and 5.10, are undoubtedly useful in that they tell us in unmistakable terms the trend of developments over recent years, and also throw interesting light on the characteristic differences between different classes of companies. However, from the viewpoint of potential control over corporate managements, we must further enquire into the question: in what proportion of companies is the public institutions' equity-holding large enough to open up the possibility of significant institutional control?

Now, it has been pointed out earlier that there is no direct relation between the percentage of institutional equity-holding and the degree of potential institutional control since it all depends upon a variety of factors which are likely to vary from case to case. Hence, the best that can be done here is to examine the distribution of companies according to the size of public institutions' equityholding. This is shown in Tables 5.11 and 5.12 for 1971–72 and 1959-60 respectively.

[1]Investment by the LIC in equity shares formed 40·9 per cent of its total investment in industrial securities in September 1956 and 60·2 per cent in March 1966. The figure for 1971 is about the same as in 1966. See Gupta, op. cit., p. 61 and 14th *Annual Report* of the LIC for the year ended March 31, 1971, p. 56.

Concentrating our attention for the moment on Table 5.11, which presents data for 1971–72, the most outstanding fact that we discover is that, so far as the relatively large-sized companies are concerned, the public institutions have come to own in the majority of them such large proportions of the equity as ordinarily invest the institutions with considerable potential power of control over the company managements concerned. Thus, in 46 out of 81 companies, which had equity capitals of Rs. 50 lakh or more each, the public institutions' equityholding exceeded 25 per cent; in another one-fourth of these cases, the equityholding of the institutions lay in the range of 10–25 per cent.

Even among the medium-sized companies having equity capital of Rs. 25–50 lakh each in 1971–72, the institutions' equityholdings exceeded 25 per cent in one-fourth of these companies; and it lay between 10–25 per cent in another one-fourth of them.

In the smaller size classes of companies, substantial equityholding by the institutions was rather rare in 1971–72—a holding exceeding 25 per cent was found in only 17 per cent of the companies in the equity-capital-size of Rs. 10–25 lakh, and in only 3 per cent of those in the equity-capital-size of below Rs. 10 lakh; institutional holdings of 10–25 per cent were found in roughly one-tenth of companies in both these size-classes.

A comparison of Tables 5.11 and 5.12 shows how much away we have moved from the position obtaining in 1959–60. Taking companies of all sizes as a whole, we find that, in 1971–72, public institutions' equity-holding exceeded the 25 per cent level in about one out of every four companies, and it ranged between 10–25 per cent in about one out of every six companies. Compared to this, in 1959–60, public institutions' equityholding had exceeded 25 per cent level in only about 5 per cent of all companies and that too mostly among the smaller companies, and had been in the range 10–25 per cent in another about 6 per cent of the companies.

Our data show that so far as the relatively larger companies are concerned, joint ownership between public institutions and private groups has already become the rule.

(d) A General Picture of the Relative Importance of Different Public Institutions in Equityholding in Quoted Companies

Our data throw useful light on the relative position of the various public institutions as equity shareholders in quoted companies generally. In interpreting the data, it must be borne in mind that we have relied for our analysis on the top ten equityholdings only. Hence our data are not as complete as one may desire them to be. It is likely that in many of the companies in which the public institutions did not appear among the first ten equityholders, they must have been among the lower ranks of shareholders. To the extent this is so, the role of the public institutions, as indicated by our data, is somewhat understated. It may also be noted that the extent of understatement will not be the same for all categories of public institutions, some of which have a monolithic structure (like LIC and UTI), while others have a decentralised structure to a

TABLE 5.11

DISTRIBUTION OF SAMPLE COMPANIES IN EACH SIZE-CLASS ACCORDING TO THE PERCENTAGE OF THEIR EQUITY HELD BY NON-BANK PUBLIC INSTITUTIONS APPEARING AMONG TOP 10 EQUITYHOLDERS, 1971–72

Percentage of equity held	Size-class by subscribed amount of equity in Rs. lakhs.						
	Under 10	10 to under 25	25 to under 50	50 to under 100	100 to under 300	300 and over	All size-classes
Under 2	2 (3·1)	2 (1·9)	4 (5·6)	(Nil)	1 (3·1)	(Nil)	9 (2·7)
2 to under 5	6 (9·4)	8 (7·6)	7 (9·7)	1 (2·3)	1 (3·1)	1 (6·7)	24 (7·2)
5 to under 10	2 (3·1)	11 (10·4)	12 (16·7)	5 (11·6)	4 (12·5)	1 (6·7)	35 (10·5)
10 to under 15	2 (3·1)	5 (4·7)	4 (5·6)	1 (2·3)	4 (12·5)	1 (6·7)	17 (5·1)
15 to under 20	1 (1·6)	1 (0·9)	5 (6·9)	2 (4·7)	3 (9·4)	2 (13·3)	14 (4·2)
20 to under 25	3 (4·7)	6 (5·7)	8 (11·1)	3 (7·0)	4 (12·5)	1 (6·7)	25 (7·5)
25 to under 30	—	1 (0·9)	2 (2·8)	3 (7·0)	2 (6·3)	2 (13·3)	10 (3·0)
30 to under 40	1 (1·6)	9 (8·5)	6 (8·3)	10 (23·3)	4 (12·5)	3 (20·0)	33 (9·9)
40 to under 50	1 (1·6)	4 (3·8)	2 (2·8)	5 (11·6)	6 (18·8)	2 (13·3)	20 (6·0)
50 to under 60	—	3 (2·8)	2 (2·8)	3 (7·0)	1 (3·1)	1 (6·7)	10 (3·0)
60 and above	(Nil)	1 (0·9)	1 (1·4)	2 (4·7)	1 (3·1)	1 (6·7)	6 (1·8)
Sub-total	18 (28·1)	51 (48·1)	53 (73·6)	35 (81·4)	31 (96·9)	15 (100·0)	203 (61·1)
Not among top ten	46 (71·9)	55 (51·9)	19 (26·4)	8 (18·6)	1 (3·1)	(Nil)	129 (38·9)
Grand Total	64 (100·0)	106 (100·0)	72 (100·0)	43 (100·0)	32 (100·0)	15 (100·0)	332 (100·0)

Note: Figures within parentheses represent percentage to column totals. Totals may not exactly tally because of rounding off.

TABLE 5·12

DISTRIBUTION OF SAMPLE COMPANIES IN EACH SIZE-CLASS ACCORDING TO THE PERCENTAGE OF THEIR EQUITY HELD BY NON-BANK PUBLIC INSTITUTIONS APPEARING AMONG TOP 10 EQUITYHOLDERS, 1959–60

Percentage of equity held	Size-class by subscribed amount of equity in Rs. lakhs						
	Under 10	10 to under 25	25 to under 50	50 to under 100	100 to under 300	300 and over	All size-classes
Under 2	3 (4·16)	4 (6·45)	4 (16·00)	—	2 (20·00)	1 (50·00)	14 (7·57)
2 to under 5	5 (6·94)	4 (6·45)	4 (16·00)	2 (14·28)	1 (10·00)	—	16 (8·65)
5 to under 10	1 (1·39)	6 (9·68)	3 (12·00)	3 (21·43)	2 (20·00)	—	15 (8·11)
10 to under 15	—	3 (4·84)	2 (8·00)	3 (21·43)	1 (10·00)	—	9 (4·86)
15 to under 20	—	—	1 (4·00)	—	—	—	1 (·54)
20 to under 25	—	1 (1·61)	—	—	1 (10·00)	—	2 (1·08)
25 to under 30	—	—	—	—	—	—	—
30 to under 40	2 (2·78)	—	—	—	—	—	2 (1·08)
40 to under 50	2 (2·78)	—	—	1 (7·14)	—	—	3 (1·62)
50 to under 60	—	—	—	—	—	—	—
60 and above	1 (1·39)	2 (3·22)	—	—	—	1 (50·00)	4 (2·16)
Sub-total	14 (19·44)	20 (32·26)	14 (56·00)	9 (64·28)	7 (70·00)	2 (100·00)	66 (35·68)
Not among top ten	58 (80·56)	42 (67·74)	11 (44·00)	5 (35·71)	3 (30·00)	—	119 (64·32)
Grand Total	72 (100·00)	62 (99·99)	25 (100·00)	14 (99·99)	10 (100·00)	2 (100·00)	185 (99·99)

Note: Figures within parentheses represent percentage to column totals. Totals may not exactly tally because of rounding off.

varying degree. Thus, for instance, shares held by general insurance companies, nationalised only recently, were still held in the names of individual companies, numbering slightly over hundred, and not in the single name of the General Insurance Corporation of India which was set up in 1972 after nationalisation and which is to hold all the shares of the nationalised general insurers. Hence the extent of understatement arising from our reliance only on the top ten equity-holdings is likely to be somewhat greater in the case of general insurance companies than in the case of the LIC and the UTI which are monolithic institutions and which are, therefore, most likely to appear among the top ten shareholders whenever they hold shares in a company.

At the same time, we may stress that the understatement arising from our method is unlikely to be of a significant order in terms of the amount of shareholding because, as fully explained earlier, the size of individual equityholdings below the top ten tends to be relatively insignificant in the great majority of companies.

Bearing in mind the limitations pointed out above, the relative importance of the various categories of public institutions in equityownership in our sample companies may be observed from Table 5.13. The table presents data with respect to numbers of companies in which the particular type of public institution was found to be among the top ten equity holders as also with respect to the amount of equityholding of the different public institutions. Further, in order to give a broad indication of the preferences which the institutions may have between large and small companies, the data have been bifurcated on the basis of two broad size categories of companies.

The Central Government's equity-holding, although the biggest in terms of amount, is clearly exceptional as it relates to a single isolated case. This was the case of the Fertilisers and Chemicals (Travancore) Limited. The Central Government held nearly 81 per cent of its equity so that the company would legally be regarded as a Government company. However, since it is a listed company, and had as many as 5292 equity shareholders in 1971, we have included it in our analysis.[1] Among the other top ten equityholders in this company were three state governments, the LIC and two commercial banks.

Leaving aside this exceptional case, the LIC is by far the most important equityholder among the public institutions both in terms of numbers of companies and in terms of amount of shareholding. State level development banks, mainly state industrial development corporations, which have been active in recent years, occupied the next place in terms of amount, followed by the all-India development banks. The general insurance companies are seen to have spread their equityholding more widely than all other categories except the LIC, but their contribution in terms of amount was not very large. The UTI had concentrated nearly the whole of its equityholding in the large companies. The State Governments were more significant contributors to equity than both the UTI and the general insurance companies. The public sector commercial banks were the least important equityholders among all public institutions in

[1]There were similarly a few other listed companies which are also included in our analysis and in which some state governments held the majority of equity shares.

TABLE 5.13

THE RELATIVE IMPORTANCE OF THE DIFFERENT PUBLIC INSTITUTIONS IN EQUITYHOLDING IN THE LARGE AND SMALL SAMPLE COMPANIES, 1971–72

Category of public Institution	(a) Large companies (having equity share capital of Rs. 50 lakhs or more each)		(b) Medium and small companies (having equity capital of below Rs. 50 lakhs each)		All companies	
	No. of companies in which each institution was among top ten equity-holders	Equityholding of the institution in Rs. crores	No. of companies in which each institution was among top ten equity-holders	Equityholding of the institution in Rs. crores	No. of companies in which each institution was among top ten equity-holders	Equityholding of the institution in Rs. crores
LIC	68	14·48	67	1·33	135	15·81
UTI	41	5·09	9	0·06	50	5·15
All-India Dev. banks	25	7·74	21	0·92	46	8·66
State-level Dev. banks	32	11·75	41	1·93	73	13·68
General Insurance cos.	55	4·62	49	0·92	104	5·54
Central Government	1	15·10	—	—	1	15·10
State Governments	13	6·17	11	0·50	24	6·67
All non-bank public institutions	81*	64·95	122*	5·66	203*	70·61
Public sector com. banks	50	3·28	63	0·86	113	4·14
No. of sample companies covered	90		242		332	
Total equity capital of the sample companies		214·19		45·76		259·95

*Counting the shareholding of two or more non-bank public institutions in the same compay as one shareldning only.

terms of amount. Their true significance is likely to be still lower, if all the nominee holdings held in their names were excluded. So far as the medium and small-sized companies are concerned, the state-level development banks clearly turn out to be the most important among the equityholding public institutions, followed by the LIC.

A more detailed analysis of the different categories of public financial institutions is givcn in the next chapter.

6

Public Institutions' Equityholding: Characteristics of Individual Institutions

THE LAST CHAPTER provided an over-all view of equity ownership in quoted companies by public sector institutions taken as a whole and also gave a general indication of the relative importance of each type of institution in this regard. In the present chapter, we shall further examine the distinctive role of the different public institutions.

1. THE LIFE INSURANCE CORPORATION OF INDIA

The role of the LIC as a shareholder has attracted spectacular attention ever since its formation in September 1956. The aspects that we shall examine in this section cover (*a*) LIC's over-all share in the ownership of quoted equity, (*b*) the spread of LIC's equityholding over companies in different size-groups and age-groups, (*c*) LIC's percentage equityholding in individual companies, and (*d*) LIC's rank among equityholders in individual companies. We shall take these aspects one by one below.

(a) LIC's OVER-ALL SHARE IN THE OWNERSHIP OF QUOTED EQUITY

Table 6.1 presents a comparison of the available studies on share-ownership with regard to the percentage of quoted equity owned by the LIC.

A comparison of the various studies on share-ownership, conducted from time to time, can give us an idea of the trend of the LIC's percentage equityholding. Before interpreting the data presented in Table 6.1, we may sound a note of caution regarding the comparability and representativeness of the various studies. Since the LIC's percentage shareholding has been found to vary substantially between size-classes of companies, the composition of the samples, specially in terms of representation of the different size-classes of companies, becomes extremely important.

The average paid-up capital of listed companies in India moved up from Rs. 56 lakh in 1961 to Rs. 68 lakh in 1965 and further to Rs. 99 lakh in 1971. From this viewpoint, the Reserve Bank sample for 1965, in spite of the Bank's claim that the sample companies 'were selected on the basis of stratified random sampling from different size ranges by paid-up capital ',[1] is not at all representative of the listed companies generally, in as much as the average equity capital of the 189 companies included in the Reserve Bank sample was about

[1]See *Reserve Bank of India Bulletin* February, 1968, p. 137.

TABLE 6.1

A COMPARISON OF STUDIES ON LIC's EQUITYHOLDING

Year covered by study	Author	No. of companies covered	Average paid-up capital of companies covered (Rs. lakhs)	LIC's percentage equity holding
1971–72	Present study	332	81	6·1
1968–69	Bombay Stock Exchange	515	145*	8·7
1965	Reserve Bank	189	224*	9·0
1963	L. C. Gupta	368	125	6·2
1959–60	Present study	185	31*	2·4
1958	R. K. Hazari	644†	49	3·6
1957	L. C. Gupta	251	101	2·8

*Equity capital only.

†Data relating to only public limited companies are presented here. Hazari had covered private limited companies also.

Sources:

Bombay Stock Exchange, *Profile of Stock Exchange Activity in India* (Bombay, 1970), p. 37; *Reserve Bank of India Bulletin*, February 1968, p. 140; R. K. Hazari, *The Corporate Private Sector: Concentration, Ownership and Control* (Calcutta, 1967), p. 341; L. C. Gupta, *The Changing Structure of Industrial Finance in India* (London, 1969), p. 54.

three-and-a-half times the average for all listed companies in 1965.[1] The wide variation in the percentage equity holding of the LIC between broad size-classes may be gauged from the fact that, in the author's study for 1963, such holding was 1-2 per cent in the case the smallest size-group of companies (having a paid-up capital of below Rs. 10 lakh each) and 8–10 per cent for the largest size-group (with paid-up capital of over Rs. 1 crore each).[2] Hence the Reserve Bank's study for 1965 definitely and significantly overstates the LIC's average percentage equityholding in quoted companies generally.[3] The same criticism also applies, albeit to a lesser degree, to the study conducted by the Bombay Stock Exchange for the year 1968-69. The author's studies for the years 1963 and 1957 are also somewhat over-weighted by the larger companies. Hazari's study is not confined to quoted companies but includes some unquoted ones.

In contrast to the above studies, the figure for 1971–72 yielded by the present study should be regarded as a slight understatement of the percentage of quoted equity shares held by the LIC for two reasons, viz., (*i*) our data are based on top ten equityholdings only and (*ii*) the average paid-up capital of our sample

[1]In the light of this fact, one wonders about Reserve Bank's method of stratified random sampling.

[2]Gupta, op. cit., p. 57.

[3]The Reserve Bank's earlier survey of shareownership for the year 1959 did not show the LIC's percentage holding separately. See *Reserve Bank of India Bulletin*, May 1962.

companies was a little below the average for all listed companies. As regards the first factor, it has been explained earlier that the individual equityholdings below the tenth rank averaged below 1 percent and hence, even if we were to include all those companies in which the LIC, as equityholder, occupied a rank below the tenth largest holder, it would not add more a fraction of one per cent to the LIC's percentage equityholding obtained by our method. If our result was adjusted also for the second factor mentioned above, the proportion of quoted equity shares held by the LIC is most likely to fall somewhere between 7–7·5 per cent in 1971–72.

The estimate of the LIC's percentage share in the ownership of all quoted equity shares arrived at in the manner explained above for the year 1971–72 can be fortunately verified by another method. The aggregate market value of equity shares listed on the Indian Stock Exchanges was Rs. 2173 crores as on 31st December 1970.[1] Against this, the market value of the LIC's equity-holdings as on 31st March, 1971 was Rs. 163·6 crores.[2] Since the LIC's holdings of equity shares consist almost wholly of quoted shares, the two figures are in comparable terms. On this basis, the LIC's equityholdings (at market value) formed 7·5 per cent of the aggregate market value of all quoted equity shares in the beginning of 1971.

A break-up of our data by size and age-class of companies is presented in Tables 6.2 and 6.3 for the years 1971–72 and 1959–60 respectively. The data disclose that the percentage share of the LIC is positively correlated not only with the size of companies but also with the age of companies.[3]

TABLE 6.2

PERCENTAGE OF EQUITY CAPITAL HELD BY THE LIC AS ONE OF TOP TEN EQUITYHOLDERS IN ALL SAMPLE COMPANIES BROKEN UP BY SIZE AND AGE, 1971–72

Size-class of companies by subscribed equity capital in Rs. lakhs	Age since incorporation			
	Upto 6 years	Over 6 upto 15 years	Over 15 years	All age-classes
Under 10	Nil	1·5	1·3	1·3
10 to under 25	1·1	0·6	2·3	1·8
25 to under 50	1·3	2·6	5·1	4·0
50 to under 100	1·7	7·7	7·3	7·0
100 to under 300	*	5·7	9·9	8·4
300 and over	4·1	5·2	7·3	5·9
All size classes	3·8	5·2	7·2	6·1

*None of the sample companies fell in this cell.

[1]Bombay Stock Exchange, *The Stock Exchange Official Directory*, Vol. 2.

[2]Life Insurance Corporation of India, *14th Annual Report* for the year ended March 31, 1971, p. 106.

[3]The author's earlier study also brought out the LIC's strong preference for the established companies as compared to new companies. See Gupta, op. cit., p. 61.

TABLE 6.3

PERCENTAGE OF EQUITY CAPITAL HELD BY THE LIC AS ONE OF TOP TEN EQUITYHOLDERS IN ALL THE SAMPLE COMPANIES BROKEN UP BY SIZE AND AGE OF COMPANIES, 1959–60

Size of companies by subscribed equity capital in Rs. lakhs	Age since incorporation			
	Upto 6 years	Over 6 upto 15 years	Over 15 years	All age-classes
Under 10	0·2	0·6	0·5	0·5
10 to under 25	Nil	1·4	1·4	1·3
25 to under 50	Nil	2·7	2·7	2·4
50 to under 100	13·6	5·7	3·1	5·0
100 to under 300	3·7	3·8	2·9	3·6
300 and over	*	*	0·1	0·1
All size classes	4·3	3·4	1·6	2·4

*None of the sample companies fell in this cell.

(b) THE SPREAD OF THE LIC'S EQUITYHOLDINGS

The percentage of companies in which the LIC was one of the top ten equityholders is shown in Table 6.4, with a detailed break-up according to both size and age-class of companies. For the sample companies as a whole, the percentage in question increased from 28·1 in 1959–60 to 40·7 in 1971–72. These averages, however, hide behind them significant differences between size classes, as also between age classes, in both the years, as may be observed from the break-up of data given in Table 6.4. The great majority of the relatively large companies with an equity capital of over Rs. 50 lakh each in 1971–72 had the LIC among the first ten equityholders. The frequency with which the LIC appeared among top ten equityholders declined rapidly for the smaller size classes of companies.

Although the percentage of companies in which the LIC was one of the top ten equityholders is positively correlated with company-size in both 1959–60 and 1971–72, a careful comparison of the data for the two years suggests that the LIC's preference for the larger company has acquired a somewhat sharper edge over the years. This conclusion follows from a comparison of the relative increases from 1959–60 to 1971–72 in the percentages for different size groups, as given in Table 6.4. While the bigger sized companies show decisive and significant increases in the percentages in question, the same cannot be said about the smaller companies. The LIC's appearance among top ten equityholder, remains somewhat of an exception in the small companies having as equity capital of below Rs. 25 lakh each. This suggests that this class of companies is regarded by the LIC as too small from its point of view.

The spread of the LIC's equityholdings, as indicated by our data, is somewhat less than their actual spread if we took into account all the equityholdings of

TABLE 6.4

PERCENTAGE OF SAMPLE COMPANIES BROKEN UP BY SIZE AND AGE, IN WHICH THE LIC RANKED AMONG TOP TEN EQUITYHOLDERS, 1971–72

Size-class of companies measured by subscribed equity capital in Rs. lakhs	Age since incorporation			
	Upto 6 years	Over 6 upto 15 years	Over 15 years	All age-classes
Under 10	Nil (16·7)	20·0 (13·3)	19·0 (11·8)	18·8 (12·5)
10 to under 25	16·7 (Nil)	8·7 (25·0)	29·9 (26·7)	24·5 (24·2)
25 to under 50	16·7 (Nil)	25·0 (62·5)	52·4 (57·1)	40·3 (52·0)
50 to under 100	25·0 (50·0)	82·4 (66·7)	59·1 (55·6)	65·1 (57·1)
100 to under 300	* (100·0)	63·6 (66·7)	90·5 (33·3)	81·3 (60·0)
300 and over	66·7 (*)	100·0 (*)	100·0 (50·0)	93·3 (50·0)
All size-classes	33·3 (17·7)	41·2 (26·4)	41·9 (26·6)	40·7 (28·1)

*None of the sample companies fell in this cell.

Note: Comparative figures for 1959–60 are given in parentheses.

the LIC, whether among top ten or not. It is likely that, besides the companies in which the LIC's equityholding was large enough to place it among the top ten equityholders, it held some equity shares in many of the remaining companies too. The aggregate number of companies in which the LIC had some equityholding in 1971 was 853, being 56 per cent of the number of all quoted companies.[1]

According to an earlier investigation into the LIC's shareholdings, the percentage of quoted companies in which the LIC held equity shares was 38 in 1957 and 58 in 1963.[2] A comparison of the available data suggests that the spread of the LIC's equityholding has become no wider between 1963 and 1971.

(c) THE LIC'S VOTING STRENGTH

An idea of the voting strength of the LIC is obtained by calculating its percentage equityholding for those companies only in which it was an equityholder.

[1]This information was kindly supplied by the LIC in their letter dated September 17, 1971, in reply to the author's letter to Mr. T. A. Pai, then Chairman of the LIC.

[2]See Gupta, op. cit., p. 57. The other studies on shareownership give no data on this aspect of shareholding.

A distribution of the sample companies according to the percentage equityholding of the LIC in individual companies is given in Tables 6.5 and 6.6 for the years 1971–72 and 1959–60 respectively. The companies, which had the LIC among their top ten equityholders in 1971–72 can be divided into three approximately equal groups containing one-third of the cases each: (*a*) those in which the LIC's percentage equityholding was below 5 per cent (*b*) those in which it was in the range of 5-10 per cent, and (*c*) those in which it was 10 per cent or more. In only 6 per cent of the total number of the sample companies covered by our investigation for 1971–72 did the LIC's percentage equityholding exceed 15 per cent of a company's equity. A comparison of the Tables 6.5 and 6.6 indicates that there has been a significant increase since 1959–60 in the proportion of companies in which the LIC's percentage equityholding was over 5 per cent.

Tables 6.7 and 6.8 give an idea of how the voting strength of the LIC varied between different size-classes and age-classes of companies for the two years 1971–72 and 1959–60 respectively. The difference between this set of tables and the Tables 6.1-6.3, presented earlier, should be noted in order to avoid confusion. In the Tables 6.1-6.3, the percentages represent the ratio of the LIC's aggregate equityholding in a group of companies to the aggregate equity capital of the group as a whole, including even those companies in which the LIC was not found to be a shareholder. The percentage obtained in this manner gives an idea, not of the voting strength of the LIC, but of its general significance in the share market. On the other hand, the Tables 6.7 and 6.8 are intended to indicate the LIC's voting strength; as such, they are restricted to only those companies which had the LIC among their top ten equityholders. The LIC's voting strength as indicated by its percentage equityholding tends to rise directly with the size of the company. This tendency is found to be more regular in 1971–72 than in 1959–60. The top size-class in 1971–72 seems to be an exception in this respect. The explanation for this seems to be that several of the largest companies happened to be foreign subsidiaries in which, not only was the bulk of equity held by a foreign company but the general public also subscribed avidly to the shares offered publicly in India. Hence, the percentage holding of the large institutional subscribers like the LIC in these companies tended to be smaller than in the other groups.

The average voting strength of the LIC for all those companies in which it was one of the top ten equityholders was 8·08 per cent in 1971–72[1] and 4·66 per cent in 1959–60. Although the average figure for 1971–72 is significantly high, it does not suggest that the LIC alone could exercise a decisive controlling influence on company managements in most cases. However, as the largest institutional shareholder with widespread shareholdings, it is bound to play a

[1]According to the figures given by Mr. T. A. Pai, then Chairman of the LIC, at a press conference held in Bombay on August 31, 1971, and subsequently confirmed in a letter to the author, the ratio of LIC's equity holdings to the aggregate equity capital of only those companies in which the LIC was an equityholder, came to as much as 13 per cent in 1971. It can be shown that this figure is very much of an over-estimate. We have estimated earlier in more than one way that the LIC's equityholding as a percentage of *all* quoted equity in 1971 was around 7-7·5 per

TABLE 6.5

DISTRIBUTION OF SAMPLE COMPANIES IN EACH SIZE-CLASS ACCORDING TO THE PERCENTAGE OF THEIR EQUITY HELD BY THE LIC APPEARING AMONG TOP 10 EQUITYHOLDERS, 1971–72

Percentage of equity held by LIC	Size-class by subscribed amount of equity in Rs. lakhs						
	Under 10	10 to under 25	25 to under 50	50 to under 100	100 to under 300	300 and over	All size-classes
Under 1%	— —	— —	— —	— —	1 (3·12)	2 (13·33)	3 (·90)
1% to under 2%	1 (1·56)	2 (1·89)	1 (1·39)	1 (2·33)	2 (6·25)	— —	7 (2·11)
2% to under 5%	5 (7·81)	9 (8·49)	9 (12·50)	5 (11·63)	1 (3·12)	5 (33·33)	34 (10·24)
5% to under 10%	3 (4·69)	9 (8·49)	8 (11·11)	9 (20·93)	12 (37·50)	3 (20·00)	44 (13·25)
10% to under 15%	1 (1·56)	4 (3·77)	6 (8·33)	8 (18·60)	6 (18·75)	2 (13·33)	27 (8·13)
15% to under 20%	1 (1·56)	1 (·94)	3 (4·17)	2 (4·65)	2 (6·25)	— —	9 (2·71)
20% to under 25%	1 (1·56)	1 (·94)	1 (1·39)	2 (4·65)	— —	2 (13·33)	7 (2·10)
25% to under 30%	— —	— —	— —	1 (2·33)	2 (6·25)	— —	3 (·90)
30% and above	— —	— —	1 (1·39)	— —	— —	— —	1 (·30)
Sub-total	12 (18·75)	26 (24·53)	29 (40·28)	28 (65·12)	26 (81·25)	14 (93·33)	135 (40·66)
Companies not having LIC among top ten	52 (81·25)	80 (75·47)	43 (59·72)	15 (34·88)	6 (18·75)	1 (6·67)	197 (59·34)
Grand Total	64 (99·99)	106 (99·99)	72 (100·00)	43 (100·00)	32 (99·99)	15 (99·99)	332 (99·98)

Note: Figures within parentheses represent percentage to column totals. Totals may not exactly tally because of rounding off.

TABLE 6·6

Distribution of Sample Companies in each Size-class According to the Percentage of Their Equity held by the LIC Appearing Among Top 10 Equityholders, 1959–60

Percentage of equity held by LIC	Size-class by subscribed amount of equity in Rs. lakhs						
	Under 10	10 to under 25	25 to under 50	50 to under 100	100 to under 300	300 and over	All size-classes
Under 1%	1 (1·39)	1 (1·61)	2 (8·00)	—	—	1 (50·00)	5 (2·70)
1% to under 2%	2 (2·78)	3 (4·84)	2 (8·00)	—	1 (10·00)	—	8 (4·32)
2% to under 5%	5 (6·94)	4 (6·45)	4 (16·00)	2 (14·28)	2 (20·00)	—	17 (9·19)
5% to under 10%	1 (1·39)	6 (9·68)	4 (16·00)	3 (21·43)	2 (20·00)	—	16 (8·65)
10% to under 15%	—	1 (1·61)	1 (4·00)	2 (14·28)	1 (10·00)	—	5 (2·70)
15% to under 20%	—	—	—	—	—	—	—
20% to under 25%	—	—	—	—	—	—	—
25% to under 30%	—	—	—	1 (7·14)	—	—	1 (·54)
30% and above	—	—	—	—	—	—	—
Sub-total	9 (12·50)	15 (24·19)	13 (52·00)	8 (57·14)	6 (60·00)	1 (50·00)	52 (28·11)
Companies not having LIC among top ten	63 (87·50)	47 (75·81)	12 (48·00)	6 (42·86)	4 (40·00)	1 (50·00)	133 (71·89)
Grand Total	72 (100·00)	62 (100·00)	25 (100·00)	14 (99·99)	10 (100·00)	2 (100·00)	185 (99·99)

Note: Figures within parentheses represent percentage to column totals. Totals may not exactly tally because of rounding off.

TABLE 6.7

PERCENTAGE OF TOTAL EQUITY CAPITAL HELD BY THE LIC IN THOSE COMPANIES IN WHICH THE LIC WAS ONE OF THE TOP TEN EQUITYHOLDERS, ACCORDING TO THE SIZE-CLASS AND AGE-CLASS OF COMPANIES, 1971–72

Size measured by subscribed equity capital in Rs. lakhs	Age since incorporation			
	Upto 6 years	Over 6 upto 15 years	Over 15 years	All age-classes
Under 10	—	7·01	6·70	6·73
10 to under 25	6·25	6·92	7·31	7·23
25 to under 50	10·00	8·84	9·26	9·20
50 to under 100	6·67	9·00	12·48	10·47
100 to under 300	—	8·44	11·37	10·52
300 and over	6·20	5·15	7·25	6·55
All size-classes	6·26	6·95	8·97	8·08

TABLE 6.8

PERCENTAGE OF TOTAL EQUITY CAPITAL HELD BY THE LIC IN THOSE COMPANIES IN WHICH THE LIC WAS ONE OF THE TOP TEN EQUITYHOLDERS, ACCORDING TO THE SIZE-CLASS AND AGE-CLASS OF COMPANIES, 1959–60

Size measured by subscribed equity capital in Rs. lakhs	Age since incorporation			
	Upto 6 years	Over 6 upto 15 years	Over 15 years	All age-classes
Under 10	·76	3·13	3·28	2·93
10 to under 25	—	6·14	4·46	4·73
25 to under 50	—	4·01	4·89	4·56
50 to under 100	25·00	8·76	5·86	8·89
100 to under 300	3·71	5·39	6·35	5·14
300 and over	—	—	·10	·10
All size-classes	7·43	5·57	3·46	4·66

cent. The companies in which the LIC was an equityholder formed 56 per cent of the number of quoted companies but these were generally the larger companies. The quoted companies in which the LIC was *not* an equityholder were generally of small size and would account for only a small fraction of the aggregate equity capital of all quoted companies. In view of this, the figure of 13 per cent is certainly much higher than the actual figure. This figure was given by the LIC only as an estimate. For this purpose, the ratio of the equity capital of those companies in which the LIC was an equityholder to the capital of all quoted companies seems to have been wrongly taken to be equal to the percentage of quoted companies in which the LIC held equity shares.

leading role and, in combination with the other public institutions, it could exercise considerable pressure on managements if a need arises. The relationship between institutional influence and institutional equityholding has been examined in detail in an earlier chapter.

(d) The LIC's Rank Among Equityholders in Individual Companies

From the point of view of the LIC's potential influence on company managements, it is interesting to enquire into its rank among the equityholders in

TABLE 6.9

Distribution of Sample Companies According to LIC's Rank among the Top Ten Equityholders in each Company, 1971–72

LIC's Rank among top 10 equityholders	No. of companies	Percentage distribution	Percentage of equity capital held by LIC in companies under each rank
1	43	13·0	16·7
	(14)	(7 6)	(10·7)
2	23	6·9	13·0
	(9)	(4·9)	(4·5)
3	27	8·1	4·4
	(8)	(4·3)	(2·0)
4	14	4·2	4·6
	(9)	(4·9)	(4·2)
5	11	3·3	1·6
	(1)	(0·5)	(2·4)
6	4	1·2	3·7
	(4)	(2·2)	(1·6)
7	5	1·5	4·0
	(2)	(1·1)	(1·0)
8	3	·9	3·0
	(1)	(0·5)	(0·5)
9	3	·9	3·4
	(3)	(1·6)	(1·2)
10	2	·6	3·1
	(1)	(0·5)	(1·3)
Sub-Total	135	40·7	8·1
	(52)	(28·1)	(4·7)
Not among top ten	197	59·3	—
	(133)	(71·9)	(—)
Grand Total	332	100·0	6·1
	(185)	(100·0)	(2·4)

Note: Comparative figures for 1959–60 are given in parentheses.

individual companies. Table 6.9 presents a distribution of the sample companies according to the rank of the LIC among the top ten equityholders. It is worth noting that out of the ten ranks occupied by the LIC in different companies the topmost rank shows the highest frequency. Taking only the 135 companies in which the LIC was among the first ten equityholders in 1971–72, we find that about one-third of the time it occupied the first rank, and about half the time it occupied at least one of the top two ranks. The LIC ranked as the topmost equityholder in 13 per cent of all the 332 sample companies in 1971–72. In the first two ranks, its percentage equityholding was also substantial, being 16·7 and 13·0 in the two ranks respectively. In the remaining eight ranks its percentage equityholding generally lay between 3–4·5 in 1971–72.

An important point to note is that the topmost rank was occupied by the LIC more frequently among the large-sized companies than among the smaller ones (see Table 6.10). However, here again, as before, the largest size-class was an exception. The LIC was the topmost equityholder in about one-fourth of the companies having a subscribed equity of Rs. 1–3 crore each and in about one-fifth of those with equity capitals of over Rs. 25 lakh but below Rs. 1 crore. Another interesting feature that we found was that the LIC ranked as the top-

TABLE 6.10

NUMBER AND PERCENTAGE OF COMPANIES IN WHICH THE LIC RANKED AS THE TOPMOST EQUITYHOLDER IN THE DIFFERENT SIZE-CLASSES OF COMPANIES, 1971–72

Size-class of companies by subscribed equity in Rs. lakhs	No. of sample companies covered	No. of companies having LIC as topmost equityholder	(2) as per cent of (1)	Percentage of equity held by the LIC in companies having it as topmost equityholder
	1	2	3	4
Under 10	64	4	6·3	13·4
	(72)	(1)	(1·4)	(6·0)
10 to under 25	106	6	5·7	15·1
	(62)	(4)	(6·5)	(8·5)
25 to under 50	72	15	20·8	10·3
	(25)	(3)	(12·0)	(7·5)
50 to under 100	43	8	18·6	17·2
	(14)	(5)	(35·7)	(11·2)
100 to under 300	32	8	25·0	17·4
	(10)	(1)	(10·0)	(13·4)
300 and over	15	2	13·3	17·8
	(2)	(Nil)	(Nil)	(Nil)
All size-classes	332	43	13·0	16·7
	(185)	(14)	(7·6)	(10·7)

Note: Comparative figures for 1959–60 are given in parentheses.

most equityholder mainly among established companies but among very few of the new companies in which the promoters and foreign collaborators often have large equityholdings.

2. The Unit Trust of India

The UTI as an equityholder is only about a third as important as the LIC.[1] The UTI was found to be among the first ten ranks of equityholders in only 15·1 per cent of 332 sample companies covered by our investigation for 1971–72 (against 40·7 per cent in the case of the LIC), and it held only 2·0 per cent of the aggregate equity of all the sample companies taken as a whole. Taken by itself, it cannot be regarded as a weighty influence on company managements. However, it has close working relationship with the LIC in this respect.

Table 6.11 shows a distribution of sample companies according to the percentage of their equity held by the UTI appearing among the first ten equityholders in 1971–72. Its equityholding most frequently ranges between 2-5 per cent and in only exceptional cases goes beyond 10 per cent. Table 6.12 gives the percentages of companies, by size and age class of the companies, in which the UTI was among the top ten equityholders. Table 6.13 shows what percentage of the aggregate equity of each of the sub-groups of companies was owned by the UTI in 1971–72. Table 6.14 gives the voting strength of the UTI in those

TABLE 6.12

PERCENTAGE OF SAMPLE COMPANIES, BROKEN UP BY SIZE AND AGE, IN WHICH THE UTI RANKED AMONG TOP TEN EQUITYHOLDERS, 1971–72

Size-class of companies measured by subscribed equity capital in Rs. lakhs	Age since incorporation			
	Upto 6 years	Over 6 upto 15 years	Over 15 years	All age-classes
Under 10	Nil	Nil	Nil	Nil
10 to under 25	Nil	Nil	3·9	2·8
25 to under 50	Nil	4·2	11·9	8·3
50 to under 100	Nil	17·6	45·5	30·2
100 to under 300	*	36·4	61·9	53·1
300 and over	66·7	60·0	85·7	73·3
All size classes	13·3	12·9	16·3	15·1

*None of the sample companies fell in this cell.

[1]This is indicated both by our data and by a comparison of the book values of the equity shares held by the LIC and the UTI as given in their annual reports, the respective figures being Rs. 127·1 crore for the LIC as on March, 31 1971, and Rs. 39·7 crore for the UTI as on June 30, 1971.

TABLE 6.11

DISTRIBUTION OF SAMPLE COMPANIES IN EACH SIZE-CLASS ACCORDING TO THE PERCENTAGE OF THEIR EQUITY HELD BY THE UTI APPEARING AMONG TOP 10 EQUITYHOLDERS, 1971–72

Percentage of equity held by UTI	Size-class by subscribed amount of equity in Rs. lakhs						
	Under 10	10 to under 25	25 to under 50	50 to under 100	100 to under 300	300 and over	All size-classes
Under 1	—	—	1(1·4)	—	1(3·1)	—	2(·6)
1 to under 2	—	—	2(2·8)	3(7·0)	2(6·3)	1(6·7)	8(2·4)
2 to under 5	—	2(1·9)	3(4·2)	6(14·0)	6(18·8)	8(53·3)	25(7·5)
5 to under 10	—	1(·9)	—	3(7·0)	5(15·6)	1(6·7)	10(3·0)
10 to under 15	—	—	—	1(2·3)	3(9·4)	1(6·7)	5(1·5)
15% and over	—	—	—	—	—	—	—
Sub-total	—	3(2·8)	6(8·3)	13(30·2)	17(53·1)	11(73·3)	50(15·1)
Companies not having UTI among top ten	64(100·0)	103(97·2)	66(91·7)	30(69·8)	15(46·9)	4(26·7)	282(84·9)
Grand Total	64(100·0)	106(100·0)	72(100·0)	43(100·0)	32(100·0)	15(100·0)	332(100·0)

Note: Figures within parentheses represent percentage to column totals. Totals may not exactly tally because of rounding off.

TABLE 6.13

PERCENTAGE OF EQUITY CAPITAL HELD BY UTI AS ONE OF TOP TEN EQUITYHOLDERS IN ALL SAMPLE COMPANIES BROKEN UP BY SIZE AND AGE, 1971–72

Size-class of companies by subscribed equity capital in Rs. lakhs	Age since incorporation			
	Upto 6 years	Over 6 upto 15 years	Over 15 years	All age-classes
Under 10	Nil	Nil	Nil	Nil
10 to under 25	Nil	Nil	·1	·1
25 to under 50	Nil	·1	·2	·2
50 to under 100	Nil	·7	2·4	1·5
100 to under 300	*	2·3	3·2	3·0
300 and over	1·8	2·1	2·8	2·3
All size-classes	1·6	1·5	2·3	2·0

*None of the sample companies fell in this cell.

TABLE 6.14

PERCENTAGE OF EQUITY CAPITAL HELD BY UTI IN THOSE COMPANIES IN WHICH THE UTI WAS ONE OF THE TOP TEN EQUITYHOLDERS, ACCORDING TO SIZE-CLASS AND AGE-CLASS OF COMPANIES, 1971–72

Size-class of companies measured by subscribed equity capital in Rs. lakhs	Age since incorporation			
	Upto 6 years	Over 6 upto 15 years	Over 15 years	All age-classes
Under 10	—	—	—	—
10 to under 25	—	—	3·3	3·3
25 to under 50	—	2·4	2·2	2·2
50 to under 100	—	3·8	5·1	4·8
100 to under 300	—	5·7	5·3	5·4
300 and over	2·7	4·1	3·9	3·6
All size-classes	2·7	4·6	4·4	4·1

companies only in which it was one of the top ten equityholders. This table has been constructed in the same way and with the same object as Table 6.7 presented earlier for the LIC.

The difference between the LIC and the UTI, with regard to their equityholdings, is not simply one of magnitudes. There are important characteristic differences between the two in respect of their investment policies. The most

distinguishing feature of the UTI's equityholding is its much stronger preference, compared to the LIC, for the large companies. This is clearly revealed by Tables 6.12 and 6.13 if we compare the figures for the three smallest size-groups (having equity capitals below Rs. 50 lakh) with those for the three largest size groups (having equity capitals of over Rs. 50 lakh). The main reason for this preference lies in the fact that all investment trusts of the ' unit trust ' (i.e., ' open-end') variety have necessarily to restrict their equity investments to the actively traded equity shares because they must announce a daily price of their units based on the market value of their holdings.[1] It is unfortunate that this important point has so far been totally missed by the authorities concerned with the reshaping of the country's financial mechanism. Investment trusts of the closed-end variety, being free from the kind of constraints applicable to unit trusts, can normally operate over a much wider area than unit trusts. For this reason, ' they offer perhaps the only practical solution to the problem of finding equity capital for small companies, whose securities can have no ready marketability.'[2] To rule out completely the closed-end variety of investment trusts is inconsistent with the developmental objective of strengthening the financial facilities for the smaller and medium-sized companies.

3. The Other Public Institutions

The role of the remaining categories of public institutions as equityholders in quoted companies will be examined below.

(a) Development Banks

The development banks acquire equityholdings largely through underwritings and direct subscriptions and not through market purchases. The rise of development banks as equityholders is thus related particularly to the growth of their underwriting operations. Development banks, as a group, were not significant holders of equity shares in 1959–60. They came to hold increasing amounts of equity shares during the 1960s. The percentage of equity held by all the development banks together (at both all-India and state levels) in 1971–72 in the 332 sample companies was 8·6 per cent as compared to 6·1 per cent held by the LIC.[3] The development banks as a group have thus surpassed the LIC in equityholding.

It is noteworthy that among the development banks, the percentage equityholding of the state-level bodies (mainly state industrial development corporations) was higher than that of the all-India development banks, the respective figures being 5·3 per cent and 3·3 per cent in 1971–72 for our sample.

An outstanding feature of the equityholding of development banks, both all-

[1]For a more detailed examination of this point in the context of the Indian share market, see Gupta, op.cit., pp. 77–78.

[2]Ibid.

[3]These are percentages to the aggregate equity capital of all the 332 sample companies.

India and state-level, was that the equity percentage held by them was inversely related to the age-class of companies (see Tables 6.15 and 6.16). The all-India

TABLE 6.15

PERCENTAGE OF EQUITY CAPITAL HELD BY ALL-INDIA DEVELOPMENT BANKS APPEARING AMONG TOP TEN EQUITYHOLDERS IN ALL SAMPLE COMPANIES BROKEN UP BY SIZE AND AGE, 1971–72

Size-class of companies by subscribed equity capital in Rs. lakhs	Age since incorporation			
	Upto 6 years	Over 6 upto 15 years	Over 15 years	All age-classes
Under 10	—	—	—	—
10 to under 25	6·3	8·7	—	2·5
25 to under 50	1·3	4·6	·8	2·0
50 to under 100	—	8·8	1·3	4·3
100 to under 300	—	3·5	1·7	2·3
300 and over	7·7	8·2	·3	4·1
All size-classes	6·9	6·5	·8	3·3

TABLE 6.16

PERCENTAGE OF EQUITY CAPITAL HELD BY STATE-LEVEL DEVELOPMENT BANKS APPEARING AMONG TOP TEN EQUITYHOLDERS IN ALL SAMPLE COMPANIES BROKEN UP BY SIZE AND AGE, 1971–72

Size-class of companies by subscribed equity capital in Rs. lakhs	Age since incorporation			
	Upto 6 years	Over 6 upto 15 years	Over 15 years	All age-classes
Under 10	19·4	11·5	—	1·4
10 to under 25	23·9	11·1	·2	4·3
25 to under 50	8·0	8·7	2·0	4·6
50 to under 100	18·3	15·8	1·4	8·7
100 to under 300	—	4·0	0·9	1·9
300 and over	12·3	13·8	—	6·4
All size-classes	12·7	10·6	·6	5·3

and state-level development banks together held 19·6 per cent of the aggregate equity of the youngest group of companies (upto 6 years), 17·1 per cent of the middle group (6-15 years), and only 1·4 per cent of the oldest group (over 15 years).[1]

The concentration of the development banks' equityholding in the relatively younger companies marks them apart from the LIC and the UTI. It reflects

[1]These figures are derived from Tables 6.15 and 6.16 by totalling the corresponding figures.

the fact that the facilities provided by development banks for underwriting equity issues are availed of primarily by new and relatively young companies. The old and well-established enterprises offer their new equity issues generally by way of ' rights '.

There has thus come to be a kind of a natural division of spheres between the development banks on the one hand, and the savings institutions like the LIC and the UTI on the other: while the former concentrate their operations, in the form of underwriting, on the younger enterprises, the latter, mainly through their market purchases, concentrate on the established companies.

No systematic relation seems to exist between the development banks' percentage equityholding and company-size (see Tables 6.15 and 6.16).[1] The all-India development banks, as well as the state-level ones, operate over almost all size classes of quoted companies in the matter of equity underwriting and direct subscription, quite often by joining hands with each other.

There are two important forces working in the direction of further increasing the relative importance of development banks significantly in the near future. The first of these is the recently adopted practice of lending partly in convertible forms. The conversion rights reserved by the lending institutions in the recent loan agreements will mature in the next few years and their exercise will give the development banks a still larger participation in the equity of many companies. The second factor in this regard is the growing role being played by state industrial development corporations in the promotion of new enterprises in general and in the setting up of ' joint sector ' enterprises in particular.

The development banks are becoming true ' nurseries ' of new enterprises. Even though they are expected to revolve their funds by unloading their holdings in course of time, they would still be holding increasing amounts of equity in the near future.

The voting strength of development banks is likely to vary widely between individual companies, depending upon the result of the particular underwriting operation. Relating the equityholding of the development banks to the aggregate equity of only those sample companies in which they were among the top ten equityholders, we computed the percentage voting strength of the two classes of development banks separately in terms of the percentage of equity held by them in 1971–72. The percentage was 10·6 for the all-India development banks and 18·8 for the state level development banks.[2]

(b) The General Insurance Companies

The general insurance business, before its nationalisation in 1972, was carried on by more than a hundred separate units and, at the time of our study, the shareholdings were still held in names of individual units. We have pointed out in the previous chapter how this is likely to result in some understatement of

[1]See also Table 5.13 given earlier.

[2]The two percentage figures given here cannot be added together because the companies in which the all-India development banks were among the top ten equityholders are not the same as those in the other case.

the equity percentage held by the general insurers, as arrived at by us. Allowing for this fact, the general insurers, as a group, are more important equityholders than the UTI. Inspite of this, their operations in the share market have gone on almost unnoticed because they were conducted in a decentralised manner, while those of the UTI and the LIC have attracted spectacular attention.

After the setting up of the General Insurance Corporation of India in 1972, the investment function is being centralised. It has been announced that this Corporation would hold, with effect from January 1, 1973, all the shares of the nationalised general insurance companies. Thus a monolithic structure has replaced a decentralised one, so far as the investment of general insurance funds is concerned.[1] As the experience of the LIC shows, an unfortunate effect of such centralisation is to strengthen the tendency to hold only large packets of securities so that the investment of these funds is likely to become more concentrated in the large-sized companies. The creation of monolithic investment institutions also has the effect of thinning market activity in shares by excluding much of inter-institutional sales. Further, to the extent that centralisation reduces scope for interplay of market opinions, the efficiency of the share market is impaired.

The general insurers were among the top ten equityholders in 31·3 per cent of the 332 sample companies in 1971–72 and held 2 1 per cent of the aggregate equity of these companies. A detailed analysis of their equityholding by size-class and age-class of companies is presented in Tables 6.17–6.19.

TABLE 6.17

PERCENTAGE OF COMPANIES IN EACH CLASS IN WHICH GENERAL INSURERS WERE AMONG TOP TEN EQUITYHOLDERS: A BREAK UP BY SIZE AND AGE OF COMPANIES, 1971–72

Size-class of companies by subscribed equity capital in Rs. lakhs	Age since incorporation			
	Upto 6 years	Over 6 upto 15 years	Over 15 years	All age-classes
Under 10	Nil	40·0	3·5	6·3
10 to under 25	33·3	56·5	6·5	18·9
25 to under 50	66·7	54·2	19·1	34·7
50 to under 100	Nil	70·6	36·4	46·5
100 to under 300	—	81·8	66·7	71·9
300 and over	66·7	80·0	85·7	80·0
All size-classes	40·0	62·4	18·9	31·3

[1]Four separate operating units are being retained for conducting the general insurance business. However, the investment function will be centralised in the General Insurance Corporation of India.

TABLE 6.18

PERCENTAGE OF EQUITY CAPITAL HELD BY GENERAL INSURERS APPEARING AMONG THE TOP TEN EQUITYHOLDERS IN ALL SAMPLE COMPANIES, BROKEN UP BY SIZE AND AGE, 1971–72

Size-class of companies by subscribed equity capital in Rs. lakhs	Age since incorporation			
	Upto 6 years	Over 6 upto 15 years	Over 15 years	All age-classes
Under 10	Nil	1·9	·2	·3
10 to under 25	2·8	5·7	·2	2·5
25 to under 50	1·6	2·7	1·0	1·6
50 to under 100	Nil	3·6	2·0	2·5
100 to under 300	*	3·4	2·4	2·8
300 and over	1·2	1·4	1·9	1·6
All size classes	1·2	2·8	1·8	2·1

*None of the sample companies fell in this cell.

TABLE 6.19

PERCENTAGE OF TOTAL EQUITY CAPITAL HELD BY GENERAL INSURERS IN THOSE COMPANIES ONLY IN WHICH THEY APPEARED AMONG THE TOP TEN EQUITYHOLDERS ACCORDING TO THE SIZE-CLASS AND AGE-CLASS OF COMPANIES, 1971–72

Size-class of companies by subscribed equity capital in Rs. lakhs	Age since incorporation			
	Upto 6 years	Over 6 upto 15 years	Over 15 years	All age-classes
Under 10	Nil	5·9	6·7	6·3
10 to under 25	10·1	9·5	2·7	8·1
25 to under 50	3·0	4·6	4·9	4·4
50 to under 100	Nil	5·4	5·4	5·4
100 to under 300	*	4·3	3·4	3·7
300 and over	1·8	1·6	2·6	2·2
All size classes	2·0	3·6	3·4	3·2

*None of the sample companies fell in this cell.

(c) GOVERNMENT

We have pointed out in the previous chapter that direct shareholdings by the Central Government is not common. State governments, however, many a time subscribe to equity capital of companies by way of encouragement to the development of industry within their boundaries. Before the integration of the 'princely' states with the Indian Union, some of them, such as Mysore and

Hyderabad, often took up sizable participations in the equity of companies. This is now being done by almost all the state governments increasingly through the medium of state-owned industrial development corporations.

(d) THE NATIONALISED COMMERCIAL BANKS

Our analysis in the previous chapter was expressly restricted to the equity-holding of the *non-bank* public institutions for the reason already given.[1] To complete the picture, we shall briefly comment on the equityholdings of the nationalised commercial banks.[2] According to Table 5·13, these banks were, in terms of the amount of equityholding, at the lowest rung of the ladder among all the categories of public institutions. They held approximately 1·5 per cent of the aggregate equity capital of all our sample companies. Their true significance is still lower, since some of the shareholding appearing in the names of banks is held by them, not as beneficiaries, but as nominees or trustees. The proportion of companies having the nationalised banks among the top ten equityholders was 34·0 per cent. Thus, although the amount of equity held by the banks was relatively small, the spread of their holding was fairly wide, next only to that of the LIC. The banks' equityholding is positively correlated with both size and age of companies (see Table 6.20).

TABLE 6.20

PERCENTAGE OF COMPANIES IN EACH CLASS IN WHICH PUBLIC SECTOR BANKS WERE AMONG TOP TEN EQUITYHOLDERS: A BREAK UP BY SIZE AND AGE OF COMPANIES, 1971–72

Size-class of companies by subscribed amount of equity in Rs. lakhs	Age since incorporation			
	Upto 6 years	Over 6 upto 15 years	Over 15 years	All age-classes
Under 10	Nil	Nil	25·9	23·4
10 to under 25	Nil	13·0	26·0	21·7
25 to under 50	Nil	16·7	50·0	34·7
50 to under 100	25·0	29·4	50·0	39·5
100 to under 300	*	63·6	62·0	62·5
300 and over	50·0	100·0	100·0	86·7
All size classes	13·3	28·2	38·3	34·0

*None of the sample companies for 1971–72 belonged to this class.

We have surveyed in this chapter the relative importance of the different categories of public institutions as equityholders and the distinguishing features of their investment policy in this respect. An attempt was also made to point out the forces of change which are likely to alter the contours of the public institutions in the near future.

[1]A general indication of the relative importance of the nationalised commercial banks in equityholding was given in Table 5.13 along with all other public institutions.

[2]See also the Section 2 of previous chapter.

Part Three

Top-Management Structure

Hyderabad, often took up sizable participations in the equity of companies. This is now being done by almost all the state governments increasingly through the medium of state-owned industrial development corporations.

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TABLE 6.20

Percentage of Companies in each Class in which Public Sector Banks were Among Top Ten Equityholders: A Break up by Size and Age of Companies, 1971–72

Size-class of companies by subscribed amount of equity in Rs. lakhs	Age since incorporation			
	Upto 6 years	Over 6 upto 15 years	Over 15 years	All age-classes
Under 10	Nil	Nil	25·9	23·4
10 to under 25	Nil	13·0	26·0	21·7
25 to under 50	Nil	16·7	50·0	34·7
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300 and over	50·0	100·0	100·0	86·7
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50 to under 100	25·0	29·4	50·0	39·5
100 to under 300	*	63·6	62·0	62·5
300 and over	50·0	100·0	100·0	86·7
All size classes	13·3	28·2	38·3	34·0

*None of the sample companies for 1971–72 belonged to this class.

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[1] A general indication of the relative importance of the nationalised commercial banks in equityholding was given in Table 5.13 along with all other public institutions.

[2] See also the Section 2 of previous chapter,

Part Three

Top-Management Structure

7

The Board and the Top Executive

THE OBJECT OF this chapter is to examine certain basic problems pertaining to the top managerial organization in corporate undertakings. The importance of top management cannot be overemphasized. It has been well said that ' no business is likely to be better than its top management, have broader vision than its top people, or perform better than they do '.[1]

The central problem of top management structure is one of reconciling the chief executive's imperative need for considerable freedom and authority with the need for accountability of the executive to the interests concerned. The problem is essentially the same, whether the enterprise is private or public. The present situation in India is bedevilled by either absolute power (i.e., no accountability, as in private enterprise) or absolute paralysis (i.e., no freedom and authority to the chief executive, as in public enterprise). We have, therefore, to devise organizational structures which would reconcile executive power with executive accountability.

1. THE ROLE OF COMPANY BOARDS: THE MYTH AND THE REALITY

The law has placed the entire managerial responsibility and power in respect of a company's affairs in the hands of the company's board of directors but this is no more than a legal fiction. Contrary to the popular impression, the role of the board of directors is not of ' decision-making ' nature but only supervisory and advisory. Typically, the members of company boards have neither the time, nor the inclination, and in many cases not even the ability to undertake lengthy and penetrating analysis that ' decision-making ' requires. A director, unless he is a full-time employee of the company, is not expected to give continuous attention to the company's affairs. He is not even bound to attend all, or nearly all, board meetings and is usually not liable for anything done at a meeting which he did not attend. Although, on the face of it, members of company boards seem to carry an onerous burden of legal duties and liabilities, in actual practice, it has been found that only a fairly low level of skill and diligence is needed from them to escape all legal liability. Galbraith has the following satire on ' decision-making ' by company boards:

> Corporate liturgy strongly emphasizes the power of the Board of Directors and ultimately, thus, of the stockholders they are assumed to represent. The rites which attest this point are conducted with much solemnity; no one

[1]Peter F. Drucker, *The Practice of Management* (Indian ed., New Delhi, 1970), p. 161.

allows himself to be cynical as to their substance. Heavy dockets, replete with data, are submitted to the Board. Time is allowed for study. Recommendations are appended. Given the extent and group character of the preparation, rejection would be unthinkable. The Board, nonetheless, is left with the impression that it has made a decision.[1]

From what has been said above, it should not be concluded that company boards have no impact on corporate decision-making.[2] The executive still ' decides ' but the board has to ' ratify ' the major decisions of the executive. That boards are, contrary to popular impression, *not* the ' deciding ' bodies has been emphasized by several well-known writers. Thus in the words of Gordon:

> Executives rather than directors make the bulk of decisions which enter into the leadership function in the large corporation......directors, in so far as they participate at all in the decision-making function, do so through their power to veto or approve decisions laid before them by the chief executive. *By virtue of this fact, the creative and dynamic elements of business leadership cannot be expected to develop out of the deliberations and activities of the board as a formal group.*[3] (emphasis added)

Similarly, Mace remarks:

> The board is not really a decision-making body, but it is involved in the decision-making process as a sort of corporate conscience.[4]

Drucker's view is no different:

> ...... the board cannot and must not be the governing organ that the law considers it to be. It is an organ of review, of appraisal, of appeal. Only in

[1]J. K. Galbraith, *The New Industrial State* (London, 1967), p. 83. Galbraith's view agrees with the general view about boards' functioning. Thus another writer observes:

> ' The lack of active discussion of major issues at typical board meetings and the absence of discerning questions by board members result in most board meetings resembling the performance of traditional and well-established, almost religious rituals. See Myles L. Mace. 'The President and the Board of Directors', in *Harvard Business Review*, March-April 1972, p.42,

[2]Nor does it mean that company boards are superfluous. To quote Drucker again:

> But there are real functions which only a Board of Directors can discharge. Somebody has to approve the decision what the company's business is and what it should be. Somebody has to give final approval to the objectives the company has set for itself and the measurements it has developed to judge its progress toward these objectives. Somebody has to look critically at the profit planning of the company, its capital-investment policy and its managed-expenditures budget. Somebody has to discharge the final judicial function in respect to organisation problems, has to be the ' Supreme Court '. Somebody has to watch the spirit of the organization. *The Practice of Management*, p. 179.

[3]Robert Aaron Gordon, *Business Leadership in the Large Corporation*, (Berkeley and Los Angeles, 1966), p. 128.

[4]Mace, op. cit., p. 40.

a crisis does it become an organ of action—and then only to remove existing executives that have failed, or to replace executives who have resigned, retired or died. Once the replacement has been made, the Board again becomes an organ of review.[1]

We should, therefore, say that the board's true function in relation to corporate management consists not in ' decision-making ' but in ' advising ' and ' supervising ' the executive. The outside board members in particular can provide useful inputs of advice on a variety of matters but the extent to which advantages is taken of such advice depends almost wholly on the executive.

2. Top Management: Structural Aspects

The most logical structure of a company's top administration would consist of two distinct layers:

(*i*) *The Executive:* To the executive belongs the role of business ' leadership ' in the sense of originating and formulating proposals, making business decisions, and initiating action.[2] Its function is to prepare the company's plans, programmes and policies, to get these approved by the ' legislative wing ', and to run the day-to-day administration. To be able to discharge its leadership function effectively, the executive must be vested with the necessary authority and considerable freedom.

(*ii*) *The Legislature* (i.e., the board of directors, representing the owners, and, may be, certain other interests): It meets only periodically to undertake a review and appraisal of plans, policies and performance of the executive.

There has been increasing questioning in recent years as to whether company boards are discharging the supervisory function expected of them. The feeling has grown that in most companies they are no more than dummy bodies controlled by executive managements.

' Inside ' vs. ' Outside ' Directors

On the above reasoning, it would be anomalous to have a board of directors composed wholly or predominantly of ' insiders '. Management consultants are almost unanimously against such boards. Drucker describes an ' inside ' board, with a touch of sarcasm, as ' one composed exclusively of executive management men who meet the first Monday in every month to supervise and approve what they themselves have been doing the other twenty nine days of the month.'[3] The issue involved is put more simply by Charles Wohlstetter, Chairman and Principal Executive Officer of Continental Telephone Corpo-

[1] *The Practice of Management*, p. 179.

[2] Robert Aaron Gordon, *Business Leadership in the Large Corporation* (Berkeley and Los Angeles, 1966), p. 128.

[3] *The Practice of Management*, p. 178.

ration: ' I don't think a management should mark its own examination papers.'[1]

An inside board can never be expected to take an independent and objective view of management and is most likely to be dominated by the chief executive on whom the other executives depend for their promotion.[2]

An excellent recent article in the *Harvard Business Review* questions the usefulness of ' insider ' board members in the context of the functions expected of company boards. To quote:

> If the functional roles of the board of directors are to:
>
> Provide advice and counsel, do inside officer-directors have to be on the board in order to advise the President?
>
> Serve as some sort of discipline, how does an insider on the board serve as a discipline on himself ?
>
> Be available in the event of a crisis, can insiders objectively conclude that their President's performance is so unsatisfactory that he should be replaced?
>
> Determine objectives, strategies, and major policies, inside officer-directors can recommend objectives and strategies, but should those who recommend also approve?
>
> Ask discerning questions, can an inside officer-director ask discerning questions at board meetings without jeopardy to his working relationship with the president?
>
> Evaluate the president, how does an officer-director with aspirations of continued employment evaluate the president except in favourable terms.[3]

The article suggests a five point programme of reform to improve the functioning of company boards; it categorically prescribes the first item of this programme as follows: ' Ask all insiders on the board other than the chairman and the president to resign.'[4]

Drucker emphasizes the point that the members of the board must be detached from operations. He goes on to suggest that ' the Board will be stronger and

[1]Quoted by Roy Hill in ' A Wider Role for Outside Directors ', *International Management*, November 1970, reproduced in the *Management Review*, March. 1971, p. 19.

[2]The point is well illustrated by the following two examples given by a U.S. businessman:

> ' The President was pushing a certain acquisition. He was all for it. It was his baby and he was so committed to it that he couldn't see the problems. The insiders on the board said nothing, but we outsiders shot it out of the water. After considering all the facts and figures management could present, we argued—and carried our point that there must be better ways in which to spend money borrowed at today's rates.
>
> ' In another company one division was losing money. The president kept saying it was getting better, but the improvement was hard to see. Finally we outsiders got him to define satisfactory performance for the division, and got the board to set a date when the performance would be reached or the division chopped. The division was chopped.' Cited by Roy Hill, op. cit., p. 21.

[3]Mace, op. cit., p. 46

[4]Ibid.

more effective if it is genuinely an ' outside ' Board, the bulk of whose members have never served as full-time officers of the company '.[1] The outside directors would help to correct the general tendency among the full-time executives ' to think too much in terms of immediate or technical problems '.[2] He concludes:

> What is needed on a Board is not people who agree with management anyhow, but people who are likely to see things differently, to disagree and to question—especially to question the assumptions on which the chief executives team acts without, usually, knowing that it is making them.[3]

The German law makes a clear distinction between the two layers of the companies' top management: all members of the *Vorstand*, or ' management board ', are executive directors and, as such, expected to initiate developments within their departments for the benefit of the company as a whole. In contrast, all members of the *Aufsichtsrat*, or supervisory board, are non-executives of the company and their function is to act as ' watch-dogs ' exercising over-all control.[4] Members of *Vorstand* cannot ordinarily be members of the *Aufsichtsrat*. The *Vorstand* may consist of one or more members who are appointed by, and can be dismissed by, the *Aufsichtsrat*.

The French company law since 1966 gives companies the option to choose the German model. Further, it prescribes that in the case of single-board companies, not more than one-third of the board's members at any time would consist of executive directors. Under Swedish law, the managing director is not allowed to be the chairman of the board of directors.[5]

The trend in the United States seems to be away from full-time boards. Outside directors were predominant in 54 per cent of the American Manufacturing companies in 1953, 57 per cent in 1958, and 63 per cent in 1967.[6]

As will be shown in the next chapter, very few companies in India have boards composed wholly or predominantly of full-time executives. In spite of the unanimous verdict of management experts against ' inside ' boards, there is in actual practice much greater general satisfaction, in India in any case, with the performance of full-time boards. The reason perhaps lies not so much in the ' inside ' character of the board as in the professionalisation of management and in the fact that the full-time professional directors would usually not be having any private business interests of their own which may conflict with their duties to the company. In companies not under full-time boards, the conflict between the ' private ' business interests of the important board members on the one hand, and the interests of the enterprise on the other is far too common in India. This conflict arises from the directors having their finger in many a pie.

[1]Drucker, op. cit., p. 180.
[2]Ibid.
[3]Ibid., p. 181.
[4]See Roy Hill, op. cit., p. 20.
[5]See Houghton (ed.) *The Company*, pp. 151 and 160.
[6]Cited by Roy Hill, op. cit., p. 20.

To sum up, the alternative forms of top organizational structure that are available for corporate enterprise may be classified as follows:

(1) 100-per-cent ' Outside ' board, the executive power being vested in a chief executive officer who is not a board member.

(2) 100-per-cent ' Inside ' board whose members are executive heads of the various divisions.

(3) Board composed partly of ' insiders ' and partly of ' outsiders ', either with equal weightage or with more weightage for one of the two groups.

(4) Two-board system on the German model—a ' board of supervision ' elected by shareholders and a ' board of management ' which is appointed by the board of supervision and whose members are not allowed to be members of the other board. If the board of management consists of only one member, as it may in Germany, this system becomes identical with (1) above.

The most rational system, on the reasoning given above, seems to be the two-board system which provides for a clear bifurcation between the executive function and the control function. A single board system with a minority of ' insiders ' is sometimes preferred because it affords a better opportunity to the ' outside ' board members to know the executive members and also gives the executives a more satisfying status. The knowledge acquired by the board can be helpful to decide management succession, as and when the problem arises. In this connection, it is also worth taking note of Drucker's strong advocacy of replacing the ' one-man chief-executive concept ' with what he calls ' the chief-executive team.' The essence of his proposal is the creation of a number of positions at the top level that are virtually of equal importance with only a slight difference in remuneration and status. One of the main troubles with the one-man chief-executive is that no matter how poor he turns out to be, he cannot ordinarily be removed nor effectively neutralised. There is much to be said in favour of the team approach, at least in the case of the larger companies.[1]

3. Managerial Accountability through Company Boards

No effective system of accountability of the executive to the shareholder and, hopefully, to the other interests in the enterprise, can be there unless the board of directors is made an independent organ of review and appraisal. In the absence of board's independence, the executive acquires uncontrolled power; and uncontrolled power, whether in government or private hands, is always susceptible to abuse.

The failure of company boards to supervise and control the executive is basically the result of the fact that, in most Indian companies, boards are not truly independent of the chief executive who usually happens to be a member of the controlling group. Hence, while in law, it is the board which appoints and controls the chief executive, in reality, it is the chief executive who, along with his group, selects the members of the board and whom the board obeys.

If the independence of boards is to be ensured, the boards should not be

[1]See Drucker, *The Practice of Management*, pp. 167–78.

controlled by any single group, whether inside or outside the company. The system of proportional representation on company boards is worth considering in this connection and will be examined at length in the last chapter.

While we advocate that there should be more effective supervision of the executive by company boards, we would like to warn against the boards' usurping the function of the executives by meddling with day-to-day management. A more ' active ' board should not be taken to mean that it converts itself into a kind of parallel executive organization. In the final analysis, the performance and progress of an undertaking will depend on the ability and dynamism of its top executive and not on its board. The business leadership and initiative have to come from the top executive who must have the necessary motivation and power. The board is to be a watch-dog and adviser. Its basic functions would be three: (*a*) to keep control over broad policies and the direction in which the enterprise may be going, (*b*) to ' audit ' management performance, and (*c*) to tender advice as and when necessary. There is a danger in making the boards too ' active ' since it might result in producing the kind of situation in which government enterprises find themselves today in India because very little freedom and authority are given to their executive managements.

It is important to stress that the relationship between the chief executive and the board is a delicate one and requires utmost trust and understanding. It should also be borne in mind that although the legal relationship between a company and its chief executive is one of a contract of employment, there are weighty considerations which put him in a special category quite distinct from the ordinary employees of the company. His real position is more akin to a partner implying the idea of a durable association between him and the company. The special relationship often arises because the enterprise may owe its origin to the initiative of the chief executive who would also have staked his money in the enterprise. Further, whereas ordinary employees can move easily from one company to another, this is not so for the chief executive. For these practical reasons, the chief executive would certainly need all the sympathy from his board.

We would also like to advocate greater use of ' audit *of* management ' where managerial performance falls seriously short of the requirements. Unfortunately this has received very little attention in our country. In India so far, the Government's chief methods of dealing with cases of mismanagement are either ' takeover ' of management, or ordering investigation which is oriented mainly towards uncovering frauds and irregularities instead of organisational and managerial weaknesses. While prevention of fraud was the dominant object of company legislation in the past, it appears that we have now reached a stage when our most important concern should be the improvement in managerial performance and competence. It is, therefore, suggested that both the government and the company boards should make greater use of ' audit *of* management ' conducted by qualified management consultants. This would also give an impetus towards professionalisation of management.

8

The Composition of Company Boards in India

THIS CHAPTER EXAMINES three main aspects of the composition of company boards in India, viz., (1) the size of boards, (2) the proportions of executive and non-executive directors, and (3) institutional representation. Some studies of company boards in India have been conducted in the past but they were concerned almost exclusively with the problem of 'interlocking' directors. This aspect has been excluded from the present study. Our attempt will be to present a general picture of board composition, throwing particular light on the aspects mentioned above. The study is of an exploratory and limited nature, and is based on a quick survey of a selected group of companies.

1. METHODOLOGY AND SCOPE

The study is based on a specific survey undertaken for the purpose through a questionnaire. The survey presents the picture as it obtained about the middle of 1972.

We decided to give somewhat more attention to the big-sized companies in this survey because it is this class of companies which have been in the centre of public discussion regarding problems of accountability and economic power. At the same time, in order to present a comparative picture, we covered the medium and small-sized companies also.

The big-sized companies which we addressed included all those having a paid-up equity capital of at least Rs. 1 crore and listed on the Bombay, Calcutta and/or Madras Stock exchanges. Financial companies were excluded from the survey.

The medium and small companies included in the survey were those listed on the Madras Stock exchange.

The companies covered have been divided into eight size classes and most of our data will be presented separately for each size class. The criterion adopted for size classification is paid-up equity capital. It is arguable that this is not the ideal criterion and that total paid-up capital or total assets might have been better. However, since our size-classes were intended to be only broad categories, the purpose of our enquiry is reasonably well served by the rough criterion adopted by us.

The number of companies addressed respectively in the big and small categories and the number which responded are shown below:

	No. addressed	*Replies received*	*Per cent response*
(*a*) Big Companies (having paid-up equity of at least Rs. 1 crore each)	218	134	61·5%
(*b*) Smaller companies (having paid-up equity of below Rs. 1 crore each)	227	91	40·1%
Total	445	225	50·6%

All companies whose managements had been taken over by the government have been excluded from our analysis.

2. The Findings

The major findings of the survey are presented below.

(a) Size of Company Boards

The Companies Act, 1956, lays down that every public limited company shall have at least three directors. While the Act prescribes no maximum limit, companies are required to obtain the Central Government's administrative sanction for increasing the board strength beyond 12.[1]

The actual size of company boards covered by our survey varied over a fairly wide range from a minimum of 3 to a maximum of 19. Approximately 60 per cent of the companies had a board strength of between 7–10 (see Table 8.1). Only 19 of the 225 sample companies had a board strength exceeding 12. The average number of directors per company was found to be 8.9.

The size of company had only a slight effect on the size of boards, as may be seen from the average number of board members per company in each size-group (Table 8.2). A close observation of the frequency distributions, given for different size-classes in Table 8.1, shows that in companies with paid-up equity capitals of over Rs. 50 lakh each the board typically had 9 or 10 members while the typical board strength in the smaller companies was 8–9.

The main significance of the size of a company board lies in the extent to which it reflects a variety of experience and backgrounds. From this angle, too small a board, although apparently economical, may fail to provide a breadth of viewpoint needed in modern times. Incidentally, we may mention that the average strength of company boards in India is significantly lower than in the United States.

(b) Executives and Non-executive Directors[2]

Only a handful of companies in India have boards composed wholly or predominantly of executive directors. Out of the 225 companies surveyed by us,

[1]See Section 259 of the Companies Act, 1956.

[2]For a discussion of the relative merits and demerits of boards composed predominantly of ' insiders ', see the preceding chapter.

TABLE 8.1

FREQUENCY DISTRIBUTION OF COMPANIES ACCORDING TO THE NUMBER OF BOARD MEMBERS FOR DIFFERENT SIZE-CLASSES OF COMPANIES

No. of board members	Size-class of companies measured by subscribed equity in Rs. lakhs								
	Over 2500	Over 1000 upto 2500	Over 300 upto 1000	Over 100 upto 300	Over 50 upto 100	Over 25 upto 50	Over 10 upto 25	Upto 10	All size-classes
3	—	—	—	1	—	—	—	—	1
4	—	—	—	4	1	—	2	—	7
5	—	—	—	5	1	2	3	—	11
6	—	—	5	5	3	5	1	2	21
7	—	—	6	13	3	5	1	1	29
8	—	3	3	5	3	5	7	2	28
9	—	—	10	18	4	4	5	—	41
10	—	1	9	14	5	3	1	2	35
11	—	—	5	8	3	4	1	—	21
12	—	1	2	5	2	2	—	—	12
13	—	—	2	3	—	2	1	—	8
14	1	—	—	1	—	2	—	—	4
15	—	—	1	—	—	—	1	—	2
Over 15	—	—	2	1	1	—	1	—	5
Total	1	5	45	83	26	34	24	7	225

Note: The maximum strength of the board among the companies surveyed was 19.

TABLE 8.2

AVERAGE NUMBER OF BOARD MEMBERS FOR COMPANIES IN DIFFERENT SIZE-CLASSES

Size-class of companies by subscribed equity in Rs. lakhs	No. of companies covered	Average No. of Board Members per company
Over 2500	1	14·00
Over 1000 upto 2500	5	9·20
Over 300 upto 1000	45	9·51
Over 100 upto 300	83	8·76
Over 50 upto 100	26	8·92
Over 25 upto 50	34	8·91
Over 10 upto 25	24	8·42
Upto 10	7	7·86
	225	8·92

TABLE 8.3

PARTICULARS OF COMPANIES HAVING ALL OR AT LEAST HALF OF BOARD MEMBERS AS EXECUTIVE DIRECTORS

Name	No. of Board Members	
	Executive	Non-Executive
(*a*) *Wholly Executive Boards:*		
1. Britannia Biscuit Co.	4	—
2. Golden Tobacco Co.	9	—
3. Hindustan Lever	8	—
4. India Tobacco Co.	8	—
5. Sandoz (India)	5	—
(*b*) *Predominantly Executive Boards:*		
1. Avery India	2	2
2. Glaxo Laboratories (India)	7	4
3. Greaves Cotton & Co.	5	4
4. Hindustan Ferodo	4	3
5. Jardine Henderson	3	3
6. Martin Burn	3	2
7. Pfizer	3	3
8. Shree Ram Mills	4	4

5 had boards exclusively composed of executive directors and 8 had boards in which at least half the strength was made up of executive directors (see Table 8.3).

A more detailed analysis of the representation of executive directors on the boards of Indian companies is presented in Tables 8.4 and 8.5. Of a total of

TABLE 8.4

FREQUENCY DISTRIBUTION OF COMPANIES HAVING SOME EXECUTIVE DIRECTORS ACCORDING TO THE NUMBER OF EXECUTIVE DIRECTORS, CLASSIFIED BY SIZE OF COMPANIES

No. of Executive Directors	Size-class of companies measured by subscribed equity in Rs. lakhs								
	Over 2500	Over 1000 upto 2500	Over 300 upto 1000	Over 100 upto 300	Over 50 upto 100	Over 25 upto 50	Over 10 upto 25	Upto 10	All size-classes
1	—	1	9	29	9	8	8	3	67
2	1	—	5	17	6	9	2	—	40
3	—	1	8	9	3	2	—	—	23
4	—	1	5	4	—	—	—	—	10
5	—	—	2	3	—	—	—	—	5
6	—	—	—	—	—	1	—	—	1
7	—	—	1	—	—	—	—	—	1
8	—	2	—	—	—	—	—	—	2
9	—	—	1	—	—	—	—	—	1
10	—	—	—	—	—	—	—	—	—
Total	1	5	31	62	18	20	10	3	150

2007 directorships in all the companies examined, the proportion held by executive directors was 15·7 per cent. Two-thirds of the companies covered had at least one executive director, while the remaining one-third had boards composed, wholly of non-executive directors or ' outsiders '. About 30 per cent of the sample companies had only one executive director on their board, 18 per cent had two executive directors, while 19 per cent had three or more such directors.

The practice of appointing whole-time directors became more common with the decline of the managing agency system during the 1960s and, more particularly, after the system was totally abolished in 1970.

The proportion of companies having at least one executive director was generally higher for bigger companies (Table 8.5). All sample companies in the top two size-classes (paid-up equity of over Rs. 10 crore) and only between 70-75 per cent of the companies in the next three size-classes (paid-up equity of Rs. 50–300 lakh) had at least one executive as a board member. The proportion declined further for the smaller companies.

TABLE 8.5

DISTRIBUTION OF COMPANIES BETWEEN THOSE HAVING SOME EXECUTIVE DIRECTORS AND THOSE HAVING NONE

Size-class of companies by subscribed equity in Rs. lakhs	No. of companies covered	No. of companies with no executive directors	No. of companies having some executive directors	(3) as per cent of (1)
	(1)	(2)	(3)	(4)
Over 2500	1	—	1	100·0
Over 1000 upto 2500	5	—	5	100·0
Over 300 upto 1000	45	14	31	68·9
Over 100 upto 300	83	21	62	74·7
Over 50 upto 100	26	8	18	69·2
Over 25 upto 50	34	14	20	58·8
Over 10 upto 25	24	14	10	41·7
Upto 10	7	4	3	42·9
	225	75	150	66·7

This survey has shown that the vast majority of company boards in India are composed predominantly of non-executives with just one or two executive directors at the most.

(c) THE REPRESENTATION OF PUBLIC INSTITUTIONS ON COMPANY BOARDS

The Government of India recently took a policy decision that the public financial institutions should play a more active role in the control and manage-

ment of companies. The representation of the institutions on company boards is one important way of giving effect to this policy.[1] An important aspect of our survey was, therefore, to enquire into the extent of such representation at the present moment. Our findings in this respect will represent the bench-mark for measuring future changes which may result from the government's policy in this regard.

The extent to which public institutions are *directly* represented on company boards in India is analysed in Tables 8.6 and 8.7. Of the 225 companies examined, 98 (i.e., 43·6 per cent of the total) had at least one board member nominated by one or more of the public institutions. Of the 98, approximately one-half had only one such representative, about one-fourth had two representatives, and the remaining one-fourth had three or more representatives. (Table 8.6).

The proportion of companies which had at least one nominee of the public institutions is not systematically related to the size-class of companies.

TABLE 8.6

FREQUENCY DISTRIBUTION OF COMPANIES ACCORDING TO THE NUMBER OF THEIR BOARD MEMBERS NOMINATED BY PUBLIC INSTITUTIONS

No. of board members nominated by public institutions	No. of Companies
1	50
2	26
3	13
4	5
5	2
6	—
7	1
8	—
9	1
Companies having public institutions' nominees	98
Companies having no nominees of public institutions	127
Total	225

A detailed distribution of companies according to the nominating public institution is given in Table 8.7 for the various size-groups separately. Among the public institutions which had nominated directors, the following four were the most common: all-India development banks, state financial corporations, state industrial development corporations, and state governments. Direct

[1]The other ways are: the exercise of voting right as a shareholder in company meetings; advising, influencing and restraining company managements in regard to important matters; and reserving through loan and underwriting agreements, the right to be consulted on certain key appointments and important matters,

TABLE 8.7

NUMBER OF COMPANIES IN EACH SIZE-CLASS HAVING REPRESENTATIVES OF THE VARIOUS PUBLIC INSTITUTIONS

Size-class of companies measured by subscribed equity in Rs. lakhs	Public Institutions									
	Central Government	State Government	All-India Development Banks	State Financial Corporations	State Industrial Dev. Corporations	Commercial Banks	LIC	UTI	At least one of the Public Institutions*	Total No. of companies covered
Over 2500	1	—	—	—	—	—	—	—	1	1
Over 1000 upto 2500	1	1	1	—	—	—	—	—	2	5
Over 300 upto 1000	4	9	8	2	5	2	3	2	21	45
Over 100 upto 300	3	8	15	5	9	—	—	—	30	83
Over 50 upto 100	—	2	6	3	4	—	—	—	10	26
Over 25 upto 50	—	6	3	14	8	—	—	—	22	34
Over 10 upto 25	—	2	—	7	4	—	—	—	8	24
Upto 10	—	1	—	3	—	—	—	—	4	7
Total	9	29	33	34	30	2	3	2	98	225

*If the same company has representatives of more than one public institution, it has been counted only once. This column, does not, therefore, represent the simple total of the other columns.

representation of the LIC, the UTI and the commercial banks on company boards was uncommon. Of the 225 sample companies, the LIC was represented on the board in 3 cases, the UTI and the commercial banks in 2 cases each.

An over-all indication of the extent of direct representation of public institutions on company boards in India is provided by the fact that the aggregate number of directorship in the companies examined was 2007 of which 187 (or, 9·3 per cent of the total) represented the public institutions.

Apart from the direct representation on company boards, a board appointment is sometimes done with formal or informal approval of the lending and/or shareholding public institutions. Such cases are not disclosed by the present survey.

It may be mentioned that the nomination of directors by the all-India development banks and the state financial corporations is generally based, not on the strength of their equityholding, but on the rights reserved in their loan and underwriting agreements. Although the right to nominate one or two directors is invariably reserved by the development banks in their loan and underwriting contracts, the right is actually exercised, not in all cases, but with a certain degree of selectivity.

It would not be easy for the public institutions under the present system of electing directors by ordinary majority, to get even one of their nominees elected to the board *on the strength of their shareholding alone* without the acquiescence of the controlling interests in the majority of companies even today. In view of the size of public institutions' equityholdings, as shown by our survey in Chapters 5 and 6, there is a case for adopting the system of proportional representation on company boards. The point will be examined in the next chapter.

3. Institutional Participation in Management in the New Companies

The shift towards a more interventionist attitude on the part of the public financial institutions is clearly reflected in the greater institutional participation in control and management of some new companies floated recently. No uniform pattern of institutional control is discernible. The diversity in the extent of institutional control is the result of variations in the extent and form of financial involvement of the institutions, the size of the project and the background of the private promoting group concerned. Some important features of the new trends are, however, noticeable. First, the participating financial institutions are frequently adopting a ' consortium ' approach to management participation, usually under the leadership of the IDBI. Secondly, the powers being assumed by them, not only entitle them to nominate a certain number of board members, but frequently also extend to a general control over the composition of the whole board. Thirdly, hitherto, only the development banks used to have a reserve power to appoint nominees on the board by virtue of a requisite provision in their loan and underwriting contracts; the LIC and the UTI had generally stayed away from any involvement in management affairs even when they had joined the underwriting. Many of the new floatations

show a distinct change in this regard inasmuch as the LIC and the UTI are also coming forward to share the right of participation in management. Fourthly, the board representation is approximating to a system of proportional representation so that the entire board is no more controlled by any single group. Finally, the control of the institutions extends to the selection and remuneration of all top managerial and technical executives as well as to selling arrangements and award of constructional contracts.

Some typical illustrations of recent floatations are described below.

The *Southern Petrochemical Industries Corporation Limited*, a 'joint sector' project of the Tamil Nadu Government can be regarded as typical of the big-sized new floatations. Its project cost, as per the Company's prospectus, was estimated at Rs. 71·1 crores. The Company was publicly floated in February 1972. The IDBI, which heads the consortium of all-India financial institutions concerned with this project, stipulated the following pattern for the company's board of directors:

(1)	M. A. Chidambaram Group (The Private sector partner)	4
(2)	Tamil Nadu Industrial Development Corporation Group (i.e., State Government Group)	4
(3)	Professional Management Group	3
(4)	Public Financial Institutions (IDBI, ICICI, IFC, LIC and UTI)	3
(5)	Other distinguished professionals from outside to be appointed	2
	Total	16

The IDBI consortium also stipulated that the Chief Executive Officer (designated as President of the Company), two nominees of the TIDCO group and two of the IDBI Group, will be non-rotational directors.

The Professional Management Group comprised three functional directors, designated as the President, the Technical Director and the Finance Director. The appointment/reappointment/removal of the three functional directors, as also their remuneration and other terms of appointment, would be in consultation with, and prior approval of, the IDBI consortium.

The IDBI, ICICI, IFC, LIC and UTI have reserved the right to nominate amongst themselves three directors to the board at any time so long as they hold shares of the company as a result of their underwriting contracts or conversion of their loans into equity or any portion of their loans remains outstanding.

The company is required to obtain the prior approval, in writing, of the IDBI consortium for awarding certain constructional contracts.

The *Mangalore Chemical and Fertilizers Limited*, publicly floated in November 1972, is another typical example of the emerging pattern of institutional participation in the management of large-sized new companies. Its project cost, as per the Company's prospectus, was estimated at Rs. 57·50 crores. Although the expression 'joint sector' was not used in the prospectus, it is for all practical purposes a 'joint sector' project of the Mysore State Government. The Government of Mysore, the Mysore State Industrial Invest-

ment and Development Corporation Limited (a wholly-owned company of the Government of Mysore), the Mysore State Agro-Industries Corporation Limited (owned jointly by the Government of India and the Government of Mysore), and the Mysore State Cooperative Marketing Federation Limited are all parties to the promotion of this company and are represented on its board of directors. The degree of control exercisable by the all-India public financial institutions over the composition of its board, and its executive management is shown by the following extract from the Company's prospectus:

> Each of IDBI and IFC shall have the right to appoint two nominees and each of ICICI and LIC shall have the right to appoint one nominee on the Board of Directors of the Company so long as they respectively hold shares in the Company as a result of underwriting or conversion of a part of the rupee loans into equity share capital or any portion of the loans advanced by them remains outstanding......
>
> The Board of Directors of the Company shall be reconstituted in consultation with IDBI, ICICI, LIC and IFC. Apart from the nominees of the financial institutions, the Board of Directors, shall consist of not more than 12 members, three of whom shall be full-time functional directors and four others (including the Chairman) shall be appointed in consultation with and with the prior approval of IDBI, ICICI, LIC and IFC.
>
> The company shall constitute a Management Committee of Directors to look after the day-to-day management; the composition of the Committee shall be subject to the prior approval of IDBI, ICICI, LIC and IFC. The IDBI nominees shall have the right to attend the meetings of the Management Committee.
>
> The Company shall have three full-time functional Directors, namely, a Managing Director, a Financial Director and a Commercial Director. The Financial and Commercial Directors who are yet to be appointed, shall be appointed with the prior approval of IDBI, LIC and IFC. The appointment/reappointment/removal of the three functional Directors and/or any other whole-time Directors as also their remuneration and other terms of appointment shall be subject to the prior approval in writing of IDBI, LIC and IFC.
>
> The Company shall, in consultation with and to the satisfaction of IDBI and IFC, streamline its administrative and technical set-up and shall shift its administrative headquarters including the office of the Managing Director and other full-time Directors and the General Manager to Mangalore.
>
> So long as IDBI holds shares in the Company as a result of underwriting or any portion of the loan remains outstanding, the Company shall not, without the prior approval in writing of IDBI:
>
> (*a*) undertake any project or expansion/diversification scheme other than that for which the assistance has been sanctioned to it,
>
> (*b*) pay dividend in excess of 9% on its equity capital, and
>
> (*c*) make any inter-corporate investment and/or raise or make any loan by way of deposit or otherwise.

So long as LIC, ICICI and IFC hold shares in the Company as a result of underwriting or any portion of the loan remains outstanding, the Company shall not undertake any project of expansion/diversification scheme other than the present project without the prior approval in writing of LIC, ICICI and IFC.

The Company has agreed that the proposed selling/distribution arrangements, the appointment/reappointment of sole selling agents/distributors as also their terms of appointment will be subject to the prior approval of the financial institutions.

The *Punjab Tractors Limited,* floated in September 1972, is an example of a relatively small-sized 'joint sector' company. Its project cost was estimated, as per the Company's prospectus, at Rs. 3·7 crores. The Company was promoted by the state-owned Punjab Industrial Development Corporation Limited which is to hold not less than 51 per cent of its share capital. The salient features of the Company's management pattern are:

(*a*) Out of 8 board members, 4 are nominees of the State Government, Two of these nominees are senior secretaries in the Industries and Finance Departments.

(*b*) The IDBI and the IFC have the right to appoint two nominees each, while the ICICI, the LIC and the UTI can each nominate one member on the board of directors of the Company at any time during which any portion of their loans/debentures remain outstanding, or so long as they hold shares as a result of underwriting or conversion of loans/debentures into the equity capital of the Company. Such nominees shall not be liable to retire by rotation.

(*c*) The Company shall appoint whole-time Financial and Marketing Directors to the satisfaction of the Institutions.

(*d*) The appointment or re-appointment of the whole-time directors and their terms and conditions of appointment shall be subject to prior approval of the Institutions.

(*e*) The Company shall form a Committee of Management consisting of the whole-time directors and a director nominated by the Institutions to look after the implementation and management of the project.

(*f*) The Company shall appoint suitable technical and administrative personnel to the satisfaction of the Institutions.

(*g*) The Company has agreed with the Institutions to appoint Sole Selling Agents/Distributors with their prior approval.

Another 'joint sector' company, the *Punjab Breweries Limited,* floated in May 1973, had 51 per cent equity participation by the Punjab State Government (through the Punjab State Industrial Development Corporation Limited) and 24 per cent by the private sector partner (East India Hotels Limited) with the balance of 25 per cent offered to the general public. The Articles of the Company expressly provide that the Punjab State Industrial Development

Corporation and the East India Hotels *shall nominate directors in proportion to their respective equityholdings* and one nominee of each of these two parties shall be non-rotational. It is further provided that while the Chairman of the company will be nominated by the Development Corporation, the Managing Director will be a nominee of the East India Hotels. Thus, in this case, the responsibility for executive management has been entrusted to another ' business group ' rather than to a professional individual.

The *Modi Rubber Limited*, floated in June 1972, was promoted by the Modi Group to manufacture automobile tyres and tubes with an estimated project cost of Rs. 18 crores. It is a private sector company, and not a joint sector company in the formal sense, but the institutional participation in its management will be considerable as summed up below:

(*a*) The IDBI, IFC, ICICI, LIC and UTI amongst them have the right to nominate upto three directors so long as any portion of their loan/debentures remains outstanding or so long as they hold shares as a result of underwriting subscription or conversion of loans/debentures into equity shares.

(*b*) The U.P. State Industrial Corporation Limited (wholly owned by the Uttar Pradesh State Government) will have the right to nominate upto two directors so long as it holds any shares as a result of its underwriting.

(*c*) The Company shall constitute a Management Committee in consultation with the financial institutions to look after the day-to-day management. The two whole-time functional directors shall be members of this Committee and the nominee of the IDBI shall have the right to attend its meetings.

(*d*) The board of directors shall be broad-based as may be approved by the IDBI.

(*e*) The Company shall appoint two whole-time directors (one financial and the other Technical) in consultation with the financial institution.

(*f*) The appointment and reappointment of all whole-time directors, as also their remuneration and other terms of appointment, shall be subject to the IDBI's approval.

In the private sector companies floated in recent months with the financial support of the IDBI in the form of loans and underwriting, the following stipulations have become common:

(*a*) The company shall broad-base its board of directors in such manner as may be approved by the IDBI;

(*b*) The IDBI and other participating financial institutions shall have the right to nominate one or two directors each (upto a certain maximum for all the institutions together) so long as any portion of their loans remains outstanding or they hold shares as a result of their underwriting;

(c) The company shall appoint senior technical, commercial and administrative personnel to the satisfaction of the IDBI;

(d) The selling arrangements shall be subject to the IDBI's approval; and

(e) The company shall award contracts for civil works by inviting tenders.

To conclude, our examination of the illustrative cases of new public floatations, whether 'joint sector' or otherwise, has revealed a considerable measure of institutional participation in their control and management. In the new companies being formed since 1972, the board of directors is no more an exclusive preserve of any controlling group. In some cases, the directors representing the public financial institutions, both central and state, are in clear majority. The selection of directors in the new companies is roughly approaching the system of proportional representation.

Part Four

Policy Implications

9

The Joint Sector: Some Problems and Policy Issues

THE SYSTEM OF control and top management in the large industrial firms, both in the public and the private sectors in India, needs a thorough review, specially from the viewpoint of evolving a structure which will reconcile executive efficiency with executive accountability. While examining the problem of top management in corporate enterprises in Chapter 7, we made a reference to the fact that the managerial situation in India is bedevilled in private undertakings by absolute power (i.e., no accountability) and, in public undertakings, by absolute paralysis (i.e., no managerial authority). Earlier, in connection with the problem of economic power, we had observed how political opinion in India seems to be permanently deadlocked over the fruitless controversy of public-versus-private sector. The trend in India since Independence has been towards statism chiefly because of a growing social concern about concentration of power in private hands. This has not proved to be an entirely satisfactory solution because, as our fairly long experience about the public sector indicates, the checks on abuse of political and official authority in India are rather weak, and the checks on inefficiency are altogether non-existent.

How far can the 'joint sector' idea provide a way out of this dilemma and in what manner should the idea be implemented if it is to succeed? This is the central theme of the present chapter which has been divided into seven sections.

1. A Panoramic View of the Changing Structure of Corporate Finance, Ownership and Control since Independence

The purpose of this section is to show that the joint sector idea is a product of the peculiar Indian situation and, in fact, represents a continuation, or perhaps the culmination, of a clearly discernible historical trend.

The system of promotion and financing of industry in India has changed wholesale over the last twenty five years as a result of a succession of events which, viewed as a whole in retrospect, seem to represent a continuing process of evolution under certain inexorable social tendencies.

At the time of Independence, the promotion and financing of industry in India was greatly dependent on entrepreneurial groups, organised as managing agency houses. In descriptions of the managing agency system, the role of the 'system' has often been confused with that of particular entrepreneurial 'persons', whether individuals, families or firms, and most writers have talked of the managing agency *system* and the managing agency *firms* in the same breadth.

The basic fact is that in the early days of modern industry in India, the promoters of an enterprise were also its principal financiers. A practice grew and became almost universal, that when a joint stock company was founded, the promoters and principal financial interests in the concern appointed themselves, under a formal agreement with the concern, as its managing agents. The entrepreneurial interests thus constituted themselves into a legally distinct group, separate from the other shareholders of the concern. Some entrepreneurial groups came to control and manage a large number of concerns and, by virtue of this activity, achieved a distinct professional status of ' managing agents '.

As will be evident from the above, the managing agency system signified a special kind of legal relationship between the entrepreneurial interests and the enterprise promoted by them. This relationship was formalised in the managing agency contract.

Finance was derived by each entrepreneurial group chiefly from sources under its own control. Banks, insurance and investment companies were frequently part of industrial complexes. ' Outside ' or ' open ' financing facilities were lacking and this was a matter of general complaint, both from large scale industry and from others.

Between 1948 and 1972, a complete change in the corporate financing and ownership pattern has been brought about by stages. The first stage of the change is represented by the period 1948–55 when mortgage borrowing facilities were created for industry through government-sponsored institutions. A second phase began in 1955 with the provision of institutional underwriting facilities for share issues. Beginning slowly at first, underwriting became a universal practice over the following decade. Since the market for shares was relatively slow to expand, the underwriting institutions began to accumulate shareholdings.

The next significant development was the nationalisation of the life insurance business in 1956. This at once transferred a sizable and growing proportion of corporate ownership from a host of dispersed private institutions to a monolithic public agency viz., the LIC.

The setting up of the Unit Trust of India in 1964 substantially accelerated the above trend. The trend has been carried a step further by the nationalisation of the general insurance companies in 1972.

The nationalisation of the fourteen major commercial banks, earlier in 1969, was not very significant from the viewpoint of transferring the ownership of industrial shares from the private to the public sector because, as we have shown in Chapters 5 and 6, the commercial banks are not among the important shareholders in Indian companies. This act of nationalisation was, however, extremely important from another viewpoint, viz., the politicalisation of the banking system which is the main supplier of working capital finance for private industry.

The more recent innovation of convertible lending by development banks is bound to push up the public institutions' ownership of private equity in the near future.

Thus, we find that from 1956 onwards, the ownership of the private corporate sector had been progressively slipping into the hands of the public sector institutions and, by the beginning of the 1970s, corporate ownership had already become 'joint' to a substantial extent.

The sweeping changes that were occurring in the financing and ownership of private industry had, however, no significant impact on the basic structure of corporate control till 1970. Towards the end of the 1960s, the Government seemed to suddenly wake up to the realisation that its agencies were not only playing a dominant part in the financing of private sector industry but had also acquired a sizable stake in its ownership. The role of the private controlling groups in the financing of industry stood sharply reduced with the rise of institutional financing. In this situation, the financial institutions' traditional attitude of remaining completely aloof from control began to look somewhat illogical. The Government, partly as a result of political pressure, and partly out of necessity, decided on a new policy of managerial intervention and instructed the public financial institutions to adopt more interventionist attitudes towards the control and management of corporate enterprises.

Lately, even the responsibility for the promotion of industry is being increasingly assumed by the industrial development corporations set up by state governments, as evident from the large number of industrial licences obtained by these corporations. For the execution of their industrial projects they usually join hands with private parties so that the function of promotion is also tending to become a joint affair between governmental agencies and private groups.

We have moved far away from a wholly private system of promotion, financing, and controlling industry, as it existed at the time of Independence. In the new system which has emerged, the promotion, financing, ownership and control are all becoming a joint affair between the public sector institutions and the private groups.

2. The Present Power Structure within Companies

Since the joint sector idea is, in our view, primarily directed at reforming the power structure within corporate undertakings and since corporations constitute the main vehicle for the concentration of economic power, an examination of the existing power structure is a pre-requisite for understanding both the problem of power and its possible solutions. This section is, therefore, devoted to an analysis of the structure of control as found in Indian companies.

The traditional narrow legal view of a company as a juridical 'person' disguises an important truth of great social consequence. The personality of this group-person created by law is fundamentally different from that of a natural person, although, from a superficial legal view, the two seem to be similar in terms of their power to enter into contracts. But there the similarity ends. Advanced thought in many countries on the nature of corporate personality seems to be converging on the view that the company is a 'social institution';

that it has an autonomous goal, viz., continuity and growth, and that it is a community of human elements, much wider than the owners of capital.[1]

The company has been described by some writers as a ' body politic ', since it represents a public system, a characteristic common with the state.[2] Perhaps, we can call it an ' economic arm ' of the state. Professor Berle views it as a quasi-political institution[3] presumably because its powers are less absolute than those of the state, but this does not take away the basic similarities between the two systems.[4] The ' joint sector ' idea may be said to formalise the quasi-political character of corporate enterprise.

What concept of a company we adopt has a direct bearing on public policy towards the control of corporate enterprise. The point will become clearer if we analyse the company-community schematically in terms of the various interest-groups who compose it and who may have some share in its control, directly or indirectly. These groups, two or more of which may sometimes coalesce, may be classified as follows:

(a) *Internal:*
(1) Members of the company board
(2) Controlling group
(3) The top executive

(b) *External:*
(1) Non-controlling shareholders
(2) Creditors
(3) Workers
(4) Consumers

[1]See Chapter 2 above. For the concepts of company as they have been evolving in different countries, see Charles De Hoghton, *The Company: Law, Structure and Reform in Eleven Countries* (London, 1970), particularly, pp. 69–97.

[2]Earl Latham, ' The Body Politic of the Corporation,' in Edward S. Mason, *The Corporation in Modern Society* (Harvard University Press, 1959), p. 219. He observes:

' Every political system, whether the state or the corporation, has an apparatus for ratifying and making legitimate the basic choices of the collectivity. It has a ritual for approval of the choices of policy, of the fundamental decisions, of the selections among broad alternatives of action—in short a legislative system. The corporation has its legislature, and moreover, it has parties and publics which attempt, respectively, to win legislative power and to influence its course.' (pp. 223–24).

[3]He observes:

' Corporations have been analysed as legal entities for generations. Some thirty years ago a new approach was attempted: they were dealt with as economic institutions. The time seemed to have come to study them now as quasi-political institutions as well. The study thus comes to be more a study in the field of political science than in that of technical law.' See *The 20th Century Capitalist Revolution* (New York, 1954), p. 5.

[4]The term political system is used here in the Aristotelian sense as an over-all term for the usages and traditions, for the arrangements and policies through which men are governed.

(5) Suppliers
(6) General Public
(7) Government

In law, all powers of a company vest in the board of directors, except those specifically reserved, either by the Companies Act, or by memorandum or articles of the company, to be exercised by the company in a general meeting of the shareholders.[1] Real control, however, rests not with the directors but with those who appoint these directors. Here again, the reality is different from the legal position. In legal theory, the directors are appointed by the shareholders but, in reality, they are the appointees of the controlling group.

So far, in the contemplation of law, the existence of a distinct controlling group within the body of equity shareholders was not recognised: all equity shareholders were supposed to be sharing the power to appoint directors. This myth has now been fully exploded and the law is just beginning to take account of the reality. That ' control ' has a separate existence of its own is indicated by frequent transfers of control through sale of the controlling blocks at a price higher than the ordinary market price of the shares concerned. The value put on control basically arises from ' the ability which the holder has to dominate property which in equity belongs to others.'[2]

Most companies, including the biggest ones, in India have even today a shareholder group which ' controls ' the company by virtue of its shareholding, usually large enough, with or without proxies, to give it a working majority of votes to carry out its will. This is how some controlling groups have expanded into enormously large and far-flung industrial complexes.

The chief executive and other top managerial personnel, as also at least some members of the board of Indian companies, are frequently drawn from the controlling group. However, this need not necessarily be the case. The power of any controlling group over the affairs of a company arises basically from its ability to change the personnel of the board and the executive. For this reason, ' its desires, opinions, advice, remonstrances, or cajolings tend to be heeded by management.'[3] Hence controlling groups can achieve their purpose even when they remain outside the formal structure of top management. How to neutra-

[1]However, even shareholders cannot over-ride the decisions taken by directors and have no right to interfere in the general management of a company except to the extent expressly provided in the articles. They cannot themselves usurp the powers which, by virtue of the articles, are vested in the directors. They may, if they can, refuse to re-elect any directors or alter the articles. See V. P. Arya, *Company Directors* (2nd ed., New Delhi, 1970), pp. 29–30. This is also the position under the English Company Law. See Charles De Hoghton, *The Company*, p. 145.

[2]Berle and Means, *The Modern Corporation and Private Property*, p. 217. They also remark:

> Evolution of the corporation, however, has developed a situation in which the dominant forces within the corporation are frequently not the directors or the ordinary officers, but are individuals or controlling groups who have no necessary titular place in the corporate scheme. (p. 207).

[3]See Robert Aaron Gordon, *Business Leadership in the Large Corporations* (Rev. ed., Berkeley and Los Angeles, 1966), p. 151.

power is combined with effective executive *accountability*. As we have explained earlier, so long as accountability and economic power go together, there should be no reason for complaint.

Apart from helping to solve the problem of economic power, the joint sector form would also serve to check gross incompetence and dishonesty in corporate administration. Given the present power structure within companies, no chief executive, however incompetent he may be, can ordinarily be thrown out by the shareholders. In a joint sector enterprise the board will control, and not be controlled by, the executive group, and will have the power to hire and fire the chief executive and other top personnel. This new type of board may be said to be the hall-mark of the joint sector. This will help to restore the lost function of the company board., viz., to represent and protect the interests of the shareholders and the community at large. Almost all the present problems are traceable mainly to the fact that the boards ordinarily represent the interests of the controlling group alone.

The adoption of the joint sector form would in course of time lead to professionalisation of company managements, as senior executives would be appointed, not on the basis of family ties, but on the strength of their qualifications and suitability. We must clarify in this connection that professionalisation does not simply mean the appointment of managers having professional qualifications, as is commonly supposed. So long as effective decision-making authority remains vested in controlling groups and not in the professional managers themselves, the management cannot be said to have been professionalised in the true sense. Hence professionalisation requires not only that we appoint managers possessing professional qualifications but also that we give them effective executive power.

(b) JOINT SECTOR *versus* PUBLIC SECTOR

The joint sector was considered above as an alternative to the private sector. It will not be altogether out of place here to examine briefly the joint sector as an alternative to the public sector. The strongest argument in favour of substituting the joint sector form of enterprise in place of the public sector form rests on grounds of efficiency. In the state-owned enterprises, since their losses are ultimately borne by taxpayers, there is no built-in compulsion towards achieving even a minimum rate of return on the investment. The existence of private investors and institutional bodies as partners in the equity of joint sector enterprises is expected to provide the required built-in pressure for achieving profitability. Also, the joint sector enterprises are expected to work outside the bureaucratic framework of Government machinery. Government enterprises, even when organised as companies, have been unable to free themselves from bureaucratic shackles.

It is a somewhat queer phenomenon that the boards of Government companies have been found in practice to be as devoid of all power as the boards of private corporations. In India, the boards of Government companies have not been regarded as ' link,' for purposes of managerial accountability which is

directly linked to the ministry and the legislature. The boards have functioned as purely advisory, rather than supervisory, bodies. The effective supervisory authority has been the concerned Ministry. It is the ministry, and not the board, which selects the senior executives of government companies. The board appears to be, for all practical purposes, a non-entity.

The system of organising Government companies on the above lines is unsatisfactory from the viewpoints of both managerial accountability and efficiency. It is this system which is largely responsible for the dismal performance of Government undertakings in general. It would be a great improvement if the responsibility for appointing as well as for supervising the executive management is entrusted squarely to the boards of the enterprises concerned. The Ministry and the Parliament should be concerned only with laying down broad policies and targets for the country as a whole. There are important advantages in making the executive managements accountable immediately to the boards rather than to the remotely situated bureaucrats and political bodies. The composition of the boards of Government companies will have to be decided keeping in view the nature of the responsibilities placed on them.

If Government undertakings are run as joint sector companies, the above problems are at once solved in a large measure. The conversion of existing Government undertakings into joint sector enterprises involves, however, a number of practical problems which will require separate examination and are not discussed here.

4. Proportional Representation on Company Boards

In this section we shall examine the case for the adoption of the system of proportional representation on company boards in place of the present system of voting for directors by ordinary majority. In view of the sizable equityholdings of the public institutions, particularly in the large companies, as shown by our analysis in Chapter 5, this reform will at once transform a good part of the present private sector into the joint sector.

While the Government has been putting pressure on the public financial institutions to participate more actively in the control and management of companies, the institutions have generally not found this possible by virtue of their voting strength alone. They have to rely on the contractual terms of their new loan and underwriting agreements for securing powers of control and board representation. In spite of the impressive increase in equityholding by public institutions over the last decade or so, they are still in the position of a minority group in most companies and cannot, therefore, succeed to put their nominees on the boards on the strength of their voting power alone.

The extent to which public institutions are presently represented on company boards was analysed in Chapter 8 and it was pointed out that such representation has largely been on the basis of contractual terms of their loan and underwriting agreements rather than their voting strength.

While the Government has been expressly desiring greater participation by

its agencies in the control and management of all private sector undertakings, specially the big ones, its policy declarations on the joint sector expressly relate only to the new enterprises to be set up in the future. In official policy, the joint sector has been viewed, not as a living form of business, but as a cut-and-dried formula with a specification of the exact percentages of equity to be held by each of the parties concerned. The Government's own declarations of policy have been unable to grasp the common element that is present in its general advocacy of active participation by the public institutions in corporate management on the one hand and the encouragement given to the setting up of new concerns as joint sector undertakings on the other.

The problems of power and accountability, which have been a matter of increasing social concern in recent years, affect both new and existing enterprises equally. The reform of the structure of corporate control must, therefore, be viewed as a problem common to both new and old companies. For this reason, as explained in the beginning of this study, we consider the joint sector concept, not as something to be applied to new companies alone, but as a principle having far greater general applicability for reforming the entire corporate system.

The adoption of the principle of proportional representation on company boards, at least in cases where the public institutions together hold more than, say, ten per cent of the total equity of a company, can at once transform a large number of private sector companies into joint sector companies.

At present, where the public institutions are not already represented on the board of a company, they have a very limited opportunity to object even if the management is not being carried on in the best interests of the shareholders. Their main opportunity is to raise objections at the company's general meetings, usually held once a year. Such objections can be raised only with regard to matters required to be placed for shareholders' approval and not with regard to those disposed of by the board itself. It is true that in many cases the protests of the institutional shareholders have been heeded by company managements. However, there are also as many cases where managements, commanding a good majority of votes, have ignored the objections and protests of the institutions. The institutions can also organise proxy wars against managements but, as we have pointed out earlier, this is an extremely expensive procedure and can be resorted to in exceptional circumstances only.

We consider that the best method would be to enable institutions to get board representation more easily. This would make it possible to keep a more continuous and closer watch over the affairs of companies in the general interests of the shareholders and the community.

Under the present system of voting for directors by ordinary majority, all the board members are ordinarily either members or nominees of the controlling group. If a controlling group in a company had no interest other than that of maximising the return on its shareholding in the particular company, there will be absolutely no conflict of interest between the controlling group and the other shareholders. Unfortunately, this is rarely the case. In fact, in most cases the return on a controlling group's shareholding, taken by itself, represents only a

fraction of the total profit which the group may make for itself in innumerable ways by using its power of control over management. Since most of the important groups in India have a finger in many a pie, the conflict of interests between the controlling group and the controlled company is an unfortunate but common feature of company enterprise in India. Its prevention has been, and continues to be, the most important concern of company legislation over the last fifteen years.

With the entire board nominated by the controlling group, the board fails to function as an independent supervising authority. It fails also to infuse public confidence in private business as the goings-on inside companies are looked upon with suspicion by workers, ordinary shareholders, and the general public.

Suggestions have been made from time to time to introduce at least some outside and independent element on company boards. One suggestion in this respect is to appoint one or two ' public ' directors on every company board. This is to some extent being achieved in India by the increasingly common practice of having nominees of financial institutions on company boards. However, the appointment of one or two such nominees has so far failed to have any significant impact on the general functioning of company boards. The reason for this is that a single independent director, or even two of them, will always be in a hopeless minority on the board, and, allowing for human nature and our concept of social etiquette and good manners, he may avoid pitching himself against all the rest of the board.[1] The proportional representation system is a surer and more satisfactory way of transforming boards into independent supervising agencies.

An optional provision for the adoption of proportional representation for the appointment of directors was introduced by the Companies Act 1956 but hardly any company seems to have taken advantage of this option,[2] indicating the natural reluctance of any controlling group to give up its exclusive privilege of selecting the board members. With the substantial accumulation of shareholding in the hands of public financial institutions over the last decade and with Government insisting on the institutions to participate more actively in the control and management of companies, company boards are showing increasing representation of financial institutions. The time has come when the system of proportional representation could be made mandatory by company law in certain situations.

The main objection against the system of proportional representation seems

[1]See also Mace, op. cit., p. 42.

[2]Section 265 of the Companies Act 1956 reads:

> 265. *Option to company to adopt proportional representation for the appointment of directors*—Notwithstanding anything contained in this Act, the articles of a company may provide for the appointment of not less than two-thirds of the total number of the directors of a public company or of a private company which is a subsidiary of a public company, according to the principle of proportional representation, whether by the single transferable vote or by a system of cumulative voting or otherwise the appointments being made once in every three years and interim casual vacancies being filled in accordance with the provisions, *mutatis mutandis*, of Section 262.

to be that it might take the board of directors a contending field for warring factions and may thereby hamper smooth working of the company. Honest and good managements need have no such fear. The acceptance of proportional representation system will increase public confidence in private enterprise and eliminate the widespread atmosphere of suspicion.

The adoption of a proportional representation system would also go a long way to strengthen the position of minority interests generally and, in particular, to solve the problem of preventing oppression of minorities. The company law, in both U.K. and India, has failed to deal with this problem adequately because the court action, required to be initiated by minority interests or by the government at the instance of such interests, is expensive, tedious and dilatory, and is usually applicable in a rather narrow range of circumstances.[1]

Cases in which legal action could be initiated by minority shareholders under Indian Company law include not only those coming under ' oppression ' of minority but also where the company is mismanaged or where its affairs are being conducted in a manner prejudicial to public interest.[2] Further Section 408 of the Companies Act, 1956, empowers the Central Government to appoint, either *suo moto* or on an application by minority shareholders, two directors on a company board ' in order to prevent the affairs of the company being conducted either in a manner which is oppressive to any members of the company or in a manner which is prejudicial to the interests of the company or to public interest.' Even this has not been found adequate; it has now been proposed, under the Companies Amendment Bill, 1972, to enhance the Central Government's powers by enabling it to appoint even a majority of board members in such cases.[3] Although the tightening of company law has gradually eliminated cases of downright managerial frauds, no law can ever deal adequately with all cases of mismanagement, managerial abuse of power, pursuit of personal profit, disregard of shareholders' interests, and it cannot at all deal with cases of even proved incompetence.

The adoption of proportional representation would directly enable the minority interests affected to protect themselves much more effectively than under the present law and would minimise occasions requiring direct government intervention in managerial affairs.

We have earlier also shown in Chapter 8 how the board composition in the case of new companies being formed with institutional assistance is already

[1]For U.K., See *Report of the Company Law Committee*, i.e., Jenkins Committee, as it is generally known (London, 1962), Chapter VI. For India, see A. Ramaiya, *Guide to the Companies Act* (6th ed. Madras, 1971), Chapter VI. See also Section 397 and 398 of the Indian Companies Act, 1956.

One particular reason why it is almost impossible for minority members to succeed under Section 397 is that sub-section (2) (b) of this Section requires intervention by the court only if the applicant can show ' that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding up order on the ground that it was just and equitable that the company should be wound up.' This is extremely difficult to establish.

[2]See Sections 397 and 398 of the Companies Act, 1956.

[3]See Clause 30 of the Companies (Amendment) Bill, 1972.

tending approximately towards the system of proportional representation. In our opinion, the system should be adopted more generally in all companies, specially the big ones.

5. The Proposal Regarding Full-time 'Public' Directors

The Dutt Committee had suggested the creation of a 'well trained managerial cadre of full time Public Directors who will represent the state on the joint sector industrial concerns'.[1] Proposals on similar lines have been made in the United States to provide greater protection to the interests of the scattered shareholders.[2] The idea underlying the suggestion is the creation of a new full-time profession of company directors who will be adequately remunerated and who would provide sustained supervision over the work of management.

In our opinion, the proposal of having full-time public directors is neither desirable, nor feasible.

It is not desirable because it would in all likelihood degenerate into continuous interference with the functioning of the executive management. The situation that may result from creating such a cadre of directors may not be very different from that in which the executives of wholly Government-owned companies find themselves under the continuous 'watch' of Government secretaries. We have earlier emphasized that, for ensuring smooth and efficient conduct of enterprises, the board of directors should not usurp the function of the executive management who should also have the necessary authority and freedom. The creation of full-time 'public' directors would amount to creating a parallel executive organisation within the board. The resulting friction may paralyse the executive management, as has been the case with Government enterprises.

In our opinion, the proposal of full-time public directors is not feasible, partly for reasons of cost, and partly because the requisite number of qualified persons is unlikely to be available.

What we need on the company boards are men of broad vision and experience who will be *independent* of the executive management and who can, therefore, take an objective view of the management's performance.

In this connection, we think that it would be desirable to bring down further the maximum number of company directorships that an individual might hold. The present law permits a person to be a director in as many as 20 public limited companies and, in addition, any number of private limited companies. No individual, who takes his directorship seriously, can be expected to play an effective role of a company director in so many companies. In our opinion, the maximum limit should be brought down to 10 (including both public and private companies). This would enable directors to devote more time to the affairs of a company and to attend board meetings more regularly. Incidentally,

[1]See Robert Aaron Gordon, *Business Leadership in the Large Corporation* (Rev. ed., Berkeley and Los Angeles, 1966), pp. 346–47 and E. V. Rostov, op. cit., p. 54.

[2]See the Committee's Report (Delhi, 1969), p. 187.

this would help to check concentration of power and also curtail the area of possible conflict of interests.

We have also suggested earlier that the board of directors should make greater use of ' audit of management ' by management consultants in cases where the performance of the executive management falls short of desirable standards or the organizational structure and procedures are in need of an expert review.

6. Is a ' Holding Company ' for Financial Institutions Desirable?

There has been a suggestion that some kind of formal arrangements should be evolved for a pooling of votes of all the public institutions in order to facilitate effective control on their behalf. As mentioned earlier, the Central Government is considering the setting up of a ' holding company ' for public financial institutions with this end in view.

At the present moment, the voting power is held by the various individual institutions and, if an occasion arises for using this power to intervene in management, the manner of its exercise will need mutual consultation among the institutions. The requirement of mutual consultation is an extremely useful and necessary safeguard against the abuse of power, specially in view of the widespread complaint of political corruption. A convention seems to have been evolved under which the public institutions join hands with the LIC at the latter's request. The question of intervention in management is such that both its form and extent must be decided with reference to each individual case, and it is as well to allow scope for an exchange of views among the different institutions. There should be no difficulty in operating the present arrangements effectively whenever the intervention of shareholding institutions becomes necessary.

The proposed ' holding company ' arrangement would take away this safeguard of mutual consultation. The holding company is bound to come under more direct political pressure. There appears to be no reason why the aims of Government policy cannot be realised under the present arrangements.

7. Some Final Reflections

The trend of developments in India over the past twenty five years has clearly been in the direction of statism. The two outstanding features of India's economic system, as it has evolved over the years, are, first, a large and expanding public sector, and, second, a tight system of multifarious direct controls on the private sector.

While some of the Government controls have been necessitated by the need for economic coordination and planning, a large part of them are concerned with overseeing individual company managements with the object of preventing mismanagement and abuse—a responsibility which should have been discharged by company boards. On account of the failure of company boards to provide

any sort of effective supervision of the executive and the widespread public complaints against company managements on many counts, the Government felt not only amply justified, but even compelled, to interfere increasingly in what may be regarded as matters of purely internal management. If only the company boards were more independent and vigilant bodies, there would certainly have been much less need for direct Government interference in managerial matters.[1]

The essence of the joint sector idea lies in the reform of company boards to make them truly independent supervisory bodies. Some experimental joint sector enterprises have been started during the last few years but our experience of running them is as yet too brief and limited. However, this limited experience does afford some ground for hope.

Much will depend on evolving proper working relationships between the board on the one hand and the executive management on the other. A good deal of confusion has prevailed about the pattern of management to be adopted for joint sector undertakings. One widely-held notion is that while the chairman of the board of a joint sector enterprise should be nominated by the public-sector partner, the managing director should be a nominee of the private-sector partner and should have full managerial control. This notion caused some second thoughts in political circles about the usefulness of the joint sector concept for achieving social objectives, the main suspicion being that the joint sector may in practice amount to ' a situation where the bulk of the capital funds are provided by the Government while the roost is ruled by the private gentlemen'.[2] Perhaps for this reason, in the opinion of some, sharing of management should not merely be limited to placing more institutional representatives on the board but should extend to the top and middle level executives in order to regulate the enterprise from within.[3] Some consider the appointment of full-time public directors as an essential part of the joint sector scheme.

Some suspicions were also aroused by the readiness with which the joint sector idea was initially welcomed in private business circles.[4] It began to be feared that the device would be used by private groups as a convenient method for getting the patronage of the Government and for establishing closer liaison with government officers and departments. Alongside the general welcome of the joint sector idea by business leaders, there has also lurked a fear that the device might be used by the Government as ' back-door nationalisation '.

[1]The dishonesty of some of the private managements of life insurance companies was used by the Government as one of the important arguments for nationalising the life insurance business. Mismanagement of affairs has provided a ground for government take-over of business in certain cases. The take-over of the Indian Iron and Steel Company Limited by the Central Government in 1972 was an important case of this kind.

[2]*Economic and Political Weekly*, October 28, 1972, p. 2173.

[3]A.N. Oza, ' Dissecting the Joint Sector ', *Economic and Political Weekly*, October 28, 1972, p. 2179.

[4]See *Economic Trends* (A journal of the Federation of Indian Chambers of Commerce, and Industry) July 1, 1972, pp. 7–9. See also J. R. D. Tata, *Suggestions for Accelerating Industrial Growth*, popularly called the Tata Memorandum (Bombay, 1972), pp. 21–27. Mr. Tata expressed his readiness to convert the Tata Iron & Steel Company into a joint sector enterprise in order to facilitate its expansion programme.

We would like to point out that the notions, suggestions and fears, such as the above, betray a widespread confusion of thought about the appropriate relationship between the board and the executive management in a corporate enterprise.

Most people seem to confuse *sharing of control* with *sharing of management.* The entire problem of corporate top management was discussed at length in Chapter 7. The important point is that the board, which would include representatives of both the public sector and the private sector partners, should have complete *ultimate control* over the executive management and the board policies of the enterprise. The executive team should be selected and appointed by the board as a whole and not by the private partner alone. The board should also have the authority to dismiss any of the executives in appropriate cases. The idea of ' handing over ' managerial control to the private sector partner in the joint sector undertakings is a misconception. At the same time, it must be stressed that in the interest of efficient functioning, the executive management should be vested with reasonable authority and freedom, and that supervision by the board should not mean that it usurps the function of the executive. In this connection, we have also pointed out in Chapter 7 how the chief executive's position is different from that of the other employees.

In the working of joint sector units, we would need to evolve clearer concepts of how authority should be shared between the board and the executive management from the viewpoint of combining executive efficiency with executive accountability. If there is friction between the board and the top executive, the smooth functioning of the enterprise will be seriously hampered.

It must be made clear that the executive team in a joint sector enterprise should not represent any private group interests; it is conceived to be a professional management team, with whom all executive power would lie and who should function in the best interests of the enterprise as a whole under the general guidance and control of the board. In our opinion, the German model—with a board of supervision and a board of management—is the most desirable structure of top management for all large corporate enterprises, and particularly the joint sector ones.

The evolution of the joint sector form of enterprise may well prove to be a decisive influence on India's future economic organisation. If the present experiments succeed, it may be used as a major reform in the system of control and management, not only for the big private sector firms, but also for the public sector enterprises. This may have the effect of arresting the present drift towards statism and rendering some of the present Government controls unnecessary. Government controls should then be restricted to only those which are necessary for economic coordination and planning. Much will, however, depend on the Government's willingness to accept honestly the limitations of the machinery of the Government and to shed the power enjoyed by ministers and bureaucrats under the present arrangements. With the adoption of the joint sector idea, we would also need to look afresh at current policies towards the problem of monopoly and economic power. The joint sector is undoubtedly an idea with a revolutionary potential.

The full economic and social consequences of the adoption of the joint sector idea cannot be clearly foreseen at the present moment. One interesting result of this may be to transform the public financial institutions into kinds of holding companies, controlling a large number and variety of subsidiary companies. This in turn will need the adaptation of current managerial practices. Above all, it would require a new style of business leadership. Perhaps we are on the threshold of new era in the relation between the Government and the business.

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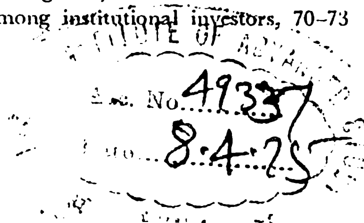

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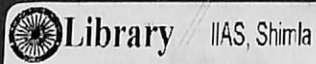
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