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**INDUSTRIAL ENTERPRISE  
IN INDIA**

BY THE SAME AUTHOR  
*Banking and Industrial Finance in India*

# INDUSTRIAL ENTERPRISE IN INDIA

BY  
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HUMPHREY MILFORD  
OXFORD UNIVERSITY PRESS  
1938

OXFORD UNIVERSITY PRESS

AMEN HOUSE, LONDON, E.C.4

Edinburgh Glasgow Bombay

Calcutta Madras Melbourne

New York Toronto Capetown

HUMPHREY MILFORD

PUBLISHER TO THE

UNIVERSITY

X9:6-8.2

G8

11300

*Abridged and adapted from the thesis approved  
for the Ph.D. (Econ.) degree of the  
University of London*

PRINTED IN GREAT BRITAIN BY HEADLEY BROTHERS  
109 KINGSWAY, LONDON, W.C.2; AND ASHPORD, KENT

## PREFACE

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

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

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

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

N. DAS

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*May 1937*

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## CHAPTER I

### THE FINANCING OF INDUSTRIAL ENTERPRISE IN INDIA AND THE INDIAN MONEY MARKET

#### *The Twin Problems of Industrial Enterprise in India*

THE development of modern industrial enterprise in India is not more than half a century old. It is true that a few industrial undertakings were started in the first half of the nineteenth century—by British capitalists in the Bengal Presidency and by some Indian merchants in the province of Bombay, but they were more or less simple pioneer undertakings started in rather a haphazard fashion and none of them presented the elaborate problems of modern capitalistic enterprise—the problems of finance and management. It was only after the *Swadeshi* movement of 1905 had stirred up the industrial consciousness of the people that regular promotion and development of industrial enterprises by Indians commenced.<sup>1</sup> As, however, more and more people turned their attention towards the promotion of new industrial ventures, difficulties began to be encountered. These difficulties have only increased with the passage of years. Entrepreneurs complain that capital is inadequate both for the launching of new enterprises and for the development of existing ones and for this they blame the apathy of the general body of investors and the conservative policy of the commercial banks. Investors and the general public, on the other hand, reply that it is the defective management of industrial enterprises that is at the root of all the trouble. The task of the economist is to find out in which of these two conflicting statements truth lies, and also to suggest ways out of the impasse in which industrial enterprise finds itself today.

<sup>1</sup> For a very exhaustive historical survey the reader is referred to the author's *Banking and Industrial Finance in India* (Calcutta, 1936), Chapters II-VII.

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### *The Principles of Financing Industry*

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

Far too many conflicting and vague statements regarding the 'financial requirements' of industries in India have been made in recent years. Not infrequently, people have forgotten the fundamental distinction between block or fixed capital and working capital, and have naively stated that it is the business of banks or the State to find both. As a matter of fact, in a capitalist economy, it is never the duty of banks or the State to supply industry with block or fixed capital. And even with regard to working capital, it has to be remembered that a certain portion of it, although used for current expenditure, is in reality of the nature of permanent capital. The stock of raw materials, manufactured and semi-manufactured commodities, never falls below a certain minimum, and the capital required for holding them is of the nature of permanent capital. Only that amount of working capital which is over and above this minimum falls under the category of so-called industrial finance.<sup>2</sup>

Let us now consider for what various purposes block capital and working capital are required by industry. Block capital is required by new industries for fixed assets, such as land, buildings, machinery and other appliances of a durable and permanent character. It is also required in the case of established industries for purchase of goodwill or for purposes of extensions and replacements. Working capital is required for the purchase and working up of raw materials into finished products, for stores, for expenses incidental

<sup>1</sup> N. Das, op. cit., pp. 9-32.

<sup>2</sup> Von Beckerath, *Industrial Organization* (New York, 1933), p. 62.

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to the marketing of products, for financing outstanding operations in respect of goods supplied, and for providing the necessary funds to meet day-to-day requirements. The capital that is invested in this latter way is, as has been observed already, of the nature partly of permanent or long-term capital and partly of short-term credit.

The relative proportion between block and working capital required in an enterprise varies from industry to industry. As the process of production becomes more and more roundabout or capitalistic, the proportion of fixed to working capital needed increases. But it is not improbable that in some such cases, although the proportion of fixed to working capital is great, the *actual volume* of working capital needed is still very considerable.

The amount of working capital needed in an industry will depend mainly upon the value of the output and the average length of time occupied by the productive process.<sup>1</sup> But there are other governing circumstances as well. The time at which a manufacturer gets paid and the methods of buying raw materials and effecting sales often affect the amount of working capital needed by a particular enterprise or industry.<sup>2</sup>

### *Capital Requirements in some of the more important Industries in India*

It is very difficult to make an exact estimate of the capital requirements of particular concerns in an industry, because the estimate must of necessity vary with what one considers to be the 'optimum size' of a unit in that industry. Nevertheless, it is necessary to get some concrete figures in order to appreciate the magnitude and complexity of the whole problem of industrial finance in India. Certain figures about average or representative establishments in some of the industries are given in the various reports of the Indian Tariff Board and these may be quoted with advantage.

In the cotton textile industry of Bombay, for instance, a big cotton mill with 100,000 spindles and 2,000 looms

<sup>1</sup> Cf. J. M. Keynes, *A Treatise on Money*, Vol. II (London, 1930), p. 103.

<sup>2</sup> Cf. P. S. Lokanathan, *Industrial Organization in India* (London, 1935), pp. 157-8.

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requires a fixed capital of at least Rs. 100 lakhs and Rs. 150 lakhs annually by way of working capital.<sup>1</sup> It has been calculated that the fixed capital needed in a steel concern is about Rs. 400 lakhs; on the other hand, the working capital needed is equal to about the cost of six months' production output, and this, representing provision for raw materials and stocks of finished goods normally held by the Tata Steel Company, was estimated at Rs. 2½ crores in 1924.<sup>2</sup> In the paper industry, again, a unit of production with four machines and an annual output of 10,000 tons was estimated to require a fixed capital of about Rs. 80 lakhs and an annual working capital of Rs. 16 lakhs.<sup>3</sup> The capital equipment of an average cement works in India with an annual capacity of 60,000 tons has been estimated to cost about Rs. 48 lakhs and its working capital at Rs. 9 to 10 lakhs.<sup>4</sup> In the sugar industry, a moderately sized factory producing about 117,000 maunds of sugar per annum would require a fixed capital of about Rs. 13½ lakhs and a working capital of about Rs. 3 lakhs annually.<sup>5</sup> There are no definite figures available for an average jute mill, but it has been ascertained that the requirements of working capital in a jute concern are about half of the total value of the fixed capital investment. And in the case of tea-gardens, it has been calculated that a garden of 500 acres would require an initial capital of Rs. 7 to 8 lakhs while the working capital that would be required would vary according to the stage of production that has been reached.<sup>6</sup>

All the above representative figures show that almost all industrial concerns in India must possess a considerable amount of fixed capital to start with and a substantial amount of working capital every year, if they are to carry on their manufacturing operations efficiently, smoothly, and economically. While it is not impossible to have smaller units of production with a small initial capital and an

<sup>1</sup> *The Indian Textile Journal* (Bombay), January 1925.

<sup>2</sup> *Report of the Indian Tariff Board on the Steel Industry* (1926), p. 36.

<sup>3</sup> *Ibid.*, on *Paper and Paper Pulp Industries* (1931), p. 89.

<sup>4</sup> *Ibid.*, on *Cement Industry* (1925), p. 24.

<sup>5</sup> *Ibid.*, on *Sugar Industry* (1931), p. 67.

<sup>6</sup> *Report of the Bengal Banking Enquiry Committee* (1930), Vol. I, p. 120. No specific figures regarding the jute industry are available.

## FINANCING OF INDUSTRIAL ENTERPRISE IN INDIA ;

equally small amount of working capital, it should be remembered that when industrial units are too small they cannot afford to produce economically. It is true that size by itself does not necessarily ensure economy and it is again true that when there are not many experienced industrial leaders it is wiser to start a unit on the minimum scale which would be suitable for that industry on technical and other grounds and allow it to grow slowly. But it is also important to bear in mind that, in their eagerness anyhow to commence a business on the minimum scale, promoters and managers often start with insufficient capital and thereby bring ruin upon themselves.<sup>1</sup>

### *How Fixed Capital is Raised for Industry in India*

So far most of the major industries in India have obtained their capital for financing fixed assets either by public or private subscription of shares or debentures of the undertaking, or by direct deposits, or by the system of providing money on private account by an individual or a partnership. The part played by these diverse methods has of course varied from industry to industry, and the recent tendency has been towards securing the block or fixed capital by public or private subscription of shares or debentures. Older methods of finance have, however, co-existed with the modern methods of raising capital by means of shares and debentures, and it would be interesting to enquire into the extent to which the various industries are dependent upon the older and the newer methods for obtaining their capital requirements.

We may start with the cotton textile industry. Apart from the few older establishments which still retain their private proprietary character, the fixed capital here has been found mostly from paid-up share capital, and from deposits from the public, though in some cases this has been supplemented by debentures.<sup>2</sup> The share capital again has been raised mainly in the form of ordinary shares, particularly in Bombay city. Out of the 60 mills mentioned in the *Investor's India Year Book*, 1935-6, as many as 35 had only ordinary

<sup>1</sup> *Capital* (Calcutta), 28 June 1934.

<sup>2</sup> The significance of the 'public deposits' is discussed later on.

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shares, and only 25 had preference shares.<sup>1</sup> The percentage of preference share capital to total paid-up capital is also small—it was only 18 per cent. in 1935-6. In some mills extension of the fixed plant and machinery was wisely provided by issuing preference shares at a time when the companies concerned had established a sound reputation by their unbroken record of dividend payments.<sup>2</sup> In most of the mills the ordinary share capital consists of shares of face value varying from Rs. 25 to Rs. 1,000 per share. There has been a commendable tendency in recent years to split up shares of larger face value into shares of smaller denominations with a view to bringing them within the easy reach of smaller investors. Some of the mills have also started the practice of securing capital by issuing debentures: out of the 60 mills mentioned in the *Investor's India Year Book*, 1935-6, as many as 17 mills had issued debentures up till the end of March 1936. These debentures have been issued for limited periods only on the security of the fixed assets consisting of land, buildings, plant and machinery of the mills for the same purpose of extension or introduction of new devices. The amount for which debentures have been issued by a mill has generally been determined by a conservative valuation of its fixed assets and also by the state of the industry at the time of issue.<sup>3</sup>

In the jute industry almost all the companies have got both ordinary and preference shares. Moreover, in 1935-6, as many as 13 out of 54 jute mills (whose shares were quoted on the Calcutta Stock Exchange) were known to have financed their extensions and replacements by issuing debentures. The amount raised by way of debentures in this industry has always been fairly substantial, and in 1935-6 the proportion of debenture capital to the total capital was over 18 per cent.<sup>4</sup>

<sup>1</sup> *The Investor's India Year Book*, 1935-6. There seems to have been a slight rise in the number of mills issuing preference shares: in 1932-3 only 21 mills out of 67 had issued preference shares.

<sup>2</sup> e.g., Bengal Nagpur Cotton Mills, Ltd. (1896), Dunbar Mills, Ltd. (established 1896), Elgin Mills, Ltd. (established 1864), Muir Mills, Ltd. (established 1874), R. G. Cotton Mills Co., Ltd. (established 1910), etc.

<sup>3</sup> Written evidence of Mr. A. D. Shroff before the Indian Central Banking Enquiry Committee, Vol. II, pp. 986-7.

<sup>4</sup> *Investor's India Year Book*, 1935-6 (Calcutta).

In the iron and steel industry, too, share capital (including preference shares, and ordinary and deferred shares) has provided nearly all the money needed for financing the fixed assets, and the experience of the hydro-electric industry has also been the same. The premier iron and steel concern of India, the Tata Iron and Steel Co., has always relied on the method of issuing debentures to finance extensions and replacements, and during 1920-35 it successfully appealed on four occasions to the Indian capital market with its debenture loans.<sup>1</sup>

In the tea industry, on the other hand, the fixed assets have been mostly financed either by public or private subscriptions of the share capital or by one-man entrepreneur-promoters. Debentures have played a very subordinate part in the financing of this industry, and by 1935-6, out of 135 tea companies having a rupee capital, only 11 had issued some debentures. Similarly, in the coal industry, out of 72 coal companies in the list, only 6 had debenture capital at the end of 1935-6.<sup>2</sup>

In most of the newer types of industry (e.g. sugar, some mining enterprises, paper, match, etc.), the method of raising funds by public issue of shares has played a comparatively unimportant part. New enterprises in these industries have been frequently started by providing money on private account by an individual or a firm or a partnership, and it is only in isolated instances that attempts have been made at the very outset to secure funds from the public. This has been, to some extent, inevitable owing to the pioneering character of these new lines of industrial activity.

#### *How Working Capital is Found for Industry in India*

Coming now to the question of working capital, one is surprised at the variety of ways in which this has been found by different enterprises and industries in India. Broadly speaking, there are four sources of getting working capital—(1) public deposits; (2) private deposits or money on private account provided by the entrepreneurs, their friends, and/or the managing agents; (3) advances by

<sup>1</sup> *Investor's India Year Book*, 1935-6 (Calcutta).

<sup>2</sup> *Ibid*,

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indigenous shroffs; (4) advances by joint-stock banks. We shall consider the part played by each of these in the financing of industrial enterprise in India.

(1) *Public Deposits.* We may start with the public deposits.<sup>1</sup> This system prevails almost solely in the cotton textile industry of Bombay and Ahmedabad—particularly in the latter. The system arose owing to the imperfect banking development of the country: on the one hand, people naturally had more trust in, and preferred to confide their savings to, those men in their communities whom they knew and with whom they could deal without the formalities necessary in dealing with banks; on the other, the mill owners of Bombay and Ahmedabad were ready to accord to depositors a safe return with certain net advantages which the latter could not possibly get either from banks run on western lines or from indigenous shroffs.<sup>2</sup> So arose an arrangement whereby the mills got most of their working capital from the public on short-term deposits, usually for six months or a year. The importance of this system to the cotton textile industry of Bombay and Ahmedabad is illustrated by the following figures:<sup>3</sup>

|                                               | BOMBAY<br>(Figures for 64 mills) |                                   | AHMEDABAD<br>(Figures for 56 mills) |                                   |
|-----------------------------------------------|----------------------------------|-----------------------------------|-------------------------------------|-----------------------------------|
|                                               | Lakhs<br>of<br>Rupees            | Percentage<br>of total<br>finance | Lakhs<br>of<br>Rupees               | Percentage<br>of total<br>finance |
| 1. Amount loaned by the<br>Managing Agents .. | 532                              | 21                                | 264                                 | 24                                |
| 2. Amount loaned by banks ..                  | 226                              | 9                                 | 42                                  | 4                                 |
| 3. Amount of public deposits ..               | 273                              | 11                                | 426                                 | 39                                |
| 4. Amount of share capital ..                 | 1,214                            | 49                                | 340                                 | 32                                |
| 5. Amount of debentures<br>issued .. ..       | 238                              | 10                                | 8                                   | 1                                 |

It will be seen from the above that in Ahmedabad public deposits are the most important source of industrial finance for the cotton industry, and they are considerably in excess

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

<sup>2</sup> Evidence of Mr. B. F. Madon before the Indian Tariff Board: *Cotton Textile Industry Enquiry*, 1927, Vol. IV.

<sup>3</sup> *Indian Central Banking Enquiry Committee, Minority Report* (1931), pp. 329-30. The figures relate to October 1930.

of the amount raised by share capital and debentures. In Bombay, the importance of public deposits has diminished considerably, but until 1921 (when public confidence in the Bombay cotton mills was rudely shaken), public deposits played as important a part there as it plays at Ahmedabad now.<sup>1</sup>

Let us now analyse the economic significance of this method of finance. The rates of interest paid on these deposits by the mills have never been exorbitant, and have generally varied from  $4\frac{1}{2}$  to  $6\frac{1}{2}$  percent. In no case have these been more than 1 per cent. above the rate at which loans are advanced by banks and not infrequently they have been even  $\frac{1}{2}$  per cent. less.<sup>2</sup> Looked at from the interest rate point of view, therefore, these public deposits have never been 'costly'. Instead, they have been a real convenience to the cotton mills of Bombay and Ahmedabad inasmuch as they have enabled the mills to keep their interest charges low, and to borrow at cheap rates to pay higher dividends—a feat which would not have been possible if the whole of the working capital had to be raised by different methods. On the other hand, this system of industrial finance has some inherent weaknesses, and these were demonstrated during the depression of 1925-9. In times of stringency, mills whose financial position is not strong, find real difficulty in obtaining deposits, although it is these mills which need help: the tendency of depositors to withdraw their money on the slightest rumours of difficult times ahead puts the mills in a most awkward position. That is precisely what happened in Bombay and, to some extent, in Ahmedabad during 1925-6 and the three years after. Public confidence was shaken and depositors were anxious to withdraw their deposits from all the mills—good, bad and indifferent. Some mills had to close down and others had to borrow money from friends or indigenous bankers at high rates of interest.<sup>3</sup> The depositors could not, of course, be blamed for the way in which they behaved. They could not possibly follow the movements of the money market and

<sup>1</sup> *Indian Central Banking Enquiry Committee* (1931), Vol. III, pp. 775-80.

<sup>2</sup> *Indian Tariff Board: Cotton Textile Industry Enquiry* (1932), Vol. IV, pp. 33-8.

<sup>3</sup> *Ibid.*, pp. 37-8.

understand what was happening ; they were in the position of unsecured creditors, and as there was no intervening banking institution between themselves and the mills, they were apt to be easily led away by any bazaar gossip regarding the solvency or otherwise of a concern. The system of public deposits is, therefore, a source of great danger to an individual industrial enterprise, and in spite of the services it has rendered in the past, the dependence of industry on this method of industrial finance cannot but be regarded with some genuine misgivings.

In recent years, however, there has been a tendency at Ahmedabad to develop a system of long-period deposits, usually from five to seven years, and more and more mills are being financed by these new long-period deposits. Moreover, a system of 'inter-deposits', i.e. deposits as between one mill and another, has also become prominent during the post-depression years : the profits of a mill held in the form of reserves are often 'deposited' with another mill which is believed to be in a sound position. These new developments make the danger of sudden withdrawal of deposits more remote, but even so the system cannot be said to be a satisfactory one from the standpoint of the proper development of the investment market. This undue reliance on public deposits 'restricts the supply of good industrial securities, shares, debentures, etc., available for an ordinary investor, and unduly narrows the market for such investment . . . and the losses which must occur in a crisis or panic owing to money lent on such deposits being locked up in almost fixed capital assets, must tend to frighten many Indians both from investing in industrial shares and from putting their money on deposit with a bank or anyone else at all'.<sup>2</sup>

(2) *Private Deposits or Money Provided on Private Account.* While the system of industrial finance through public deposits holds only in the cotton textile industry of Bombay and Ahmedabad, the method of finding working capital from private deposits or from money on private account provided by the entrepreneurs, their friends and/or the

<sup>2</sup> *Indian Central Banking Enquiry Committee* (1931), Vol. III, pp. 478-80.

<sup>2</sup> Speech of Sir Basil P. Blackett, quoted by Lokanathan, op. cit., p. 183.

managing agents is to be found in almost all the medium-sized and comparatively new industrial enterprises of India today.<sup>1</sup> Exact figures as to the extent to which private deposits or money provided on private account contribute to the 'finance' of the various industries are not available, but certain instances may be quoted. In some of the Indian owned tea-gardens of Bengal and Assam, after the gardens have been acquired and work commenced with the initial capital, the promoters find it necessary to ask their friends or partners to deposit certain amounts (these vary from Rs. 5 to Rs. 50,000) at rates from 9 to 15 per cent. for fixed periods of one to three years. In the sugar industry again, many new entrepreneurs find it useful to get hold of selected friends and ask them to deposit some money in their respective concerns in lieu of a share in the profits until the deposits have been fully paid up.<sup>2</sup> In the match industry also, it was found by the Indian Tariff Board in 1928 that many of the small concerns would have been eliminated from the competitive market had it not been for the fact that they managed to get some private deposits every year from a selected circle of 'friends and others interested in the business'.<sup>3</sup>

As regards money directly advanced by the managing agents, we have already seen from the figures of the Bombay and Ahmedabad cotton mills that managing agents provided as much as Rs. 7.96 crores as against Rs. 6.99 crores provided out of public deposits and Rs. 2.68 crores lent by banks.<sup>4</sup> We shall study the subject of the economic importance of the managing agents in the industrial organization of India in a subsequent chapter, but it should be recognized at the very outset that managing agents have played, and are still playing, a very important and direct part in the matter of industrial finance in India. In the tea industry, firms of managing agents have often granted advances against mortgage of gardens, buildings, machinery, or hypothecation of crops.<sup>5</sup> In the jute industry, on the other

<sup>1</sup> *Financial Times* (Calcutta), December 1935.

<sup>2</sup> *Capital* (Calcutta), 14 June 1934.

<sup>3</sup> Indian Tariff Board: *Report on the Indian Match Industry* (1928), Vol. II, pp. 42-50.

<sup>4</sup> For a detailed analysis, see Lokanathan, op. cit., pp. 214-33.

<sup>5</sup> *Report of the Bengal Banking Enquiry Committee* (1930), para. 213.

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hand, the direct assistance of the managing agents in the matter of finance has not been needed, firstly, because the normal requirements of the industry have easily been raised from the public by issue of additional shares or debentures and, secondly, because banks have usually not been reluctant to advance money to the jute mills with their established reputation for efficiency and integrity.

✓ The loans given by managing agents to the concerns they manage are generally given at only  $\frac{1}{2}$  per cent. above the Bank rate and sometimes at par with the Bank rate. In the last depression in particular, when public deposits were being withdrawn and advances from banks could not also be obtained, it was these loans by the managing agents that saved many of the tea concerns of Bengal and Assam and the cotton mills of Bombay and Ahmedabad from ruin. ✓ The same thing happened in the coal-mining industry and some minor industries of the country. It was the large and steady advances made by the managing agents that helped many of these under-capitalized concerns out of difficulty.

Looked at from the standpoint of efficiency, these private deposits and money obtained on private account have been much more useful to industry in India than public deposits. ✓ The danger of sudden withdrawal of deposits is absent in this method of finance as those who have made deposits or advanced loans are themselves more or less vitally interested in the concerns and hence would prefer to 'see the matter through' rather than withdraw the money. ✓ Secondly, as there are no proper banking facilities available for new and middle-sized concerns which do not have the backing of the name of a big firm or a big individual, such methods of industrial finance are the only solution. Finally, in a period of depression when banks are reluctant to make advances even to fairly solvent concerns which are in temporary difficulty, it is these private deposits and moneys provided on private account by entrepreneurs, their friends and managing agents that help many of the concerns to pull themselves through the depression.

There are, however, some defects in this method of finance also. Very often a managing agent manages a

number of concerns and in such cases when all the concerns need financial help, it becomes too much of a burden for the agent to accommodate all of them. During the difficult period of 1925-30 a number of managing agents in Bombay took upon themselves the work of directly assisting with money *all* the concerns that were under their management, and the task proved far too heavy for them. The managing agency firms themselves were ruined as a result of their bold efforts to bolster up the cotton mills.<sup>2</sup> Secondly, although not to the same extent as public deposits, the system of private deposits also hampers the proper development of the investment market. When industry depends so much on direct financial assistance by private individuals, it is not unnatural that the ordinary investor from the public does not feel interested in industrial ventures or industrial securities, and tends to retire all the more into his habitually shy groove.

(3) *Indigenous Shroffs or Bankers*. Neither public deposits nor private deposits and private loans are adequate to meet all the various needs of industry in India, and hence industrialists and entrepreneurs have often to approach the indigenous shroff or banker for financial assistance. Here also it is difficult to assess to what extent industrial enterprise in India is dependent on the services of this type of financial agency. Certain generalizations can, however, be made. Firstly, old and established industries (e.g. cotton, jute and iron and steel) are more or less independent of the indigenous banker as they can get their capital without much difficulty from the public and/or the regular joint-stock banks. Secondly, under-capitalized or small concerns in some of the newer industries (e.g. paper, sugar, match, etc.) are more or less dependent on them for finance as they have no public deposits to fall back upon and their resources by way of private deposits or loans are also extremely limited.

At the very outset we should make a broad distinction between real bankers and money-lenders pure and simple. Generally speaking, the latter work with their own capital and do not, as a class, receive deposits; they finance

<sup>2</sup> Indian Tariff Board: *Cotton Textile Industry Enquiry* (1934), Vol. I, pp. 95-6.

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consumption rather than trade, and advance more often without than with security. The indigenous shroffs or banks, on the other hand, receive deposits from the public and finance industry and trade rather than consumption; and they lend more often with than without security. The distinction is sometimes blurred and there are cases where money-lenders do some banking business, and bankers take to forms of pure money-lending. Nevertheless, there is a broad difference between the two classes, and the distinction is important from our standpoint inasmuch as it is the indigenous bankers and not the money-lenders who play a prominent part in the sphere of industrial finance.<sup>1</sup>

These indigenous bankers had a flourishing business all over the country during the early years of British rule in India. Political turmoil and incessant wars, however, severely affected their business, and the unification of coinage in 1835 deprived them of their profitable business of money-changing. The impact of a new economy and changes in the whole basis of India's trade, external as well as internal, only hastened their downfall. The creation of Government treasuries and the establishment of banking institutions on western lines operated to their further disadvantage, and with the decrease in the volume of their business their resources also diminished.<sup>2</sup>

As already stated, some small concerns have still to resort to the indigenous banker. This is the result partly of necessity and partly of preference. The small industrialist has to go to the indigenous banker because he cannot get accommodation from any other source. He also goes to him because he thinks that the latter is better acquainted with his means, character and trading methods: he is content to pay the shroff's charges, high though they may be, rather than 'expose himself to the enquiries, the regularized procedure and (as he believes) the greater risks of a joint-stock bank with a grilled counter and a uniformed peon in the doorway'. A regular bank would demand of him a trade-bill, a deposit of valuable securities, or at least a

<sup>1</sup> *Indian Central Banking Enquiry Committee, Majority Report (1931)*, pp. 73-5.

<sup>2</sup> N. Das, *op. cit.*, Chapters II and III.

friend's counter-signature on his promissory note; the indigenous banker, on the other hand, lends on personal knowledge, and often on simple personal bond, relying on his acuteness to forestall, or on the pressure of his friends to compromise, a possible failure of his debtor. The result is that he charges a high rate of interest. Coal companies, for instance, have to borrow money from indigenous bankers for the practical development of their collieries at as high a rate as 12 to 18 per cent., and sometimes even at 24 per cent. Industries like leather, tanning, oil mills, rice mills, smaller tea-gardens, have to pay as high as 24 per cent. even when they borrow on the security of their assets."

The importance of indigenous bankers in the realm of industrial finance pure and simple is gradually diminishing. They are losing their hold on deposits and the competition of joint-stock banks is gradually reducing their interest rates. Even so, the very fact that some enterprises have to go to them for the costly finance supplied by them is a reflection on the efficiency of the Indian joint-stock banking organization and the general development of the capital market. It is certainly a weak spot in the organization of industrial finance in India that these indigenous bankers can charge such exorbitant rates of interest from the promoters or managers of industry.

(4) *Joint-stock Banks.* It is recognized by all students of banking and industrial finance that 'the chief reliance of the average industrial concern for meeting the demands of variations in cash requirements is the commercial bank, which may make a direct loan on the borrower's own rate, or may in effect make the loan by discounting the notes or accepted drafts or trade acceptances of the borrower's customers'.<sup>1</sup> In India, however, banks did not become important providers of capital until recently. This was not the fault of the banking system, but was the inevitable consequence of the imperfect industrial development of the country. As a matter of fact, until

<sup>1</sup> *The Banker* (London), June 1930.

<sup>2</sup> *Indian Central Banking Enquiry Committee Report*, Vol. II, pp. 504-29.

<sup>3</sup> C. W. Gerstenberg, *Financial Organization and Management* (New York, 1924), p. 412.

recently, no one complained that the financial facilities accorded by the banks in India were inadequate and even the Indian Industrial Commission concluded in 1918 that 'no industrial company, supported by reputed managing agents and with good prospects, found any difficulty in getting the required finance'. Soon after the War, however, the attitude of industry changed, and the alleged difficulty of financing industry and agriculture in India led to the appointment of the Indian Central Banking Enquiry Committee in 1929.<sup>1</sup> We shall now study what our joint-stock banks are like and how they finance industrial enterprises.

So far as the financial requirements of the major industries are concerned, we may leave out of account the exchange banks, co-operative banks, land mortgage banks, and such organizations as those of *Nidhis* and *Chettiyars*. Although the exchange banks have got large deposits in India and possess big capital and reserve, their principal business is the financing of India's foreign trade and occasionally of her inland trade: they do not take any part in the financing of industry. The co-operative banks, on the other hand, are mostly concerned with agricultural credit, and in the few cases where non-agricultural credit societies have been formed, the beneficiaries are officers of Government, contractors, small traders, artisans, weavers, and so forth. Under the Acts and under the rules of the Co-operative Department, the co-operative banks and societies are debarred, except with the general or special sanction of the Registrar, from lending to anyone who is not a member of the institution; the result is that the financial requirements of industries (except perhaps cottage industries) are almost completely outside their purview. Land mortgage banks also have got little connexion with industrial finance as they are mostly occupied to meet the requirements of agriculturists for long-term credit for the redemption of mortgages of land, for the clearance of debt and for land improvements, and such organizations as those of *Nidhis* and *Chettiyars* are more or less mutual benefit societies exercising little direct effect on

<sup>1</sup> N. Das, op. cit., Chapters IV-VII.

the supply of, and demand for, capital in the general capital market.<sup>1</sup>

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

[Let us start with the Imperial Bank of India. This Bank was formed in 1921 by the amalgamation of the three Presidency Banks of Bengal, Bombay and Madras. It is a commercial bank with private shareholders, but, until recently, it also had some of the functions appertaining to a bankers' bank. Most of the lending banks in India had to keep their cash balances other than till money with it; it managed the eleven clearing houses in India, and it opened branches, under statutory obligation, in different parts of the country. It also acted, to a very large extent, as the Central Bank of the country: it did the Treasury work of Government free of cost, managed the Indian public debt and provided the machinery for the floatation of loans; and during the busy season when the Bank rate would be 6 per cent. or above, the Paper Currency department of the Government of India would grant loans to it to an amount not exceeding Rs. 12 crores by transferring to that department internal bills of exchange or *bundis* of an equivalent amount. In view of the fact that the Imperial Bank occupied a position analogous to a Central Bank, it had to submit itself to some statutory restrictions by the Act of 1920. Thus it was not able to make any loan or advance for a longer period than six months or upon the security of its own stocks or shares or on the original security of immovable property, nor could it discount bills for, or lend or advance in any way to, any individual or

<sup>1</sup> *Indian Central Banking Enquiry Committee, Majority Report* (1931), pp. 29-34.

<sup>2</sup> *Ibid.*, p. 37.

partnership firm an amount exceeding at any one time Rs. 20 lakhs except on certain specified securities.<sup>1</sup> It was also not empowered to discount or advance on the security of any negotiable instrument unless it carried on it the signatures of at least two persons or firms unconnected with each other in general partnership, nor was it empowered to grant unsecured overdrafts in excess of Rs. 1 lakh.<sup>2</sup> Within these limitations it played its part as the most influential member of the Indian money market: having the biggest share capital and reserve and the largest number of branches all over India, it was the bank to which all other banks looked for assistance and guidance, and to which most of the indigenous bankers applied for help and accommodation.]

These restrictions on the activities of the Imperial Bank of India remained until the year 1935, when a proper Central Bank called the Reserve Bank of India was established. Even so, the restrictions have not entirely disappeared, firstly because the Imperial Bank Amendment Act (Act III of 1934) does not even now allow it to do certain types of business, and, secondly, because tradition dies hard, and so the Imperial Bank has not considered it feasible to embark on a new financial policy as soon as it ceased to act as banker to the Government. Thus, although the amending Act of 1934 now authorizes the Imperial Bank to make advances or open cash credits upon the security of debentures of any company with a limited liability and of goods which are hypothecated to the Bank, the Bank is still not authorized to make any loan or advance for a longer period than six months or upon the security of its own stocks or shares or on the original security of immovable property. On the other hand, it is important to note that the restrictions regarding the extent or conditions of discounting of bills or other forms of negotiable instruments were never laid down in the statute, but were imposed by by-laws. As the Imperial Bank is now released from most of its responsibilities as banker to the Government, it is not improbable

<sup>1</sup> E.g. trustee stocks, funds and securities, securities issued by certain state-aided railways, the debentures and other securities issued by district boards under the authority of the legislature, and goods or documents of title thereto.

<sup>2</sup> Ibid., pp. 370-4.

that, despite tradition, it will gradually embark on a more forward policy.<sup>1</sup>

The limitations under which the Imperial Bank of India worked, as also the orthodox practice of English banks, have, however, had enormous influence on the policy of the other Indian joint-stock banks. These latter, although registered under the Indian Companies' Act which imposes no restrictions on the business they may do, have followed the orthodox practice of English banks in general and the Imperial Bank of India in particular, and given loans for short periods and against certain forms of security alone. The bigger banks perform the ordinary business of banking and, among other services, receive deposits and make loans and advances, including the discounting of bills. They also take part in the movement of produce from the village to the exporting ports and in the distribution of imports from the ports of entry to the distributing centres. The smaller banks, on the other hand, are generally loan offices which advance money to the professional and agricultural classes. They take practically no part in the financing of India's foreign trade which continues to be more or less a sort of monopoly of the exchange banks.<sup>2</sup>

Let us now analyse the conditions on which short-term credit is lent by the joint-stock banks (including the Imperial Bank of India).<sup>3</sup> At the beginning of this chapter

<sup>1</sup> The Reserve Bank of India took over the control of the Issue Department from the Government and the management of Public Debt and Government accounts from the Imperial Bank on 1 April 1935. By the end of 1935-6 it took over all other functions as a Central Bank. The Imperial Bank now is an 'independent' joint-stock bank, regulated by the Act of 1920 as modified by Act III of 1934. The relations between the two Banks are governed by Schedule III of the Reserve Bank of India Act (Act II of 1934) which provides (a) that the Imperial Bank shall be the sole agent of the Reserve Bank of India at all places where there was a branch of the Imperial Bank of India that was in existence at the commencement of the Reserve Bank of India Act of 1934 and where there is no branch of the Banking Department of the Reserve Bank of India, and (b) that in consideration of the performances of the preceding functions the Imperial Bank shall receive certain remuneration every year.

<sup>2</sup> *Indian Central Banking Enquiry Committee, Majority Report (1931)*, pp. 374-5.

<sup>3</sup> No figures as to the actual distribution of short-term credit are available. Commenting on this point in their report, Professors Bowley and Robertson stressed the need that 'once a year, or preferably, in view of the violent seasonal movement in India, twice a year, the scheduled banks should be required to submit to the Reserve Bank, for publication in a single consolidated account, a return of their advances, classified so far as possible, in accordance with the purpose for which the advance is being used'. (A. L. Bowley and D. H. Robertson: *A Scheme for an Economic Census of India*, New Delhi, 1934, p. 54.)

we have recognized that it is no business of a bank to supply industry either with fixed capital or with that minimum of working capital which is of the nature of permanent capital. Our duty will, therefore, be to consider whether banks in India have been able to assure an efficient and inexpensive flow of money to meet the reasonable demands for non-permanent working capital by industries, both old and new, and also whether in the existing economic circumstances it is possible for them to do more than they have hitherto done.

The advances generally given by joint-stock banks fall under two main heads : (1) advances against tangible and marketable security lodged or pledged with the lender, and (2) clean advances against personal credit with a second signature to the pro-note. In India there are very few clean advances without a second signature—a class of advances that occupy an important place in the highly developed banking systems of Europe and America.<sup>1</sup>

The most usual form of borrowing in India is the cash credit account 'under which an advance is allowed against a promissory note signed by the borrower and secured by the hypothecation of stocks'. Under this system, 'interest is paid by the borrower only to the extent to which the credit is availed of from day to day, and he can reduce his obligation at any time subject, in some cases, to a minimum interest clause, i.e. subject to the provision that the bank would charge its client interest on a minimum amount which is generally one-half of the maximum limit of the drawing power allowed to the borrower by the bank. Similarly, the lending bank can curtail and withdraw the facilities at any time.' The system is thus advantageous to both sides, and although it is said to have hindered the development of the bill and acceptance market, it is very common.<sup>2</sup>

Another very common method of raising funds is what is loosely called 'two-name borrowing'. This takes various forms. Sometimes a promissory note is endorsed by a shroff or shroffs, or by a managing agent or a firm of managing agents; sometimes this signature is needed even in the

<sup>1</sup> *Indian Central Banking Enquiry Committee, Majority Report (1931)*, p. 380.

<sup>2</sup> *Ibid.*, p. 381.

case of advances made on the hypothecation of stocks ; and sometimes it may be just a *bundi* which is in effect a two-name paper. The bulk of the accommodation afforded is, however, based 'on the tangible security of valuable assets such as bonds, shares, and immovable property, or on the security of merchandise deposited either in the bank's godowns or in the godowns of the borrower under letters of hypothecation'

In all these forms of advance, there is a rigidity almost characteristic of primitive banking. But it should be realized that to some extent this rigidity has been the inevitable result of tradition and peculiar historical circumstances. The principal reason why joint-stock banks in India have insisted on having tangible securities or the guarantee of two names before they would lend out money to merchants and industrialists has been the tradition established by the old Presidency Banks and later followed by the Imperial Bank of India. This tradition has been reinforced by the memory of unfortunate banking collapses that have taken place from time to time as a result of somewhat speculative and improvident advances. Another contributory cause has been the provisions of the Indian Companies' Act which require that, for the purpose of the balance sheet, a bank's advances should be classified as secured and unsecured, and shown separately. The result has been that the granting of unsecured loans on properly appraised credit has not been regarded as good banking ; moreover, shareholders have frowned on such advances as they have been supposed to be unsafe and imprudent.<sup>1</sup>

The above rigidity in the matter of short-term credit has both affected, and been affected by, the managing agency system of organization. It has affected the system in two ways : firstly, it has made many managing agents (e.g. in Ahmedabad) almost unwilling to go to a bank for a loan which would require them to pledge their stocks and thereby lose the confidence of their public depositors ; secondly, the two-name rule has made the backing of the managing agents in the matter of finance virtually indispensable and has thereby effectively curtailed

<sup>1</sup> Report of the Bengal Banking Enquiry Committee (1930), paras. 420-63.

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the independence of the industrial units. On the other hand, the very responsiveness of the managing agency system to their demands has made it possible for the banks to remain rigid with regard to their loans and advances, and to insist on full backing by the agents.<sup>1</sup>

Rigidity is not the only defect of short-term credit in India. In recent years, short-term credit has tended to become costly also. In course of the enquiries made by the Indian Central Banking Enquiry Committee during 1929-30, it was repeatedly asserted by Indian entrepreneurs that 'the rates of interest charged to industries for loans and advances are generally higher than the industries can bear'. The larger joint-stock banks make advances usually at the Imperial Bank (now Reserve Bank) rate or 1 per cent. higher; but the smaller ones—and there is a multitude of them—charge 2 to 4 per cent. higher. The Chhotanagpur Banking Association in their evidence before the Central Banking Enquiry Committee admitted that they charged 12 per cent. per annum to small colliery proprietors.<sup>2</sup> The Puri Bank Ltd. advanced loans at 16 per cent. per annum on sums above Rs. 5,000, and at 18 per cent. per annum on amounts less than Rs. 5,000 on the security of mortgage bonds.

### *A Loosely Organized Money Market*

We thus see that while there has been a good deal of confused thinking among business men and industrialists in India as to the part that banks should play in the matter of industrial finance, the services of the latter have been rather costly and rigid. This has been partly the result of the play of certain economic forces and partly the result of English banking tradition. The position, however, is one that badly needs improvement and the first improvement ought to be in the direction of evolving a 'system' out of the medley of credit agencies that cater for the needs of industry to-day.

The absence of a 'system' could be seen, until the other day, in the absence of a central co-ordinating agency in the

<sup>1</sup> Indian Tariff Board: *Cotton Textile Industry Enquiry* (1932), Vol. II, pp. 185-90.

<sup>2</sup> *Indian Central Banking Enquiry Committee Report* (1931), Vol. II, pp. 60-1.

Indian money market. The foundations of a sound credit organization could not be truly laid because neither the joint-stock banks and indigenous bankers nor the exchange banks were able, when necessary, 'to turn into cash a maximum of their assets with a minimum of disturbance to general conditions'. There having been no true Central Bank in the Indian credit system until 1935, the facilities of re-discounting, which only a Central Bank could properly afford, were almost nil.<sup>1</sup> The Imperial Bank of India played the role of a bankers' bank, but there was no legal provision compelling the other banks to keep minimum balances with it, and the service that it rendered to other banks by granting loans against the security of Government paper at Bank rate was largely negated by the relatively high level of that rate on most occasions. As a matter of fact, owing to the special privileges enjoyed by the Imperial Bank as Government banker, the other banks looked upon it more as an unfair rival than as a friendly coadjutor. On the other hand, some of the joint-stock banks looked upon (and they still do so) the exchange banks as formidable rivals on account of their large resources and their ability to attract deposits at more favourable rates of interest than themselves. Moreover, neither the exchange banks nor the indigenous shroffs were under any obligation to keep balances or accounts with the Imperial Bank of India.

Because the Indian banking system has been so loosely organized, the Bank rate in India has never had the significance and influence which it has in countries with better organized and developed banking systems. In these latter countries (e.g. England, Germany, France, and the U.S.A.) all the various rates that prevail in the market move simultaneously and sympathetically with the Bank rate (which is the rate at which first class trade-bills can be discounted at the Central Bank), and, in spite of certain limitations, the Bank rate policy of the central institution becomes a most delicate but beautiful instrument for the purpose of controlling the currency and credit of those countries. In India, on the other hand, 'there has been no

<sup>1</sup> Report of the Royal Commission on Indian Currency and Finance (1926) (Cmd. 2687), p. 33.

fixed relation between the rate paid by banks on deposits and the Imperial Bank rate. The holdings of bills have never been on a large scale, and such bills as have been purchased by banks have been looked upon as a definite investment and there has rarely been any question of re-discounting them'.<sup>1</sup>

Even a cursory analysis of the various rates that prevail in the Indian money market at any one time would show that the movement of credit between the various markets inside the 'system' is extremely sluggish. Truly speaking, there is no one money market in India, and the Imperial Bank rate (now the Reserve Bank rate), which has been quoted in financial journals along with the Bank rates of the Central Banks of other countries, has simply meant the rate at which the Bank would ordinarily advance money against Government securities. On the other hand, the rate at which the Imperial Bank (now the Reserve Bank) would discount or re-discount first class bills has been called the Bank *bundi* rate. And although there is some connexion between the two rates, their seasonal movements are by no means simultaneous or proportionate. Then again there are the inter-bank call money rates and bazaar rates. The former are the rates for day-to-day loans given by banks, and while in other countries such rates tend to move *pari passu* with the Bank rates, there has been no such movement at all in India.<sup>2</sup> 'In India we find that call money is sometimes unlendable at the slack season at almost any rate, while it may not be obtainable even at Bank rates in the busy season.'<sup>3</sup> The bazaar rates (rates at which the bills of small traders are discounted by shroffs) are more fantastic still, bearing little relation to the Bank rate and often varying widely even between two adjacent business centres. There is practically no link between the bazaar market and the market controlled by banking institutions on western lines, and hence rates in the former are more or less established by local custom, and do not necessarily rise or fall with the Bank rates of interest which are determined

<sup>1</sup> *Indian Central Banking Enquiry Committee, Majority Report (1931)*, p. 397.

<sup>2</sup> See Appendix IV.

<sup>3</sup> *Ibid.*, pp. 397-402.

with reference to the general trade conditions all over the country. Large seasonal fluctuations in the demand for the financing of staple crops only intensify the independence of the various prevailing rates.<sup>1</sup> The net result is that the Bank rate in India is a very poor index of the general trend of the rate for investment money, and hence no more significant than the various other rates that prevail in the money market.<sup>2</sup>

Another grave defect in the organization of the Indian money market lies in the fact that the market has to a large extent been dominated by Government which has controlled the currency and exercised a decisive influence on the Bank rate.<sup>3</sup> Not that there is anything inherently pernicious in the Government interfering with the credit mechanism of the country: but, as was well pointed out by the Commission of 1926, the system in which control of currency and credit was in the hands of two distinct authorities (viz. Government and the Imperial Bank of India) whose policies might be widely divergent, was inherently weak. The system resulted in a serious lack of elasticity and stability of monetary conditions.<sup>4</sup>

This brings us to the credit operations of the Government of India, and their repercussions upon the money market. The Government of India have encroached on the money market in two ways: (a) by floating long-term loans for its capital and other expenditure, and (b) by issuing Treasury bills for short-term funds. Both these operations have had important effects on the credit system of the country.

Let us first consider the long-term loans raised by the Government of India in the Indian capital market for capital and other expenditure. These loans have become very substantial since 1920 and have been raised at rates that have had serious repercussions on industrial investments.<sup>5</sup>

<sup>1</sup> The Reserve Bank of India Act contains an interesting provision (Section 18 of the Act) giving the Bank powers to go outside its normal sphere of business on special occasions, e.g. in times of seasonal stringency. These powers do not seem to have been exercised yet.

<sup>2</sup> *Report of the Controller of the Currency for 1928-9* (Calcutta, 1929), p. 12.

<sup>3</sup> *Report of the Royal Commission on Indian Currency and Finance* (1926) (Cmd. 2687), p. 33.

<sup>4</sup> *Report of the Controller of the Currency for 1928-9* (Calcutta, 1929), p. 12.

<sup>5</sup> See Appendix V.

The masses are extremely conservative and nearly all of them prefer a low but safe rate of interest to an uncertain (and risky) high rate of interest. When the Government issue bonds at rates varying from 4 to 6 per cent., it is but natural that industry, with its attendant risks and uncertainties, will have to pay a higher rate. It should, however, not be forgotten that in India part of the loans floated by the Government is as much industrial capital as capital raised by private industry, and it is certainly a tribute to the efficiency of the Government that capital has been raised by them so economically.

The issue of Treasury bills for short-term funds has, on the other hand, been prompted mainly by exchange and currency considerations. Treasury bills have affected the rates in the money market in two ways. Firstly, owing to the large extent and high rate at which the Government have often borrowed on long-dated Treasury bills, financial houses have been anxious to purchase them in preference to industrial shares or debentures, and so the legitimate needs of industry have suffered. 'By investing largely in bills, the capacity of the banks to make advances was diminished, and industry felt the restriction of credit.' Secondly, even when the proceeds of the Treasury bills were disbursed into the money market and contraction of credit counteracted, advances to industry were made only at a higher rate of interest: the operations of the Government caused *dearer money without causing a real scarcity of money.*<sup>1</sup>

The net results of the credit operations of the Government have been these. They have tempted banks to invest largely in gilt-edged Government securities, and have thereby reduced the margin of their investments in commercial bills or industrial bonds. They have also raised the price that industry has to pay for advances from banks or other financial agencies. Finally, the Treasury bill transactions of the Government have often caused temporary or seasonal stringency in the money market, and have hard hit particular industries at times when a smooth and inexpensive flow of capital was essential to their steady development.

<sup>1</sup> *Indian Central Banking Enquiry Committee Report*, Vol. III, pp. 490-6.

These disturbances have been due mainly to the absence of a central co-ordinating agency. There being no true Central Bank until 1936, the Government of India were unable to work in close co-operation with the credit agencies of the country in respect of their borrowing operations. There was no organization which could guide or advise them on the far-reaching repercussions of their credit policy on the industrial and agricultural development of India, and as very often they had to think mainly in terms of keeping the exchanges stable and the credit of the Government sound, they were apt to overlook the needs and difficulties of industry and agriculture in the country.<sup>1</sup>

<sup>1</sup> For recent developments, please see the next chapter.

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## CHAPTER II

### INDUSTRIAL FINANCE ABROAD AND THE PROBLEM BEFORE INDIAN BANKS

#### *Introductory*

THE question of industrial finance in India and the policy of the Government with regard to this particular problem have been so much discussed in recent years that a proper analysis of the fundamental forces at work is impossible without a comparative study of the agencies of industrial finance in countries that are economically more highly developed than India. The study is also important from another point of view. Ever since the days when industrial finance in India presented itself as a problem of some magnitude to her economists and politicians, people have been loud in their complaints that India has not been following in the footsteps of some countries which possess 'ideal organs of finance' for the promotion and development of their industries. The traditional and conservative ways of banking on the part of the Imperial Bank of India and other joint-stock banks have only served to confirm a suspicion that things are manipulated in this country in a certain way by certain people with interested motives. It has been openly asserted that in India the State evinces little or no living concern for the growth of industrial enterprise, and this lack of enthusiasm has been attributed by many to the overwhelming influence which foreign vested interests enjoy in India and also to the obvious fact that those who govern and direct the industrial policy of the country have not in any appreciable way been responsible to the representatives of the people for what they do or omit to do.<sup>1</sup>

#### *Industrial Finance in England*

We shall start our study with England, not only because her models have been more or less copied in India but also

<sup>1</sup> A very frank expression of this suspicion is to be found in the pages of the *Indian Central Banking Enquiry Committee, Minority Report*, by Mr. Manu Subedar (Calcutta, 1931).

because her industrial life is decidedly longer and more varied than that of any other country in the world. The first thing that strikes an observer here is that the relations between the British financial world and British industry, as distinguished from British commerce, have never been very close. The proprietors of British banks have invested but a small proportion of their funds in industry and the requirements of the latter have been met more by the extremely varied facilities and unrivalled financial machinery of the English capital market' than by the direct participation of banks in industrial ventures.'

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

\* S. E. Thomas, *British Banks and the Finance of Industry* (London, 1931), p. 133.

† *Report of the Committee on Finance and Industry* (London, 1931) (Cmd. 3897), pp. 161-2.

Generally speaking, industrial investment in England has not been 'guided' by any financial institution or organization of any standing or reputation. A few issuing houses have occasionally entered into the field of industrial promotion, and the organizations of stockbrokers have often been known to give advice, but, in the main, banks or other financial institutions have never fathered an issue or been in any way responsible for it beyond seeing that the prospectus of a projected company complied generally with the law and that the issue was, on the face of it, respectable. There are practically no established houses to assist investors in subscribing to shares in local industries and enterprises; the real issuer is 'the company itself, if it is a strong and good one, or a finance company or syndicate—few large, many small, some good, some indifferent, some bad—and sometimes it is a company or a syndicate got together for the sole purpose of making a particular issue'.<sup>1</sup>

The current requirements of industry are supplied by the joint-stock banks. They increase the supply of capital by collecting lodgements from the public; by compounding these lodgements with their own capital and reserve funds they convert a large number of small quantities and short lengths of capital, individually ineffective, into an aggregate available for productive employment; finally, by a continuous re-distribution of this capital among the points of highest yield they maximize its earning capacity.<sup>2</sup> This last service of continuous re-distribution of available funds is performed in the City of London by the short-term money market which gives facilities for the employment of home or foreign funds. This money market supplies the day-to-day needs of industry with an elasticity and efficiency that are unknown in any other financial system of the world. On the other hand, intermediate credit (i.e. credit advanced for periods ranging from one or two up to five years) and long-dated capital are not adequately supplied by this market, this being 'due in part to the historical organization

<sup>1</sup> *Report of the Committee on Finance and Industry* (London, 1931) (Cmd. 3897), p. 167.

<sup>2</sup> F. Lavington, *The English Capital Market* (London, 1929), p. 178.

of British industry and to the fact that industry, having grown up on strongly individualistic lines, has been anxious to steer clear of anything which might savour of banking control or even interference.<sup>1</sup>

The most important feature of the English credit system is the Bank of England, which stands at the apex of the whole banking organization of the country. By its control over the cash base of the country the Bank of England is in a position to regulate the volume of bank deposits, so long as the joint-stock banks adhere to their normal practices in regard to the distribution of their assets, or indeed to offset any change which might be made in those practices. The link between the Bank of England and the commercial banks is established through the discount market 'which is the first outlet of any surplus funds held by the banks and from which funds are withdrawn when the banks find it necessary to replenish their reserves'. If the withdrawal causes a shortage of funds in the market, the market borrows in some form or other from the Bank of England, and the accommodation thus given by the central institution provides the means of replenishing the cash resources of the commercial banks.<sup>2</sup>

In England business men thus depend on the ordinary credit mechanism of the country for the accommodation they require for purposes of trade and industry. For historical and sociological reasons the system has worked wonderfully well, and the contact between industry and credit has never been very close and intimate. But with the rise of highly industrialized systems in other countries of Europe and in America, England has found that the old practice of 'little conscious direction of the national activities to definite ends' no longer pays; the feeling has grown that her former policy of *laissez-faire* would no longer ensure her prosperity in a crowded and increasingly competitive world. The question of finding new and up-to-date agencies of industrial finance has attracted the attention of business men and financiers in England as well.<sup>3</sup>

<sup>1</sup> Report of the Committee on Finance and Industry, pp. 169-71.

<sup>2</sup> Ibid., pp. 44-5.

<sup>3</sup> Ibid., pp. 4-5. 'We may well have reached the stage when an era of conscious and deliberate management must succeed the era of undirected natural evolution.'

*Industrial Finance in the U.S.A.*

In the United States of America the connexion between banks and industry has been more intimate than in England, but less so than in Germany. From the very outset the American financial world devoted itself more to the development of her industry than to international finance. In the building up of some of the national industries, and in particular in the merging of most of the great American corporations, some financing house or bank has invariably played a leading part, with the consequence that the relationship between them has usually remained a close and continuous one. 'It may be said that all industrial issues of well-known companies are sponsored by some responsible issuing institution: the smaller issues by smaller firms, the larger by large firms or large banks. In both cases it is common for a group of issuing institutions to combine in making the issue. In every case the names of the issuing institutions appear prominently on the prospectus, so that the public are left in no doubt as to who is sponsoring the issue.' 'Moreover, the American banks are closely concerned with industry from another aspect. The banks lend either directly or through brokers very large amounts of money to investors and speculators against industrial securities of all kinds. The loans of this kind are sometimes at least equal to the loans made direct by them to industry.'<sup>1</sup> The result is that banks in America are always specially interested in the stock market and in the industrial securities quoted there. In view of the fact, however, that the number of banks competing is large and it is easy to find the necessary capital from the public, the connexion between banks and industry in the U.S.A. is not as close as it is in Germany.

*Industrial Finance in Germany*

We may now turn to a study of the relationship between banks and industry in Germany.<sup>2</sup> A very large section of Indians desire that India should take a leaf out of German

<sup>1</sup> Report of the Committee on Finance and Industry, pp. 163-4.

<sup>2</sup> A very comprehensive account will be found in P. B. Whale, *Joint-stock Banking in Germany* (London, 1930).

industrial history and develop her industries after the German fashion. Even apart from this consideration, the study is important because, of all the Continental countries, Germany shows *par excellence* how economic circumstances force bankers to associate themselves with industrial development, and how industries themselves are forced to count on the support and guidance of banks.

Let us first analyse the historical forces at work. The close association between banks and industry in Germany arose out of the necessities of the situation—from the scarcity of capital and of independent investors. ‘The comparative poverty of Germany about the middle of the last century and the great demand for capital to supply the needs of her rapidly growing industries led naturally to the development of banks which took a large and active part in providing the capital requisite for the creation and extension of business undertakings, both by the grant of long loans and by the floatation of joint-stock companies.’<sup>1</sup> In order to compete with England, which had the advantage of an early start, industry in Germany had to turn to banks for their capital requirements. Accepting the heavy responsibility of supplying capital to industry, banks on their part were obliged to keep in more intimate touch with, and maintain a more continuous watch over, firms with which they had allied themselves than were the English banks.<sup>2</sup>

It was not exactly an *absolute* shortage of capital that resulted in this peculiar relationship between German banks and industry. Capital there was, but it was misdirected. ‘Those who had the necessary funds were for the most part neither willing nor fitted to become progressive entrepreneurs themselves, nor would they entrust their money to others who had the required qualities.’ Hence there was an urgent need for some agency which could obtain the confidence of the investing classes and use this confidence to direct the capital towards sound industrial undertakings. The new credit banks filled up this gap.<sup>3</sup>

The close co-operation between banks and industry in

<sup>1</sup> Lavington, *op. cit.*, pp. 209-10.

<sup>2</sup> *Report of the Committee on Finance and Industry*, pp. 162-3.

<sup>3</sup> Whale, *op. cit.*, pp. 10-12.

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

What is often overlooked in all discussions about the German banking system is that the special services to industry are performed not by a separate or special type of credit agency, but by the ordinary joint-stock or commercial banks. The various activities carried out in the British banking system by various kinds of agencies are executed in Germany by the joint-stock banks alone: these latter comprise the functions of a commercial bank, mortgage bank, discount house, issue house, company promoter, bill-broker, and stockbroker. The German Great Bank, unlike the English

\* *The Bankers' Magazine* (London), April 1931.

\* Leopold Joseph, *The Evolution of German Banking* (London, 1913), pp. 95-105.

Investment Trust, does not specialize in investment business alone, but combines the functions of an investment bank with those of an ordinary commercial bank.<sup>1</sup> The ordinary credit banks carry on various lines of business which to an outsider would seem rather risky and speculative. But inside the integrated system there is a considerable amount of specialization. The various routine transactions are done by the respective departments, while the higher financial activities, such as the floating of state and municipal loans, syndicate operations in connexion with the promotion of industrial undertakings, etc., are dealt with by the managing directors themselves with the help of their secretaries.<sup>2</sup> Organization, elaborate and methodical, characterizes the German system and gives it power. In banking, as in industry, though the individual units are often large enough by themselves, the method of the kartel is frequently adopted. On the one hand, each of the leading banks has a large group of allied banks working in general co-operation with it; on the other, in addition to this primary grouping, they are specially organized in their own ways to deal with large financial propositions. The result is that in Germany risks which even the largest banks might regard as dangerous are made quite manageable by distribution.<sup>3</sup>

Let us now analyse the transactions between a bank and a particular customer undertaking. These transactions are very varied—a sort of ‘an indivisible many-sided whole, rather than a sum of separate relations’. The first connexion arises in the matter of current account which is distinct from cheque account. When a current account relationship exists between the two parties, money claims arise on both sides and ‘these claims are not settled individually, but are treated as items in an account of which the balance is struck periodically’. The average German firm depends to a remarkable extent on this arrangement not only for its working funds but also for the purpose of extending its permanent assets in anticipation of recourse to the investment market. The current account relationship

<sup>1</sup> *The Indian Journal of Economics* (Allahabad), April 1925.

<sup>2</sup> *Written Evidence of Dr. L. Nemenyi before the Indian Central Banking Enquiry Committee*, Vol. II, pp. 286-7.

<sup>3</sup> H. S. Foxwell, *Papers on Current Finance* (London, 1912), pp. 115-16.

is very important as it is a continuous connexion and thus gives the bank an insight into most of the money transactions of a customer; it also provides much of the data required for estimating the risk involved in the intermittent capital transactions; and it leads up to capital transactions even more directly, in the sense that improvements and extensions of plant are often undertaken by means of current account credit which is repaid later with the proceeds of a capital issue. The industrial current account is the pivot of all transactions between banks and industry; promotion and issue transactions, direct participation in industrial undertakings and co-operation in management through Boards of Supervisors—these stand in very many cases in a close causal sequence with bank credit.”

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

✓ The third and last important connexion arises in the representation accorded to banks on the Board of Supervisors of an industrial undertaking. ✓ This Board comes in between the Executive and the General Meeting of shareholders to keep a check on the executive in the interests of shareholders and has got considerable powers over both. By this means banks 'strengthen their connexion with the undertakings in question and exercise more influence on their policy and more insight into its execution'.<sup>1</sup>

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

<sup>1</sup> Whale, op. cit., pp. 49-51.

<sup>2</sup> Reisser tells us, as the result of an enquiry into 169 banks, that the paid-up capital and reserve of these banks was 45 per cent. of their liabilities, while the proportion in England at that time was only 9 per cent. Cf. also Foxwell, op. cit., pp. 116-17.

another, and the holdings of banks in the different syndicates are kept very confidential.<sup>2</sup>

*A Comparison of the English, American and German Systems and Some Recent Developments*

The English banking system is an instance of excessive division of labour, but it suits the temperament of the English people and has got historical forces behind. In America the process of specialization is less marked; although banks come to the front to assist in the promotion and financing of industrial undertakings, the contact is by no means as close as it is in Germany. In Germany, banking is more non-specialized, and it is almost a marvel that ordinary commercial banks should engage in activities of so diverse and complex a character and yet maintain their soundness and liquidity. As we have seen already, this is achieved by a punctilious insistence on self-balancing transactions and by a judicious distribution of risk. The German system provides a very efficient machinery for investigating business ventures and at the same time is strong enough to sustain the heavy risks to which industry is exposed. The companies enjoy expert financial advice and assistance; the banks, by virtue of their position as directing heads of industrial groups, obtain a comprehensive view of economic conditions which enable them to promote amalgamations and introduce or, if necessary, even force through schemes of rationalization or other remedial measures. The investing public also benefits inasmuch as it obtains as a matter of course a large measure of security through the active intervention of banks. Moreover, as the German banker undertakes a more definite responsibility and a greater risk in connexion with capital issues, he is naturally more concerned about the success and stability of the securities issued under his name than the average English banker.

On the other hand, certain weak features of the German system should not be overlooked. While the charge of having caused the annihilation of small businesses in

<sup>2</sup> *Written Evidence of Dr. Neményi*, op. cit., p. 293.

Germany should not be laid at the door of the credit banks, it cannot be denied that one of the far-reaching results of the direct intermingling of the vital interests of the banks and of industry has been that the value of the small capitalist and investor has been somewhat overlooked, and the State has often been forced to step in to avert a crisis.<sup>1</sup> Moreover, in the years before the War, the ordinary industrial or commercial firm of moderate means often found its freedom of action conditioned by the goodwill of its bank, even when it was in a sound and fairly prosperous state itself.<sup>2</sup> Although initiation in industrial combination did not actually come from the banks, it is difficult to dispute the fact that banks had some part in the development. At a very early stage they helped to prepare the way by encouraging fusions between individual undertakings, and thus reducing the number of competitors. Throughout, their attitude towards fusions was sympathetic, even while it remained passive. Finally, once the plans for combination had reached a certain stage and were within a measurable distance of fruition, the banks gave active support to ensure their success.<sup>3</sup>

Another weakness of the German system lies in the relation of banks to the short-term money market. In their desire to meet the credit needs of their industrial customers on the cheapest terms, the banks place their acceptances at the disposal of their customers to a very large extent. Such acceptances are largely used to obtain long-term credits. Now, a demand for long-term credit for capital investment means more bank acceptances and a tendency towards over-burdening of the money market, with the result that the interest rate of legitimate short-term credit reflected in the discount rate is forced up without justification and at a time when trade expansion may be vitally necessary. The practice of the banks employing the nation's liquid resources as long-term advances to industry has had a disturbing influence on the money market on more occasions than one and, paradoxical though it may seem,

<sup>1</sup> *The Bankers' Magazine* (London), April 1932.

<sup>2</sup> Whale, *op. cit.*, p. 55.

<sup>3</sup> J. H. Clapham, *The Economic Development of France and Germany* (Cambridge, 1928), p. 384.

the rapid reconstruction of Germany's industrial plant after the War with the active help of banks has been, through its effect on the money market, a major obstacle to the desired expansion of the country's foreign trade.<sup>1</sup>

In spite of these weaknesses, the system has undoubtedly been suited to the genius of the German people, and been a signal success so far as the industrial development of the country is concerned. The banks have assisted with their credit in the development of production on a large scale and their concentration and decentralization of establishments combined with an elaborate and methodical organization have enabled them to keep a finger 'on everything that is going on'. Finance and industry have gone hand in hand and the grim determination of the German people to achieve a rapid economic development has only strengthened this process of alliance. The influence of the pre-war bureaucracy is also not negligible: it is this bureaucracy that ensured economic stability by restricting the liberty of the industrial unit and thus built up a banking tradition which lost none of its essential characteristics during the difficult War and inflation years.<sup>2</sup>

Post-war developments in Germany have, however, revealed the weaknesses in this relationship between banks and industry to a very large extent. War profits increased the power and independence of industry as against banks, and banks were seriously affected by the fall in the value of the mark.<sup>3</sup> Although stabilization came after some time, banks could not go back to their strong pre-war position. As a matter of fact, the latest balance sheets of the leading German banks, while showing substantial expansion in resources, seem to bear a greater resemblance to the normal English balance sheet than did the majority of the German balance sheets in pre-war days. Moreover, the melancholy bank failures that took place in Austria and Germany in 1930 and after, showed far too clearly that the system of mixed industrial banking had helped to make Germany's economy more vulnerable. Germany's economic depression

<sup>1</sup> J. W. Angell, *The Recovery of Germany* (New Haven, 1929), p. 214.

<sup>2</sup> *The Bankers' Magazine* (London), June 1930.

<sup>3</sup> H. Schacht, *The End of Reparations* (Translated by Lewis Gannett) (London, 1931), pp. 99-101.

of 1932-3 was certainly aggravated, and her financial crisis caused by the destruction of Germany's working capital during the inflation period and the sudden withdrawal of foreign confidence and money, but there is not a shadow of doubt that her system of intimate alliance of banks with industry had made her position inherently weak.<sup>1</sup> So when the crisis came nothing could lessen the steepness of the crash.

As a matter of fact, until recently, the tendencies were that the German banks were less bound up with industry than they used to be. There was a growing feeling that promotion of industry by banks was not so desirable, and special financial companies to afford assistance to industry were growing up. 'Even the big banks are now devoting more attention to deposit banking. Their holdings of shares in industrial undertakings have been reduced both relatively to other investments and advances, and absolutely.'<sup>2</sup> Through financial trust and holding companies operating chiefly with funds raised by the issue of debentures, the banks exercised influence on industrial concerns without being too closely identified with them.<sup>3</sup>

In England, on the other hand, the tendency today is for a closer association between banks and industry than existed before. The Big Five in the English banking system have now got considerable investment in industrial shares and debentures, and although they are still unwilling to be drawn into too intimate a relationship with industry, the connexions which the post-war years have brought about are likely to endure.<sup>4</sup> As, however, the high proportion of funds invested by continental banks in industry is subscribed by the proprietors (the capital and reserve of such banks are relatively much higher than they are in England), whereas the funds invested by English banks in industry

<sup>1</sup> Dr. Erich Roll in *The Bankers' Magazine* (London), February 1933.

<sup>2</sup> *League of Nations Memorandum on Commercial Banks*, 1933-28 (Geneva, 1931).

<sup>3</sup> These statements do not, however, apply to present-day Germany under the dictatorship of Hitler and Schacht.

<sup>4</sup> Thomas, *op. cit.*, pp. 125-6. A typical instance is that of the Midland Bank: in June 1928 the percentage distribution of the total advances of this bank were—basic industries, 57½ per cent.; wholesale and retail traders, 11½ per cent.; stocks and shares, 8½ per cent.; insurance companies, etc., 8 per cent.; others, 14½ per cent.

represent customers' deposits and are largely repayable on demand, the average English banker must continue to be more conservative and cautious than the average German banker.<sup>1</sup>

*Mixed Banking for India on the German Model?*

✓ It has been suggested by advocates of reform that the Indian joint-stock banks should forthwith pursue a policy of mixed banking, i.e. combine investment banking with commercial banking, on the lines followed by German banks. ✓ Now, except perhaps the Imperial Bank of India, not one of the joint-stock banks is fitted today to embark on the undoubtedly difficult and complex policy of mixed banking. ✓ This, for a variety of reasons. ✓ Firstly, most of the joint-stock banks in India are small, with inadequate resources of paid-up capital and reserve, and their deposit assets which consist largely of customers' deposits liable to be withdrawn at short notice, cannot obviously, without incurring serious risks, be locked up in long-term advances or loans to industry.<sup>2</sup> ✓ Secondly, there is still an inconceivably low level of understanding and integrity among many of the bankers today, and, until things improve, it would be risky, nay disastrous, for banks to embark on mixed banking operations. ✓ The extraordinarily large number of bank failures that have been occurring every year since 1913 leave no room for optimism or hope that banking habits and traditions have been firmly established in India.<sup>3</sup> ✓ As a matter of fact, the large number of bank failures in 1913-17 was partly the result of the attempts on the part of certain banks to combine investment banking with commercial banking. ✓ The failure of the People's Bank, due to investments in mills and other industrial concerns, also points the same lesson.<sup>4</sup> ✓ Thirdly, the whole history of industrial finance in India shows that investment banking by institutions which are organized as commercial banks inevitably leads to speculation and rash promotion. As has been well

<sup>1</sup> Thomas, op. cit., p. 133.

<sup>2</sup> See Appendix VI.

<sup>3</sup> See Appendix VII.

<sup>4</sup> G. F. Shirras, *Indian Finance and Banking* (London, 1919), p. 366.

remarked by a German banking expert, 'it is not to the advantage either of the commercial banking system or Indian industries that any of the weaker banks should participate in industrial financing. This new class of business requires much experience and an established policy of sound banking. It also demands considerable capital and a firm resistance to speculation temptations which easily arise in a line of business where securities are created and sold. The bulk of the joint-stock banks in India are at present not ready for this activity, and even the larger ones can cultivate it only slowly, with great caution, and preferably under competent guidance as participants in strong syndicates.'

Another point that is important for India to remember is that in Germany block capital is never provided by banks. Their share and syndicate operations are in the nature of guarantees only: they never supply the initial block capital themselves. It is not the function of a bank to provide fixed capital, and even such capital as is needed for subsequent improvements and extensions should either be supplied out of the undivided profits of a concern or obtained by an increase of share capital or an issue of debentures. As regards the success of the current account system in Germany, it should not be forgotten that its success has ultimately been due to the fact that the savings of the community there (which are the ultimate source of capital) have been poured into those credit banks in enormous quantities for years together.<sup>2</sup>

Notwithstanding the general misconception in India about the exact nature of industrial finance in Germany and notwithstanding the fact that mixed banking after the German fashion may be fraught with disastrous consequences, it is desirable that a start should be made somewhere. The Imperial Bank of India is the only institution strong and experienced enough to enter into the field of mixed banking. It has a large paid-up capital and reserve, amounting to over 11 crores of rupees in 1935.

<sup>2</sup> *Indian Central Banking Enquiry Committee*, Vol. I, p. 635, Memorandum of Dr. O. Joidels.

<sup>3</sup> Solomon Flink, *The German Reichsbank and Economic Germany* (New York, 1930), p. 257.

Its staff contains men who are trained and efficient. Its experience in the matter of financing agriculture and industry, on the short-term loan basis, has been unique, and it has got local offices in almost all parts of India from where the inmost details of the requirements of the various companies can be studied. On the other hand, the newly established Reserve Bank of India has relieved the Imperial Bank of most of its responsibilities as a central bank, and the latter need not, therefore, be unduly cautious and conservative. The wish was expressed by the Indian Central Banking Enquiry Committee in 1931 that in course of time the Imperial Bank should find it possible and convenient to combine investment banking with commercial banking, and with the Reserve Bank of India securely established and in function, this is the opportune moment for the Imperial Bank to make a real beginning in that direction.

The Imperial Bank need not act alone, but it must take the lead. It should set an example to other banks which are strong enough to follow in its footsteps. The most important need of the hour is a better understanding and a closer contact between banks and industry, and this can be partially achieved, as it has been achieved in post-war England, even without adopting a rigid policy of investment banking. Firstly, the more important joint-stock banks, headed of course by the Imperial Bank of India, should begin to make special surveys of industries that fall more or less within their respective spheres of activity. Secondly, they all should cultivate a more sympathetic attitude towards industries, copy the *spirit* of the German system, and 'establish useful liaison between themselves and industries by appointing one of their managing directors or managers as one of the directors of the industrial concerns financed by them'. This should not be difficult, as even under the present system of managing agency finance quite a number of directors on the board of a company are appointed by the managing agents and the new Act also statutorily empowers managing agents to nominate up to one-third of a total directorate. Thirdly, the more important banks should appoint local advisory committees in the industrial centres so that they may get better and more

reliable information regarding the status and financial position of their actual as well as potential clients.

*The Problem of the Commercial Bill in India*

Even in the matter of granting commercial credit, banking activity in India has been hampered by the fact that no well-developed and expansive bill market exists in India. Now, a typical commercial bill is created in this way: a manufacturer, say a cotton mill, sells goods on three months' credit to a wholesale dealer and, as a preliminary condition of the credit, the dealer accepts a draft drawn on him by the mill. Such a bill is self-liquidating inasmuch as it arises out of a bona fide sale, and has got the backing of goods sold behind it. When the manufacturer is in need of cash he approaches his bank with a request to discount his bill. If the manufacturer is of good standing, and if the acceptor of the bill is also reputed to be sound, the bank will gladly discount such a bill, especially when he knows that the Central Bank is willing in its turn to re-discount the bill.<sup>1</sup>

In India, however, this method of obtaining money by discounting bills has not been very common, for a variety of reasons. Firstly, the major part of Indian business consists of agricultural produce, and there is not the same chance to create bills there as in manufacture. 'When crops are marketed they are sent on their way to the consumer by small merchants through large ones, and it is evident that in practice such small merchants are not in a position to grant credit to the large ones. On the contrary, it is the bigger merchants who often advance money to the smaller traders to buy agricultural produce for themselves.'<sup>2</sup> Secondly, even where commercial bills could be created, the banks were reluctant to discount them, because they could re-discount them only at the Imperial Bank of India, but they did not like that the said bank, their rival so far as commercial business was concerned, should know their bill portfolios. Thirdly, the system of cash credits was regarded

<sup>1</sup> The bank discounts the bill by deducting the interest for the period in question and crediting the balance to the manufacturer.

<sup>2</sup> S. Bhatner and L. Nemenyi, *The Reserve Bank of India and its Functions* (Calcutta, 1933), pp. 110-19.

as more convenient both by banks and borrowers. And hence there was no particular preference on either side for commercial bills as an instrument of credit. Finally, a high stamp duty on bills has also acted as a deterrent.<sup>1</sup>

With the establishment of the Reserve Bank of India and the facility that *all* banks now get to have their bills re-discounted at the Reserve Bank, the second formidable obstacle enumerated above should disappear. A lot, however, would depend on propaganda; a reduction of the stamp duty on bills would also help. The real problem, however, is to make the commercial bill acceptable to all members of the banking organization: it should not be exclusively dependent on the standing and respectability of the borrower, but should represent a real value in non-perishable, readily saleable goods. This can be achieved by basing the credit system on valuable and liquid assets such as bonds, shares and movable goods. In certain countries (e.g. Java) where no true money market and no inland bills exist, loans and advances are made against the warehouse warrants or warehouse receipts representing such assets. India, too, should develop the method of licensed warehousing: firms requiring temporary accommodation should store their raw products or manufactured articles in these warehouses, and the receipts issued against them should be used as collateral for loans which commercial banks are ordinarily able to make on the strength of covered bills. An organized and well-managed system of warehousing would enlarge the basis of credit and facilitate the grant of short-term advances by bankers to industry and trade.<sup>2</sup>

### *Some Recent Facts and Figures and the Future*

The Reserve Bank of India started work on 1 April 1935, and before the end of the year it had taken over from the Imperial Bank all functions which it was to take over under the Act. The country was, however, still suffering from agricultural depression, and the condition of the money

<sup>1</sup> S. Bhatler and L. Nemenyi, *The Reserve Bank of India and its Functions* (Calcutta, 1933), pp. 119-22.

<sup>2</sup> *Memorandum by Dr. L. J. A. Trip before the Indian Central Banking Enquiry Committee* (1931), Vol. IV, pp. 362-3.

market was very easy. This and the weight of money awaiting investment compelled a further reduction of the Bank rate from  $3\frac{1}{2}$  per cent. to 3 per cent. in November 1935, and the rate has continued at that figure ever since.<sup>1</sup>

The most interesting feature in the Indian money market today is the sluggishness in the movement both of advances and of bills discounted by the scheduled banks. The following figures are illuminating :

CONSOLIDATED STATEMENT OF SCHEDULED BANKS<sup>2</sup>  
(In lakhs of Rupees)

|                       | Balance with<br>the Reserve<br>Bank of India | Advances | Bills<br>discounted |
|-----------------------|----------------------------------------------|----------|---------------------|
| 2 August 1935 .. ..   | 29.11                                        | 93.79    | 2.86                |
| 1 November 1935 .. .. | 31.64                                        | 82.57    | 2.72                |
| 9 February 1936 .. .. | 35.99                                        | 86.79    | 4.58                |
| 31 July 1936 .. ..    | 32.13                                        | 87.71    | 2.82                |
| 4 December 1936 .. .. | 25.00                                        | 89.92    | 4.30                |

These figures show that in spite of the fact that industrial recovery is within sight in India, the demand for bank credit in the form either of advances or of bills discounted is still slow. In England also there has been a similar sluggishness in the response of bank advances during this period, but there this was due to such factors as (a) the 'unfreezing' of commercial and industrial loans in the sense that loans written off during the depression as bad or doubtful were repaid and brought back into profit and loss, (b) rationalization of industry, (c) the habit of many companies obtaining fresh capital from, or placing fresh debentures with, the public, and (d) the practice of many municipalities raising direct loans from the public and repaying bank loans.<sup>3</sup> In India there has been no large-scale 'unfreezing' of commercial and industrial loans in the sense in which this has taken place in England nor has there been any significant rationalization of industry. Nor can it be said that local bodies there are raising large loans in order to repay the

<sup>1</sup> *First Annual Report of the Reserve Bank of India* (Calcutta, 1936).

<sup>2</sup> Compiled from various issues of *The Economist* (London).

<sup>3</sup> *The Economist* (London), 1 August 1936.

banks. The sluggish figures of bank advances and bills discounted are, therefore, a pointer to the fact that ultimately it is not the banks that are most responsible for the financial difficulties of industry in India.<sup>1</sup>

Another fact emerging out of the figures is the comparative unimportance of commercial bills in the realm of business finance in India. We have already seen that the cash credit system has a peculiar predominance in Indian business and that commercial bills are not popular at all. Even the establishment of the Reserve Bank of India with its re-discounting facilities has not made any appreciable difference to the use of the commercial bill as an instrument of credit. As a matter of fact, no re-discounting of commercial bills was made at the Reserve Bank of India up till the end of 1936.<sup>2</sup> This seems to have been partly due to the fact that money was so plentiful in each of the scheduled banks that none of them considered it necessary to get their commercial bills re-discounted at the Reserve Bank of India.<sup>3</sup>

The future, therefore, seems uncertain. Until and unless the present easy condition in the money market disappears to some extent, it will be difficult for the Reserve Bank of India to exercise a policy which will have substantial influence on the entire credit system of the country. On the other hand, even this comparatively short period of the working of the Reserve Bank of India shows that 'while a Central Bank has to perform duties which are as intricate as they are vital to the well-being of a country, it cannot do all the work for other banks: the commercial banks have a part to play in the economic structure which no Central Bank, charged with its special responsibilities, can take over from them'.<sup>4</sup>

One thing, however, is clear. All the joint-stock banks (including the Imperial Bank) will now be compelled to pursue a more forward policy with reference to industry

<sup>1</sup> *Indian Finance* (Calcutta), 6 February 1937.

<sup>2</sup> *Second Annual Report of the Reserve Bank of India* (Calcutta, 1937).

<sup>3</sup> This is the opinion of Mr. Ram Nath, Manager of the London Branch of the Reserve Bank of India, with whom the writer discussed the subject at length.

<sup>4</sup> *Legislative Assembly Debates*, New Delhi, 1933, Vol. III, p. 2200.

simply because they must have some decent return on their capital, and also on the deposits that are lodged with them by the public. There are already signs that banks in India are taking a more progressive view of industrial ventures and it is quite conceivable that in another twenty years' time many of them will actually have taken upon themselves some of the so-called 'mixed banking activities'.<sup>1</sup>

<sup>1</sup> *Indian Finance* (Calcutta), 13 February 1937.

### CHAPTER III

## THE MANAGING AGENCY SYSTEM AND ITS RELATIONS TO INDUSTRIAL FINANCE IN INDIA

### *Introductory*

IT has been universally recognized that the successful financing of an enterprise depends on sound and efficient management,<sup>1</sup> but nowhere is the truth of this statement as pointedly demonstrated as in India. The managing agency system arose in India during the latter part of the nineteenth century, and this system of organization and management gradually spread to almost all industrial enterprises—Indian as well as British.<sup>2</sup> The rise of the managing agents was due to the fact that they fulfilled the role of promoters and pioneers in many of the newly established industries in India; they came into prominence because it was they and they alone who could supply a regular stream of trained and efficient managers; and they gathered power as they found that the capital market was notoriously shy, and that industry looked to them for financial aid, both direct and indirect. The continuance and prevalence of the managing agency system in industrial enterprise in India has been due more to this last factor than to any other. Banks were not prepared to finance the long-term needs of industry, and were unable to provide more than 'circulating' capital and even that for short periods; on the other hand, many of the enterprises were under-capitalized at the very outset, and needed adequate financial assistance or guarantee at every stage of their work. So the managing agency system came to dominate Indian industry.

<sup>1</sup> E. S. Mead, *Corporation Finance* (New York, 1933), p. 248.

<sup>2</sup> N. Das, *op. cit.*, Chapter VI. For a very detailed account see Lokanathan, *op. cit.*, Chapter I.

*Direct Financial Assistance by Managing Agents*

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

Direct loans are not the only aspect of direct finance by managing agents. Ever since the system grew up, managing agents (particularly in Bombay and Ahmedabad) started the practice of purchasing shares of the companies they managed in the name either of themselves or of their friends, and in recent years they have also taken up debentures floated (often by themselves) by those companies. In the Ahmedabad cotton mills, for instance, the proportion of share capital held by the managing agents is generally 40 to 50 per cent., and it is considerably higher in Bombay.<sup>1</sup> As regards debentures, in some cotton mills, members of the managing agency firms have lately taken up a substantial portion of the debentures that have been issued.<sup>2</sup>

Coming back to the question of direct loans, it would be interesting to analyse why industries in India have come to rely to such a large extent on managing agents for their finance. The reason is that in India there are no large classes of investors, and capital—both for fixed and floating assets—has to be provided by the agents or their friends. Moreover, particularly in Calcutta and Madras, the managing agency firms are the inheritors of the tradition of the early European Agency houses who had a large amount of banking business in addition to their rather subsidiary activities.<sup>3</sup> The firms of Messrs. Arbuthnot & Co., of Madras, for example, had invested in 1906 a sum of 25 lakhs in several industrial concerns. Again, the firm of Messrs. Andrew Yule & Co., of Calcutta—one of the most important managing agency firms of India—have hardly ever borrowed from any joint-stock or exchange bank for their enormous financing operations: they have a separate

<sup>1</sup> Indian Tariff Board: *Report of the Cotton Textile Industry Enquiry* (1932), p. 85.

<sup>2</sup> *Financial Times* (Calcutta), January 1935.

<sup>3</sup> N. Das, *op. cit.*, Chapter III.

banking department of their own for the financing of the fifty-four industrial companies which they manage.<sup>1</sup>

*Indirect Financial Assistance by Managing Agents*

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

We have seen that joint-stock banks in India are very rigid with regard to the grant of short-term credit. They make advances against tangible and marketable securities lodged or pledged with them and/or they want the several responsibilities of at least two persons or firms unconnected with each other in general partnership. These practices have compelled the managing agents to come forward and give the necessary guarantees to the banks. Except in Calcutta, for instance, most banks in the up-country and in Bombay insist on the signature of the managing agents even when goods are hypothecated; and when goods are not hypothecated, the guarantee of the managing agents on notes of hand in addition to the signature of a director of the company is insisted upon.<sup>2</sup> This rather exacting requirement is defended by bankers on the ground that 'the banker cannot know at any given time what the exact financial position of the company is, and he has greater confidence in the agency firm, and is willing to advance only on the guarantee of the agents'. Nevertheless, it is unfortunate that banks in India are not willing to take the reasonable risks they often do in other types of lending operations and, by their rigidity, help to strengthen the hold of managing agents on industrial enterprise in India.

Even with regard to public deposits which form such an

<sup>1</sup> Lokanathan, op. cit., pp. 217-18.

<sup>2</sup> Indian Tariff Board: *Cotton Textile Industry Enquiry* (1927), Vol. IV, p. 23.

important source of finance to the cotton textile industry, it is the name of the managing agents that ensures a steady flow of deposits. In Ahmedabad, for instance, deposits are automatically renewed for years together in those mills which are controlled by reputed firms of managing agents. On the other hand, during the depression of 1929 and after, public deposits were withdrawn from those concerns where managing agents were reputed to be inefficient, lazy or dishonest.<sup>1</sup>

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

#### *The Economic Background of the Managing Agency System of Finance*

The question has repeatedly been asked why industry in India is so utterly dependent on managing agents for its finance. As has been hinted already, this dependence has been the result of certain fundamental gaps in the economic system of the country. Three broad reasons may be mentioned. Firstly, the Indian investor has been notoriously shy, and has not, until very recently, cared to invest his capital in debentures or shares as the investor elsewhere. Secondly, we have had in India neither issuing houses nor securities companies which in other countries float new concerns and take up the risks in their initial stages, nor have our banks pursued a policy sympathetic and elastic enough for the varied needs of industry. Finally, there has been a general tradition in the country

<sup>1</sup> Indian Tariff Board: *Cotton Textile Industry Enquiry* (1932), Report, p. 84.

<sup>2</sup> Ibid., Vol. I of *Evidence and Memoranda*, pp. 95-100.

from the time of early industrial beginnings that the financing of industry is always the privilege and duty of private managing agency firms. It was only when the burden of finance became heavy that people began to wonder whether it was inevitable that industry must look to the managing agents for all help, inspiration, and guidance.<sup>1</sup>

*The Cost of the Managing Agency System of Finance*

The managing agency system has, in recent years, been assailed from various quarters for its alleged inefficiency, and the opportunity it gives for lazy or fraudulent management, but very few people have attacked the system on the score of its financial policy. A recent writer has suggested that the system of managing agency finance reveals certain characteristic defects. He has stated that owing to the prevalence of the managing agency system of finance, industry has come to be dominated too much by financial considerations, and too little by industrial ones; he has further asserted that owing to the managing agency system of industrial finance, no mill company has been able to develop its own system of financing independently of the managing agents; and finally, according to him, the managing agency system of finance has led to enormous speculation in the shares of cotton mill companies.<sup>2</sup>

The present writer is not an apologist for the managing agency system, but he believes that the financial policy of the managing agents has been their least objectionable feature. When it is said that, under the managing agency system of finance, industry is dominated too much by financial considerations and too little by industrial ones, and it is pointed out that in the cotton textile industry of Bombay and Ahmedabad, transfers of agency often took place because one firm happened to be less solvent financially than the other, it should not be overlooked that under any

<sup>1</sup> Indian Tariff Board: *Cotton Textile Industry Enquiry* (1932), Vol. I of *Evidence and Memoranda*, pp. 136-8.

<sup>2</sup> P. S. Lokanathan, op. cit., pp. 225-8. The present writer, however, agrees with Dr. Lokanathan that many managing agents in India are inefficient and their services costly in the sense that they are not technical experts and that they pay too little consideration to such matters as modern machinery, organization, and marketing.

form of management this becomes more or less inevitable. Similar instances are not rare in Great Britain and the U.S.A., and in these latter countries one finds hundreds of large-sized private limited companies passing hands from one set of proprietors or managers to another because the former are unable to provide or find the necessary finance.

The managing agency system of finance does not exaggerate financial considerations at the expense of industrial ones any more than any other system of finance.

Next, the charge that owing to the managing agency system of finance, no mill company has been able to develop its own system of independent finance, is like arguing in a circle. We have seen already that the managing agency system of finance arose *because of* the fact that there was no system of independent finance. No blame, therefore, attaches to the agents for the fact that independent systems of finance have not been developed by the concerns they manage. As a matter of fact, it is *not* true that all concerns managed by managing agents are dependent on them alone for their finance. The concerns managed by the European managing agents and the up-country Indian managing agents are notable exceptions to the general dependence of enterprise in India on managing agency finance.<sup>1</sup>

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

<sup>1</sup> Memorandum on the Indian Companies' Act (Amendment) Bill, 1936, submitted by the Bengal National Chamber of Commerce to the Government of India (Typescript).

<sup>2</sup> *Report of the Bombay Stock Exchange Enquiry Committee* (1924), pp. 24-6.

Viewed in its proper economic background, the managing agency system of finance has, on the whole, been both inexpensive and efficient. This has been recognized in the findings of the various Tariff Boards and the Central Banking Enquiry Committee of 1929-31, and must be conceded even by the most uncompromising critics of the system. Managing agents have, in almost all industries, found the bulk of the initial capital of a company and have provided it with necessary financial accommodation (both direct and indirect) at all stages of its development and particularly during lean years. For this particular service, which is unique in the industrial history of the world, their charges have not been excessive, and during the period of post-war depression many of them advanced money to the companies on the most liberal terms, often ready to forgo not only the interest but a substantial portion of the principal as well.<sup>1</sup>

<sup>1</sup> Indian Tariff Board: *Cotton Textile Industry Enquiry*, Vol. I of *Evidence and Memoranda*, p. 95.

## CHAPTER IV

### MANAGEMENT BY THE MANAGING AGENTS

#### *Introductory*

**B**ROADLY speaking, managing agents in India perform three important functions. Firstly, they pioneer new industries, and play the role of promoters: they discover an industrial proposition, assemble the elements of the business, and finally procure the funds to put those elements into operation. Secondly, they provide finance required for industries in respect of both fixed and working capital. Finally, they perform the day-to-day management of industries—a work that is performed in other countries by a manager or a managing director.

Regarding their work as pioneers and promoters, it is undoubtedly true that in the past they have been more or less instrumental in developing many of the industrial enterprises in India. They brought into existence a means of producing wealth which did not exist before and thereby they created value. In recent years, however, managing agents have definitely been pushed into the background so far as their pioneering and promoting activities are concerned. This has happened for three reasons. Firstly, not every managing agent can claim the ability, prudence, or resources of the great business houses by which the system was founded, although every agent, whatever his capacity for fulfilling the functions of managing agents, benefits by the tradition, and to a large extent owes his existence to it. Secondly, with the progressive industrialization of India, the range of pioneer enterprises has been steadily restricted. New enterprises are now started on the model of older ones already in existence, and the problem becomes one more of management and finance than of pioneering. Finally, and this is perhaps the most important, very slowly and steadily there is growing up a separate class of entrepreneurs who do not always belong to the established 'firms' of managing

agents and who, therefore, prefer to do the major work of promotion themselves, although they find it convenient and useful to consult managing agents or banks.<sup>1</sup>

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

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

### *The Rise of a New Class of Entrepreneurs*

Before we proceed to analyse the dominance of managing agents in almost all the organized industries of India, we may note that a new class of entrepreneurs is definitely emerging. This is particularly noticeable in new industries like sugar, cement, paper, chemicals, and match. Accurate statistics regarding the number of these new entrepreneurs are not available, but there are sufficient data to warrant the conclusion that the managing agency system is not the only form of industrial organization in the India of today.

We shall quote a few typical instances. In the sugar industry for instance, of the 145 sugar mills working in India in 1933-4, no less than 71 (i.e. just under 50 per cent.) were *not* under the control of any managing agency firm. Of the remaining 74 also, at least 25 were under firms of managing agents formed specifically and exclusively for the purpose of promoting and managing those concerns.<sup>2</sup> Again, in the cement industry, which in India consists of

<sup>1</sup> Memorandum of the Bombay Shareholders' Association on the Indian Companies' Act (Amendment) Bill, 1936.

<sup>2</sup> M. P. Gandhi, *The Indian Sugar Industry* (Calcutta, 1934), Appendix III.

some dozen major concerns, nearly a half are not managed by any so-called firm of managing agents.<sup>1</sup> In the paper industry also, nearly 50 per cent. of the concerns are organized as private limited companies without any managing agency control.<sup>2</sup> Similarly, in the match industry, except half a dozen large companies, almost all the establishments are run on a private and proprietary basis, and have got nothing to do with any managing agency firm.<sup>3</sup>

The rise of this new class of entrepreneurs has received very insufficient attention from economists for two principal reasons.<sup>4</sup> Firstly, they have come out in the limelight only recently. Until about 1930 industrial enterprise in India was really and truly dominated by firms of managing agents and, on account of the very severe world-wide trade depression from which not even India could escape, new promotions were undertaken only by the older and more experienced firms of managing agents. Secondly, even when entrepreneurs unconnected with a managing agency firm started a new undertaking, they sometimes banded themselves in an *ad hoc* firm of managing agents and, therefore, were, to the outsider, indistinguishable from the regular managing agency firms. This they did because people had a kind of morbid faith in enterprises controlled and managed by managing agents and were generally sceptical about the success of concerns not so controlled and managed. This latter factor explains why even now so many new concerns are placed under the control of managing agents. Thus, when the Sugar and Investment Trust, Ltd., was floated in Madras in 1936 with an authorized capital of Rs. 25 lakhs, it was stated in the prospectus that the managing agents of the concern were the firm of Messrs. Chari & Srinivasan, Ltd., of Madras. Actually, there was no managing agency firm of this

<sup>1</sup> *Investor's India Year Book*, 1935-6.

<sup>2</sup> Indian Tariff Board: *Report on Paper and Paper Pulp Industries*, Vol. I of *Evidence* (Calcutta, 1932).

<sup>3</sup> Indian Tariff Board: *Report on the Match Industry*, Vol. I of *Evidence* (Calcutta, 1928).

<sup>4</sup> As a matter of fact, Dr. Lokanathan hardly mentions these new entrepreneurs in his book, *Industrial Organization in India*.

name in existence until the floatation of the Trust, and Messrs. Chari & Srinivasan were two independent entrepreneurs unconnected with any existing firm of managing agents.<sup>1</sup>

The number of these new entrepreneurs is steadily on the increase.<sup>2</sup> To some extent, they confine themselves to new industries, because in the older industries like cotton, jute, iron and steel, or coal, concerns under the control of managing agents are far too strongly entrenched to be disestablished easily. On the other hand, there is a danger that these new entrepreneurs may try to do things rather too fast and without careful planning and forethought, and may ultimately bring ruin upon themselves and the shareholders. There is a daily swelling stream of new capital issues in India today, and in the present mood of the country almost any industrial proposition can find its particular niche in the capital market. This is a situation fraught with grave dangers and it is difficult to prophesy what will happen in the future.<sup>3</sup>

### *The Dominance of the Managing Agency System*

In spite of the rise of the above new class of entrepreneurs, it is still true that the managing agency system dominates industrial enterprise in India. There are few organized industries in India which do not contain a large number of concerns controlled and managed by managing agents. In the cotton textile industry of Bombay and Ahmedabad, managing agency firms have shown a remarkable variety of organization: some of them have been simple proprietary firms while others have been partnerships with unlimited liability, or limited companies with shares privately held, or public joint-stock limited liability companies.<sup>4</sup> Whatever their internal organization, it is remarkable that there is scarcely any mill of importance either at Bombay or at Ahmedabad that is not controlled

<sup>1</sup> *Indian Finance* (Calcutta), 14 March 1936.

<sup>2</sup> A perusal of the new capital issues floated in India every month during 1936-7 shows that at least 25 to 30 per cent. of the floatations had nothing to do with managing agency firms.

<sup>3</sup> *Capital* (Calcutta), 10 September 1936.

<sup>4</sup> *Indian Central Banking Enquiry Committee, Majority Report* (1931), p. 643.

by some firm of managing agents. The same is the position in the jute industry of Bengal and Bihar. Even in the tea industry the majority of the concerns are controlled and managed by managing agents, and in the iron and steel industry also all the concerns of any importance are under the management of managing agency firms. As has been noted already, it is only in some new types of industry like cement, paper, chemicals, or match that one finds enterprises free from the control of managing agents.

This dominance of managing agents in the sphere of industrial activity in India has been due to certain special circumstances. Firstly, in many industries, the managing agents themselves or their friends have got holdings of substantial blocks of shares. In 1927 in the cotton textile industry of Bombay the percentage of shares held by managing agents was, on the average, 40 to 60 per cent., and in exceptional cases it was as high as 90 per cent. In the jute mill and coal industries, also, managing agents or their friends hold an important percentage of shares in the concerns they manage.<sup>1</sup> Secondly, control is secured by managing agents as the principal creditors (or guarantors of credit) of the companies managed. Sometimes managing agents are the largest debenture holders, having charges on the assets and undertakings of the companies. Thirdly, even when managing agents do not hold any substantial percentage of shares in their concerns, they are assured of their control because the majority of shareholders, being distributed over long distances, are unable to unite effectively against their dictatorial management. Fourthly, although the managing agency system has been in existence in India for well over seventy or eighty years, the Indian law relating to companies never statutorily recognized them or curtailed their activities until the other day (1936), and consequently unscrupulous managing agents could easily do a lot of things without actually transgressing the law. Finally, and this is most important, managing agents have secured enormous control by means of their written agreements.

<sup>1</sup> *Indian Legislative Assembly Debates* (1936), Vol. V, pp. 3945-6. The exact figures are not known.

*Managing Agency Agreements*

Managing agency agreements have come in for a good deal of criticism in recent years and hence it is important to analyse what they imply. A managing agency agreement is, strictly speaking, a written agreement between a firm of managing agents on the one hand and an industrial concern (a partnership or a joint-stock company) on the other by which the former undertake to 'manage' the concern in return for a certain office allowance and/or some commission on sale, output or profits. The agreements are generally of two kinds—terminable and non-terminable. In Bombay and Calcutta a managing agency agreement is usually fixed for a specified initial period at the end of which the discontinuance of the agreement is dependent on an extraordinary resolution of the company to that effect. The usual period in Bombay has been from 30 to 40 years, while in Calcutta it has been from 10 to 20 years. The majority required for an extraordinary resolution is invariably three-fourths in Calcutta, while in Bombay it is often as high as four-fifths, and sometimes even five-sixths, including in some cases a provision to the effect that a specified minimum of paid-up share capital should be represented. In Ahmedabad, on the other hand, with hardly any exception, the agreements are subject to no time limit and are more or less permanent and non-terminable.<sup>1</sup>

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

<sup>1</sup> Indian Tariff Board : *Report on the Cotton Textile Industry Enquiry* (1932), p. 78.

<sup>2</sup> *Ibid.*, Vol. II of *Evidence and Memoranda*, pp. 185-90.

*Remuneration of Managing Agents*

We have seen that the managing agency agreement (or 'articles of association' as it is sometimes called) contains a stipulation regarding payment of a certain office allowance and/or some commission by the company to the agents. A good deal of criticism has, in recent years, been levelled at these stipulations on the ground that they are arbitrary, excessive, and unfair. It would, therefore, be proper to consider what these remunerations include and whether industry is justified in making these payments to the managing agents.

First, we may take up the so-called 'office allowance'. In Bombay and Ahmedabad in particular, a certain fixed monthly or annual sum of money is invariably given to managing agents for their head office expenses. This covers 'head office accommodation, rent and taxes thereon, lighting, fans, managing agents' clerical establishment, share of services of dispatch, enquiry and cash departments in several instances, part-time services of a senior accountant and the secretariat staff, and, in several cases, also all postages, stationery, telegrams, and menial staff'. In Bengal, however, a separate office allowance is not usually insisted upon, unless, of course, the managing agents are compelled to appoint extra or special staff for the individual requirements of a company. Many industrial units, however, make a sort of 'fractional contribution towards the expenses of a federal constitution'.<sup>1</sup>

Now, the question is whether these office allowances are justified or not. In deciding this point it is important to remember that a statistical tabulation, industry by industry, of the remuneration received by managing agents under this head will not yield any fruitful conclusion inasmuch as the conditions governing the respective industries are widely divergent, and the circumstances attached to the various concerns even in the same industry are not uniform. There is accordingly no specific test of 'fairness' which can be applied uniformly to the office allowances received by the various managing agents. General considerations,

<sup>1</sup> Indian Tariff Board: *Cotton Textile Industry Enquiry*, Vol. IV of *Evidence and Memoranda*, pp. 39-43.

coupled with the circumstances attached to each concern, are the only criteria by which opinion can be formed whether the office allowances are fair or excessive.

We may take a few concrete figures. From the evidence tendered before the Indian Tariff Board in connexion with the cotton textile industry enquiry of 1932, it appears that not all the mills paid an office allowance and for the thirty-one mills that paid it, the average was Rs. 16,670 per annum per mill. When we consider that managing agents provide valuable secretarial and clerical services on behalf of the companies which would have to spend much more if each were to have a self-contained office of its own, this average allowance does not appear excessive at all. In the jute industry, however, the amount of office allowance is much less, usually Rs. 500 to Rs. 1,000 per annum per company. This is, to a certain extent, due to the superior and more economical organization of the European managing agents, and also to the fact that in Calcutta one firm of managing agents usually controls at least 15 to 20 concerns and thus can afford to charge less per unit than the Bombay managing agents.<sup>1</sup>

The second method of payment is by way of a certain commission with a stipulated minimum which is payable under all circumstances, whether the industrial companies make profit or not. This has to be paid by *all* concerns under managing agency control without exception. The commission is calculated in one or other of three ways : (a) on production ; (b) on sale ; or (c) on profit. In the early days of the establishment of the cotton mill industry, commission on production (or output) was the vogue. The system, however, led to over-production and sacrifice of quality to quantity, as managing agents were always tempted to increase the volume of output in order to make higher profits. It was, therefore, largely abandoned towards the close of the nineteenth century, and the system of commission on profits was adopted. 'Of the 71 mills which were members of the Bombay Millowners' Association in 1928, only one mill paid commission on production ; one

<sup>1</sup> Indian Tariff Board : *Cotton Textile Industry Enquiry*, Vol. III of *Evidence and Memoranda*, pp. 341-50.

mill was managed by a managing director whose remuneration was fixed by the Board of Directors; 8 mills paid commission on sales, and 61 mills paid commission on profits." The rate at present is usually 10 per cent. on profits. In Ahmedabad, however, the commission is calculated on gross proceeds of sales and the rate varies from 3 to 4 per cent. In the other industrial centres of the cotton industry, the most common method is that of a commission on output, but there are a fair number which pay commission on sales and a few which calculate it on profits. In the jute industry, the majority of the mills still pay commission on sales, but there are a few which pay commission on profits besides a minimum commission and a generous allowance for office expenses. The same is the practice in the coal industry. With regard to the sugar industry, a commission of  $7\frac{1}{2}$  per cent. on profits is the usual remuneration for managing agents engaged in that industry, although, in the case of several companies floated after protection was granted, provisions have been made for commission on sales, and in some cases for a combined commission on sales and profits.<sup>1</sup>

Of the three systems in vogue, there is no doubt that the system of commission on profits is the best. 'The great defect of the system of commission on production is that it tends to concentrate attention on output rather than on quality, but a greater objection to that system is that it removes the incentive to the disposal of production at the best possible price. These same objections apply, though in a less degree, to the system of commission on sales. The mills which adopt this system, unless they are managed by agents who hold the majority of the shares, are obviously only concerned with getting rid of their production and not with the price at which it is disposed of.'<sup>2</sup> Moreover, as has been well pointed out by the Bombay Shareholders' Association, where the managing agent is paid on production or sales, his interest becomes divorced from that of the

<sup>1</sup> Indian Tariff Board: *Cotton Textile Industry Enquiry*, Vol. II of *Evidence and Memoranda*, pp. 200-10.

<sup>2</sup> Memorandum of the Bombay Shareholders' Association on the Indian Companies' Act (Amendment) Bill, 1936.

<sup>3</sup> Indian Tariff Board: *Report on the Cotton Textile Industry Enquiry* (1927), p. 87.

shareholders by making him reluctant to agree to short-time working when necessary in the interest of the industry as a whole : he becomes interested primarily in the output of his own concern and hardly cares to consider the far-reaching consequences of excessive output in the profit-making capacity of the entire industry.

The question now is whether the remunerations made to managing agents (over and above their office allowances) are fair or excessive. Here again, it would be foolish to dogmatize. As in the case of office allowances, these remunerations should be considered only in the light of widely divergent conditions that prevail from one industry to another, and also from one concern to another in the same industry.

In the course of the Indian Tariff Board enquiry into the position of the cotton textile industry in 1932 it was asserted that managing agents often made substantial sacrifices in the matter of commissions and other allowances. The Bombay Millowners' Association gave the following figures covering 74 mills and 2 dye-works regarding the financial sacrifices made by managing agents in Bombay during 1926-31<sup>\*</sup> :

|                                                                                                 |                 |
|-------------------------------------------------------------------------------------------------|-----------------|
| (1) Amount of commission given up by managing agents .. .. .                                    | Rs. 28,68,718   |
| (2) Amount of interest on loans given up by managing agents .. .. .                             | Rs. 31,20,526   |
| (3) Amount of loans advanced by managing agents and converted into capital during the period .. | Rs. 1,75,92,950 |
| (4) Losses incurred by managing agents through guaranteeing loans to mills from banks .. ..     | Rs. 69,49,228   |
| (5) Other financial sacrifices made by managing agents .. .. .                                  | Rs. 44,628      |

Now, as far as the last four items are concerned, they belong more properly to their 'financial' activities. Even the first item, however,—with which we are primarily concerned here—looks impressive at first sight. But a close scrutiny would show that the commissions alleged to have been given up were neither real nor substantial. When the Bombay Shareholders' Association asked for particulars of these figures, the Bombay Millowners' Association could

<sup>\*</sup> Indian Tariff Board : *Cotton Textile Industry Enquiry* (1932), Vol. I of *Evidence and Memoranda*, p. 95.

not supply them. Even in the absence of particulars, the alleged sacrifice of commission amounts to only Rs. 6,291 per mill or dye-work per year during the period 1926-31. This is very insignificant compared to the allowances and commissions actually drawn about this time in the industry. The following figures are illuminating<sup>1</sup> :

| Year       | No. of mills represented | Total allowances and commission drawn |
|------------|--------------------------|---------------------------------------|
| 1927 .. .. | 75                       | Rs. 3,087,477                         |
| 1928 .. .. | 73                       | Rs. 1,832,225                         |
| 1929 .. .. | 76                       | Rs. 2,026,173                         |
| 1930 .. .. | 71                       | Rs. 1,345,444                         |

These figures work out at Rs. 28,107 per mill per annum during the period 1927-30, i.e. nearly five times the alleged sacrifices of allowances and commissions made. A statement given by the Bombay Shareholders' Association, giving particulars of cases in which managing agents have received commission although the mills made losses, further disproves the contention of managing agents that it is *usual* for them to forgo commission when mills make losses.<sup>2</sup>

Now, is the figure of Rs. 28,107 per mill per annum excessive? It is difficult to give a categorical answer. It has been alleged that a managing director would have charged as much, if not more. 'Managing agents manage as well as finance, whereas managing directors would manage but not finance, and hence industry should be prepared to pay slightly more to the managing agents.'<sup>3</sup> There are, however, three important points to be considered. Firstly, for the direct services that managing agents perform in respect of finance, they always get a separate remuneration (viz. interest) and they should not be anxious to get something 'extra' for the indirect services they perform by way of securing loans from others or of guaranteeing loans. Secondly, while a new or difficult enterprise should always be prepared to pay more for management, the burden of

<sup>1</sup> Quoted by Lokanathan, op. cit., p. 345.

<sup>2</sup> Appendix VIII.

<sup>3</sup> Oral evidence of representatives of the Bombay Millowners' Association before the Cotton Textile Industry Enquiry of 1932, Vol. IV, p. 43.

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

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

It has been contended by some apologists of this method of calculating commission on profits that it does not in itself adversely affect the financial position of the industrial company, because (so the argument runs) if depreciation and other elements were deducted, the scale of commission which is normally 10 per cent. would be increased and the net cost to the company would remain more or less the same.<sup>2</sup> This does not, however, seem to be correct. Firstly, there are many companies which charge less than 10 per cent. commission even *after* allowing for depreciation, and it does not, therefore, hold that a rate round about 10 per

<sup>1</sup> Memorandum of the Bombay Shareholders' Association on the Indian Companies' Act (Amendment) Bill, 1936.

<sup>2</sup> It seems that Dr. P. S. Lokanathan is also, to some extent, of this opinion: *op. cit.*, p. 340.

cent. on gross profits is, so to speak, the absolute minimum. Secondly, any attempt to increase the rate to more than 10 per cent. (when commission is calculated after making certain deductions) would be resisted, because a rate like 15 or 20 per cent. would, on the very face of it, seem excessive and exorbitant.<sup>1</sup>

The second device to get an additional remuneration for managing agents is by the method of compensation. If the business of a company is transferred during the pendency of the agreement to another party, the managing agent has the right of continuing in office in spite of the change of ownership; in case of refusal, he is entitled to claim compensation. In Bombay when a company is wound up, the managing agent is entitled to claim compensation, according to the general practice, on a scale equivalent to the commission earned by him during the previous five years, and, in individual cases, even a higher rate of compensation is claimed. At Ahmedabad the general practice is to claim compensation at a rate ranging from five to seven times the average annual commission earned by the managing agent over a period of five years. In the latter place, sometimes the managing agent is entitled to compensation even if the agency has been terminated by mutual agreement. On the other hand, in Calcutta there are no agreements containing a provision for the payment of compensation as in Bombay and Ahmedabad. Even in those few cases where provision is made for compensation, it is expressly provided that such compensation would be payable only if the winding up takes place at the instance of a party other than a creditor, and the amount payable would be mutually agreed upon, failing which it may be settled by arbitration.<sup>2</sup>

Is this principle of giving compensation economically sound? It has been argued by some that managing agents must have some protection against the wrongful termination of their agreements on flimsy or no pretexts, and that the latter should, therefore, be entitled to recover damages,

<sup>1</sup> Memorandum of the Bombay Shareholders' Association on the Indian Companies' Act (Amendment) Bill, 1936.

<sup>2</sup> Indian Tariff Board: *Report on the Cotton Textile Industry Enquiry* (1932), p. 80.

for the loss of the future office allowance, and also for loss of future commission.<sup>1</sup> Now, while theoretically speaking it is desirable that managing agents should have some protection against frivolous termination of their agreements, it is important to note that in practice this device has been used 'almost to put a premium on inefficiency or dishonesty'. In not a few instances winding up has taken place as a result of mismanagement by the managing agent, unprofitable trading conditions or the deliberate action or initiative of the managing agent himself. In all those cases managing agents did not care to discharge their duties as managers faithfully and efficiently because they knew that they were 'insured' by the compensation clause. Broadly speaking, a managing agent should take the possibility of liquidation or winding up as one of the risks attached to his office, and should not be entitled to compensation in addition to the allowances and commissions he receives.<sup>2</sup>

A third device to get additional remuneration is by inserting clauses in the agreement for supplementary or secret profits. In a recent managing agency agreement there was a reference to 'every profit, remuneration, and compensation including any profit which they (the managing agents) might make as the agents for the insurers of the properties, assets, and effects of the company, and *any profit which they might make under any arrangement with the agents of the company for selling cloth yarn or muccadams of the company*'. The latter class of profits clearly pointed to the fact that there was an arrangement for some additional (and secret) profits in addition to the usual office allowance and commission.<sup>3</sup>

All these show that although the normal office allowance and commission payable to managing agents are not excessive, the special devices resorted to by some managing agents to get more out of a company are both unfair and

<sup>1</sup> Circular Letter No. 193/1936 of the Bengal Chamber of Commerce (Calcutta) on the Indian Companies' Act (Amendment) Bill, 1936.

<sup>2</sup> Memorandum of the Bombay Shareholders' Association on the Indian Companies' Act (Amendment) Bill, 1936.

<sup>3</sup> Indian Tariff Board: *Cotton Textile Industry Enquiry* (1932), Vol. II of *Evidence and Memoranda*, p. 186.

excessive. The managing agency system has come into disrepute mainly because it has given opportunities to some unscrupulous (and possibly dishonest) persons to get various kinds of extra remuneration without actually transgressing the law relating to companies in India.

*Assignment of Functions and Interests by Managing Agents*

Another abuse that has crept into the managing agency system in recent years is the practice of assignment of functions and interests. In Bombay and Ahmedabad the agreements generally provide that the managing agent may assign to a third party his interests or his duties under the agreement, and for this assignment no specific sanction by the directors is required. The Indian Tariff Board came across a case in 1932 in which the managing agent could assign not merely his interest in the profit of the company, but the agreement itself, to a third party. This agreement was executed by one of the most important managing agency houses of Bombay.<sup>1</sup> To quote some specific instances, Messrs. Currimbhoy Ebrahim & Sons, Ltd., mortgaged their agency commissions in several companies under their control, and as a result the mortgagee acquired considerable influence in the management of the affairs of those companies. Again, the partners of Messrs. Morarjee Goculdas & Co. mortgaged their commission in the Sholapur and Morarjee mills with the result that the mortgagees acquired undue influence over those mills.<sup>2</sup> Similarly, in Ahmedabad it is not unusual in agreements to provide for the right of the managing agent to assign at his will not merely his interest in earnings but also the whole agreement. A usual feature of the system in Ahmedabad is that the right to the commission earned by the managing agent is divided among several persons holding fractional shares, these persons generally being those who helped the managing agent in the promotion and financing of the company in the early stages. Even in Calcutta where such sweeping rights of assignment without the sanction of the

<sup>1</sup> Indian Tariff Board : *Report on the Cotton Textile Industry Enquiry* (1932), p. 80.

<sup>2</sup> Memorandum of the Bombay Shareholders' Association on the Indian Companies' Act (Amendment) Bill, 1936.

company is unknown, there are certain types of agreement in which the powers conferred on the managing agents can be vested in their assigns as well as successors.

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

#### *Several Companies under the same Managing Agents*

From the very beginning of the rise of the managing agency system, it has been the practice for one managing agency firm to control a number of concerns—sometimes belonging to widely different branches of industry. 'From one industry they (the early firms) turned to another, not only because the experience gained in the one was equally valuable in the other, so that all that they needed was to get experts versed in the technique of each industry, but also because each line of business opened the way for another, and the market for the products of one line of business was found in another. . . . The field open to them was large and had to be shared out only among a limited number of firms.'

In recent years, however, owing to the intensification of competition in almost all kinds of industrial activity, this system of one managing agency firm controlling several companies, often of diverse character, has been called into question. It has been asked whether this does not impose an undue strain on the firm that manages and thereby make the management of each individual company less efficient and hence less economical. It has also been asked whether a firm of managing agents controlling two or more concerns in the same industry which are competing with one another

<sup>1</sup> For an interesting table of figures, see Lokanathan, op. cit., pp. 48-9.

can really reconcile the interests of *all* the companies they control.

It would be interesting to make an estimate of the efficiency of the system in practice so far as this question of multiple management is concerned. It seems that multiple management of industrial enterprises has secured a substantial measure of administrative integration as opposed to integration in respect of technical management. It has ensured a co-ordination of the activities of all the units working under common management; it has secured economies in respect of sales and purchases, of supervision and of day-to-day administration; and it has also secured a certain measure of financial co-ordination.<sup>1</sup>

On the whole it appears that there is nothing wrong in allowing a managing agent to act for more than one company carrying different types of business so long as the work does not prove an undue strain on his energy and resources, and so long as he is not in a position to make 'secret' profits, which may work out unfairly to one or other company. There is also nothing intrinsically wrong in his acting for more than one company carrying the *same* type of business so long as 'they do not directly compete with one another'. But it is certainly unfair and inequitable that a managing agent should, *on his own account*, start a business or be engaged in a business which may be a source of danger, by reason of competition, to the business managed by him before. 'If a managing agent is paid a handsome remuneration by the company for all his time, energy, talent and capacity, he ought not to have a competing call on these qualities of his by another company which he would be carrying on on his own account and which would be doing the same business as that carried on by the company originally under his management.'<sup>2</sup>

On the whole it seems that better results are likely to be achieved by economies resulting from close personal attention than from large-scale production or management. The latter requires for its successful working and for the

<sup>1</sup> For a detailed analysis, see Lokanathan, op. cit., pp. 286-96.

<sup>2</sup> *Indian Legislative Assembly Debates* (1936), Vol. VIII, pp. 2268-72.

realization of its potential economies, either a very high level of organizing ability and driving force among those in ultimate control, or an equally high level of reliability and intelligence among the rank and file. These conditions are not easily satisfied and where they fail, large scale operations, instead of resulting in economies, lead to further waste. There are great dangers inherent in most merger schemes of excessive capitalization; on the other hand, there are important economies which may be derived from intensive personal control and watchfulness on the part of the managing agents. As a matter of fact, the greater part of the industrial irregularities that have been brought to the notice of the Indian Tariff Board from time to time occurred in concerns which were included in large groups. This is a significant fact and should convey its own warning.<sup>1</sup>

#### *Inter-investment of Funds by Managing Agents*

Another recent feature of the managing agency system has been the practice of inter-investment of funds among companies under the same agents. This is very prevalent in the cotton textile industry of Bombay and Ahmedabad,<sup>2</sup> but it is not confined to that industry alone. Almost all industries managed by managing agents share this feature.

Inter-investment takes two forms: surplus funds raised on the credit of one company may be invested in other companies under the same managing agent, or debentures issued by one company may be subscribed to entirely or mainly by other companies in the same group or in which the managing agent has an interest. Now, when everything is going on well, this inter-investment does not cause any particular harm to any of the enterprises. On the one hand, the comparatively weak concerns profit by this inter-investment; on the other, the comparatively strong ones are satisfied, because their funds are quickly invested and are, at the same time (especially when it is a cash investment), easily realizable. But over a long period this practice has definite drawbacks. What really happens is this: although the financial position of an individual company is

<sup>1</sup> Report of the Indian Tariff Board on the Cotton Textile Industry Enquiry (1932), p. 89.

<sup>2</sup> See Appendix IX.

strong, the company and its shareholders are often deprived of its benefit by being called upon to assist weaker sister concerns which are managed by the same managing agent. Not only does it involve serious unfairness to shareholders in the concern whose funds are thus transferred, but the practice often tends to the perpetuation of thoroughly insolvent concerns which it would be to the interest of the industry as a whole to have closed down.<sup>1</sup> To quote a few recent instances, large loans were advanced by the Hydro-Electric group of companies under the agency of the Tatas to the Kundli Valley Power Co., Ltd., under the same agency, and these resulted in heavy losses running into several lakhs of rupees. The heavy losses incurred by the Bengal Luxmi Cotton Mills, Ltd., as a result of loans advanced to the Bengal National Bank, have become a matter of history.<sup>2</sup>

Recent experience has been rather unfortunate in the matter of inter-investment of funds in the form of shares and debentures also. The purchase of debentures in the Tata Mills by the Nagpur, Swadeshi, and Ahmedabad Advance Mills under the management of Messrs. Tata Sons, Ltd., seriously crippled the financial resources of the purchasing companies, so much so that some of them had to borrow from outside sources and raise fresh capital while their own moneys were locked up in the debentures of the Tata Mills. The Tata Mills being unable even to pay interest on the debentures, the purchasing companies had to agree to schemes of modification involving reduction of interest charges and extension of the period of payment. Again, in the jute industry, the deferred shares of the Bhatpara Power Co., Ltd., were purchased by the jute companies under the management of Messrs. Begg, Dunlop & Co., Ltd., but the investments proved unproductive and the purchasing companies were not able to get back the capital invested, as the Bhatpara Power Co., Ltd., was ultimately sold to the Calcutta Electric Supply Co.<sup>3</sup> All these show that the system is full of disastrous possibilities

<sup>1</sup> *Report of the Indian Tariff Board on the Cotton Textile Industry Enquiry* (1932), p. 85.

<sup>2</sup> Memorandum of the Bombay Shareholders' Association on the Indian Companies' Act (Amendment) Bill, 1936.

<sup>3</sup> *Ibid.*

and leads to serious abuses. Even where the managing agents are men of integrity and character the system cannot be recommended as they are likely to be influenced in their investment policies by considerations which may not be to the advantage of the shareholders of the purchasing companies.

### *Loans to Managing Agents*

Another far-reaching abuse of the system has been the practice of managing agents taking huge loans or advances from the companies they manage. The allegation that many managing agents take such loans or advances was hotly denied by the Bombay and Ahmedabad Millowners' Associations before the Indian Tariff Board Cotton Textile Industry Enquiry of 1932, but the Bombay Shareholders' Association proved, with the help of facts and figures, that the evil existed.<sup>1</sup> Nor is this evil confined to the cotton textile industry. The loans taken by Messrs. Vakil Ankleseria & Co. from the Western India Oil Distributing Co., Ltd., brought infinite trouble upon the company which was eventually saved only by reorganization. The loans obtained by Messrs. J. F. Madan & Co. from the Madan Theatres, Ltd., tell a similar tale. The function of managing agents is to finance companies. To allow companies to finance managing agents is, to say the least, fundamentally wrong. Such abuses of the system have been far-reaching. Apart from inflicting heavy losses on individual companies, their shareholders, and their creditors, the general confidence of investors in the integrity of managing agents has been rudely shaken by these questionable methods of 'management'.

### *Subsidiary Services Performed by Managing Agents*

Another interesting feature has been that in practically all industries the managing agent is entitled to work for and contract with the company in respect of various services such as purchase of materials, sale of finished goods, insurance of building, plant, stock, etc. ~~This power to~~

<sup>1</sup> See Appendix X.

contract is very wide and very often the agent is not bound to account for the profits made in the transactions resulting from the exercise of this power: as a matter of fact, the profits that he makes from these subsidiary services are in the nature of additional remuneration.

Now, it is undoubtedly true that these subsidiary services performed by the managing agents have effected substantial economies in many of the enterprises and have also led to a sort of co-ordinated control in respect of production, sales, and day-to-day management. But the fact that, generally speaking, he has not been bound to 'explain his transactions' to the Board of Directors or to the shareholders has led to a considerable amount of suspicion. It has been pointed out that when the managing agent himself acts as supplier there is no independent scrutiny or supervision as regards the price or quality of the goods supplied, and similarly when he acts as purchaser there is no assurance that he gives the company for its products the best price obtainable. It is true that, according to the agreement, purchases or sales are made at the fair market price, but only the managing agents are permitted to judge that 'fair market price'. Not infrequently, this power has been regarded by managing agents as a valuable right and privilege, and the strongest resistance has been offered to any curtailment of this power.<sup>2</sup>

#### *Management by the Managing Agents—an Evaluation*

All the above instances of 'management' show that managing agents have, in recent years, been inclined to usurp for themselves more and more power through the instrument of the 'agreements'. This process has been largely facilitated by the fact that Indian company law was, until the passing of the amending Act in 1936, conveniently silent on this most important organization in the industrial life of the country. Even a company having a joint-stock organization and a majority of independent shareholders was completely under the domination of the agent by virtue of the agreement which was almost beyond the pale of legal

<sup>2</sup> Memorandum of the Calcutta Shareholders' Association on the Indian Companies' Act (Amendment) Bill, 1936.

control. We shall study in a subsequent chapter the relations of the shareholder and the director *vis-à-vis* the managing agent, but it may be noted here that as the system worked in practice, neither the shareholders nor the average board of directors had any effective say in the working and management of their company: it was the managing agent who ruled—almost like a dictator.

Now, while a dictatorial form of management may not be quite to the liking of shareholders, it need not necessarily be inefficient. It would, therefore, be opportune to consider whether management by the managing agents has been inexpensive, efficient, and suited to the economic development of the country. In judging this, one has to divide the various managing agents into two broad classes—the European managing agents having offices mostly in Bengal, Bihar, and Assam, and the Indian managing agents having offices mostly in Bombay and Ahmedabad.

On the whole, the European managing agency firms are more efficient and less expensive. They have one intrinsic value: they are never strictly or wholly hereditary. They have always taken in 'outside talent' with the result that they have had both continuity of policy and variety of experience. They have frequently taken in new partners not because the latter have got more money, but because they have got some special industrial or technical experience. The Indian managing agency firms, on the other hand, are more or less hereditary in character. Succession to a firm by the son or heir of the family has invariably taken place to the exclusion of other talent and experience, and even in the few cases where 'outsiders' have been taken in, they were taken in because they had money and not because they had any special industrial or technical knowledge. The result has been that, barring a few firms like Messrs. Tata Sons & Co., most of the Indian managing agency firms have been dominated in their policy of management of industries more by financial considerations than by industrial ones. In their eagerness to make more money, they adopted methods which were either unscrupulous or objectionable, and thereby they brought the entire managing agency system into disrepute. As has been well remarked by a

recent writer, 'the comparative weakness of Indian industries is largely traceable to grave defects in the principles and structure of business organization, inadequate and unsatisfactory technical equipment both in personnel and machinery, the failure to adopt modern methods of marketing and, last but not least, over-capitalization and the consequent excessive burden of fixed charges. These are obviously, in a large measure, due to the lethargy, thoughtlessness, mistakes, and miscalculations of those who are individually and collectively responsible for the management of industrial enterprises in India.'<sup>1</sup>

The fact is that some managing agency firms (mostly Indian) have grossly abused their privileges and opportunities and, as we have already seen in this chapter, resorted to devices for making money which were neither straightforward nor in the best interests of the companies they managed. It was frankly suggested by one Indian managing agent of Calcutta<sup>2</sup> that 'perhaps in Bombay the managing agent had bitten off more than he could chew', and a detailed analysis of the abuses of the managing agency privileges clearly shows that Bombay and Ahmedabad led the way in this matter, and other managing agents followed them only to a limited extent. It was no wonder, therefore, that at the end of the post-war depression period there were angry shouts all over India to end 'this abominable managing agency system' for all time to come.

<sup>1</sup> H. L. Dey, *The Indian Tariff Problem in relation to Industry and Taxation* (London, 1933), p. 283.

<sup>2</sup> *Cotton Textile Industry Enquiry* (1932), Vol. V, p. 46, Evidence of Mr. K. C. Mahindra.

## CHAPTER V

### MANAGING AGENTS, DIRECTORS, AND SHAREHOLDERS

#### *Introductory*

RECENT discussions on the managing agency system in India have revealed a very interesting fact—the disharmony and conflict of interests between managing agents and shareholders and between managing agents and those directors who are more or less responsible to the shareholders. Of course, in every large industrial concern all over the world there is a possibility of divided interests between the entrepreneurs and the shareholders, and in fact such conflict of interests does occasionally appear even in democratic countries like Great Britain and the U.S.A. But the Indian managing agency system has accentuated this conflict of interests by literally shutting out all independent shareholders from any effective voice in the control of industry. It will be our purpose in this chapter to see how and to what extent this has been achieved and whether the hardship suffered by shareholders in India is any greater than that suffered in Great Britain and the U.S.A.

#### *Residual Powers of Managing Agents*

We have seen that the duties and obligations of managing agents are stated in detail in the agreement which is drawn up between themselves and the company. Generally speaking, all residual powers (i.e. those not specifically mentioned in the agreement) vest in the Board of Directors, and it is specifically mentioned in the Articles of Association that the affairs of the company would be managed 'subject to the control and supervision of the Board of Directors'. But in recent years some new agency firms, particularly at Bombay and Ahmedabad, have so worded the relevant clauses in the agreement that even the residual powers have

vested in themselves. In other cases, it has been laid down that where concurrent powers are vested in both the directors and the managing agent, it is to be understood that the powers will be exercised by the managing agent alone.<sup>1</sup> The effect of such clauses is that in almost all matters of management the agents have a free hand without any effective control by the directors : the protection given to shareholders through their directors is thereby reduced to nil.

### *Nomination of Directors by Managing Agents*

Under the managing agency system, the choice of directors by the shareholders is limited in many ways. The most important restriction arises in the general practice of managing agents nominating one, two, or even three directors on the Board of Directors, and they are virtually irremovable. Now, while it is always desirable that managing agents who virtually 'nurse' an enterprise from its infancy should have some important say in the constitution of the Board of Directors, it has often happened that they themselves have had the majority of directors on a Board (many companies have had Boards consisting of one or two directors only) and as they were irremovable, shareholders have had no voice at all even in the matter of suggesting a policy.<sup>2</sup>

It is sometimes suggested that managing agents nominate directors on the Board because they hold a substantial portion of the shares of the company. Now, this is not quite correct : excepting in the cotton textile industry of Ahmedabad, nowhere do the managing agents (individual exceptions apart) hold more than half the shares of the company, and, outside the cotton textile and jute industries, they hold, if they hold any shares at all, no more than 10 to 15 per cent. of the shares of a company. As such it would be idle to say that the extravagant power of nomination they enjoy is just and proper.

<sup>1</sup> Indian Tariff Board: *Report of the Cotton Textile Industry Enquiry* (1932), pp. 79-80.

<sup>2</sup> Memorandum of the Bombay Shareholders' Association on the Indian Companies' Act (Amendment) Bill, 1936.

*More about the Constitution of the Board of Directors*

Apart from the nominees of the managing agent, there is frequently on a Board a debenture or special director (selected for some special assistance he has given to the managing agents) who is also irremovable. This seat is generally filled up at the expense of the general body of shareholders and hence it means further curtailment of their fundamental rights.

A more serious and less conspicuous evil is the attempt of some managing agents to deprive the shareholders as a class of their voting rights and to acquire disproportionate or multiple voting rights for themselves with a view to retaining the control of the undertaking in their own hands. In many cases, preference shares are issued without any voting rights whatsoever. On the other hand, managing agents often issue management or deferred shares with excessive or multiple voting rights. A few instances would show the far-reaching implications of this device. In December 1920 the Indian Jute Mills of Calcutta, under the management of Messrs. Mackinnon, Mackenzie & Co., resolved to increase its share capital from Rs. 37½ lakhs divided into 1,000 shares of Rs. 375 each to Rs. 1½ crores divided into 39,920 ordinary shares of Rs. 375 each, and 30,000 deferred shares of Re. 1 each, both classes carrying the same voting rights, viz. one vote per share. The deferred shares were taken up by the management. The balance sheet as at 31 December 1935 showed that 23,200 ordinary shares had been issued. That meant that ordinary shareholders who had subscribed to the capital of the company to the extent of Rs. 87 lakhs were entitled to 23,200 votes only, while the deferred shareholders who had subscribed to the extent of Rs. 30,000 only were entitled to 30,000 votes. A paltry contribution of Rs. 30,000 had enabled the management to secure permanent control of the undertaking. Again, in the New Victoria Mills Co., Ltd., of Cawnpore, it was ingeniously arranged that ordinary shareholders holding shares of Rs. 2/8 each and preference shareholders holding shares of Rs. 5 each were entitled to one vote for each share, while deferred shareholders holding shares of Re. 1 only

were entitled to two votes per share. The deferred shares were largely controlled by the management, and by reason of the plural voting rights carried by these shares, the ordinary and preference shareholders could hardly assert themselves in the annual meetings of the company. In the Western India Oil Distributing Co., Ltd., also ordinary shareholders holding shares of Rs. 100 each were entitled to one vote for each share, while deferred shareholders holding shares of the same value were entitled to five votes each.<sup>1</sup>

This system of management shares and multiple voting rights is objectionable from many points of view. Firstly, it tends to perpetuate control in a body of persons who have got a comparatively small stake in the concern. Secondly, it shakes the bona fide investor's confidence that he will be given a fair deal, and thereby tends to retard the flow of investment. Thirdly, it leads to corruption and dishonest management.

Another method by which managing agents seek to render control by shareholders ineffective is by providing that only a small proportion of the directors shall retire by rotation at the annual general meeting. Very often the first directors of a company are appointed by them for a fixed period of ten or fifteen years, and even when the time comes for some directors to retire it is provided that a person other than a retiring director shall not be elected unless his name has been 'approved by the Board', the object being to maintain the oligarchy intact for an indefinite period. Moreover, sometimes special notice has to be given by the shareholders when they want to have a man of their own choice elected in place of the retiring director and in one instance the managing agency firm hit upon the ingenious idea of having an electoral college in the appointment of directors!<sup>2</sup> Not for nothing does the average shareholder in India chafe at the almost dictatorial powers of the managing agents.

<sup>1</sup> Memorandum of the Bombay Shareholders' Association on the Indian Companies' Act (Amendment) Bill, 1936.

<sup>2</sup> Ibid. The electoral college was proposed in the Articles of Association of the National Petroleum Co., Ltd.

*Removal of Directors from the Board*

While it is not easy for the independent shareholder to elect a director of his choice to the Board, it is still more difficult for him to remove one whom he does not like, but who happens to be a man of the managing agency firm. In every country shareholders are at a disadvantage *vis-à-vis* the executives (boards of directors), because they are always scattered over a large area and are far too many in number to combine effectively and put forward an alternative constructive policy. In India, however, they are under additional handicaps in view of the fact that managing agents possess, by their Articles of Association, almost autocratic powers. In most cases an extraordinary or special resolution is needed and sometimes a special notice is also insisted upon. Then again at the general meeting at least a three-fourths majority is required—a majority that it becomes impossible for any body of shareholders to obtain in view of the multiple voting rights secured by managing agents or their friends through 'management shares'.

*Other Aspects of the Conflict between Shareholders and Managing Agents*

The result has been that in recent years shareholders have tended to become more and more critical of *any* policy pursued by their executives—the managing agents and the more or less dummy Board of Directors. Having no voice at all in the affairs of the concern in which they have invested their money, they suspect every move made by the executives, and this certainly does not improve the credit of the company in the investment market. On the other hand, it is also true that many managing agents have taken undue advantage of their position as the autocratic executives of their company. With the assistance of their confidential brokers they have often sold out their shares on the Stock Exchanges whenever they have apprehended that the company would be losing. This has meant that they themselves have suffered no financial loss, but the other

\* Memorandum of the Calcutta Shareholders' Association on the Indian Companies' Act (Amendment) Bill, 1936.

shareholders have been hit because their sale on the Stock Exchanges has signified that something was wrong with the company. Again, managing agents have generally regarded their earnings from shares (as shareholders) as subordinate to their earnings in other capacities and in other fields of activity, with the result that they have been anxious to make money in all sorts of questionable ways. That explains why in many industries the general body of shareholders regard them as parasites rather than patrons and are so very insistent that their present system of control must be ended.

### *The Question of Democracy in Finance and Management* ✓

✓ This acute conflict between the interests of managing agents on the one hand and those of the independent shareholders on the other in India has brought to the front the question if and how far democratic finance and management is possible in industry in India today. Ever since the Indian Tariff Board started its enquiries into the position of the cotton textile industry, there have been repeated complaints that the average shareholder in India has got no voice at all in the finance or management of his company. The complaints came to a head on the occasion of the cotton textile enquiry of 1932 when the Bombay Shareholders' Association took up the challenge of the Bombay and Ahmedabad Millowners' Associations and proceeded to rebut the arguments of the latter bodies in favour of unrestricted continuance of the managing agency system with the help of elaborate facts and figures. Finally, on the occasion of the preliminary enquiries regarding the managing agency system and the Indian Companies' (Amendment) Act, both the Bombay and the Calcutta Shareholders' Associations took a leading part in exposing some of the worst features of the system: as a matter of fact the passing of the amending Act of 1936 was largely due to their untiring propaganda.<sup>1</sup>

Let us now consider the real implications of democracy in finance and management. It has been suggested by some

<sup>1</sup> *The Statesman* (Calcutta), 10 October 1936.

that industry should be governed more or less in the same way as the parliamentary state is governed and that just as in the parliamentary state the cabinet is responsible to the parliament, so also in industry the Board of Directors should be responsible to the general body of shareholders. And it has been contended that in India the managing agent should have strictly defined rights and duties which he shall exercise subject to the supervision of a Board of Directors, elected by and responsible to the general body of shareholders.<sup>1</sup>

Now, anyone knows that even in government, modern practice does not accord with the popular theory of cabinet 'responsibility' to parliament: the cabinet, in the modern parliamentary state, guides, rather than is guided by, the parliament. Moreover, in industry, where the average investor understands the technique of finance and management much less than the average M.P. understands the technique of governmental administration, it is sheer madness to contend that the Board of Directors should be responsible to the shareholders in the same way as the cabinet is responsible to the parliament. Moreover, and this is a crucial point, while the interest of the shareholder stops with his getting a dividend, those who administer the concern are not merely interested in their own dividends but anxious that a reserve should be built up and the company established on a firm footing. In all conflicts between the shareholders and the management the former are not necessarily always wise and the latter necessarily always wrong.<sup>2</sup>

What seems desirable is that while the Board of Directors should not be above *all* control, they should be in a position to guide effectively the general policy of the company. When there are managing agents attached to a concern these agents should have their rights and duties strictly defined so that they may not have much chance of transgressing or abusing them. As regards the general body of shareholders, they should have an opportunity of knowing as fully as possible how the company stands and

<sup>1</sup> *Indian Legislative Assembly Debates* (1936), Vol. V, pp. 3948-52.

<sup>2</sup> P. Ripley, *A Short History of Investment* (London, 1934), p. 16.

how it is being run, and, in cases of extreme default, inefficiency or dishonesty on the part of the management, they should have some power of finding an alternative management.

It is in the light of the above principles that we should now consider some of the more important problems of company management in India in so far as they affect both the shareholder and the potential investor.

### *Multiple Directorships*

In recent years criticism has been levelled at the fact that in India directors hold their position in far too many concerns, and it has been argued that this 'pluralism' in directorship results in indifference and inability to perform properly the functions of a director. In the cotton mills of Bombay, for instance, it was found in 1927 that one person was director in 30 mill companies, one in 14, one in 13, one in 12, one in 8, and as many as three in more than 5.<sup>1</sup> Again, in the city of Bombay, one person was found to be a director of 65 concerns, another of 42, a third of 34, a fourth and fifth of 29, and a sixth of 26.<sup>2</sup> It has been suggested that howsoever well qualified a director may be, it is impossible for him to discharge his responsibility towards all the companies fully and fairly when he happens to be on the directorate of as many as 15 or 20 or 25 concerns.

Let us see if the evil is really as acute as it is made out to be. In the first place, one has to remember that multiple directorship has been, at least in part, the result of the managing agency system itself. The managing agents practically nominate the directors of the companies and they nominate one another. Moreover, India is still deficient in business leadership and hence the few people who have got some industrial experience are naturally very much in demand and they become 'stock' directors in all sorts of concerns.<sup>3</sup> Nevertheless, the 'evil' is certainly not as acute in India as it is in other countries of the world.

<sup>1</sup> S. M. Rutnagar, *The Indian Cotton Mills* (Bombay, 1927), pp. 249-51.

<sup>2</sup> Indian Tariff Board: *Cotton Textile Industry Enquiry* (1932), Vol. III of *Evidence and Memoranda*, p. 242.

<sup>3</sup> D. H. Buchanan, *The Development of Capitalistic Enterprise in India* (New York), pp. 142-4.

In England, for instance, an enquiry into the number of directorships which 30,000 individuals held revealed (in the year 1932) that at least 13 of them were directors of 40 or more companies, 27 of 30 to 39 companies, 112 of 20 to 29 companies, 175 of 15 to 19 companies, and 520 of 10 to 4 companies; and as many as 2,222 persons were directors of 5 companies or more. The variety of industries of which these directors assumed control was equally striking: many of these 'plural' directors directed such diverse concerns as an insurance company, an investment trust, an electric railway, a cotton textile mill, a motor company and a general store.<sup>1</sup> Even a cursory perusal of the first 250 pages of *The Directory of Directors* published annually from London revealed to the writer a formidable array of 19 directors whose 'portfolios' ranged from 20 to 78 directorships.<sup>2</sup>

Compared with these figures, the problem of multiple directorship in India is by no means a serious one. Moreover, in view of the fact that the managing agency system is prevalent in the majority of concerns, the work of a director in India is much less onerous than that of one in an English or American company having no such intermediate organization as a firm of managing agents. Finally, the problem at bottom is one of getting more industrial leaders, and as long as the present inadequate supply of industrial leaders continues, 'pluralism' will have to be tolerated.

### *Surplus Directorships*

Analogous to the problem of multiple directorships is the problem of surplus directorships or of '~~directors who do not direct~~'. In Europe and America there is a convention among many companies to fill up their Boards to quite an appreciable degree with directors whose chief qualification is not their financial or commercial ability, but their prestige. Sometimes they are no better than professional public men 'hired for the show'. On the other hand, there are many companies which have grossly swollen

<sup>1</sup> M. Miller and D. Campbell, *Financial Democracy* (London, 1933), pp. 107-13.

<sup>2</sup> *The Directory of Directors* (London, 1936). The book consists of 1,844 pages, and the writer went through the first 250 pages to get a representative 'sample'. See Appendix XI.

directorates. The following instances from ten of the leading companies in England are instructive :

| Company                                            | No. of Directors |
|----------------------------------------------------|------------------|
| 1. Barclays Bank, Ltd. . . . .                     | 38               |
| 2. Lloyds Bank, Ltd. . . . .                       | 35               |
| 3. Midland Bank, Ltd. . . . .                      | 33               |
| 4. Law Fire Insurance Co., Ltd. . . . .            | 29               |
| 5. Royal Exchange Assurance Co., Ltd. . . . .      | 25               |
| 6. Westminster Bank, Ltd. . . . .                  | 24               |
| 7. National Provincial Bank, Ltd. . . . .          | 24               |
| 8. London & North-Eastern Railway Co. . . . .      | 22               |
| 9. Alliance Assurance Co., Ltd. . . . .            | 21               |
| 10. London, Midland & Scottish Railway Co. . . . . | 21               |

In almost all these cases, barely 50 per cent. pull their weight at meetings of the Board, and of the remainder 40 per cent. are 'prestige' directors or 'connexion' directors, i.e. directors who have been given a seat on the Board either for the purpose of ornamentation or with the object of acquiring business.\*

In India the evil of 'surplus directorships' is steadily on the increase. An eminent business man, the late Mr. F. J. Dinshaw, lent his 'prestige' to as many as 80 companies, while another eminent expert, Sir Purshottamdas Thakurdas, permits himself to remain on the Board of at least 42 companies.<sup>1</sup> Swollen directorates are not, however, very common in India yet, mainly because it is the managing agents who run most of the show and hence it becomes pointless to have exaggerated boards with dummy directors. As was observed in the case of multiple directorships, the problem of surplus directorships is also ultimately resolvable to one of getting more industrial leaders within the country.

### *Directors and Dividends*

In many countries conflict arises between the management and the shareholders over the question of the dividend. Excluding a very small number of persons who buy shares or securities for capital appreciation, (the majority of investors purchase them in the hope of enjoying the dividends that they anticipate will be paid and hence they are always anxious to get as much as they can out of the

\* H. B. Samuel, *Shareholders' Money* (London, 1935), pp. 111-20.

<sup>1</sup> Indian Tariff Board, *Cotton Textile Industry Enquiry* (1932), Vol. III of Evidence and Memoranda, p. 242.

'profits' of the company. The management, on the other hand, have to think of depreciation and of various other unforeseen liabilities, and naturally they tend to adopt a more cautious and conservative attitude with regard to the distribution of dividends.

In India, however, in some industries (e.g. the cotton textile industry of Bombay and Ahmedabad) the management have not only not been cautious in their dividend policy, but they have often distributed dividends most extravagantly without providing for any depreciation whatsoever. This has been partly the result of the fact that the managing agents themselves or their friends are an important fraction (often a majority) of the shareholders, and hence heavy dividends have generally been to their immediate gain.<sup>2</sup> On the other hand, in other industries a more or less stable and reasonable dividend policy has been maintained because the Boards have been actuated by the motive of doing their duty by the shareholders and of retaining their popularity. Moreover, upon a stable and reasonably high dividend policy rests the credit of a company and, therefore, managing agents as well as directors are anxious to maintain a good dividend record.

### *The Board of Directors versus the Shareholders*

In India the conflict of interests between the Board of Directors and the shareholders is accentuated by the fact that in most cases the Board is packed with the nominees of the managing agents, and that many of the directors are virtually irremovable. We have seen that in recent years managing agents have tended to become more and more dictatorial in their methods of management and, as a result, they and their Boards have come in sharp conflict with the shareholders. It will be our purpose here to consider how far it is possible to reconcile the apparently divergent views and aims of the management and the shareholders.

The first point to be kept in view is that every shareholder in a joint-stock company (private or public) is from the practical, financial standpoint a partner in the enterprise.

<sup>2</sup> Indian Tariff Board: *Report on the Cotton Textile Industry Enquiry* (1927), pp. 147-9.

He may, therefore, legitimately demand that he should receive adequate, periodic information with regard to the financial position of the concern in which he has invested his money. Now, in England this is effected by the annual publication of the balance sheet and by laying the profit and loss account before the general meeting. In order to ensure that the accounts are accurate, it is provided by the legislature that they shall be accompanied by a report or certificate of certain officers of the company (usually Chartered or Incorporated accountants) who are known as auditors.<sup>1</sup> In India also this legal requirement as to the annual audit of the accounts and publication of the balance sheet and profit and loss account has obtained since 1913, but the managing agents always took care that only the minimum required to be legally disclosed was disclosed and no further. It was possible within the law to present a more or less truthful but entirely misleading presentation of affairs.<sup>2</sup> The balance sheet, for instance, need not have contained any statement as to the remuneration received by managing agents or directors nor need it have contained any particulars as to subsidiary companies in which the parent company had stake or interest.<sup>3</sup>

A second point is that although the auditor was technically appointed by the general body of shareholders, in practice he was appointed by the managing agent and held service more or less during the pleasure of the latter. In spite of the fact that the function of the auditor was, in theory, to act on behalf of the shareholders as a check on the managing agents and the directors, in practice he stood in a somewhat strange and inverted position both to those whom it was his duty to check and to those whom it was his duty to protect. As he was in practice nominated by the managing agents, he was reluctant to offend or annoy those to whom he owed his appointment, and the result was that balance sheets and profit and loss accounts prepared by him were more often empty pious statements than detailed

<sup>1</sup> Samuel, *op. cit.*, p. 231.

<sup>2</sup> Memorandum of the Bengal National Chamber of Commerce, Calcutta, on the Indian Companies' Act (Amendment) Bill, 1936. (Typescript.)

<sup>3</sup> S. C. Sen, *Indian Companies' Act* (Calcutta, 1937), pp. 156-9.

and faithful representations of the actual position of the companies audited.<sup>1</sup>

It should, however, be noted that even in England the situation is not perfect with regard to the question of 'disclosure of facts' and that in that country also where the managing agency system is unknown and control is more democratic than in India, auditors are said to work 'under pressure'. It has been alleged, for instance, that 'if the company is prospering, the directors will hide some of the company's revenues by applying it to some secret reserve in order that at some subsequent period, when the company has done badly, they may utilize this amount behind the backs of their shareholders for the purpose of paying dividends; if, on the other hand, the company is not prospering, there are various considerations which will deter them from exposing too starkly the nakedness of the situation.' Again, 'though, as a matter of abstract theory, the auditor is elected and paid by the company, he is in practice nominated by the directors, and his election, unless there should be a division among the Board or some internal strife in the company, is the merest formality; under these circumstances, if an auditor falls foul of the Board, he will inevitably lose his appointment, unless, of course, the Board should be removed.'<sup>2</sup> While, therefore, admitting that Indian company law was defective until it was amended in 1936, it should be wise to recognize that even law has its limitations, and that ultimately economic forces and circumstances considerably modify the application or administration of rules laid down by the legislature.

### *Government and Protection of the Interests of Shareholders*

This brings us directly to one of the most talked of topics in India today, viz. that it is the duty of the State to come to the aid of the shareholders and protect them against the dictatorship of the managing agents and their Boards. The controversy became very acute during and after the post-war years when the glaring defects of the managing agency system in certain industries brought

<sup>1</sup> S. C. Sen, *Indian Companies' Act* (Calcutta, 1937), p. 159.

<sup>2</sup> Samuel, *op. cit.*, pp. 233-4.

forward the suggestion that the State should come and put an end to the system by passing special legislation. The large number of company failures only served to reinforce this argument, and in all Tariff Board enquiries regarding the grant of protection to the various industries the suggestion was repeatedly re-affirmed. Eventually Government decided to introduce legislation, and we shall now study the various steps taken before introducing the new legislation and also the significance of the latter from the standpoint of industrial finance and management in India.

## CHAPTER VI

### THE NEW INDIAN COMPANIES' ACT AND ITS ECONOMIC SIGNIFICANCE

#### *An Historical Retrospect*

AS trade and industry increased in India, the necessity and importance of company legislation also increased. The first Indian Companies' Act consolidating the principle that 'no member of a joint-stock association shall be liable for more than the unpaid portion of his share, and that in case of guaranteed companies no member was to be liable beyond the amount of his guarantee' was passed as early as 1866, when the joint-stock form of organization was just being adopted in some schemes of industrial promotion or development. A really comprehensive Companies' Act, however, followed sixteen years later—in the year 1882, based on the English law then prevailing, the English Companies' Act of 1867. There were minor amending Acts in 1887, 1895, 1909 and 1910 and, finally, in the year 1913 another comprehensive Indian Companies' Act was passed—based on the amended English Act of 1908. There was an amending Act in India in 1914, but, after that, company legislation in India remained untouched until the year 1936.<sup>1</sup>

By 1930 the situation became ripe for a thorough overhaul for three reasons. Firstly, even the Acts of 1913 or 1914 did not take into account a system which was in vogue in India but was unknown in England, viz. company management through managing agents. Indian company law followed the English law rather too closely and remained conveniently silent about this most important economic institution in India. The result was that unscrupulous persons soon began to take advantage of the loopholes and omissions in the law, and abuses and malpractices by

<sup>1</sup> *Indian Legislative Assembly Debates* (1936), Vol. V, p. 3936.

some managing agents became far too common a phenomenon. Secondly, while in England some modifications were made in the law in the light of experience, no corresponding steps were taken in India. (The English Act of 1908 was examined by a committee presided over by Lord Wrenbury in 1918, but the recommendations of this committee were not acted upon. In 1926, however, another committee presided over by Mr. Greene, K.C., examined the existing law and made extensive recommendations, and many of these were subsequently incorporated, with or without modification, in the Companies' Consolidation Act, 1929. While, therefore, in England modifications were made to meet changed circumstances, India continued to labour under the antiquated Act of 1913 (as amended in a few particulars in 1914). Finally, no serious attempts were being made to study the Indian company law from a comparative standpoint—in the light of the experience of joint-stock associations in other countries. In 1908 and again in 1911 comparative analyses of the company law of the United Kingdom, India, Canada, Australia, New Zealand, and South Africa were prepared in England by direction of the Board of Trade,<sup>1</sup> but no serious effort was made to secure uniformity of the company laws of the Empire, nor did India ever seek to amend her laws in the light of the working of the company law in other parts of the Empire.

Agitation for removing the defects of the Indian Act continued ceaselessly after 1930, and at last in September 1934 the Government of India placed a lawyer<sup>2</sup> with experience in the administration of company law on special duty to examine the materials collected and to make proposals for the amendment of the Indian law. This lawyer's report was published in January 1935, and his proposals were further discussed by a small committee of business experts specially convened for the purpose. In this committee representatives of diverse interests—Chambers of Commerce, Shareholders' Associations, Millowners' Associations, and the Imperial Bank of India—took part and

<sup>1</sup> *Comparative Analysis of the Company Law of the United Kingdom, India and the Dominions*, 1911 (Cmd. 5864), p. 6.

<sup>2</sup> Mr. S. C. Sen, a solicitor of Calcutta.

made their suggestions. Out of these proposals and discussions there crystallized a Bill to amend the Indian Companies' Act of 1913 and this was introduced into the Indian Legislative Assembly by the Law Member, the Honourable Sir N. N. Sircar, in March 1936. The Bill went to a very representative Select Committee and came back to the Assembly with a number of important modifications in August 1936. After this the progress of the Bill was rapid: there was an exhaustive discussion on almost every clause of the Bill on the floor of the Assembly, but the Honourable Member-in-charge piloted it so very skilfully that it emerged out of the Assembly and received the assent of the Viceroy before the end of the year.<sup>1</sup>

The revision of the law in England in 1929 took the form of a consolidating Act which completely replaced the Act of 1908. In India, however, the form of the Act of 1913 was retained and the changes, extensive though they are, were introduced in the form of amendments.<sup>2</sup> In the amendments the lines followed in the overhaul of the English law were adopted where the problems dealt with were problems common to India and England. There were, however, some special clauses—for the first time—for the problems peculiar to India herself, for example, those connected with the managing agency system.

### *Considerations Behind the New Act*

We have seen that for a time the abuses and malpractices of the managing agency system loomed so large that a considerable section of Indians were emphatically of opinion that the system should be abolished altogether by special legislation. As, however, the first passions gave way to a scientific examination of the system, it was discovered that many of the abuses and malpractices had grown only in recent years, and that they were by no means inevitable. Even the Bombay Shareholders' Association which had all along been insistent on the total abolition of the managing

<sup>1</sup> *Financial Times* (Calcutta), December 1936.

<sup>2</sup> This was done because there were 'manifest advantages in retaining the form of the existing Indian Act with the administration of which the courts were familiar'.

agency system, acquiesced in its continuance, and only urged that it should be 'purged of all its patent abuses' and compelled to have certain 'standards of management' in a manner which would 'make difficult, if not impossible, the repetition of the exploitation of the investing public by them'.<sup>1</sup>

As was well put by Sir N. N. Sircar in the Indian Legislative Assembly, the new Act<sup>2</sup> is based on two considerations: firstly, that every attempt should be made to make extremely difficult the malpractices which had come to light as a result of the working of the Act of 1913; secondly, that the provisions for stopping these apprehended malpractices must not be so unreasonable and onerous as to keep away honest men from having anything to do with joint-stock companies.<sup>3</sup> As a matter of fact, the new Act attempts to arrive at a mean between two extreme views—one view which it is difficult to shake off from one's mind, viz. that business men or, for that matter, any set of men can be made honest by force of statute, and that all possible avenues of dishonesty and malpractices can be effectively stopped by legislation, and the other view that nothing can be done by legislation and hence things should be left to run their usual course. The new Act recognizes that the management must have some freedom in pursuing their policy, and that it would be unwise to lose all sense of proportion about the abuses in which, after all, only some companies have indulged; it also implies that no legislation, however comprehensive, can possibly rouse those shareholders who make up their minds to go to sleep.

In the light of the above principles we shall now try to appreciate the economic significance of the changes introduced by the new Act in so far as they have a direct bearing on industrial finance and management in India.

<sup>1</sup> Introductory to the Memorandum of the Bombay Shareholders' Association on the Indian Companies' Act (Amendment) Bill, 1936.

<sup>2</sup> The new Act deals with six different problems: (a) mushroom and fraudulent companies; (b) provisions relating to the issue and contents of prospectuses; (c) increased disclosure to shareholders of the financial position of companies and increased rights to shareholders in connexion with the management of companies; (d) managing agents; (e) provisions applicable to winding up; and (f) special provisions to govern banking companies.

<sup>3</sup> *Indian Legislative Assembly Debates* (1936), Vol. V, p. 3940.

*Managing Agents and Restrictions on their Powers under the New Act*

The first thing that strikes the student of the new Act is that for the first time managing agents have been brought within the purview of the Act, and a complete set of new sections<sup>1</sup> has been introduced in the Act defining their status and also their rights and liabilities. The Act defines a 'managing agent' as 'a person, firm or company entitled to the management of the whole affairs of a company by virtue of an agreement with the latter, and under the control and direction of the directors except to the extent, if any, otherwise provided for in the agreement, and includes any person, firm or company occupying such position by whatever name called'. The special clauses dealing with managing agents are, however, so framed that they do not destroy the system, but continue it with reasonable safeguards.

The very definition of 'managing agents' removes the menace of their usurping all residual powers to themselves: it will now be impossible for them to maintain that they are not subject to the control of the directors. Much more far-reaching, however, are the provisions relating to the duration of appointment, remuneration and duties and liabilities of the managing agent. It is provided that all new appointments of managing agents are to be for a period not exceeding twenty years at a time, and even in the case of existing agencies, notwithstanding the terms of their agreement or any provisions in the Articles, their period of office must come to an end after twenty years, if it does not automatically come to an end earlier within that time. Secondly, it is provided that, notwithstanding anything to the contrary contained in the Articles or the agreement, a company may remove a managing agent if he is convicted of certain criminal offences. Moreover, in general, the appointment, dismissal, and variation in the terms of appointment of managing agents are made dependent upon the approval of the shareholders, and it is specifically provided that a change or assignment of his

<sup>1</sup> See Appendix XII for the sections dealing with 'Managing Agents'.

remuneration or any part thereof effected by a managing agent shall be void as against the company. Thirdly, as regards the vexed question of remuneration, it is laid down that no managing agent appointed after the amending Act comes into force can stipulate for his remuneration anything other than a percentage of the net profits of the company, with a provision for minimum remuneration in case of inadequacy or absence of profits together with an office allowance. Any other form of remuneration has to be specially sanctioned by the shareholders. The mode for ascertaining the net profits is also laid down in detail and a formidable list of deductions (e.g. the usual working charges, interest on loans and advances, repairs and outgoings, depreciation, bounties or subsidies received from the Government or a public body, profits by way of premium on shares sold, etc.) enforces a reasonable basis for the calculation of profits. Fourthly, the bad practice of giving, or guaranteeing loans to, managing agents is absolutely prohibited, and the evil of inter-investment of funds by managing agents when they have several companies under the same management is also forbidden. Similarly, the employment of the funds of a company in the purchase of shares and debentures of another company under the management of the same managing agents is prohibited. Finally, the practice of managing agents packing the Board of Directors with their own nominees is rendered impossible by a section directing that no managing agent shall be allowed to nominate more than one-third of the total number of directors and, besides, managing agents are prevented from carrying on on their own account a business which is of the same nature as and directly competes with the business of the managed company.

It has been contended by a certain section of business men that these far-reaching provisions violate the fundamental principle of sanctity of contract inasmuch as existing contracts are interfered with, and that they prevent a company from choosing the form of management, and also basis of remuneration, which it considers to be best in its own interests. It has been argued that the vast majority of the prosperous concerns existing in India today have

been built up under the managing agency system, and undue legislative restrictions (like those embodied in the Act) would only kill a system which has rendered such splendid service to industry in the past.<sup>1</sup> It has also been suggested that the section limiting the period of managing agency to twenty years is quite inadequate considering the fact that in India industrialization is still in a nascent state: it takes about ten to fifteen years for any industry to be stabilized on a profitable and economic basis and it would not, therefore, be sufficient inducement to the managing agents to develop an industry if they are to relinquish the fruits of their labour soon after they have succeeded in developing it. As it is difficult to float companies or to carry them on successfully without the help of managing agents, it is said that the restrictive clauses, by dissuading managing agents from embarking on new industrial ventures, would only retard the industrial development of the country.<sup>2</sup>

These are gloomy prophecies, and it is not easy to say how far the future trend of events will bear them out. It seems, however, that many of these 'prophecies' were made at a time when feelings ran high and when the apologists of the managing agency system were anxious to have the 'safeguards' removed as much as possible. While it is true that in the past the successful promotion or development of a venture has been largely due to the backing of an honest and efficient firm of managing agents, it is also true that in recent years concerns without any system of managing agency control are doing as well as those guided or managed by managing agents.<sup>3</sup> It is not always true that only the name of the managing agent attracts capital to new industry: the flow of capital depends also on the prospects of an industry—the opinion that prospective holders hold about them.<sup>4</sup> Recent happenings

<sup>1</sup> Circular Letter No. 193/1936 dated 20 June 1936, from the Bengal Chamber of Commerce, Calcutta, on the Indian Companies' Act (Amendment) Bill, 1936.

<sup>2</sup> Memorandum of the Federation of Indian Chambers of Commerce and Industry on the Indian Companies' Act (Amendment) Bill, 1936.

<sup>3</sup> Sugar and cement concerns are notable instances.

<sup>4</sup> Indian Tariff Board: *Cotton Textile Industry Enquiry* (1932), Vol. V of *Evidence and Memoranda*, p. 126.

in the sugar industry seem to bear this out. As soon as Government imposed a protective duty on sugar, the industry became 'profitable' and many public issues in this industry without any backing of managing agents (but, of course, having the backing of some persons known to be honest and efficient) were over-subscribed in the two years immediately following the imposition of the duty.<sup>1</sup> The experiences of two important cement companies—the United Cement Company and the Okha Cement Company—also point the same moral. These were originally private companies, but eventually they were converted into public companies and the entire capital was raised by public subscription without any guarantee from any firm of managing agents.<sup>2</sup> These recent instances tend to show that undue emphasis need not be laid on the managing agency institution as such: it is some of the individuals who compose it that inspire confidence in the minds of investors, and if those individuals who have a reputation for honesty and efficiency were to serve on a company as paid managing directors, investors would feel equally confident and would respond with the same alacrity.

But the new Act does *not* abolish the system. It only prescribes certain standards of management and to some extent circumscribes the extravagant privileges of the managing agent *vis-à-vis* his company. Managing agents can even be re-appointed (at the end of twenty years) if the shareholders of a company so desire. The argument of 'sanctity of contract' is apt to degenerate into a fetish, and to imply that, howsoever shareholders may suffer, the Government should not take any steps towards protecting their legitimate interests is sheer nonsense. The fact is that shareholders are spread all over the country, and it is always difficult for them to take any organized and timely action, while almost all managing agents are well organized and a powerful body. It is certainly desirable that the State should take steps to protect the interests of the former, especially when, as we have seen, some managing agents have taken unfair advantages

<sup>1</sup> *Financial Times* (Calcutta), April 1935.

<sup>2</sup> *Indian Finance Year Book*, 1936, pp. 283-5.

of their position as the managers and financiers of industry.<sup>1</sup>

While, therefore, the necessary safeguards relating to managing agents are neither unfair nor inexpedient, it would be important to remember that in the long run the better industrial development of India would depend less on the abolition or modification of this institution and more on the growth of a better standard of business efficiency and honesty. Human institutions, whether Government bodies or private undertakings, are exactly as good and as bad as human beings are, and a Board of Directors can become as good or as bad as any managing agency firm.

*Directors and Limitations on their Powers under the New Act*

The second important set of provisions in the amending Act are those relating to Directors and their powers. We have seen that the safeguards relating to managing agents have been provided because some managing agents had started taking undue advantage of their position as managers of industry. While there have been no malpractices on a similarly large scale by Boards of Directors of joint-stock companies in India, cases have occurred where some directors have tried to monopolize the Board for themselves, and have also managed their concerns inefficiently or dishonestly. While legal enactments cannot enforce efficiency or honesty in industrial leaders, provisions have been made in the Act designed to give the shareholders some ultimate control over their Board of Directors.

We have seen that the amending Act provides that every company shall have at least three directors and that not more than one-third of the total number of directors on a Board shall be nominated by the managing agents. Let some directors be selected by some other ingenious method, the Act also specifically provides that, notwithstanding anything contained in the Articles, at least two-thirds of the total number of directors on a Board shall be elected by shareholders. Among the limitations on the powers of

<sup>1</sup> Memorandum of the Calcutta Shareholders' Association on the Indian Companies' Act (Amendment) Bill, 1936.

directors, the most important is the prohibition of the assignment of offices by directors except with the approval of the shareholders expressed in a special resolution. Then again, special provisions exempting directors from liability in respect of negligence, breach of duty, and breach of trust are made void. The granting of loans to directors in all companies other than banking companies is prohibited, and a director is prevented from holding offices of profit other than those of a managing director, manager, banker, or legal or technical adviser except with the consent of shareholders. Another section curtails the privilege, hitherto enjoyed by directors, of entering into contracts with the company and imposes on them the liability to obtain the consent of the Board of Directors which can now no longer be a packed body of persons representing a particular interest. Finally, it is laid down that the office of a director will be automatically vacated in the following cases, viz. failure to obtain qualification shares within the time limited by the statute, if he becomes a lunatic or is adjudged an insolvent, if he fails to pay calls in respect of shares held by him within six months, if he accepts any office of profit or takes any loan in contravention of the provisions in the Act, or if he absents himself from meetings of the Board on three consecutive occasions or for a continuous period of three months, whichever is longer.

Even these limitations on the powers of directors were criticized by a section of people in India. It was said that these special liabilities and responsibilities were blindly borrowed from the English Act, although the traditions of company management in India are different. It was also remarked that the provisions were unnecessarily stringent and that in practice they would deter good and reasonable men from serving on Boards of Directors.<sup>1</sup>

A careful perusal of the restrictive provisions, however, shows that they have all been enacted in the best interests of company management in the country. They only seek to regulate the conduct of directors, and not one of the provisions can be said to be unusual. It is true that on

<sup>1</sup> Memorandum of the Bengal National Chamber of Commerce on the Indian Companies' Act (Amendment) Bill, 1936. (Typescript.)

account of the prevalence of the managing agency system, directors in India do not possess the power that directors in England have, but, nevertheless, the present Act makes directors the ultimate holders of residual power, and hence it is necessary that their power should be regulated. Moreover, in recent years, more and more companies are being floated without the guarantee or control of managing agents, and it is necessary that their Boards of Directors also should have their duties and responsibilities broadly defined.

### *Shareholders and their Powers under the New Act*

The third important set of provisions relates to shareholders and their powers. The provisions regarding managing agents and directors also in effect mean additional powers for shareholders, but, besides those, some specific powers have been given to them under the Act.

Before the passing of the amending Act there was a general complaint that shareholders were not given sufficient information about matters relating to the company and its management.<sup>1</sup> To remedy this grievance, the new Act provides that the prospectus, which is the first official publication by a company after its incorporation, and is the document which the company publishes in order to attract subscribers, must contain all matters which would enable a prospective shareholder to form his honest judgement as to whether he should go in for shares in the company or not. Thus, in the case of companies which are to have managing agents, not only their names and addresses but the provisions in the Articles of Association or in their agreement as to their appointment and remuneration must be disclosed. Where underwriters are employed, the names of the underwriters are to be disclosed along with a statement of the directors that in their opinion the underwriters are persons of sound means to discharge the obligation taken up by them. Where property is to be purchased by a company, in order to judge the propriety or otherwise of the price intended to be paid, the prices at which the property might have been transferred during the two years preceding the acquisition of the property

<sup>1</sup> S. C. Sen, op. cit., p. xxi.

must be disclosed, and where a business is intended to be purchased, the prospectus is to disclose the profits made during the three years prior to the acquisition. Secondly, where a prospectus is issued by a company which is already carrying on business, the amending Act provides that it must contain a report of its auditors as to the dividends paid during the previous three years. Similarly, if any new business is to be acquired, the prospectus must be accompanied by a report of the accountant as to the profits made in the business during the preceding three years. Thirdly, substantial changes have also been made regarding the publication of information necessary to find out how the company is being managed. Thus in the matter of accounts a new form provides for much more information being given in the balance sheets. Particulars of the reduction of capital assets, the disclosure of good, bad, and doubtful debts, full details of loans and investments will henceforth have to be given by every public company. Fourthly the compulsory compilation of a profit and loss account, a directors' report as to the affairs of the company and a report by the auditors on the documents audited by them have been insisted upon, and it has been provided that details of the remuneration *actually* paid to the directors and managing agents should also be available to the shareholders. All these detailed provisions are expected to enable the shareholders to have intimate knowledge of the company, its work and its finances.

Regarding the powers of shareholders, for the first time in India, rights have been conferred on them by statute to remove directors out of their time by passing an extraordinary resolution. Again, we have seen already that the appointment of managing agents, their remuneration and any variation in the managing agents' contract made after the commencement of the new Act, are now dependent on a resolution of the shareholders in a general meeting. Again, any deviation from the basis of remuneration statutorily laid down for managing agents has been made dependent on a special resolution by the shareholders. Finally, it has been provided that a shareholder should

henceforth be entitled as a matter of right to have his proportionate part in the new issue of shares by the directors, and he shall be entitled to get certain informations from his company whenever he likes.

These rather far-reaching provisions regarding the rights and powers of shareholders have given rise to considerable misgivings among the business community in India. The provisions regarding the giving of sufficient information to shareholders were, on the whole, welcomed : as a matter of fact, most of the Chambers of Commerce wanted that all reasonable publicity should be given to the shareholders. But it has been complained that in the desire to secure publicity, the obvious rights of the directors and managing agents have been sacrificed and their offices laid open to harassment by individual hostile shareholders. It has been argued that a shareholder may, in contradistinction to a director, by law, exercise his votes for his personal interest and not for the interests of the company as a whole.<sup>1</sup>

As these complaints raise the far-reaching question of democracy in management and finance, it would be worth our while to consider how far the amended provisions defining the powers of shareholders are likely to promote better management or better finance in the companies that are at work in India. At the very outset it is important to remember that the question of granting larger rights and privileges to shareholders is like a double-edged weapon which cuts both ways. It is as urgent that a company should be granted proper safeguards against hostile and reckless shareholders as it is necessary that the State should afford protection to shareholders against irresponsible management.<sup>2</sup>

Now, a close analysis of the changes made by the new Act with regard to the powers of shareholders shows that they do not afford much opportunity to a minority of hostile and reckless shareholders to stir up trouble against the management. The provisions regarding the furnishing of information to shareholders (when they apply for the

<sup>1</sup> Circular Letter No. 193/1936 dated 20 June 1936, of the Bengal Chamber of Commerce on the Indian Companies' Act (Amendment) Bill, 1936.

<sup>2</sup> Memorandum of the Bengal National Chamber of Commerce, Calcutta, on the Indian Companies' (Amendment) Bill, 1936. (Typescript.)

same) may be slightly inconvenient to the management, but by themselves they are not likely to make administration 'difficult' for the latter. Of course, if a majority of shareholders take up a hostile attitude, they will be able to make things awkward for the management, but, if such a state of things ever happens, it would perhaps be more proper to conclude that something is really wrong with the management. On the whole, therefore, it seems that no powers have been granted under the Act whereby a minority of shareholders can disturb the efficient administration of a company.

*The Future : Managing Agents, Directors and Shareholders.*

It is dangerous to prophesy, but the new Act has laid down so many novel provisions regarding managing agents, directors, and shareholders, that people of all shades of opinion have been speculating what the future is going to be like. On the one hand, the various millowners and Chambers of Commerce have repeatedly emphasized that the restrictive provisions of the Act would kill all private enterprise in the sphere of business and industry in India; on the other hand, the various shareholders' associations have complained that the Act does not go far enough, and that there are still many loopholes which will be readily taken advantage of by unscrupulous managing agents or directors, and which will mean that things will be more or less the same in future as they were in the past.<sup>1</sup>

Let us take the case of managing agents first. Will the new rules and regulations mean that they will gradually die out? The writer is of opinion that the system will *not* die any death at all. Up to now, the weakness of the Indian Companies' Act has lain in this, that although the managing agency system was a fact in India, the Act did not define the rights and functions of a managing agent *vis-à-vis* the company, and hence a number of abuses and malpractices, not inherent in the system, cropped up. The new provisions in the Act will only make these

<sup>1</sup> Compare the prefaces of the interesting memoranda submitted by the Federation of Indian Chambers of Commerce and Industry, Calcutta (typescript) and by the Bombay Shareholders' Association (private pamphlet) on the Indian Companies' Act (Amendment) Bill, 1936.

malpractices difficult, they will thereby lead to a better standard of conduct among all managing agents. It is true that some of the restrictive provisions will take away their 'extra' remunerations, but the 'legal' remunerations will still be large, and it is improbable that managing agents will forgo these very substantial legal remunerations, and take to other avocations instead.

Then come the directors. The limitations on the powers of directors are meant, partly, to regulate conduct and, partly, to give some powers to the shareholders. These limitations also are not likely to make joint-stock enterprise difficult: as a matter of fact, countries like Canada, Germany, and the U.S.A. have far more statutory limitations on the powers of directors than what the English law or the new Indian law lays down, and yet in those countries joint-stock enterprise is neither decadent nor difficult. It is, therefore, foolish to say that in India the rather modest provisions in the new Act will hamper industrial development by killing all joint-stock enterprise.<sup>1</sup>

Finally come the shareholders. Here also, if one peruses the new Act carefully, one finds that no extravagant powers have been given to them: all that has been done is that some of their privileges (which are well recognized in other industrially developed countries) have been emphasized, and they have been given some limited protection against the autocracy of the management. There is not a single provision in the Act which would make it possible for an isolated shareholder or even a minority of shareholders to hamper the smooth and efficient administration of a concern.<sup>2</sup>

The fact is that it is neither possible nor desirable to secure in industry the sort of democracy that one may have in government. In England, in course of an enquiry into the shareholding of ten leading concerns, it was found that there was not a single instance in which large holders, together, controlled as much as one-third of the capital; in fact, in six of the ten

<sup>1</sup> Memorandum of the Bombay Shareholders' Association on the Indian Companies' Act (Amendment) Bill, 1936.

<sup>2</sup> Memorandum of the Calcutta Shareholders' Association on the Indian Companies' Act (Amendment) Bill, 1936.

concerns, large holdings did not account for as much as one-fifth of the whole. And yet control of particular companies was known to be associated with particular interests. This was due to the scattered ownership of capital and to the fact that, in practice, voting power on paper was very different from voting power in the general meeting of the company: the simple factor of space limited the control which numbers gave to the shareholders.<sup>1</sup>

Let us analyse this point further. The average shareholder or investor does not take any interest in the actual working of his company, and his interest stops with the getting of dividends. Moreover, shareholders being scattered over a large area, it is hardly possible for them to combine and act together against the management. The statutory right of shareholders to have the affairs of their company investigated is practically nullified by the fact that there is an intimidating financial barrier in the way of carrying through a policy of direct action by shareholders, and relatively few companies possess shareholders with both the means and the tenacity to surmount it. They are also in the unhappy position of only being able to take action to protect their interests at the possible cost of damaging the reputation of their company and possibly bringing about a fall in the market value of its shares.<sup>2</sup> The result is that even in countries having a democratic control of industry by shareholders, 'it is easier to upset a Ministry than a Board of Directors, so long as a company remains a going concern. Shareholders are powerless in the face of a directors' strike.'<sup>3</sup> Yet, in England, the vast majority of directors are neither supermen nor rogues, but well-meaning individuals doing a job of work as well as they can. As a matter of fact, the Greene Committee, which reported on company law amendment in England in 1926, was satisfied that the great majority of limited companies, both public and private, were honestly and conscientiously managed. 'Cases in which fraud or lesser forms of dishonesty or improper

<sup>1</sup> H. Parkinson, *Scientific Investment* (London, 1932), pp. 11-13.

<sup>2</sup> M. Miller and D. Campbell, *op. cit.*, p. 36.

<sup>3</sup> Parkinson, *op. cit.*, p. 134.

dealing occur are comparatively few, and the public interest which such cases naturally arouse tends to divert attention from the vast number of honestly conducted concerns and to create an exaggerated idea of the evils connected with limited companies and their activities."<sup>1</sup>

In India the problem of industrial management is ultimately two-fold. Firstly, it is necessary that those who manage a company—whether they are managing agents, managing directors, or a Board of Directors—must try to be more efficient and honest than they have hitherto been. Secondly, the ever-increasing body of shareholders and investors must begin to take an intelligent interest in the affairs of the concerns in which they have put their money, so that it may become increasingly difficult for the management to be inefficient, lazy, or dishonest. No amount of legislation can make management more efficient or honest than it is, nor can it make shareholders more active or intelligent than they are.

Regarding the first problem, the very large number of company failures during the last ten or fifteen years points to the fact that business efficiency as well as business morality are still at a low pitch in India today.<sup>2</sup> The tendency of some business men in India to take advantage of loopholes and to make money in all sorts of questionable ways should be a matter of deep concern to everyone interested in the industrial progress of the country. A very recent and typical illustration may be quoted from a report of the Registrar of Joint-stock companies, Bengal. 'A type of malpractice very much in evidence during the last few years is the practice of receiving security deposits by offering employment. The security is received by the company and is said to be spent in its business, although it means nothing but paying the remuneration and travelling and other allowances of the directors and the managing agents of the company. The services of the persons engaged are very frequently dispensed with on the slightest pretext without returning the security deposits. In many cases the companies hardly possess any assets to be able to return the

<sup>1</sup> *Report of the Company Law Amendment Committee, 1925-6* (Cmd. 2657), p. 4.

<sup>2</sup> For a more detailed discussion on this point, see *infra*, Chapter VII.

security deposits."<sup>1</sup> It is necessary that the various Chambers of Commerce and such organizations as millowners' associations should lay down strict rules of conduct for managers, directors, and managing agents, and should severely punish any breaches thereof—without the slightest scruple or hesitation.

As regards the shareholders, it is an encouraging sign that in the two most important industrial centres, viz. at Calcutta and Bombay, shareholders have banded themselves into shareholders' associations for the protection of their own interests.<sup>2</sup> Nevertheless, the general apathy of the shareholder in India is a byword, and it has been noted in successive reports on the administration of joint-stock companies in India. 'Shareholders living at a remote distance may be handicapped, but it is altogether a different matter when shareholders who live in or near the same locality refrain from taking legal measures which are within their reach and designed for their benefit. If shareholders fail to take a proper interest in the affairs of their own company and neglect to exercise the powers they possess and can assert without much expenditure of time or money, they have only themselves to thank if the management is slack and unsatisfactory. Attendance at general meetings is, as a rule, meagre in the extreme, and it is the general supineness on the part of the shareholders that is contributory to, and, to some extent, responsible for, much of the bad management that prevails, and until they evince a livelier interest and exert a more effective control in connexion with the general conduct of affairs of their company by those to whom the management has been entrusted, no material improvement is to be expected.'<sup>3</sup> Now, it will perhaps never be possible to compel all or even a majority of shareholders to take an intelligent interest in the affairs of the company. On the other hand, there will always be a section who would like to follow carefully the affairs of the

<sup>1</sup> *Annual Report on the Administration of the Indian Companies' Act in Bengal, 1934-5*, pp. 3-6.

<sup>2</sup> The Bombay Shareholders' Association was formed in 1928, and the Calcutta Shareholders' Association in 1935.

<sup>3</sup> *Annual Report on the Administration of Joint-stock Companies in British India, 1928-9*, p. 2.

company, and would like to get the necessary information on behalf of the general body of shareholders. In order to achieve this in a systematic way, India may well follow, with some modifications, the practice of an interesting country, Holland. There, the shareholders appoint a small body known as 'Commissarissen', whose duty it is to supervise and report to the shareholders upon the activities of the 'Directeuren', to whom the management of the company's affairs and all legal responsibilities in connexion therewith are entrusted. If the 'Commissarissen' wish to veto any act of the 'Directeuren', they have the power to do so, but they must afterwards account to the shareholders in a general meeting for their action. The 'Commissarissen', who are nearly always drawn from among the principal shareholders, have every incentive to see that the company does well and that the 'Directeuren' do their duty. In India, too, apart from such general bodies as the Shareholders' Associations of Calcutta and Bombay, (the shareholders of each company may appoint a small 'Shareholders' Committee' consisting of representatives of both the big shareholders and the smaller ones, and this body may be entrusted with the work of supervising and reporting upon the activities of the management—whether managing agents and/or boards of directors—to the general body of shareholders. This committee need not have the power to veto the acts of the management, but it should certainly have the power to call for details or explanations of their more important acts; and then it shall be left to the general body of shareholders to decide whether the discharge of duties by the management is satisfactory or not. This procedure will enable the average shareholder to keep himself in continuous touch with the affairs of a company and, with good will on both sides, this will certainly not hamper the smooth administration of a company. On the other hand, it will make the potential investor less nervous about sinking his money in an enterprise, as he will have the assurance that he will be kept regularly informed of all the major developments inside his company.

\* M. Miller and D. Campbell, op. cit., p. 47.

## CHAPTER VII

### THE PROBLEM OF MUSHROOM AND FRAUDULENT COMPANIES

#### *Recent Company Failures in India*

EVER since the end of the War, the number of joint-stock companies at work in India has steadily increased, as will be apparent from the following figures :

NUMBER, PAID-UP CAPITAL AND AVERAGE PAID-UP CAPITAL OF COMPANIES  
AT WORK IN EACH YEAR<sup>1</sup>

| Year       | No.   | Paid-up Capital<br>(Rs. 1,000) | Average Paid-up<br>Capital of each<br>Company<br>(Rs. 1,000) |
|------------|-------|--------------------------------|--------------------------------------------------------------|
| 1920-1 ..  | 4,708 | 1,64,46,25                     | 349·3                                                        |
| 1921-2 ..  | 5,189 | 2,30,54,89                     | 444·3                                                        |
| 1922-3 ..  | 5,190 | 2,59,78,52                     | 500·5                                                        |
| 1923-4 ..  | 5,211 | 2,65,33,42                     | 509·2                                                        |
| 1924-5 ..  | 5,204 | 2,75,52,85                     | 548·4                                                        |
| 1925-6 ..  | 5,305 | 2,76,95,77                     | 522·1                                                        |
| 1926-7 ..  | 5,526 | 2,76,90,56                     | 501·1                                                        |
| 1927-8 ..  | 5,830 | 2,76,43,54                     | 474·1                                                        |
| 1928-9 ..  | 6,330 | 2,79,30,81                     | 441·2                                                        |
| 1929-30 .. | 6,919 | 2,86,33,58                     | 413·8                                                        |
| 1930-1 ..  | 7,328 | 2,82,68,47                     | 385·7                                                        |
| 1931-2 ..  | 7,997 | 2,85,90,06                     | 357·5                                                        |
| 1932-3 ..  | 8,715 | 2,86,46,64                     | 328·7                                                        |

It will be noticed, however, that the increase has by no means been phenomenal and, as a matter of fact, the average paid-up capital has remained more or less stationary. This has been due, in the main, to the fact that these last fifteen years or so have seen a tremendous number of company failures, with the result that the average Indian investor, habitually shy, has become shyer still. Investment and joint-stock company promotion have increased very slowly, and the problem became so serious that in 1936 Government had to devise some special provisions in the new Act

<sup>1</sup> The figures subsequent to 1932-3 are not yet available for the whole of India. These figures have been compiled from the Annual Reports relating to the Administration of Joint-stock Companies in India (New Delhi).

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to deal with the menace of mushroom and fraudulent companies.

TABLE OF COMPANY FAILURES IN INDIA<sup>1</sup>

| Year       | No. | Paid-up Capital<br>(Rs. 1,000) | Percentage of com-<br>pany failures to<br>companies at work<br>every year |
|------------|-----|--------------------------------|---------------------------------------------------------------------------|
| 1924-5 ..  | 427 | 7,21,00                        | 8.5                                                                       |
| 1925-6 ..  | 374 | 6,81,00                        | 7.0                                                                       |
| 1926-7 ..  | 309 | 5,87,00                        | 5.6                                                                       |
| 1927-8 ..  | 335 | 7,64,00                        | 5.7                                                                       |
| 1928-9 ..  | 229 | 5,49,00                        | 3.6                                                                       |
| 1929-30 .. | 264 | 3,33,00                        | 3.8                                                                       |
| 1930-1 ..  | 292 | 11,12,00                       | 3.9                                                                       |
| 1931-2 ..  | 255 | 3,51,00                        | 3.2                                                                       |
| 1932-3 ..  | 361 | 3,43,00                        | 4.1                                                                       |
| 1933-4 ..  | 434 | —                              | —                                                                         |
| 1934-5 ..  | 365 | —                              | —                                                                         |
| 1935-6 ..  | 855 | 4,80,59                        | —                                                                         |

N.B.—(1) Figures of paid-up capital for 1933-4 and 1934-5 are not available.

(2) As figures of the total number of companies at work from 1933-4 to 1935-6 are not available, the percentages for these periods could not be worked out.

As a matter of fact, one might say that in India, on an average, more than half of the companies newly registered every year fail.

COMPARATIVE TABLE SHOWING THE NUMBER OF

(a) NEW COMPANIES REGISTERED AND

(b) COMPANY FAILURES EVERY YEAR.<sup>2</sup>

| Year       | No. of new<br>Companies Registered | No. of Company<br>Failures (old and new) |
|------------|------------------------------------|------------------------------------------|
| 1924-5 ..  | 416                                | 427                                      |
| 1925-6 ..  | 470                                | 374                                      |
| 1926-7 ..  | 529                                | 309                                      |
| 1927-8 ..  | 627                                | 335                                      |
| 1928-9 ..  | 726                                | 229                                      |
| 1929-30 .. | 839                                | 264                                      |
| 1930-1 ..  | 731                                | 292                                      |
| 1931-2 ..  | 922                                | 255                                      |
| 1932-3 ..  | 1,087                              | 361                                      |
| 1933-4 ..  | 885                                | 434                                      |
| 1934-5 ..  | 965                                | 365                                      |
| 1935-6 ..  | 1,027                              | 855                                      |

<sup>1</sup> These figures have been compiled from the Annual Reports relating to the Administration of Joint-stock Companies in India and the monthly bulletins published by the Government of India.

<sup>2</sup> Compiled from the same sources as the preceding table.

This is a dismal picture, and it becomes more dismal still when we compare it with the figures of a country notorious for company failures. In the U.S.A. the percentage of failures of business to the total number of businesses at work every year was  $\cdot 72$  in 1910,  $1\cdot 07$  in 1915,  $\cdot 43$  in 1920, and  $\cdot 89$  in 1932.<sup>1</sup> Compared with these, the Indian figures ranging from  $8\cdot 5$  per cent. in 1924-5 to  $4\cdot 1$  per cent. in 1932-3 are very serious indeed.

### *Causes of Company Failures*

According to a famous writer on business management, the causes of joint-stock company failures can be broadly divided into two classes: (a) those operating from outside and (b) those operating from inside. To the former class belong such causes as competition, change in the demand in the products of the company, operation of the business cycle and casualties. In the latter class lie such causes as archaic methods of production, slowness of collections, unwise distribution of cash dividends, incompetent sales organization, high operating expenses, over-capitalization, excessive floating debt, failure to make adequate provision for depreciation, and fraud. According to the same writer all these causes are ultimately due to 'incompetence': inside causes are, of course, obviously signs of 'incompetence', but even outside causes may be said to be due to 'incompetence', because with good management the evil effects of most of those causes can be nullified, even if the causes themselves cannot be humanly avoided.<sup>2</sup>

Now, in India, owing to the fact that for a long time industrial and economic policy was not completely in the hands of ministers responsible to the legislature, there has been a tendency to exaggerate the outside causes and to minimize the inside ones. An impartial study of some of these industrial failures would, however, show that in the majority of cases they were what Gerstenberg would call the 'results of incompetence and fraud'. We have seen in the previous chapter a typical instance of depraved business

<sup>1</sup> C. W. Gerstenberg, *Financial Organization and Management* (New York, 1924), p. 638.

<sup>2</sup> *Ibid.*, pp. 625-30.

morality in the form of getting 'security deposits' from employees and then misappropriating the money on some pretext or other. Only the other day one of the Indian chambers of commerce admitted that 'in recent years the floatation by numerous adventurers of companies which were inevitably closed down within a few years of their inception had not only entailed a loss involving crores of rupees to the unwary investors, but also acted as a definite hindrance to the commercial and industrial development of the country by joint-stock enterprise'.<sup>1</sup> To put it bluntly, in India depraved business morality perhaps accounts for the largest number of company failures. The old Company law left several loopholes for unscrupulous promoters, and the shareholders had no protection against their actions unless those were found to be within the orbit of criminal breach of trust.

Next to fraud, the most important cause of failures has been incompetence or inefficiency in the strict sense of the term. We have seen instances of the inefficiency of some managing agents in a previous chapter, but these are not all. Very often bona fide floatations launched with the best intentions and enthusiasm have come to grief because their prospects and possibilities had not been carefully scrutinized. In one way in particular the law connived at this form of incompetence. The law left the determination of the minimum capital with which to start business practically to the discretion of the promoters, subject only to the condition that the certificate for commencement of business shall be issued only on prior realization of 5 per cent. of the subscribed capital as the application money.<sup>2</sup> But as this percentage very often proved far too short of the capital required even for the acquisition of lands and the construction of buildings and factory, the provision failed to afford any assurance that the company had attained the actual working stage. Numerous cases occurred in which, despite serious efforts to procure sufficient funds by disposing of its shares, a company failed to secure any substantial amount in excess of the statutory

<sup>1</sup> Memorandum of the Bengal National Chamber of Commerce, Calcutta, on the Indian Companies' Act (Amendment) Bill, 1936.

<sup>2</sup> Vide section 101 of the Indian Companies' Act of 1913.

minimum, with the result that the company had to be closed down after the little money it had procured from its sale of shares had been spent in sundry preliminary expenses.<sup>1</sup>

*The New Indian Companies' Act and Mushroom and Fraudulent Companies*

✓ The most important provision in the new Act to prevent the growth of mushroom companies is a requirement that the minimum subscription (on which alone certificates of commencement of business may be obtained from the Registrar of Joint-stock Companies) shall be fixed by the directors upon a certain specified basis. The directors must provide for (a) the purchase price of any property to be purchased out of the proceeds of the issue of shares, (b) the preliminary expenses, (c) commission for procuring shares, (d) moneys borrowed by the company in respect of the preceding matters, and (e) working capital, all of which means that the minimum subscription must now be such as to provide not only for the acquisition of the necessities for the business to be carried on by the company, but also for the working capital.<sup>2</sup> Again, while under the old Act there was nothing to prevent a company from utilizing moneys received from prospective shareholders even before shares were allotted to them, it will no longer be possible under the new Act to do so. All such moneys are now to be kept away from the reach of the company and its promoters, and to be kept deposited in a scheduled bank until a certificate of commencement of business is obtained.

In the matter of fraudulent companies, so long, apart from the ordinary remedy available under the Indian criminal law, where was really no provision for the investigation and detection of frauds practised by some of the companies on the public. The amending Act removes this omission and authorizes the Registrar of Joint-stock Companies to investigate cases of fraud brought to his notice. He is then to make an enquiry and report to the local government which may, at the cost of the State, order

<sup>1</sup> *Capital* (Calcutta), 28 June 1934.

<sup>2</sup> There is a similar provision in the English Act : see section 39 of the English Companies' Act.

prosecution of persons who are believed to be guilty of an offence in relation to the company. Any officer or director of the company who is convicted as a result of such prosecution is debarred, unless permitted by the court, from directly or indirectly taking part in the management of a company for a period of five years.

These new provisions in the Indian Companies' Act have been more or less unanimously welcomed by all sections of opinion in India, and it may be reasonably hoped that they will check the further growth of mushroom or fraudulent companies and thereby diminish the number of company failures. It would, however, be foolish to conclude that these new provisions will make company failures a rare occurrence in the future. The root causes of company failures lie in the character and conduct of the industrial promoter and industrial manager in India, and it would be a pity if this point be overlooked in an enthusiasm over the new provisions of the Act. Both promotion and management require considerable skill, experience, and honesty, and it is a fact that in India today there is not an adequate number of first-class promoters and managers. Anyone who desires to see a progressive and harmonious industrial development of the country must, therefore, turn his attention to this most important aspect of the problem.

## CHAPTER VIII

### SOME BROAD PROBLEMS OF INDUSTRIAL FINANCE AND MANAGEMENT IN INDIA

#### *Introductory*

WE have so far considered various detailed aspects of the problem of industrial finance and management in India. We shall now attempt to study the broader economic facts behind India's system of industrial finance and management, find out how far they throw light on the specific problems, and also discuss some of the remedies usually suggested.

#### *India's Potential Financial Resources*

In the long run the problem of industrial finance is a problem not only of the mobility of financial resources of a country, but also of its quantity and quality. In the preceding chapters we confined our attention mostly to the mobility aspect and occasionally to the quality aspect, but we hardly studied the quantity aspect.

Even a rough estimate of the total financial resources of India is difficult because the total resources contain such indeterminate items as (a) the resources of the money-lenders and indigenous bankers, and (b) the hoards. We know more or less the total paid-up capital, reserves and/or deposits of such agencies as the Imperial Bank of India, the other Indian joint-stock banks, exchange banks, co-operative banks, and post office savings banks,<sup>1</sup> but we do not know how much capital the indigenous shroffs have. It has been suggested by a recent writer<sup>2</sup> that their *hundi* or indigenous bill operations 'play a more important part in India's internal trade than probably all the bank cheques and drafts put together', but it is difficult to test the

<sup>1</sup> See Appendix XIII.

<sup>2</sup> H. R. Soni, *Indian Industry and its Problems* (Calcutta, 1932), Vol. I, p. 183.

veracity or otherwise of this suggestion. The intensive local enquiries made by the various Provincial Banking Enquiry Committees in 1930-1, however, leave no room for doubt that these indigenous shroffs and bankers possess a considerable amount of money, and that if this money could be properly mobilized, there would have been a substantial addition to the financial resources now available for industry. At present the work of these shroffs is not regulated by any legislation nor is it co-ordinated with that of the joint-stock banks. As a result, they are outside the range of control of even the new Reserve Bank. It is very desirable that both the Reserve Bank and Government should take steps 'to safeguard, if possible, on the one hand, the interests of the shroffs who certainly do a most important work, and, on the other, to regulate the same in such a way that it may be assigned its due place in the credit system of the country'.<sup>1</sup>

Coming to the question of hoards, here we are still more completely in the dark. Many conflicting statements have been made during the last quarter of a century regarding the amount of hoards in existence, but this is mainly due to the fact that the word 'hoarding' was used very loosely. What is injurious from the standpoint of economic development is the locking up of surpluses in gold or silver bullion or coin, and not the industrial use of the precious metals. It is from this standpoint that the exact significance of 'hoarding' should be judged.

Do the people of India unduly lock up their surpluses in gold or silver bullion or coin? It is difficult to give a straight answer, but certain points are clear. The psychology of the upper, upper middle, and middle classes in India has undergone a tremendous change during the last twenty-five years, and among these people hoarding has practically disappeared. Then there are the agricultural population and small artisans who together form more than 80 per cent. of the total population of the country. All of them are under a heavy debt to middlemen and money-lenders and many of them do not have even the barest necessities of life. It is unthinkable that these people 'hoard' to any appreciable

<sup>1</sup> *The Banker* (London), June 1930.

extent. It is only among the remaining 20 per cent. of the population that the hoarding habit may still be said to exist, but even here we have to think of the nearly 12,000 Post Office Savings Banks spread all over the country offering as much security and convenience as the private holding of gold and silver, and hence it is unlikely that any very large number of people even among these remaining 20 per cent. do hoard very much.<sup>1</sup> On the other hand, when we consider the unusually low *per capita* income in India, her absorption of gold cannot be calmly dismissed as normal. The fact is that a large section of the people want the precious metals to decorate the persons of their females (and occasionally of themselves), and this craving is an indication of the medieval mentality that still retains its hold upon the people of India.

The position with regard to the hoard points this moral: that we cannot depend on the mythical hoards of India for her economic salvation, because there are not any spectacular hoards in existence. On the other hand, it is true that a considerable section of the people use large quantities of gold and silver for purposes of ornamentation, and if these could be diverted towards more productive channels, industry as a whole would benefit. But such a transformation can come, if it comes at all, only from within and after many years: no amount of legislative or financial 'action' will be able to accelerate this transformation.

### *Savings and Investment*

This brings us to the primary question of savings and investment. The most important point about the problems of capital and industrial finance is that currency and bank money are but forms of command over capital, and that the basic problem of capital is that of time valuation. It is a problem of spending and investing, of deciding between various possible enjoyments of income.

'The development of banking depends to a very great

<sup>1</sup> Soni, *op. cit.*, pp. 194-8. The recent phenomenal exports of gold do not point to the existence of 'large hoards': most of the gold came from people who used it for purposes of ornamentation and who were only too eager to take advantage of the high price of gold.

extent on the growth of the investment habit which in turn depends on the earning capacity of the people, their will to save, the incentive to save, and the facilities for investment.<sup>1</sup> In India neither of these factors is adequately developed. On the contrary, a survey of the history of industrial finance in India clearly shows that, until very recently, her equipment for financing industry more or less kept pace with the needs of industry. In the past, industry was dependent for its finance more on the resources of the managing agents and on direct deposits from the public than on credit from the banks: banks had other duties to perform more urgent than the financing of industry.<sup>2</sup>

But today industry wants banks to come to its rescue. Banks, however, plead that they have neither the resources nor the technique to assist industry in an elaborate manner. They assert that (a) people do not put enough of their savings in banks, and (b) they have not yet acquired the real investment habit.<sup>3</sup>

How far are these allegations true? We may start with a consideration of the factor of productive capacity. Both agricultural and industrial efficiency in India is strikingly low, and hence the surplus left with the population of the country is small even in normal years. 'To the few wealthy agriculturists who have a surplus during prosperous seasons, land or jewellery has a greater attraction as a form of investment than interest-bearing bank account, postal cash certificates, Government securities or industrial stock. Moreover, the landed aristocracy in several places is far from solvent.'<sup>4</sup> On the other hand, the commercial community and the salaried and professional section of the middle class have the will to save, but their capacity is very low compared with that in any other country, because the calls on them are great. 'Social institutions in India make great depredations on individual savings in the support which has to be given to relations and others in cases of

<sup>1</sup> *Indian Central Banking Enquiry Committee, Majority Report (1931)*, p. 432.

<sup>2</sup> N. Das, *op. cit.*, Chapters III-VI.

<sup>3</sup> This stand was taken by a number of Indian joint-stock banks in course of the enquiry by the Indian Central Banking Enquiry Committee in 1930-1.

<sup>4</sup> *Indian Central Banking Enquiry Committee, Majority Report (1931)*, p. 432.

distress, temporary or permanent, ceremonies and charities. There are no rules of retirement—there is no scheme of insurance.”

The fact is that India is inherently poor, which means that there are not many in the community who have a surplus to spare. But the poverty of the population is not the only obstacle. The desire to save is also conspicuously absent among certain classes and, even where it exists, it is diverted to wrong and unprofitable channels. Next to jewellery, the general preference of the people for land investment is a great stumbling-block in the way of the growth of capital in India. Even merchants and indigenous bankers invest their funds largely in the purchase and mortgage of land and buildings, and the preference of the professional classes for this particular form of investment is almost a byword today.

It has been argued by a recent writer that if more banks were established, more deposits would be attracted and that would lead to a reduction in the cost of capital. He has shown, by converting the post-war figures of nominal deposits into the pre-war price level, that deposits have more than doubled during the last twenty years or so, and thus he has argued that there is still a possibility of an enormous increase of deposits, if more banks be established in the interior.<sup>2</sup> The present writer, while not holding the view that there is no room for more banking institutions, is of opinion that the mere extension of banking facilities would not automatically increase the deposits. There may be a small increase of deposits with a further extension of banking facilities, but it is nearer the truth to say that the country does not abound ‘in untapped banking facilities’. The reasons are mainly two-fold. First, neither the *per capita* income of the people nor the productive capacity of the country has increased appreciably during the post-war period, and unless these increase, there is no chance of a real increase in the savings of the people. Secondly, although the number of banking institutions in the interior of the country is limited, the number of Post Office Savings

<sup>2</sup> Indian Central Banking Enquiry Committee, *Minority Report*, p. 350.

<sup>2</sup> P. S. Lokanathan, *op. cit.*, pp. 195-9.

Banks and Co-operative Savings Banks is well over 13,500,<sup>1</sup> and these reach the remotest corners of the interior. The deposits of these institutions do not show any spectacular increase,<sup>2</sup> and hence it is a little rash to assume that more joint-stock banks would, by themselves, accomplish a feat which the Post Office Savings Banks and Co-operative Savings Banks have failed to achieve.

In the matter of savings and investment, two important remedies seem urgent. First, the existing banks should be consolidated, all mushroom banks and loan offices should be weeded out, and a comprehensive reform of the banking law should be undertaken.<sup>3</sup> The figures of the failures of banks every year show that there are some fundamental defects in the law and some drastic provisions are needed if the depositor is to be protected from dishonest and inefficient bank managers.

The second remedy is the establishment of a Board of National Investment, either as a department of the newly established Reserve Bank of India, or as a separate body, but working in close collaboration with it. This is needed because (a) the average investor in India has not yet learnt 'to think industrially, to take and make bold ventures, to have a long view of things'; and (b) recent company and bank failures have made the Indian investor shyer than he was, and it is necessary that there should be some institution which can guide him and instil confidence in his mind.

### *Investors and Industrial Issues*

One of the deficiencies of the investment market in India is that the character and mentality of investors has never been scientifically studied and explored by any promoter or promoting institution with the result that many potential investors have often been left in the dark about the

<sup>1</sup> See Statistical Statements relating to the Co-operative Movement in India and Statistical Tables relating to Banks in India (New Delhi).

<sup>2</sup> Deposits in the Post Office Savings Banks increased by only Rs. 5 lakhs between 1928 and 1933; those in the Co-operative Banks increased on paper from 24 crores in 1928 to 30 crores in 1933, but these include many 'paper loans and deposits'.

<sup>3</sup> The new Indian Companies' Act of 1936 contains a chapter relating to banking companies, but these amendments were admitted by the Law Member to be provisional in character. While introducing the Amendment Bill, he promised to undertake a scheme of comprehensive reform of the Indian banking law 'within a few years'.

profitability or otherwise of industrial issues. The Stock Exchanges have more and more become fields for over-speculation and gambling, and their activities have deterred rather than inspired the average investor.<sup>1</sup>

The average investor in any country today is a person who has surplus funds from which he wishes to obtain a profit. He is ready to buy the stocks or bonds of any company which gives him an assurance of satisfactory returns. He is not, as a rule, in close touch with the industries whose securities he buys, and even those of his class who bring real skill and knowledge to the choice of their investments confine their study and their reasoning to the financial and statistical evidence, and do not seek to investigate (as indeed they are seldom competent to do) the economic facts and forces which are the material bases of the statistics.<sup>2</sup>

In every country there are institutions to study this aspect of the mind of investors. The underwriters in England and America and the syndicates or konsortiums in Germany perform this task of appealing to the investing public, and their expert knowledge and financial strength inspire the confidence of the investor and lead to the eventual success of a promotion.<sup>3</sup> In India, however, there has never been any expert organization like these to overcome the shyness of the investor or to bridge the gulf between the investigation and promotion of a proposition, and its finance. Managing agents have performed this function only to a very limited and imperfect extent, and rarely have they taken any steps to study the mentality of the outside investor and guide him in a positive manner with their expert knowledge and experience. This is an additional reason why some form of a Board of National Investment is a necessity in India today.

#### *The Problem of Debentures in India*

One of the important methods of industrial finance in every country is to raise capital by way of debentures or

<sup>1</sup> 'The Calcutta Stock Exchange', by W. P. O'Cock, in Pat Lovett, *Mirror of Investment* (Calcutta, 1927).

<sup>2</sup> J. A. Hobson, *An Economic Interpretation of Investment* (London, 1911), p. 15.

<sup>3</sup> E. S. Mead, *Corporation Finance* (New York, 1933), pp. 17-21.

mortgage debt, but in India debenture capital plays a very unimportant part in the capitalization of industry. This is, at least to a certain extent, the direct consequence of the absence of a suitable institution to tell the Indian investor what debentures are and what rights and privileges they convey. It will, therefore, be appropriate here to start with an elementary definition of the word 'debentures'.

The word ordinarily means a sealed bond of a company acknowledging a sum on which interest is due till principal is repaid, especially fixed interest constituting a prior charge on the assets of the company. In almost every public joint-stock company money is raised by way of subscription from the people. This subscription may take the form either of shares or of debentures. The two types of investment, however, differ widely as regards their privileges and obligations. A share represents the acquisition of a fraction of ownership in an undertaking and entitles the shareholder to a given proportion of profits earned by the company and of its 'surplus assets' when it is dissolved; the shareholder may get a very substantial return for his money if the company is in a prosperous condition, and he may get nothing if it is in a bad way. A debenture, on the other hand, represents the investor's title to a certain amount of money lent by him to an undertaking, and the debenture holder is only entitled to a certain fixed interest until the principal is repaid. If the company be dissolved, he is entitled to get back his principal prior to all other charges on the company. He, however, cannot share in the increased prosperity of the company by way of an increased return, nor is he the owner of a fraction of the undertaking. He has no voting rights and, unlike the shareholder, does not participate in the management or control of a company.<sup>1</sup>

Debentures, of course, appeal to that class of investors who are content to have a steady, though small, return on their money and, as in every country the number of such investors is quite considerable, debentures form a very important part in the financing of industry. But not all industries admit of the floating of debentures. When a

<sup>1</sup> Mead, op. cit., pp. 105-6.

concern possesses real estate and property of a non-specialized character (i.e. which can be put to a variety of uses), it can issue debentures easily. Also, even if the property be specialized, debentures can be issued successfully if the concern belongs to an industry which can be reasonably certain of relatively stable earnings, i.e. if the industry is a monopoly or quasi-monopoly. At the same time, it is one of the principles of debenture capitalization that too much money should not be raised by way of debentures: 'constant interest-credit which does not share in business losses, i.e. bonds, mortgages and short-term loans, become a danger to the existence of all legal forms of industrial enterprise, because several years in depression will eat away the capital stock if interest payments have to be continued.'<sup>1</sup>

In India, however, as we have already seen, debentures play a very unimportant part in industry.<sup>2</sup> In 1925-6, over the whole range of British industry, it was estimated that out of a total capital of 100 units, ordinary share capital accounted for 47, preference 33 and debentures 20. In India in 1927-8, the corresponding figures were 75 ordinary, 16 preference and only 9 debentures.<sup>3</sup> The comparative unimportance of debentures in India will become still more evident from a detailed survey of the various industries. As a matter of fact, only the tea and rubber companies of South India show any substantial debenture capitalization, about 19.3 per cent. of their total capital having been raised by way of debentures. The Bombay cotton mills come next with a figure of 15.9 per cent. and the sugar companies and distilleries come third with a figure of 14.3 per cent.<sup>4</sup> The actual figure of debentures was estimated in 1927-8 at 11 crores of rupees, and there are no reasons to suppose that there has ever been any appreciable increase since.

Regarding the unpopularity of debentures, it has been suggested by a recent writer<sup>5</sup> that debentures are not

<sup>1</sup> Von Beckerath, op. cit., p. 62.

<sup>2</sup> *Supra*, Chapter I.

<sup>3</sup> *The Indian Central Banking Enquiry Committee Report*, Vol. IV, p. 156.

<sup>4</sup> See Appendix XIV.

<sup>5</sup> P. S. Lokanathan, op. cit., pp. 173-4.

popular with industrialists in India because they are costly. Now, an analysis of the terms at which various debentures have been raised in India during the last twenty years or so shows that ordinarily the interest has never been more than 6 per cent. and in very recent years they have come down to 4 to 5 per cent.<sup>1</sup> Considering the high cost of obtaining capital by other methods, these rates do not seem to be at all excessive for a country like India, and the main cause for the comparative unimportance of debentures must, therefore, be sought elsewhere. As a matter of fact even in Japan the cost of debentures was very high as the following figures will show, and yet debentures are not unpopular there as in India.<sup>2</sup>

AVERAGE YIELD OF COMPANY DEBENTURES IN JAPAN  
(Per cent. per annum)

|      |    |      |      |    |      |
|------|----|------|------|----|------|
| 1924 | .. | 9.19 | 1932 | .. | 6.56 |
| 1928 | .. | 6.34 | 1933 | .. | 5.54 |
| 1931 | .. | 6.49 | 1934 | .. | 4.79 |

The main reason why debentures have not played a more important part in industry in India is that banks have never 'liked' debentures. A company which issues debentures finds its credit weakened in the eyes of banks. Debentures being a first charge on the property of a concern, a company which has raised some capital by issuing them fails to get further accommodation from banks, as the latter argue that the security of the company has weakened. This, however, is a fallacious argument. If the intrinsic position of a company is sound, debentures no more endanger its security than, say, ordinary bank loans; as a matter of fact, there has hardly been any instance in India where a company has come to grief as a result of its debenture floatations.<sup>3</sup> It is, therefore, necessary that banks should change their attitude with regard to debentures, and even come forward to popularize a method of raising capital that has proved so eminently successful in other countries of the world.

<sup>1</sup> See Appendix XV.

<sup>2</sup> Mitsubishi Economic Research Bureau, *Japanese Trade and Industry* (London, 1936), p. 107.

<sup>3</sup> *Commercial Gazette* (Calcutta), 5 October 1936.

*Investment Trust Companies in India?*

This brings us to the question whether Investment Trust companies on the model of the British or American institutions should be established in India. Now, on this subject also there is some confused thinking in India where two separate institutions, viz. the Investment Trust and its more recent variant, the Fixed Trust, are supposed to be one and the same. It would be worth our while, therefore, to analyse the functions of these two distinct institutions, and to note how they came to be established.

The Investment Trust movement first attained its vogue in Great Britain in the eighties of the last century. It arose out of the conception of co-operative subscription of non-withdrawable capital, of specialized management and of scientific spreading of investment risks. The business of the Investment Trust is limited to the investment and re-investment of capital. The trustees are not to use the funds of the Trust in connexion with, nor engage the Trust in, any enterprise involving promotion, business management, or underwriting.<sup>1</sup> The Investment Trust raises capital from the public by selling stock to them which is then put in a number of investments.<sup>2</sup> The underlying idea is the transfer of resources into depressed markets for investment where relatively high interest rates prevail. This operation never ends, and the alert management is constantly moving its resources about. When new depressed markets occur in which investment bargains prevail, they seek to re-transfer their resources from prosperous sections into these new buying opportunities. In carrying out this plan the management must confine itself to securities which are marketable, seasoned, and of definite merit. The Trust must have a statistical department manned by a trained organization constantly studying all the known securities which meet the requirements of the Trust and which the Trust either owns or might some day expect to own.<sup>3</sup>

In Great Britain a large part of the resources of these Trusts came to be invested in the New World where the demand for new capital was greatest and the potential

<sup>1</sup> *The Economist* (London), *Investment Trust Supplement*, 1 December 1934.

<sup>2</sup> M. H. Williams, *Investment Trusts* (New York, 1928), p. 27.

return highest. Management of these Trusts was excellent in Great Britain, and they came to be looked upon as very important institutions in the capital economy of the country. In America, however, Investment Trusts (which made their advent there only after the World War) have had a less smooth career. There, management of the Trusts has not been, on the whole, very efficient, with the result that they have come in for a good deal of criticism from their shareholders and also from the general body of the public.<sup>1</sup>

The prolonged agricultural and industrial depression of 1929 and after further exposed the weakness of the Investment Trust. This widespread depression affecting almost all classes of securities made the scientific spreading of investments very difficult. So came the second institution—the Fixed or Limited Trust.

These Fixed or Limited Trusts were first started in America, and it was not until 1931 that the first Fixed Trust with an entirely British portfolio was established in England. They, of course, assured the same spread of risk that the Investment Trusts were supposed to provide, but they did away with the continuous and complex process of investment and re-investment that characterized Investment Trusts. 'The securities in a Fixed Trust are fixed in number and the holding offered is definite. The portfolio may consist of any field of investment, from gilt-edged stocks and foreign government bonds to industrials, insurance shares, and gold mines, but the companies or concerns in which a particular Fixed Trust has invested are limited in number and known to every member of the investing public. The general principle is very clear. A unit of shares is picked expertly and listed for all to see. The record of each company whose shares are chosen is available in plain figures and can be examined.'<sup>2</sup>

Management in a Fixed Trust is not left to the fallibility or caprice of an individual manager or group of managers. 'The Fixed Trust is given a life from ten to twenty years, and a bank or an insurance company agrees to act as trustee during the Trust's life under conditions explicitly laid down

<sup>1</sup> M. H. Williams, *Investment Trusts* (New York, 1928), pp. 82-9.

<sup>2</sup> *The Fixed Trust Year Book*, 1936 (London), pp. 5-6.

in the Trust deed negotiated with the management company. The number of shares to be bought is decided upon, the shares are purchased in the market and the certificates lodged with the trustee. The trustee issues the sub-units, representing a small fraction of the whole unit, and the investor buys them through his bank, his stockbroker, or by direct application to the Fixed Trust office. All dividends, bonuses, rights, etc., are collected by the trustee, who distributes them to the holders of sub-unit certificates. . . . The operation is automatic, fool-proof, and fraud-proof.<sup>1</sup>

The permanent contribution of the Fixed Trust movement which has become very popular in England lies in the fact that the average individual holding of Fixed Trust certificates varies from about £200 to £300. The movement has appealed primarily to the small investor who, having only a few hundred pounds, can find more baskets into which to put his few eggs, by purchasing a given number of sub-units in a well-distributed Fixed Trust than by any other means at present open to him'. As a matter of fact, these facilities are available for amounts down to even £10 to £20. On the other hand, the unit trusteeship of almost all the Fixed Trust companies having been taken over by one of the big banks or insurance companies, continuity of management and sound unspeculative business is fully assured. The sub-units of Fixed Trusts have truly become a very convenient medium of long-term investment for that class of people who are neither gamblers, nor speculators, nor weak holders.<sup>2</sup> Incidentally, for the first time in the history of the British money market, the movement has provided an agency employing the resources of modern publicity to advertise the merits of investment in industrial shares.<sup>3</sup>

The question now is whether the establishment of Investment or Fixed Trusts on the above models will relieve the financial difficulties of India's industries. It is very doubtful. Investment or Fixed Trusts are undoubtedly

<sup>1</sup> *The Fixed Trust Year Book*, 1936 (London), pp. 7-8.

<sup>2</sup> *The Economist* (London), *Fixed Trust Supplement*, 6 April 1935.

<sup>3</sup> *Ibid.*

helpful to balanced investments, but, as they work in Great Britain and America, both the institutions confine their dealings to *established* securities, and their primary aim is financial, not industrial. The potentialities of these institutions should not, therefore, be unduly exaggerated.

Indirectly, however, by their influence on the mentality and outlook of investors, Investment or Fixed Trusts may be of some use to industrial enterprise in India. No Fixed Trust has yet come into being in India, but a few institutions on the model of the British Investment Trusts have been established. An Industrial Investment Trust, Ltd., was registered in 1933 with an authorized capital of Rs. 2½ crores, and on 31 December 1935 it had a paid-up capital of Rs. 50 lakhs. It was started 'to invest the money subscribed by the shareholders in the shares of carefully selected companies' and it even declared a dividend of 4 per cent. in 1935. Another company, called the New India Investment Corporation, Ltd., of Calcutta, was floated in October 1936, and this was hailed by some as 'a really serious effort to apply the principle of the Investment Trust in India'.<sup>1</sup> Then again, another company, the Investment and Finance Co., Ltd. (originally registered in 1896 as a private limited company), was registered as a public limited company in August 1935, with an authorized capital of Rs. 5 lakhs, and in February 1936, it had a paid-up capital of Rs. 2.45 lakhs. This was formed 'to invest the money subscribed by the shareholders in the shares of carefully selected companies and in securities of the Government of India or Municipal or Port Trust debentures, and to transact business as capitalists, financiers, and monetary agents'.<sup>2</sup> Neither of these companies has, however, so far taken any steps towards actually helping any particular industry, and, as in the case of their British prototypes, they have confined their activities to the financial aspects of investment only.

### *The Case for Industrial Banks in India*

The question of industrial finance in India today invariably leads to a consideration of the case for and

<sup>1</sup> *Capital* (Calcutta), 15 October 1936.

<sup>2</sup> *Investor's India Year Book*, 1935-6, pp. 427-8.

against the establishment of an Industrial Bank (or several Industrial Banks) in the country. Opinion in India still pathetically clings to the establishment of 'special institutions' for solving the financial difficulties of her industry, and so it would be proper to devote some attention to this subject.

Just as there is a confusion of thought in India with regard to the real implications of the German type of mixed banking, so also there is a confusion of thought with regard to the proposal for the establishment of Industrial Banks. Is it proposed to establish one Industrial Bank or several? If there are to be several banks, should there be one in each province or should there be one in each industrial area? Should these be private institutions or should these be guaranteed and/or financed by Government? These and a host of other questions are seldom properly answered by the enthusiasts for Industrial Banks and, unless we know exactly what is wanted, it is difficult to assess the suitability or otherwise of a proposal. We shall, however, consider the case broadly—for private institutions as well as for State-aided or subsidized ones. We shall take up the case for State-aided or subsidized institutions first, because the establishment of institutions of this type was recommended by the Indian Central Banking Enquiry Committee in 1930-1. But before going into details, we should make a study of the Industrial Bank of Japan which has obviously inspired the demand for the establishment of State-aided financial institutions in India.

### *The Industrial Bank of Japan*

In Japan, banking is of a specialized character, each class of banks catering for a special class of demand. There are the home trade banks, foreign exchange banks, agricultural banks, industrial banks, and colonial banks. This demarcation of functions proved to be of great value in the early days of economic development in Japan because it enabled the central institution, the Bank of Japan, to exercise a rigid control over almost every department of the economic life of the nation at a time when such control was very

necessary.<sup>1</sup> Even the ordinary deposit banks were started in Japan under State guidance, and when the State found that the deposit banks were unable to meet the long-term needs of industry, they conceived the idea of an Industrial Bank for industrial finance.<sup>2</sup> It was started in 1902 with a Government guarantee of 5 per cent. interest on the share capital limited to a period of five years. It is a joint-stock concern with a capital of 50 million yen (£5 millions), and a considerable part of the share capital was subscribed by Government. The President and Vice-President of the directorate of the Bank are appointed by Government, and even the by-laws require sanction of Government. Its working funds are raised by way of debentures (the debentures outstanding amounted to 356.67 million yen in 1933), but deposits are also taken. The Bank makes long-term loans to industrial concerns on the security of national, prefectural, or municipal bonds, and on mortgages of land, buildings, factories, ships, and railways. A great part of the advances go to newly established or weaker industries which Government has either initiated or is partly interested in. It has a technical department in which experts investigate as well as inspect the factories and mills before and after investment.<sup>3</sup> In recent years the Bank has taken special interest in the financing of small industries.

The question now is how far the Industrial Bank of Japan has been a success. That it has saved a number of concerns from ruin is true, but this has been achieved at some cost. Very often Government had to come to the rescue of the Bank—just to extricate it from its bad investments. In 1913, for instance, Government had to arrange an enormous loan to this Bank in order to save it from a collapse resulting from unprofitable investments in some gold-mining companies.<sup>4</sup> Then again the rigid official control of the Industrial Bank and the partial official control of industries has, in recent years, given rise to a good deal of dissatisfaction amongst groups of industrialists and other bankers. Finally, there has been a

<sup>1</sup> J. Inouye, *Problems of the Japanese Exchange*, 1914-26 (Glasgow, 1931), pp. ix-x.

<sup>2</sup> G. C. Allen, *Modern Japan and its Problems* (London, 1928), pp. 147-8.

<sup>3</sup> *Ibid.*, p. 149.

<sup>4</sup> *Indian Journal of Economics* (Allahabad), January 1931.

lot of patronage and pressure in the actual financial operations of the Bank, and these also have given rise to adverse comments.<sup>1</sup>

The experiment of the financing of industry by the State as it is being practised in Japan does not, therefore, inspire the outside observer with confidence. On the other hand, it should be remembered that the Industrial Bank of Japan has played a very minor part in the industrial development of that country. It is the influence exercised by a few wealthy family concerns which is the real driving force behind: it is these concerns that have contributed and are still contributing to the economic development of the country by their 'bold conception, firm and sympathetic control, and vast financial resources'.<sup>2</sup>

#### *State-aided Industrial Corporations for India?*

The case for State-aided Industrial Banks is, however, still earnestly pressed from many quarters. The arguments that are usually adduced in favour of the proposal are these. Firstly, it is said that capital is shy in India, and only an Industrial Bank aided by the State could mobilize it and turn it into productive channels of investment. Secondly, it is asserted that such a Bank would be able to take the lead in an active and efficient industrial development policy as in Japan. 'It would be able, by its experience and knowledge gathered from all parts of India and tabulated by a well-equipped intelligence department attached to the Bank, to act as a guide and friend to all industrial concerns in India, young and old. It would prevent uneconomical and wasteful efforts to start industries in places where there are no possibilities, and it would itself be in a position to formulate schemes for industrial development, besides analysing and criticizing propositions placed before it for financial assistance and support.' Thirdly, it is argued that such an institution, being aided by Government, would inspire the confidence of all investors, who would, therefore, take more interest in industrial issues and debentures, and this change of outlook on their part would eventually be

<sup>1</sup> Allen, op. cit., pp. 163-5.

<sup>2</sup> Mitsubishi Economic Research Bureau, op. cit., p. 45.

to the advantage even of those undertakings that have not come to the Bank for financial help.<sup>1</sup>

These arguments rest on two rather simple and naïve hypotheses, viz. that State help through a Bank will solve all difficulties of industry in India and that the industrial progress of Japan, the only important country possessing a State-aided Industrial Bank, is due mainly (if not solely) to her Bank. A closer examination would show that of these hypotheses neither is true. State aid through a Bank is no remedy for all the very many difficulties from which industry in India suffers. ~~The problems of promotion, of management, of co-ordinated control—in short, the many-sided problems of industrial enterprise in India—cannot~~ be solved by the mere establishment of a State-aided Industrial Bank. Not only that: the danger of direct participation by the State in such an institution should not be overlooked.<sup>2</sup> A State-aided Bank would lead to political pressure of various kinds on industrialists; it would also mean constant official interference in matters which should best be left to the decision of industrialists and entrepreneurs. Moreover, it is difficult to conceive how the semi-official directorate of such a Bank can have all the necessary expert knowledge about industries. As regards the alleged success of Japan, it should not be overlooked that the Industrial Bank of Japan has played only an unimportant part in her industrial development, and even the part it has played has not been an unmixed blessing.

#### *Private Industrial Banks for India?*

As a matter of fact, even a private Industrial Bank has not much chance of success in India today. The reasons are fundamental and may well be considered here.

A private Industrial Bank must have a large capital, and it must also be prepared to issue a fairly large amount of debentures. In order that it may be of real service to industry, it must also come to the aid of weak and struggling enterprises, and must not confine itself to the established industries alone. An Industrial Bank is very different from

<sup>1</sup> *Indian Central Banking Enquiry Committee, Majority Report* (1931), pp. 284-7.

<sup>2</sup> *The Economist* (London), 9 August 1924.

an Investment Trust : the functions of the former are primarily industrial, those of the latter, primarily financial.<sup>1</sup>

Now, the directorate of an Industrial Bank would be faced with two formidable problems. Firstly, even assuming that it were able to raise the requisite capital and the necessary debentures from time to time, it would be constantly wondering how best to employ the money and get a profitable return. Business failures have been as profuse in India as bank failures, and any Industrial Bank would be running a considerable risk in confining itself to giving purely industrial loans. The failure of the Tata Industrial Bank established in 1918 with a very efficient directorate and an intelligence service composed of a number of technical experts and commercial men, is not without its lessons. At first that bank confined itself to a very cautious policy, doing more commercial banking than industrial banking. Soon, however, it found that large amounts were lying idle and something had to be done. Thereupon the directorate started, in a spirit of genuine idealism, promoting industrial companies and supporting them by underwriting their shares : they invested in a giant sugar corporation and in a number of oil mills, iron and steel companies, and life assurance companies. Many of these concerns had, however, been started in a boom period and, as soon as the boom was over, they collapsed. With them the Tata Industrial Bank collapsed too. The experience of the Tata Industrial Bank shows that until industries in India attain greater stability and until their managers show better efficiency, a purely Industrial Bank is bound to fail.

The second problem of an Industrial Bank would be the problem of finding experts able to assess the soundness or otherwise of the various industrial undertakings. There must be a staff of administrators and experts who are acquainted with the business world thoroughly and who know the business conditions of *each* industry. Such a staff it would be wellnigh impossible to find in India today. It must be frankly confessed that India is singularly

<sup>1</sup> *The Indian Journal of Economics* (Allahabad), April 1925.

<sup>2</sup> For a detailed account, see Lokanathan, *op. cit.*, pp. 256-9.

deficient in industrial experts : enthusiasm and idealism can never make up for experience and knowledge. We must, therefore, wait upon events at least for some years more and see how industries and banks adjust themselves in the Indian economic system.

*A New Experiment: the Industrial Credit Corporation in Bengal*

While, therefore, we dismiss the idea of establishing a State-aided Industrial Bank as impolitic and a private Industrial Bank as premature, we may note that in one province in India an attempt is being made to establish an institution of this type guaranteed by Government. The move has come from Bengal, one of the two most industrial provinces in India.<sup>1</sup>

The Indian Central Banking Enquiry Committee, while rejecting the proposal for the establishment of a State-aided Industrial Bank to finance *all* kinds of industry, said that there was a case for the starting of industrial corporations in the provinces primarily to undertake the financing of public utility undertakings. They were to confine their activities mainly to pioneer enterprises of a non-competitive character, e.g. the development of mineral resources, large public utilities like electric power schemes, gas works, etc., but in course of time they were to extend their activities to ordinary competitive industry as well, particularly small and medium-sized industries.<sup>2</sup>

The arguments against a full-fledged State-aided Industrial Bank would apply, more or less, to the above industrial corporations as well. But, with important modifications, Bengal has proposed an Industrial Credit Corporation of her own to meet some of her pressing local problems.

The proposal arose out of the desire of the Bengal Government to give a start in life to certain detenus<sup>3</sup> who

<sup>1</sup> The other province is, of course, Bombay.

<sup>2</sup> *Indian Central Banking Enquiry Committee, Majority Report (1931)*.

<sup>3</sup> 'Detenus' are persons 'detained' in villages or camps for their terrorist or extremist activities. The Government of Bengal were anxious that these misguided young men should be won over to constructive activities and with this end in view they started giving special technical training to selected detenus. They were then released and the Government undertook to give them a fair start in life so that they may not return to their terrorist or extremist activities. The terrorist problem in Bengal is largely a problem of unemployment among educated young men of the middle class.

had received special technical training from the State. The detenus were expected to run small establishments representing one or other branch of the cottage industries of Bengal, but their preliminary difficulty was to get the necessary capital, small though it is. So the Bengal Government proposed that they would make available 'loans for groups of four to eight ex-detenus—sufficient funds to provide premises, plant, and initial working capital to enable them to establish small factories in the vicinity of Calcutta'. And while considering this question of giving financial assistance to the detenus, the Government also considered the wider question of the lack of credit facilities for the cottage industries and small industries of the province. So the Government of Bengal announced a scheme of an Industrial Credit Corporation with the following main features :

(a) The Industrial Credit Corporation to be set up as a public company registered under the Indian Companies' Act for the purpose of making loans to approved applicants to enable them to establish small industries in Bengal.

(b) Government to contribute towards the administrative expenses of the Corporation for a period of five years a sum not exceeding Rs. 20,000 a year.

(c) In respect of the first loans issued, up to an amount not exceeding Rs. 10 lakhs, the Government to make good from public funds one-half of any loss incurred ; and, as the first (and subsequent) loans are repaid and the sums thus set free are re-issued as further loans, the Government will similarly accept liability for one-half of any loss incurred. Profits earned after making adequate provision for reserves will accrue entirely to the shareholders.

(d) Undertakings established with the assistance of loans to be systematically inspected under arrangements to be agreed upon between the Government and the Corporation, such inspection to include the giving of technical advice and guidance.

(e) The position of the Corporation to be reviewed at the end of ten years with a view to a decision whether it should be continued with or without Government assistance or be wound up.

(f) The arrangements between the Government and the Corporation to be embodied in a formal agreement which will contain such supplementary provisions as may be found necessary.<sup>1</sup>

✓ It should be noted that the object of the proposed Corporation is to give financial assistance to cottage and small industries only, and not to the bigger industries. As a matter of fact, Bengal, like many other provinces of India, has had for a number of years a State Aid to Industries Act for giving State help to the small industries, but the rules regarding the grant of assistance under the Act have been far too rigid and exacting to be of any practical help to the small industrialist. The proposed Credit Corporation only seeks to substitute the elasticity of bank procedure for the inevitable rigidity of official departments.

It should further be noted that the Government has undertaken only a specified and limited amount of risk (in terms of money) for a specific and limited period, and it is frankly asserted that the proposal is experimental, and the position will be reviewed by the Government at the end of ten years. ✓ It is also made clear that the main object of this experiment is to end middle class unemployment and not to promote general industrial development.

Thus we see that this new Industrial Credit Corporation<sup>2</sup> is materially different from the grandiose schemes of State-aided Industrial Banks that have been suggested by enthusiasts from time to time. Nevertheless, the experiment will be watched with the keenest interest by all students of industrial finance. The success or failure of the institution will, of course, depend largely on how the rules are framed, how the agreement is drawn up, to what extent officials interfere in the actual banking field and, finally, on how the Corporation is managed.

### *The Rapid Growth of Private Companies in India*

We will now turn our attention to a very interesting feature in the development of joint-stock organization in

<sup>1</sup> *The Statesman* (Calcutta), 2 September 1936.

<sup>2</sup> The scheme was announced in September 1936. The Corporation has recently been inaugurated with an influential directorate.

India—the rapid growth of private companies (as distinguished from public ones).

The figures are interesting. Taking India as a whole, the number of private joint-stock companies registered every year rose from 158 in 1924-5 to 662 in 1932-3, though it fell to 403 in 1935-6. Expressed in terms of percentage of the total number of joint-stock companies (private and public) registered every year, these figures work out at 37.9 per cent. in 1924-5, 60.9 per cent. in 1932-3, and 39.2 per cent. in 1935-6.<sup>1</sup> The figures become more illuminating if we take the two provinces, Bengal and Bombay, separately. In Bengal, the total number of private companies registered was 54 in 1924-5, 131 in 1930-1, and 153 in 1934-5. Expressed in terms of percentage of the total number of joint-stock companies (private and public) registered each year, these figures work out at 36 per cent. in 1924-5, 43.8 per cent. in 1930-1, and 57.7 per cent. in 1934-5. In Bombay, the figures are 34 or 51.5 per cent. in 1924-5, 74 or 71.5 per cent. in 1930-1, and 136 or 71.6 per cent. in 1934-5.<sup>2</sup> On an analysis of the private companies newly registered, it is found that they cover the whole range of industrial enterprise in India: they are not limited to any 'special' branches of industry.<sup>3</sup>

What do these signify? In every country in industries which admit of small-scale organization we always find a certain number of establishments which are organized on a joint-stock, but *private*, basis. As a matter of fact, in Great Britain, the percentage of newly registered private companies<sup>4</sup> to the total number of joint-stock companies is

<sup>1</sup> See Appendix XVI.

<sup>2</sup> See Appendix XVII.

<sup>3</sup> Note the following analysis of private companies registered in Bengal during 1934-5:

Banking, 5; Insurance, 6; Transport and transit, 10; Printing, publishing and stationery, 11; Chemicals and allied concerns, 6; Petty steel and engineering workshops, 6; Cement, stone, etc., 5; Agencies, 23; Tanneries, 1; Mills and presses, 7; Mining and quarrying, 7; Sugar manufacturing, 3; other manufacturing, 51; Miscellaneous, 12.

<sup>4</sup> In Great Britain a private company is defined as a company which, by its articles, (a) restricts the right to transfer its shares, (b) limits the number of its members (exclusive of persons who are in the employment of the company) to fifty, and (c) prohibits any invitation to the public to subscribe for any shares or debentures of the company. In India the definition of a private company is the same. (Vide Sec. 2(13) of the Indian Companies' Act as amended in 1936.)

much higher than in India, as will be evident from the following figures.

PRIVATE JOINT-STOCK COMPANIES IN GREAT BRITAIN<sup>1</sup>  
(New Companies registered every year)

| Year    | No. of Private Companies | Total number of Joint-stock Companies | Percentage of Private to total number of Joint-stock Companies |
|---------|--------------------------|---------------------------------------|----------------------------------------------------------------|
| 1929 .. | 8,440                    | 8,982                                 | 93.9                                                           |
| 1930 .. | 8,712                    | 8,740                                 | 99.6                                                           |
| 1931 .. | 8,611                    | 8,680                                 | 99.2                                                           |
| 1932 .. | 10,425                   | 10,541                                | 98.9                                                           |
| 1933 .. | 11,659                   | 11,852                                | 98.4                                                           |
| 1934 .. | 12,670                   | 12,953                                | 97.8                                                           |
| 1935 .. | 13,351                   | 13,613                                | 98.1                                                           |

In Great Britain the large number of private companies is due to the conversion of many 'family businesses' into the joint-stock form of organization.<sup>2</sup> The private company grows in preference to the public company for various reasons. Firstly, no business is too small, nor is any too large to be converted into a private company. Many private companies have been framed in England with a capital as low as £100, but on the other hand the capital in a considerable number of cases has amounted to £1,000,000 or more. Secondly, there are certain exemptions from legal restrictions in the case of private companies which do not apply in the case of public companies. Private companies are exempted from the obligation imposed on public companies to file with the Registrar of Joint-stock Companies a prospectus or a statement in lieu of prospectus, giving full information as to promotion of the company and many other particulars, nor are private companies required to file detailed balance sheets as public companies are required. Thirdly, private companies continue to grow because of certain characteristics of human nature. There are many people who want to manage their own concerns themselves and at the same time require the assistance of a

<sup>1</sup> Compiled and prepared from the General Annual Reports of the Board of Trade on Companies in England and Scotland (London).

<sup>2</sup> H. W. Jordan, *Private Companies—their utility and the exemptions they enjoy* (London, 1919), p. 14.

few outsiders to get the requisite capital : the obvious thing for such people is to form a private company.<sup>1</sup>

What is striking in the case of India is not the large relative proportion of private companies to all joint-stock companies, but the *rate* of increase of this proportion. The number of private companies has been increasing much faster than the number of public companies. This seems to be due not merely to the fact that organization as a private company means exemption from a number of irksome obligations to which public companies are subject, but also to the fact that the investment market is still more or less unresponsive to a general appeal for the public subscription of shares.<sup>2</sup> Unless the profitability of an industry is definitely known, new issues are rarely successful. Hence, entrepreneurs prefer to start their businesses as private companies, especially as they know that it is always possible to convert a private company into a public one.<sup>3</sup>

While there is no reason for being unduly alarmed by the proportionate increase in the number of private companies in India (as a matter of fact, in England the proportion of private companies to all joint-stock companies is very much higher), it is desirable that the main cause of the preponderance of the private company, viz. the imperfection and unresponsiveness of the Indian investment market, should be set right. On the other hand, it is just possible that the new restrictions imposed by amended Indian Companies' Act on all public companies (private companies are exempt from many of them) will induce the shrewder entrepreneur to organize his business as a private company rather than as a public one.

### *The Close Connexion between Industrial Management and Industrial Finance in India*

Some people have a tendency to treat the problems of industrial management and industrial finance as two very separate questions, as if the one were independent of the

<sup>1</sup> H. W. Jordan, *Private Companies—their utility and the exemptions they enjoy* (London, 1919), pp. 26-36.

<sup>2</sup> Cf. the Annual Report on the Administration of the Indian Companies' Act in Bengal for 1934-5 (Calcutta).

<sup>3</sup> S. C. Sen, *op. cit.*, p. 7.

other. In India, however, these two matters are so closely inter-related that we might almost say that the problems of the one overlap those of the other. In our historical analysis we have seen how, until recently, the system of promotion and management of industries by managing agents more or less solved the problems (if there were any problems at all) of industrial finance, and banks had to come to the active aid of industry only on rare occasions. Again, in the course of our analytical study of the existing situation we have found that the gross mismanagement of some concerns has been directly responsible for the general shyness of investors, and has accentuated the recent financial difficulties of some enterprises. The amended Indian Companies' Act promises to end some of the opportunities for mismanagement and fraud, and is thereby likely to help towards a solution of the problem of industrial finance as well. Moreover, the success of any kind of investment banking (as proposed in a previous chapter) would depend mainly on the efficient and honest management of industries, and this latter again would depend on how the directors and managers of an industry are chosen and to what extent they abide by the spirit as well as letter of the new Companies' Act. As matters stand in India, the financial problems of her industrial enterprises will never be effectively solved until their standard of management rises appreciably.

*Conclusion : Industrial Leadership—the Crying Need*

Efficiency and honesty in management, however, are things which cannot be enforced by legislation. For an improvement in their standard we must count on a more enlightened public opinion, a better sense of duty among the commercial and entrepreneur classes and a really keen desire on the part of these classes to learn things. In other words, India needs a newer and a better kind of industrial leadership. The supreme need of the hour is for managers, and foremen, for pioneers and entrepreneurs. The country has had, so far, only one firm of Tatas, only one firm of Currimbhoy, and only one Sir Rajendra Nath Mookerji : industrial leadership is singularly weak and, as a result,

the general quality of management is poor. India needs leaders and managers who have experience, technical knowledge, honesty, and courage. If a sufficient supply of such men can be obtained, the so-called difficulties of industrial finance will rapidly disappear.

Let us again turn to Germany and Japan—the two countries whose footsteps economic India wants to follow. The rapid industrial development of these countries was the result more of the ‘entrepreneur spirit’ aided by ‘certain elementary causes working with irresistible force’ than of an enforced State policy. Similarly, those in charge of industry in India should sharpen their individual initiative and enterprise rather than pathetically wait for the State to come to their aid. In small matters like the calculation of overhead costs as also in large matters like the finding of capital for extensions and replacements, they should try to work out a solution themselves rather than ask the State to do it for them. As has been well observed by Reisser, a really great industrial leader is one who makes the most of the economic forces and circumstances as he finds them instead of indulging in hopes that some outside force like the State would come and shape things for him.

## APPENDIXES

### APPENDIX I

#### JOINT-STOCK COMPANIES REGISTERED IN INDIA AND AT WORK, 1923-4 to 1932-3

| Year                                                 | Number | Paid-up Capital<br>(Rs. 1,000) |
|------------------------------------------------------|--------|--------------------------------|
| <i>(a) Companies registered in British India</i>     |        |                                |
| 1923-4 .. ..                                         | 4,820  | 2,54,55.03                     |
| 1924-5 .. ..                                         | 4,822  | 2,66,50.27                     |
| 1925-6 .. ..                                         | 4,926  | 2,67,79.11                     |
| 1926-7 .. ..                                         | 5,156  | 2,67,09.40                     |
| 1927-8 .. ..                                         | 5,388  | 2,66,71.39                     |
| 1928-9 .. ..                                         | 5,795  | 2,69,11.59                     |
| 1929-30 .. ..                                        | 6,313  | 2,75,19.22                     |
| 1930-1 .. ..                                         | 6,675  | 2,71,28.83                     |
| 1931-2 .. ..                                         | 7,092  | 2,74,21.80                     |
| 1932-3 .. ..                                         | 7,544  | 2,74,49.35                     |
| <i>(b) Companies registered in the Indian States</i> |        |                                |
| 1923-4 .. ..                                         | 391    | 10,78.38                       |
| 1924-5 .. ..                                         | 382    | 9,02.58                        |
| 1925-6 .. ..                                         | 379    | 9,16.66                        |
| 1926-7 .. ..                                         | 370    | 9,81.16                        |
| 1927-8 .. ..                                         | 442    | 9,72.15                        |
| 1928-9 .. ..                                         | 535    | 10,19.22                       |
| 1929-30 .. ..                                        | 606    | 11,14.36                       |
| 1930-1 .. ..                                         | 653    | 11,39.64                       |
| 1931-2 .. ..                                         | 905    | 11,68.26                       |
| 1932-3 .. ..                                         | 1,175  | 11,93.95                       |

Compiled from the *Statistical Abstract for British India* (1936)  
(Cmd. 5158).

## APPENDIX II

JOINT-STOCK COMPANIES REGISTERED ELSEWHERE THAN IN INDIA, BUT  
WORKING IN BRITISH INDIA AND INDIAN STATES,  
1923-4 to 1932-3

| Year                                              | Number | Paid-up Capital<br>(In million sterling) |
|---------------------------------------------------|--------|------------------------------------------|
| <i>(a) Companies working in British India</i>     |        |                                          |
| 1923-4 .. ..                                      | 722    | 578                                      |
| 1924-5 .. ..                                      | 756    | 614                                      |
| 1925-6 .. ..                                      | 783    | 537                                      |
| 1926-7 .. ..                                      | 821    | 568                                      |
| 1927-8 .. ..                                      | 824    | 619                                      |
| 1928-9 .. ..                                      | 822    | 716                                      |
| 1929-30 .. ..                                     | 838    | 722                                      |
| 1930-1 .. ..                                      | 853    | 729                                      |
| 1931-2 .. ..                                      | 864    | 733                                      |
| 1932-3 .. ..                                      | 857    | 820                                      |
| <i>(b) Companies working in the Indian States</i> |        |                                          |
| 1923-4 .. ..                                      | 33     | 16                                       |
| 1924-5 .. ..                                      | 33     | 4                                        |
| 1925-6 .. ..                                      | 36     | 17                                       |
| 1926-7 .. ..                                      | 35     | 13                                       |
| 1927-8 .. ..                                      | 37     | 13                                       |
| 1928-9 .. ..                                      | 45     | 18                                       |
| 1929-30 .. ..                                     | 43     | 18                                       |
| 1930-1 .. ..                                      | 44     | 14                                       |
| 1931-2 .. ..                                      | 42     | 11                                       |
| 1932-3 .. ..                                      | 44     | 11                                       |

Compiled from the *Statistical Abstract for British India* (1936)  
(Cmd. 5158).

## APPENDIX III

## CLASSIFICATION OF JOINT-STOCK COMPANIES AT WORK IN INDIA IN 1932-3

N.B.—Some figures in the last column have been left out because the paid-up capital in those cases is less than half a million £.

- A Companies registered and at work in British India.  
 B Companies registered and at work in the Indian States.  
 C Companies registered outside India, but at work in India.

|                                           | A     |                                         | B   |                                         | C   |                                         |
|-------------------------------------------|-------|-----------------------------------------|-----|-----------------------------------------|-----|-----------------------------------------|
|                                           | No.   | Paid-up Capital<br>(In lakhs of rupees) | No. | Paid-up Capital<br>(In lakhs of rupees) | No. | Paid-up Capital<br>(In lakhs of rupees) |
| 1. Banking and loan ..                    | 1,715 | 24.74                                   | 339 | 2.08                                    | 29  | 99                                      |
| 2. Insurance ..                           | 451   | 2.29                                    | 524 | 3                                       | 144 | 73                                      |
| 3. Navigation ..                          | 24    | 2.44                                    | —   | —                                       | 19  | 42                                      |
| 4. Railways and tramways ..               | 44    | 15.02                                   | 1   | 7                                       | 18  | 25                                      |
| 5. Other transport                        | 250   | 3.83                                    | 17  | 8                                       | 11  | 2                                       |
| 6. Trading and manufacturing companies .. | 2,935 | 91.06                                   | 171 | 1.37                                    | 356 | 202                                     |
| 7. Tea ..                                 | 459   | 12.86                                   | 12  | 51                                      | 186 | 29                                      |
| 8. Other planting companies ..            | 89    | 1.92                                    | 26  | 40                                      | 41  | 5                                       |
| 9. Coal mining ..                         | 212   | 9.36                                    | 1   | 63                                      | 4   | —                                       |
| 10. Gold mining ..                        | 2     | 4                                       | —   | —                                       | 6   | 2                                       |
| 11. Other mining companies ..             | 101   | 28.79                                   | 9   | 14                                      | 36  | 195                                     |
| 12. Cotton mills ..                       | 297   | 33.20                                   | 31  | 4.28                                    | 7   | 3                                       |
| 13. Jute mills ..                         | 69    | 18.53                                   | —   | —                                       | 6   | 4                                       |
| 14. Woollen and other mills ..            | 18    | 2.28                                    | 2   | 9                                       | —   | —                                       |
| 15. Cotton ginning, etc. ..               | 101   | 2.52                                    | 5   | 13                                      | 2   | —                                       |
| 16. Jute presses, etc. ..                 | 30    | 1.71                                    | —   | —                                       | —   | —                                       |
| 17. Flour mills ..                        | 23    | 1.24                                    | 2   | 20                                      | —   | —                                       |
| 18. Estate, land and building ..          | 151   | 10.31                                   | 2   | 2                                       | 5   | —                                       |
| 19. Sugar ..                              | 107   | 2.36                                    | 3   | 9                                       | 1   | —                                       |
| 20. Other companies ..                    | 466   | 9.97                                    | 30  | 1.83                                    | 30  | 41                                      |

Compiled from the *Statistical Abstract for British India* (1936)  
 (Cmd. 5158).

## APPENDIX IV

TABLE SHOWING THE INDEPENDENCE OF THE VARIOUS RATES IN THE  
INDIAN MONEY MARKET

|                | Imperial<br>Bank<br>Rate | Call Money Rate |        | Imperial<br>Bank<br>Hundi<br>Rate | Bazaar Bill<br>Rate |        |
|----------------|--------------------------|-----------------|--------|-----------------------------------|---------------------|--------|
|                |                          | Calcutta        | Bombay |                                   | Calcutta            | Bombay |
| 1934           | %                        | %               | %      | %                                 | %                   | %      |
| April .. ..    | 3½                       | ¾               | 3      | 3½                                | 6-7                 | 6      |
| May .. ..      | 3½                       | ¾               | 1½     | 3½                                | 6-7                 | 6      |
| June .. ..     | 3½                       | ¾               | 1      | 3½                                | 7-8                 | 6      |
| July .. ..     | 3½                       | ¾               | 1½     | 3½                                | 6-7                 | 3½     |
| August .. ..   | 3½                       | ¾               | 1½     | 3½                                | 6-7                 | 3      |
| September ..   | 3½                       | ¾               | 1      | 3½                                | 6-7                 | 3      |
| October .. ..  | 3½                       | ¾               | 1      | 3½                                | 6-7                 | 2½     |
| November ..    | 3½                       | ¾               | 1½     | 3½                                | 6-7                 | 3½     |
| December ..    | 3½                       | ¾               | 1½     | 3½                                | 6-7                 | 5½     |
| 1935           |                          |                 |        |                                   |                     |        |
| January .. ..  | 3½                       | ¾               | 3      | 3½                                | 6-7                 | 5½     |
| February .. .. | 3½                       | 1               | 3½     | 3½                                | 6-7                 | 6½     |
| March .. ..    | 3½                       | 1               | 3½     | 3½                                | 7-8                 | 6½     |

N.B.—The bazaar rates above are those at which the bills of small traders are discounted by shroffs.

Compiled from the *Annual Report of the Controller of the Currency*,  
1934-5.

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## APPENDIX V

STATEMENT SHOWING THE BORROWINGS OF THE GOVERNMENT OF INDIA  
TOGETHER WITH THE RATES AT WHICH THEY WERE BORROWED,  
1923-4 to 1932-3

| Year    | Description                                    | Terms and Rate                   |
|---------|------------------------------------------------|----------------------------------|
| 1923-4  | Ten-year bonds.                                | 5 per cent.                      |
| 1923-4  | Long-term loan repayable in 1945-55.           | 5 per cent., free of income tax. |
| 1924-5  | Bonds.                                         | 5 per cent.                      |
| 1924-5  | Long-term loan.                                | 5 per cent., tax free.           |
| 1925-6  | Ten-year bonds.                                | 5 per cent.                      |
| 1925-6  | Long-term loan repayable in 1945-55.           | 5 per cent., tax free.           |
| 1926-7  | Long-term loan repayable in 1960-70.           | 4 per cent.                      |
| 1927-8  | Loan repayable in 1934-7.                      | 4 per cent.                      |
| 1928-9  | Long-term loan repayable in 1955-60.           | 4½ per cent.                     |
| 1928-9  | Five-year bonds.                               | 4½ per cent.                     |
| 1929-30 | Loan repayable in 1939-44.                     | 5 per cent.                      |
| 1929-30 | Five-year bonds.                               | 5 per cent.                      |
| 1930-1  | Loan repayable in 1933-6.                      | 6 per cent.                      |
| 1932-3  | Loan repayable in 1938-40.                     | 5½ per cent.                     |
| 1932-3  | Loan repayable in 1940-3.                      | 5 per cent.                      |
| 1932-3  | Ten-year bonds.                                | 4 per cent.                      |
| 1932-3  | Conversion loans, 1960-70.                     | 4 per cent.                      |
| 1933-4  | Cash and conversion loan repayable in 1947-50. | 3½ per cent.                     |
| 1934-5  | Loan repayable in 1947-50.                     | 3½ per cent.                     |
| 1934-5  | Bonds redeemable in 1941.                      | 3 per cent.                      |
| 1935-6  | Loan repayable in 1951-4.                      | 3 per cent.                      |
| 1936-7  | Long-term loan.                                | 2½ per cent.                     |

Compiled from *Annual Reports of the Controller of Currency and of the Reserve Bank of India.*

## APPENDIX VI

CAPITAL, RESERVE AND DEPOSITS OF THE PRINCIPAL  
INDIAN JOINT-STOCK BANKS(On 31 December of each year)  
(In Rs. 1,000)

|                                                                                         | No. of<br>Reporting<br>Banks | Paid-up<br>Capital | Reserve<br>and the<br>Rest | Total    | Deposits |
|-----------------------------------------------------------------------------------------|------------------------------|--------------------|----------------------------|----------|----------|
| <i>(a) Banks with capital and reserve of Rs. 5 lakhs and over</i>                       |                              |                    |                            |          |          |
| 1925 ..                                                                                 | 28                           | 6,73.00            | 3,86.64                    | 10,59.64 | 54,49.36 |
| 1926 ..                                                                                 | 28                           | 6,76.34            | 4,08.05                    | 10,84.39 | 59,68.02 |
| 1927 ..                                                                                 | 29                           | 6,88.70            | 4,19.35                    | 11,08.05 | 60,84.11 |
| 1928 ..                                                                                 | 28                           | 6,74.84            | 4,34.66                    | 11,09.50 | 62,85.36 |
| 1929 ..                                                                                 | 33                           | 7,86.97            | 3,66.54                    | 11,53.51 | 62,72.03 |
| 1930 ..                                                                                 | 31                           | 7,47.31            | 4,42.84                    | 11,90.15 | 63,25.51 |
| 1931 ..                                                                                 | 34                           | 7,80.30            | 4,28.14                    | 12,08.44 | 62,26.44 |
| 1932 ..                                                                                 | 34                           | 7,81.81            | 4,39.33                    | 12,21.14 | 72,34.00 |
| 1933 ..                                                                                 | 34                           | 7,78.24            | 4,55.28                    | 12,33.52 | 71,67.43 |
| 1934 ..                                                                                 | 36                           | 7,99.49            | 4,67.74                    | 12,67.23 | 76,77.26 |
| <i>(b) Banks with capital and reserve between Rs. 1 lakhs and less than Rs. 5 lakhs</i> |                              |                    |                            |          |          |
| 1925 ..                                                                                 | 46                           | 80.79              | 37.70                      | 1,18.49  | 3,41.40  |
| 1926 ..                                                                                 | 47                           | 86.22              | 39.72                      | 1,25.94  | 3,46.97  |
| 1927 ..                                                                                 | 48                           | 84.95              | 37.25                      | 1,22.20  | 3,45.58  |
| 1928 ..                                                                                 | 46                           | 81.19              | 38.68                      | 1,19.87  | 3,49.66  |
| 1929 ..                                                                                 | 45                           | 74.94              | 40.08                      | 1,15.02  | 3,57.51  |
| 1930 ..                                                                                 | 57                           | 90.57              | 50.28                      | 1,40.85  | 4,39.18  |
| 1931 ..                                                                                 | 54                           | 85.70              | 42.02                      | 1,27.72  | 3,92.16  |
| 1932 ..                                                                                 | 52                           | 85.38              | 43.97                      | 1,29.35  | 3,92.54  |
| 1933 ..                                                                                 | 55                           | 87.52              | 43.19                      | 1,30.71  | 4,74.84  |
| 1934 ..                                                                                 | 69                           | 94.46              | 54.37                      | 1,48.83  | 5,11.12  |

Compiled from *Statistical Tables relating to Banks in India*, Delhi  
(1934).

## APPENDIX VII

STATEMENT OF BANK FAILURES IN INDIA,  
1920-34

| Year    | No. | Authorized Capital<br>(Lakhs of Rs.) | Paid-up Capital<br>(Lakhs of Rs.) |
|---------|-----|--------------------------------------|-----------------------------------|
| 1920 .. | 3   | 10                                   | 7                                 |
| 1921 .. | 7   | 70                                   | 1                                 |
| 1922 .. | 15  | 1,015                                | 3                                 |
| 1923 .. | 20  | 2,187                                | 465                               |
| 1924 .. | 18  | 630                                  | 11                                |
| 1925 .. | 17  | 190                                  | 19                                |
| 1926 .. | 14  | 71                                   | 4                                 |
| 1927 .. | 16  | 69                                   | 3                                 |
| 1928 .. | 13  | 82                                   | 23                                |
| 1929 .. | 11  | 151                                  | 8                                 |
| 1930 .. | 12  | 627                                  | 41                                |
| 1931 .. | 18  | 160                                  | 15                                |
| 1932 .. | 24  | 490                                  | 8                                 |
| 1933 .. | 26  | 162                                  | 3                                 |
| 1934 .. | 30  | 242                                  | 6                                 |

Compiled from *Statistical Tables relating to Banks in India*, Delhi  
(1934).

## APPENDIX VIII

STATEMENT CONTAINING PARTICULARS OF SOME CASES IN WHICH  
MANAGING AGENTS RECEIVED COMMISSION ALTHOUGH THE MILLS  
MADE LOSSES

| Name of Company                                | Year    | Loss      | Commission |
|------------------------------------------------|---------|-----------|------------|
|                                                |         | Rs.       | Rs.        |
| 1. Meyer Sassoon Mills .. ..                   | 1929    | 1,45,385  | 36,000     |
| 2. E. D. Sassoon United Mills .. ..            | 1929    | 21,25,663 | 1,20,000   |
| 3. Edward Sassoon Mills .. ..                  | 1929    | 3,09,303  | 36,000     |
| 4. David Mills Co. .. ..                       | 1929    | 5,43,647  | 12,000     |
| 5. E. P. Mills .. ..                           | 1928-9  | 3,75,832  | 36,000     |
| 6. Pearl Mills .. ..                           | 1928-9  | 6,13,633  | 36,000     |
| 7. Fazulbhoj Mills .. ..                       | 1928-9  | 5,78,259  | 36,000     |
| 8. Currimbhoj Mills .. ..                      | 1928-9  | 4,52,631  | 40,000     |
| 9. Crescent Mills .. ..                        | 1928-9  | 3,34,626  | 12,000     |
| 10. Indian Bleaching Co. .. ..                 | 1928    | 99,684    | 24,000     |
| 11. Finlay Mills .. ..                         | 1928    | 1,19,895  | 36,000     |
| 12. M. Goculdas Spinning and Weaving Co. .. .. | 1928-9  | 9,39,843  | 36,000     |
| 13. Manockji Petit Mills .. ..                 | 1928    | 2,94,381  | 2,76,986   |
| 14. Madhaji Dharamsi Manufacturing Co. .. ..   | 1929-30 | 3,59,341  | 35,000     |
| 15. Kohinoor Mills .. ..                       | 1929    | 57,644    | 12,000     |
| 16. Framjee Petit Mills .. ..                  | 1929    | 4,07,611  | 12,309     |

Abstracted from the *Indian Tariff Board Cotton Textile Industry Enquiry* (1932), Vol. II.

## APPENDIX IX

## STATEMENT REGARDING THE PRACTICE OF INTER-INVESTMENT OF FUNDS

1. In 1927 several mills under the agency of Messrs. Currimbhoy Ibrahim & Sons, Ltd., purchased shares of the Premier Mills under the same agents in the following proportion :

|                      |    |    |                      |           |
|----------------------|----|----|----------------------|-----------|
| Fazulbhoy Mills      | .. | .. | 45,714 shares of Rs. | 4,57,130  |
| Pearl Mills          | .. | .. | 36,113               | 3,61,130  |
| Crescent Mills       | .. | .. | 36,113               | 3,61,130  |
| Indian Bleaching Co. | .. | .. | 19,200               | 1,92,000  |
| Total                | .. | .. | 137,139              | 13,71,390 |

2. Instances of inter-company loans :

| Year                   | Names                                                        | Amount of loan<br>(Rs. in lakhs) |
|------------------------|--------------------------------------------------------------|----------------------------------|
| (a) AHMEDABAD.         |                                                              |                                  |
| <i>Advances Mills.</i> |                                                              |                                  |
| 1921-2                 | Fixed deposit with David Mills ..                            | 4                                |
| 1921-2                 | Call loan with Tata Mills ..                                 | 2                                |
| 1923-4                 | Banks and joint-stock companies..                            | 11                               |
| 1924-5                 | Ditto .. ..                                                  | 11.5                             |
| 1925-6 to              |                                                              |                                  |
| 1929-30                | Joint-stock companies .. ..                                  | 4.42                             |
| 1930-1                 | Joint-stock companies guaranteed<br>by Tata Sons, Ltd. .. .. | 4.42                             |
| (b) SWADESHI MILLS.    |                                                              |                                  |
| 1924                   | Banks and companies .. ..                                    | 26                               |
| 1925                   | Ditto .. ..                                                  | 11.48                            |
| 1926                   | Ditto .. ..                                                  | 12.12                            |
| 1928                   | Ditto .. ..                                                  | 9.64                             |
| 1929 and               |                                                              |                                  |
| 1930                   | Deposits with companies .. ..                                | 4.64                             |
| 1931                   | Ditto .. ..                                                  | 4.14                             |
| (c) NAGPUR MILLS.      |                                                              |                                  |
| 1929-30                | Deposits guaranteed by Tata Sons,<br>Ltd. .. ..              | 2.72                             |
| 1930-1                 | Ditto .. ..                                                  | 2.72                             |

Abstracted from the *Indian Tariff Board Cotton Textile Industry Enquiry* (1932), Vol. II.

## APPENDIX X

STATEMENT CONTAINING PARTICULARS OF ADVANCES OR LOANS TO  
MANAGING AGENTS OR DIRECTORS

1. The balance sheet of the Sassoon Alliance Mills for the year 1931 showed that a sum of Rs. 6 lakhs was due by the Secretaries and Treasurers to the Company in current account.

2. The balance sheet for 1931 of the Standard Mills of Bombay under the agency of Messrs. Mafatlal Gagalbhai & Sons showed that a sum of Rs. 3,32,000 was lying with Messrs. Mafatlal Gagalbhai & Sons

3. The balance sheet for 1930 of the Aryodaya Spinning & Weaving Co. under the agency of Messrs. Mangaldas & Brothers showed a sum of Rs. 1,73,000 as being due by Girdhardas Hariballavdas a family concern of the agents.

4. The balance sheet for 1930 of the Chandrodaya Mills under the agency of Messrs. Chunilal Kushaldas & Co. showed an advance of Rs. 24,000 to Pari Chunilal Kushaldas on sharafi account.

5. The balance sheet for 1930 of the Shorrock Spinning, Weaving & Manufacturing Co. under the agency of Mafatlal Chandulal & Co showed different amounts due by cloth shops of Messrs. Mafatlal Gagalbhai at different centres. It also showed that a large sum amounting to Rs. 16,17,000 had been lent to the firm of managing agents.

Abstracted from the *Indian Tariff Board Cotton Textile Industry Enquiry* (1932), Vol. II.

## APPENDIX XI

NAMES OF SOME DIRECTORS IN GREAT BRITAIN WHO ARE REPRESENTED  
ON TWENTY OR MORE COMPANIES

| Name                                   | No. of Companies on<br>which represented |
|----------------------------------------|------------------------------------------|
| 1. Mr. Andrew Agnew, C.B.E. .. ..      | 78                                       |
| 2. Rt. Hon. Viscount Bearsted, M.C. .. | 57                                       |
| 3. Sir Abe Bailey .. ..                | 32                                       |
| 4. Mr. Charles F. Bernhard .. ..       | 31                                       |
| 5. Mr. J. E. Aldred .. ..              | 29                                       |
| 6. Mr. D. A. Abrahams .. ..            | 27                                       |
| 7. Mr. F. R. S. Balfour .. ..          | 27                                       |
| 8. Mr. R. Annan .. ..                  | 26                                       |
| 9. Mr. P. M. Anderson .. ..            | 25                                       |
| 10. Mr. George Balfour .. ..           | 25                                       |
| 11. Mr. Charles Boot .. ..             | 25                                       |
| 12. Mr. J. A. Agnew .. ..              | 24                                       |
| 13. Mr. H. D. Butchart .. ..           | 23                                       |
| 14. Mr. H. T. Board .. ..              | 22                                       |
| 15. Mr. P. J. Burgess .. ..            | 22                                       |
| 16. Dr. E. Barth .. ..                 | 22                                       |
| 17. Mr. R. Armitage .. ..              | 21                                       |
| 18. Mr. B. H. Binder .. ..             | 21                                       |
| 19. Captain C. E. Benson .. ..         | 20                                       |

Tabulated from the first 250 pages of *The Directory of Directors*  
(London, 1936).

## APPENDIX XII

SECTIONS OF THE NEW INDIAN COMPANIES' ACT DEALING WITH  
MANAGING AGENTS

87A. (1) No managing agent shall, after the commencement of the Indian Companies' (Amendment) Act, 1936, be appointed to hold office for a term of more than twenty years at a time.

(2) Notwithstanding anything to the contrary contained in the articles of a company or in any agreement with the company a managing agent of a company appointed before the commencement of the Indian Companies' (Amendment) Act, 1936, shall not continue to hold office after the expiry of twenty years from the commencement of the said Act unless then re-appointed thereto or unless he has been re-appointed thereto before the expiry of the said twenty years.

(3) A managing agent whose office is terminated by virtue of the provisions of sub-section (2) shall upon such termination be entitled to a charge upon the assets of the company by way of indemnity for all liabilities or obligations properly incurred by the managing agent on behalf of the company subject to existing charges and encumbrances, if any.

(4) The termination of the office of a managing agent by virtue of the provisions of sub-section (2) shall not take effect until all moneys payable to the managing agent for loans made to or remuneration due up to the date of such termination from the company are paid.

(5) Nothing in this section shall apply to a private company which is not the subsidiary company of a public company.

87B. Notwithstanding anything to the contrary contained in the articles of the company or in any agreement with the company :

(a) a company may, by resolution passed at a general meeting which notice has been given to the managing agent in the same manner as to members of the company, remove a managing agent if he is convicted of an offence in relation to the affairs of the company punishable under the Indian Penal Code, and being under the provisions of the Code of Criminal Procedure, 1898, non-bailable; and for the purposes of this clause, where the managing agent is a firm or a company an offence committed by a member of such firm or director of or an officer holding a general power of attorney from such company shall be deemed to be an offence committed by such firm or company.

Provided that a managing agent shall not be liable to be removed under the provisions hereof if the offending member, director or officer as aforesaid is expelled or dismissed by the managing agent within thirty days from the date of his conviction or if his conviction is set aside on appeal ;

(b) the office of a managing agent shall be vacated if he is adjudged insolvent ;

(c) a transfer of his office by a managing agent shall be void unless approved by the company in a general meeting :

Provided that in the case of a managing agent's firm a change in the partners thereof shall not be deemed to operate as a transfer of the office of managing agent, so long as one of the original partners shall continue to be a partner of the managing agent's firm. For the purpose of this proviso 'original partners' shall mean, in the case of managing agents appointed before the commencement of the Indian Companies' (Amendment) Act, 1936, partners who were partners at the date of commencement of the said Act, and in the case of managing agents appointed after the commencement of the said Act, partners who were partners at the date of the appointment ;

(d) a charge or assignment of his remuneration or any part thereof effected by a managing agent shall be void as against the company ;

(e) if a company is wound up either by the Court or voluntarily, any contract of management made with a managing agent shall be thereupon determined without prejudice, however, to the right of the managing agent to recover any moneys recoverable by the managing agent from the company :

Provided that where the Court finds that the winding up is due to the negligence or default of the managing agent himself the managing agent shall not be entitled to receive any compensation for the premature termination of his contract of management ;

(f) the appointment of a managing agent, the removal of a managing agent and any variation of a managing agent's contract of management made after the commencement of the Indian Companies' (Amendment) Act, 1936, shall not be valid unless approved by a resolution at a general meeting of the company notwithstanding anything to the contrary in section 86B :

Provided that nothing herein contained shall apply to the appointment of a company's first managing agent made prior to the issue of the prospectus or statement in lieu of prospectus where the terms of the appointment of such managing agent are there set forth.

87C. (1) Where any company appoints a managing agent after the commencement of the Indian Companies' (Amendment) Act, 1936, the remuneration of the managing agent shall be a sum based on a fixed percentage of the net annual profits of the company, with provision for a minimum payment in the case of absence of or inadequacy of profits, together with an office allowance to be defined in the agreement of management.

(2) Any stipulation for remuneration additional to or in any other form than the remuneration specified in sub-section (1) shall not be binding on the company unless sanctioned by a special resolution of the company.

(3) For the purposes of this section 'net profits' means the profits of the company calculated after allowing for all the usual working charges, interest on loans and advances, repairs and outgoings, depreciation, bounties or subsidies received from the Government or from a public body, profits by way of premium on shares sold, profits on sale proceeds of forfeited shares, or profits from the sale of the whole or part of the undertaking of the company, but without any deduction in respect of income tax or super-tax, or any other tax or duty on income or revenue or for expenditure by way of interest on debentures or otherwise on capital account or on account of any sum which may be set aside in each year out of the profits for reserve or any other special fund.

(4) This section shall not apply to a private company except a private company which is the subsidiary company of a public company or to any company whose principal business is the business of insurance.

87D. (1) No company shall make to a managing agent of the company or to any partner of the firm, if the managing agent is a firm, or to any director of the private company, if the managing agent is a private company, any loan out of the moneys of the company or guarantee any loan made to a managing agent.

(2) Nothing contained in this section shall apply to any credit held by a managing agent in a current account maintained subject to limits previously approved by the board of directors by the company with the managing agent for the purposes of the company's business.

(3) In the event of any contravention of sub-section (1) any director of the company who is a party to the making of the loan or giving of the guarantee shall be punishable with fine which may extend to five hundred rupees, and if default is made in repayment of the loan or discharging the guarantee shall be liable jointly and severally for the amount unpaid.

(4) Nothing in this section shall apply to a private company except a private company which is the subsidiary company of a public company.

(5) Except with the consent of three-fourths of the directors present and entitled to vote on the resolution, a managing agent of the company or the firm of which he is a partner, or any partner of such firm, or, if the managing agent is a private company, a member or director thereof, shall not enter into any contract for the sale, purchase or supply of goods and materials with the company, provided that nothing herein contained shall affect any such contract for such sale, purchase or supply entered into before the commencement of the Indian Companies' (Amendment) Act, 1936.

87E. (1) No company incorporated under this Act after the commencement of the Indian Companies' (Amendment) Act, 1936, which is under the management of a managing agent shall make any

loan to or guarantee any loan made to any company under management by the same managing agent, and no company shall after the expiry of six months from the commencement of the said Act except by way of renewal of an existing loan or guarantee given make any loan to or guarantee any loan made to any such company :

Provided that nothing herein contained shall apply to loans made or guarantees given by a company to or on behalf of a company under its own management or loans made by or to a company to or by a subsidiary company thereof or to guarantees given by a company on behalf of a subsidiary company thereof.

(2) In the event of any contravention of the provisions of this section, any director or officer of the company making the loan or giving the guarantee who is knowingly and wilfully in default shall be liable to a fine not exceeding one thousand rupees and shall be jointly and severally liable for any loss incurred by the company in respect of such loan or guarantee.

87F. A company other than an investment company, that is to say, a company whose principal business is the acquisition and holding of shares, stocks, debentures or other securities, shall not purchase shares or debentures of any company under management by the same managing agent, unless the purchase has been previously approved by a unanimous decision of the board of directors of the purchasing company.

87G. A managing agent shall not exercise in respect of any company of which he is a managing agent a power to issue debentures or, except with the authority of the directors and within the limits fixed by them, a power to invest the funds of the company, and any delegation of any such power by a company to a managing agent shall be void.

87H. A managing agent shall not on his own account engage in any business which is of the same nature as and directly competes with the business carried on by a company under his management or by a subsidiary company of such company.

87I. Notwithstanding anything contained in the articles of a company other than a private company the directors, if any, appointed by the managing agent shall not exceed in number one-third of the whole number of directors.

## APPENDIX XIII

CAPITAL, RESERVE AND DEPOSITS OF THE VARIOUS BANKING  
INSTITUTIONS IN INDIA IN 1934

|                                        | Capital and Reserve<br>(Rs. 1,000) | Deposits<br>(Rs. 1,000) |
|----------------------------------------|------------------------------------|-------------------------|
| 1. Imperial Bank of India .. ..        | 11,28,15                           | 81,00,15                |
| 2. Exchange Banks (a) .. ..            | 1,88,82,40                         | 71,39,97                |
| 3. Joint-stock Banks .. ..             | 14,16,06                           | 81,88,38                |
| 4. Co-operative Banks (b) .. ..        | 8,02,97                            | 41,12,98                |
| 5. Post Office Savings Banks (c) .. .. | —                                  | 32,11,96                |

NOTES—(a) Conversion made at the rate of Rs. 1=1s. 6d.

(b) The figures relate to the financial year 1934-5. The figures under the head 'deposits' include 'loans received'.

(c) The figures relate to the financial year 1932-3 and include interest.

Compiled from *Statistical Tables relating to Banks in India and the Statistical Abstract for British India*.

## APPENDIX XIV

ANALYSIS OF CAPITALIZATION OF THE PRINCIPAL INDIAN  
INDUSTRIES

(Companies registered in India only included)

| Industries                                          | Total Capital<br>Invested (Ordinary, deferred<br>and preference<br>share capital as<br>well as debentures) | Total<br>Debenture<br>Capital only | Percentage<br>of Debenture<br>Capital to<br>Total Capital |
|-----------------------------------------------------|------------------------------------------------------------------------------------------------------------|------------------------------------|-----------------------------------------------------------|
|                                                     | (Rs. 1,000)                                                                                                | (Rs. 1,000)                        |                                                           |
| 1. Jute .. ..                                       | 189,301                                                                                                    | 15,675                             | 8.3                                                       |
| 2. Tea—General .. ..                                | 36,864                                                                                                     | 1,869                              | 5.1                                                       |
| 3. Tea and Rubber (South<br>Indian Companies) .. .. | 7,949                                                                                                      | 1,533                              | 19.3                                                      |
| 4. Engineering .. ..                                | 172,210                                                                                                    | 20,977                             | 12.2                                                      |
| 5. Electricity and allied<br>industries .. ..       | 41,747                                                                                                     | 1,959                              | 4.7                                                       |
| 6. Sugar and distilleries .. ..                     | 45,064                                                                                                     | 6,432                              | 14.3                                                      |
| 7. Bombay Cotton Mills .. ..                        | 155,469                                                                                                    | 24,799                             | 15.9                                                      |
| 8. Other Cotton Mills .. ..                         | 56,853                                                                                                     | 3,629                              | 6.4                                                       |
| 9. Miscellaneous industries .. ..                   | 251,111                                                                                                    | 11,310                             | 4.5                                                       |
| 10. Light Railway Companies .. ..                   | 103,088                                                                                                    | —                                  | —                                                         |

N.B.—These figures have been compiled from the list of companies given in the *Investors' Supplement to the Indian Finance* (Calcutta), dated 30 January 1937. Obviously, the figures are not exhaustive, but they help us in forming an idea of the nature of debenture capitalization in the various Indian industries.

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## APPENDIX XV

### ANALYSIS OF SOME RECENT DEBENTURE LOANS FLOATED IN INDIA

| Name of Concern                                  | Paid-up Capital<br>(Lakhs of Rs.) | Amount of Debentures<br>(Lakhs of Rs.) | Year of floatation of Loan | Interest |
|--------------------------------------------------|-----------------------------------|----------------------------------------|----------------------------|----------|
| <b>1. COTTON INDUSTRY.</b>                       |                                   |                                        |                            | %        |
| Apollo Mills, Ltd. ..                            | 25                                | 20                                     | 1925                       | 7        |
| Cawnpore Textile Co., Ltd.                       | 6.35                              | 7.5                                    | 1920                       | 6½       |
| Coimbatore Spinning and Weaving Co., Ltd. ..     | 13.84                             | 5.65                                   | 1928                       | 6½       |
| Edward Sassoon Mills, Ltd.                       | 17                                | 12                                     | 1918                       | 6½       |
| Indore Malwa United Mills, Ltd. ..               | 20                                | 32.8                                   | —                          | 5        |
| Madras United Spinning & Weaving Mills Co., Ltd. | 10                                | 15                                     | 1932                       | 7        |
| Meyer Sassoon Mills, Ltd.                        | 10                                | 12                                     | 1918                       | 6½       |
| Simplex Mills Co., Ltd. ..                       | 14                                | 30                                     | 1932                       | 6        |
| Tata Mills, Ltd. ....                            | 100                               | 100                                    | 1923                       | 7½       |
|                                                  |                                   | (reduced to 3% in 1933)                |                            |          |
| <b>2. JUTE INDUSTRY.</b>                         |                                   |                                        |                            |          |
| Alexandra Jute Mills, Ltd.                       | 15                                | 9                                      | —                          | 6        |
| Birla Jute Manufacturing Co., Ltd. ..            | 50                                | 15                                     | 1928                       | 5½       |
| Calcutta Jute Manufacturing Co., Ltd. ..         | 10                                | 5                                      | 1935                       | 6        |
| Clive Mills Co., Ltd. ..                         | 32                                | 6                                      | 1904-6                     | 5½       |
| Empire Jute Co., Ltd. ..                         | 20                                | 10                                     | 1913                       | 6        |
|                                                  |                                   | (reduced to 5½% in 1927)               |                            |          |
| Lansdowne Jute Co., Ltd.                         | 32                                | 15                                     | 1901                       | 5½       |
| Presidency Jute Mills Co., Ltd. ..               | 25                                | 8.17                                   | 1933                       | 5        |
| <b>3. TEA INDUSTRY.</b>                          |                                   |                                        |                            |          |
| Bishnauth Tea Co., Ltd.                          | 15                                | 3                                      | 1934                       | 5½       |
| Dhunseri Tea Co., Ltd.                           | 6.2                               | 4                                      | 1922                       | 6        |
| Longview Tea Co., Ltd.                           | 3.44                              | 1                                      | 1925                       | 7        |
| Loobah Tea Co., Ltd. ..                          | 6                                 | 2                                      | 1934                       | 7        |
| Namburnadi Tea Co., Ltd.                         | 10                                | 3                                      | 1917                       | 7        |
| <b>4. MISCELLANEOUS INDUSTRIES.</b>              |                                   |                                        |                            |          |
| Ahmedabad Electricity Co., Ltd. ..               | 38.25                             | 12                                     | 1934                       | 5        |
| Andhra Valley Power Supply Co., Ltd. ..          | 2.09                              | 2.25                                   | 1933                       | 6        |
| Belsund Sugar Co., Ltd. ..                       | 10.5                              | 10                                     | 1934                       | 5½       |
| Bombay Telephone Co., Ltd.                       | 100.63                            | 49.37                                  | —                          | 4        |
| Britannia Engineering Co., Ltd. ..               | 1.5                               | 5                                      | 1935                       | 5        |
| Mysore Sugar Co., Ltd. ..                        | 20                                | 20                                     | 1934                       | 6        |
| Punjab Portland Cement Co., Ltd. ..              | 50                                | 25                                     | 1924                       | 6        |
| Samastipur Central Sugar Co., Ltd. ..            | 12                                | 4                                      | 1935                       | 5        |

Prepared from the details regarding various companies given in the  
*Investor's India Year Book, 1935-6.*

## APPENDIX XVI

GROWTH OF PRIVATE COMPANIES IN INDIA  
(As registered every year)

| Year       | No. of<br>Private Companies<br>Registered | No. of all<br>Joint-stock<br>Companies<br>Registered<br>(Public and Private) | Percentage of<br>Private to all<br>Companies |
|------------|-------------------------------------------|------------------------------------------------------------------------------|----------------------------------------------|
| 1924-5 ..  | 158                                       | 416                                                                          | 37·9                                         |
| 1925-6 ..  | 143                                       | 470                                                                          | 30·4                                         |
| 1926-7 ..  | 157                                       | 529                                                                          | 29·7                                         |
| 1927-8 ..  | 194                                       | 626                                                                          | 30·9                                         |
| 1928-9 ..  | 277                                       | 726                                                                          | 38·2                                         |
| 1929-30 .. | 301                                       | 839                                                                          | 36·2                                         |
| 1930-1 ..  | 366                                       | 731                                                                          | 50·1                                         |
| 1931-2 ..  | 468                                       | 922                                                                          | 50·8                                         |
| 1932-3 ..  | 662                                       | 1,087                                                                        | 60·9                                         |
| 1933-4 ..  | 354                                       | 885                                                                          | 40·0                                         |
| 1934-5 ..  | 449                                       | 965                                                                          | 46·5                                         |
| 1935-6 ..  | 403                                       | 1,027                                                                        | 39·2                                         |

Compiled and prepared from the *Annual Reports on the Working of the Indian Companies' Act and on Joint-stock Companies in British India.*

## APPENDIX XVII

GROWTH OF PRIVATE COMPANIES IN BENGAL AND BOMBAY  
(As registered every year)

| Year               | No. of<br>Private Companies<br>Registered | No. of all<br>Joint-stock<br>Companies<br>Registered<br>(Public and Private) | Percentage of<br>Private to all<br>Companies |
|--------------------|-------------------------------------------|------------------------------------------------------------------------------|----------------------------------------------|
| <b>(A) BENGAL.</b> |                                           |                                                                              |                                              |
| 1924-5 ..          | 54                                        | 150                                                                          | 36.0                                         |
| 1925-6 ..          | 65                                        | 241                                                                          | 26.9                                         |
| 1926-7 ..          | 75                                        | 276                                                                          | 27.2                                         |
| 1927-8 ..          | 65                                        | 291                                                                          | 22.3                                         |
| 1928-9 ..          | 100                                       | 340                                                                          | 29.4                                         |
| 1929-30 ..         | 112                                       | 305                                                                          | 36.7                                         |
| 1930-1 ..          | 131                                       | 299                                                                          | 43.8                                         |
| 1931-2 ..          | 108                                       | 236                                                                          | 45.8                                         |
| 1932-3 ..          | 125                                       | 248                                                                          | 42.3                                         |
| 1933-4 ..          | 140                                       | 269                                                                          | 52.0                                         |
| 1934-5 ..          | 153                                       | 265                                                                          | 57.7                                         |
| <b>(B) BOMBAY.</b> |                                           |                                                                              |                                              |
| 1924-5 ..          | 34                                        | 66                                                                           | 51.5                                         |
| 1925-6 ..          | 32                                        | 54                                                                           | 59.3                                         |
| 1926-7 ..          | 41                                        | 63                                                                           | 65.1                                         |
| 1927-8 ..          | 40                                        | 68                                                                           | 58.8                                         |
| 1928-9 ..          | 53                                        | 88                                                                           | 61.1                                         |
| 1929-30 ..         | 56                                        | 106                                                                          | 52.8                                         |
| 1930-1 ..          | 74                                        | 104                                                                          | 71.5                                         |
| 1931-2 ..          | 86                                        | 134                                                                          | 64.2                                         |
| 1932-3 ..          | 68                                        | 111                                                                          | 61.3                                         |
| 1933-4 ..          | 97                                        | 137                                                                          | 70.8                                         |
| 1934-5 ..          | 136                                       | 190                                                                          | 71.6                                         |

Compiled and prepared from the *Annual Reports on the Working of the Indian Companies' Act in the provinces of Bengal and Bombay respectively.*

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