

# INEFFICIENT MANAGING AGENCY SYSTEM

AND THE AMENDMENT OF THE  
**INDIAN COMPANIES ACT, 1913.**

By  
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PREFACE

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The question of the amendment of the Indian Companies Act of 1913 has been before the public for a number of years. Public demand in this direction has grown louder year by year and it appears that the authorities are now seriously contemplating to introduce an Amending Act at an early date. Safeguards against the defective working of the Managing Agency System were not provided for by the Act of 1913 and hence this piece of legislation, though exhaustive from the standpoint of the position as it existed before its passage, was not considered satisfactory by the author in common with a large number of the investing public, with the result that the author has been continuously for nearly twenty years pressing for adequate amendments. The advent of the Bombay Shareholders' Association, thanks to the pioneer efforts of the seasoned financier and the First President of this Association, viz., Sir Ebrahim Rahimtulla, Kt., C. I. E., gave a great impetus to the movement for amendment. The author had the advantage of being able to lend his services to this good cause, first as a Vice-President of this Association and later as its President. As this question will soon come up for public discussion, the author, at the suggestion of many of his friends interested in the healthy growth of our joint stock companies, has collected some of his ideas in a simple and non-technical form in this publication, which he trusts will be of some service.

80, Esplanade Road,  
Bombay, 20th June 1934. }

SOHRAB R. DAVAR.

# Managing Agency System

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## ITS DEFECTS AND ABUSES

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The object of these observations is to bring to the forefront various ideas in the mind of one who has been a close student of this subject for over quarter of a century and who has continuously, during these years, agitated for the amendment of our Indian Companies Act, with a view to prevent various abuses that surround the agency system, as well as with a view to induce the managing agents themselves to modernise their internal organisation which is completely out of date in most cases. It is also my object to deal with various other phases which make the alteration of our Companies Act imperative and which do not fall strictly within our discussion of managing agency activities. The time for such a detailed discussion is, we submit, at present opportune in view of the fact that :

(1) the government has declared its conviction that such alteration is necessary, and that

(2) the Central Banking Commission, as well as the Tariff Board (particularly the latter) have in their latest report recently released by the Government, made very determined and pertinent recommendations in that direction.

### **The Early History of Agencies.**

Managing Agency system is unfortunately, a peculiarly indigenous plant, which has never flourished in any other but the Indian soil. In other words, there is no country in the world which can boast of a cluster of agency firms grouped together in any important business centre, which domineer the working, as well as the promotion and floatation, of joint stock companies, under which the industries or other economic activities of the country mostly function.

These agencies originally started with our cotton and jute mill companies more than half a century ago and have gradually expanded their control not only to other industrial concerns, but also in some cases to Insurance, Banking, Shipping and similar enterprises. In early days when the joint stock company system was unknown to the Indian investor and capital was shy and backward, there may have been some justification for a firm of businessmen, primarily formed for the purpose of carrying on trade in partnership, to have promoted companies, say such as for working a cotton mill and failing to get sufficient finance from the investors through the purchase of shares offered to the public, to have nursed the company in its early stages and even later, by not only finding a good proportion of the original share capital for the purposes of block investment or fixed assets, but also by lending to these concerns their own money or through receipt of deposits under the name and prestige of their own firm, for the purpose of securing the necessary working capital for these companies. We have thus no desire to minimise the credit, which might go to the early company promoters under old conditions which have long disappeared. It may be conceded, if necessary, that perhaps this was the only practical method by which, under old conditions, new industries could have been planted and expanded in India.

### **No Justification for Continuation of the System.**

Times, however, have now changed. Not only investment and finance is easy in these days, but the investor to-day is quite capable of appreciating a new industry started under proper auspices and in such cases, is ready to supply all the capital that may be necessary for the enterprise. In fact the average investor of the day is so anxious to find suitable avenues for his surplus cash, that he is frequently led into making hasty and indiscreet deposits resulting in losses to him, as was evident in connection with some of the recent cases of cotton mill failures, where in case of one mill company alone out of many, nearly sixty lacs of rupees were lost by the depositors in addition to the bulk of the share capital being jeopardised. A little care

on the part of these parties and some investigation, not only on the money market, but also with an Association such as our Bombay Shareholders' Association, would have soon put the investor in touch with facts which would have served as a timely warning, saving him from losses which he has suffered through this neglect. Under these circumstances it is submitted that the justification for existence of the managing agency system in its present form on the excuse of being there as a necessary adjunct for the purpose of finance, has entirely disappeared.

### **A Mill-stone Round the Neck.**

As matters stand to-day, it is generally found that Managing Agents (particularly those who act as such for a large number of companies) are unable to finance not only in the times of monetary stringency in the market, but also during the normal period. The reason is easy to understand if one remembers that the present-day requirements of joint stock companies are far more larger than those of companies half a century ago, when the managing agency system took its birth and began to develop. On the top of that you generally find a much larger number of companies on the hands of these agents than their own financing capacity, or their monetary credit would warrant. The result is that some of the prominent managing agents have provided finance by investing funds belonging to one company under their agency into a sister company managed by them. Frequently, this sister company is not entirely in a sound condition and to prevent it from sinking, or going into liquidation, it is made to issue debentures which would have no purchaser on the terms on which they are offered in the open market, which debentures the stronger sister company is made to purchase as suitable securities for investment of its reserve fund. This inter-company finance under the same agency is like a mill-stone round the neck of stronger companies and sooner this practice is put a stop to through an appropriate amendment of the Companies Act the better in the interest of continued healthy existence of our joint stock companies. The latest failure of one of our managing agencies presents a peculiar example of inter-mill finance, which has reduced good

companies to a delicate financial position. The pernicious influence of inter-mill finance question was rather forcibly urged by me, along with my colleagues of the Bombay Shareholders' Association, before the Tariff Board Cotton Textile Enquiry recently, and it is gratifying to notice that the Board has entirely endorsed our plea in that regard as will be seen in the para quoted below:—

### **Tariff Board on Practice of Inter-Investment.**

The Board lays down that :—

“Another feature of the system of finance associated with managing agents of the cotton mills to which our attention has been drawn, is the practice of inter-investment of funds among concerns under the same management. Surplus funds, or funds raised on the credit, of one company may be invested in other companies under the same managing agent. 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. Practices of this kind have occurred in individual cases in recent years. The result of such a practice is that although the financial position of an individual company may be 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. The Tariff Board in 1926-27 referring to this practice stated that only one instance of this character came to its notice although where it occurred the criticism in its opinion was justified. The practice is not so rare as the Tariff Board supposed. The difficulties of cotton mills during recent years have been so great that a larger number of individual managing agents than would appear from the statement of the Tariff Board in 1926-27 have been compelled to adopt this questionable method of finance. There is in our opinion little justification for a practice of this kind. Not merely does it involve serious unfairness to shareholders in the concerns 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 managing agents and of the industry as a whole to have closed down.”

### **One Other Instance of Objectionable Finance.**

The other most objectionable feature of finance which is almost inalienable from the managing agency system, is the practice of financing capital expenditure by short term loans. An ancient method of providing finance predominant in case of a large

number of managing agency companies, is to receive deposits for short terms from the public by way of loans on the same footing as bankers and other finance houses. One should have thought that as these deposits are generally repayable on expiry of a term of a year or less, they would be utilised as working capital of the company. This means that they would be utilised in connection with the purchase of raw materials, wages and other running expenditure in the absence of sufficient finance from the share capital itself, but in practice what actually happens is that under the expectation that these deposits would be constantly renewed, or that they would be replaced by other deposits, they are actually invested in the capital expenditure, such as the purchase of machinery, building of new wings for the factory and so on. The result is that the moment the company is not working satisfactorily, or the managing agents themselves are reported to be in financial difficulties, there is a run on the company for the deposits which cannot be met for the simple reason that they are not in liquid form and the company comes to grief. One can easily cite instances of some first class concerns which have been landed into financial difficulties through this form of objectionable finance, with the result that either they are wound up, or are eventually propped up through a compromise under which the depositors agree to receive mortgage debentures in lieu of their claims.

### **Essentially Unsound.**

The Tariff Board report refers to this particular item of our mill finance and calls it "essentially unsound". They rightly state that if the managing agency provides finance on this basis then it does so "on wrong lines". Investigations of the Tariff Board have convinced the Board that in case of cotton mill companies this form of finance is prevalent both in Bombay and Ahmedabad, but their criticism "applies particularly to the finance of mill companies in Ahmedabad." According to the Tariff Board "the bulk of the fixed capital in Ahmedabad mills is supplied in form of deposits." The consequences of this type of finance happen to be that when the company gets



into hot water in times of depression, which recur in a cycle, the agents are unable to meet the monetary demands caused through withdrawal of large deposits and they have frequently resorted to negotiating with large depositors, or outside merchants with a view to provide finance and in return offering buying and selling agencies of the company, and in addition offering them substantial interest on their loans. One has not to be a businessman in order to appreciate what that means. The Tariff Board has rightly asserted in this connection that "the offer of an interest of this kind to a depositor is apt to react on the efficient working of the company and render its position worse."

### **The Only Remedy.**

The remedy and the only remedy here is the amendment of our Indian Companies Act on the same footing as is the case with the New English Companies Act of 1929. The floatation of companies with inadequate capital has been a drawback of British companies as well in the past, under their old state of law on which our present Indian Companies Act is based. This question came up before the Green Commission appointed to investigate the amendment of the English Act of 1908, with the result that the Commission recommended an amendment under which a company is not permitted to allot its shares unless it obtains the minimum subscription amounting to a figure sufficient to cover each of the following matters:—

- (i) the purchase price of any property purchased or acquired or proposed to be purchased or acquired in so far as the same is to be paid for out of the proceeds of the issue;
- (ii) any preliminary expenses and underwriting commission payable by the company;
- (iii) working capital: (See Sec. 35, Schedule IV, Part I, of the English Companies Act, 1929.)

In normal times owing to insufficient capital, besides borrowing from the public by way of loans and deposits, the managing agents are compelled to borrow from banks and other financiers for purposes of their companies. This borrowing is

done in the name of the company and frequently the Managing Agents give their personal guarantee in order to induce bankers to lend this money. This is claimed as an item of service for which they are, according to them, a necessary appendage to our company system.

### **The Real Secret.**

If a little investigation is made in this direction, as we have had occasions to do, one will find that the real secret of the whole thing is that the managing agents are afraid of pledging the manufactured goods or raw material in form of cotton etc., to the banks, which, if they did, necessity for their personal guarantee to the bank would not arise. The reason why they do not pledge these goods is that they are afraid of loss of confidence among depositors from whom they take the short term deposits as described above, because if the depositors heard that some part of the movable property of the company was mortgaged, they would naturally get nervous about their money. It will thus be seen that the financial guarantee which the managing agents claim to be essential is not a necessity, but the outcome of a system under which companies are floated without adequate capital and the modification of the Act as indicated by me above would undoubtedly result in wiping out this one excuse for the perpetuation of the agency system. This fact has been commented on by the Tariff Board itself in its earlier report of 1927.

The other impediment in connection with smooth and effective working of our companies happens to be that, as most of our companies are floated by firms of managing agents who propose to make the company a sort of household business of their own for generations, the agency agreements and the Memorandum and Articles of Association are prepared by their own lawyers under their instructions, more with a view to safeguard their own vested interests in perpetuity, than those of the investors with whose money they carry on the concern. The first step usually taken by them is to provide for themselves, their successors and assignees a sort of perpetual lease of service as managers, secre-

taries and agents. In some cases they have taken care to insert a clause in the said agreement making themselves irremovable and permanent in their office. In some cases they go so far as to provide that they cannot be removed from office on any ground except that of their voluntary resignation. In other cases a so-called concession is given to the investor in the form that the agents shall continue in office till they are "removed for fraud." Any one who knows a little of law would naturally smile at this because in case of fraud, they as servants and agents would be in any case removable by the order of the Court, irrespective of any such clause in the agreement.

### **A Perpetual Lease and Absurd Compensations.**

There have been cases where managing agents have taken a lease of 50 years to start with in agency agreements, with the power to extend the period perpetually if they so desire. It will thus be seen that under the present state of law there is nothing to prevent these parties from securing a perpetual lease. The Tariff Board in its report of 1932 refers to this peculiarity of our agency agreements and states that "in Ahmedabad, with hardly any exception, the agreements are subject to no time limit and are generally described as being permanent and non-changeable."

The extent to which the managing agents are anxious to preserve their perpetual lien on the companies' management, can be gauged from the fact that in a recent case of a new floatation, the agents have provided in the agreement for the payment of a compensation to themselves in case the agency system should by an amendment of law, be terminated and their agreement may thereby be declared a nullity. How far this clause would, under such circumstances, be binding at law is an interesting question, but this incident does serve to display the extent of the anxiety of some of the managing agents lest they lose their cherished privileges.

### **Dummy Directors**

We all know that joint stock companies, according to the principles of efficient organisation, must be effectively supervised and directed by a Board of competent persons. Whatever may

be the case with companies outside India, there is no doubt that in case of most of our companies worked under managing agents, supervision of directors is in many cases almost nominal. It will, no doubt, come as a surprise to many that there are companies who do not hold more than a couple of meetings of the Board of Directors in a year and one rarely comes across an agency managed company where more than one meeting is held per month. This is easy to understand if one remembers that both in the agency agreements and in the Articles of Association, powers of the directors are curtailed to the minimum and as a matter of fact there are a good many cases where the managing agents have taken care to invest themselves with powers which are greater than those of directors. They are thus deprived of most of these powers with wordings such as "directors are not to do such acts and exercise such powers as are exclusively vested in the agents." There are cases where the door is most effectively shut by ordes such as the following :—

"Except where a particular act is required by a statute to be performed only by the Board of Directors or a general meeting, they are to be exercised only by the managing agents till they happen to cease to be such agents."

It is easy to see that provisions such as this make, virtually speaking, the Board of Directors a Board of Dummies for all practical purposes except for passing a few resolutions which the law has expressly provided to be the exclusive function of directors. Here also an amendment of the Companies Act is necessary, so that the directors may be left free to exercise all necessary powers of supervision in the interest of the Company concerned.

### **Arbitrary Transfer of Agency.**

The agency agreement generally provides a complete set of powers under which the managing agents can transfer, mortgage or pledge their agency. Even each member of the agency firm can transfer, assign or mortgage his share to anyone he likes. For any of these assignments, transfers or mortgages, the shareholders', i. e., the proprietors' sanction is not provided for.

The situation created is novel and will be easily appreciated when one realises that it amounts to the fact that your manager, secretary or treasurer, when he joins the service, wants you to give him an agreement for long term of service and in addition stipulates that he shall have the power to retire if he chooses, and when so resigning he shall be at liberty to assign or sell this contract of service to anyone who pays him the highest price for same, irrespective of your consent, or irrespective of the fact whether the said assignee, who is going to be your new manager, secretary or treasurer, is competent and trustworthy in your opinion to carry on these duties and to deal with your capital. The result is that in many cases companies have been floated by managing agency firms of some repute and prestige, relying on whose prestige the public have liberally subscribed large capitals. Later they find that this agency firm gets a good offer for purchasing their agency rights and without consulting the investors, or shareholders, who are the real proprietors, the said managing agents transfer their agency to a firm to whom perhaps these investors would never have entrusted their money.

### **The Law Must Protect the Average Investor.**

There is no doubt a stock argument against this to the effect that it was the business of the investors to have ascertained what powers were there in this agreement. In practice very few investors can possibly do that and those that know of the existence of these powers frequently take it for granted that the said powers are merely formal and will not be exercised. The average investor is a person who is not a specialist either in Company Law or practice, which is a very complicated subject known only to those who have devoted the best part of their time to it. To take a few illustrations, a medical man, an architect, a government or a railway servant, a small shop-keeper, either in the city or on the country-side, who makes an application for shares, not only knows very little about the complications of company law and practice, but has not even the means to get these agreements, Articles of Association, etc., studied and explained to him by competent professional men. The

necessity of protecting this class of investors has been acknowledged even in England, where the company system has existed for centuries, and where the percentage of educated people is not only very high, but they have also the advantage of having to deal with documents in their own language, as against our investors who have to handle them in a language which is not only foreign, but unknown to the bulk of them. Under the circumstances the amendment of company law in this connection is imperative. This right of assignment of service without the consent of shareholders should be made illegal. If it is to be allowed at all, it should be made a condition precedent that the same can be exercised only after the consent of the shareholders by a three-fourths majority has been obtained in a meeting specially called for the purpose.

### **Tariff Board's Views on Transfer of Rights.**

In this connection the Tariff Board also in their Report of 1932 states that

“where such rights are transferred subsequently to the formation of the company, it seems to us but fair to shareholders that their approval should be obtained.” They also state as a result of their investigation that the provision in this form giving powers to assign without sanction either of directors or the company (i. e. shareholders), occurs in most managing agency agreements in Bombay and Calcutta. They further add that “as regards the right conferred on the managing agents in certain cases to transfer the agreement itself there can be no doubt that the exercise of such a right without the consent of the company (i. e., shareholders) is totally against public interest” and assert that “the very existence of such a right in agreements should be condemned”.

### **Agency Remuneration.**

As the agency agreements are, virtually speaking, prepared by the managing agents themselves, while promoting the companies, it is quite open to them under the present state of law to provide for themselves such remuneration as their fancy would dictate to them. There are various ways in which these parties fix their remuneration, the oldest and the most objectionable method being a percentage of commission on the output. This

means that whether the factory, mill or mine, is paying or not, it is to the interest of the managing agents to keep on working indefinitely and never to close the mill, factory or mine, even though the manufacturing cost is at some period higher than the market price. However, the force of public opinion against this form of charging remuneration has been so strong that gradually a large proportion of managing agency firms began to provide for their remuneration on the footing of a percentage on sales. Even this form of remuneration has proved to be working against the interest of the investors, because a percentage on sales means a charge by way of remuneration even though the concern is a largely losing concern. Ultimately, a third form has been evolved primarily through the efforts of late Mr. J. N. Tata, who, I believe, was the first as far as the Textile Industry was concerned, to declare that he would charge a percentage by way of remuneration on net profits only.

### **What Are "Net Profits."**

Of these three forms, no doubt, the last is the most satisfactory form, provided the percentage is maintained within reasonable bounds and the expression "net profits" is made to cover all expenses and charges including bad debts and depreciation. In practice, however, net profits are defined in the agency agreements in various ways according to the fancy of individual managing agent and here the law must interpose with a view to lay down a standard as far as these "net profits" are concerned, on which the managing agency commission may be charged. There are further grossly objectionable cases, such as where the managing agents not only provide for a percentage on sales, but in addition, provide for a percentage on net profits. There is, of course, nothing in law to prevent them from practising this rapacity and in times when the industry is booming, the weakness of the public happens to be that they will invest their money in anything which is offered under the hope of increasing their capital as well as making large profit—hopes that are generally disappointed, but an average investor does not get wiser by these disappointments, whether it happens to be India or England.

## Office Allowance.

The reader might imagine that all managing agents are content with a remuneration in one of the above forms and do not charge more. He will be surprised to hear, however, that that is not so. Not satisfied with getting remuneration on one of the above scales, plus getting all the expenditure of mill, office and their staff fully paid out of the funds of the company, they levy an additional toll on the companies they manage in the form of what they call "office allowance". The man in the street might imagine that this office allowance means an allowance towards the office expenditure, but it is in fact an additional remuneration to managing agents which goes straight into their pockets. The practice to charge this "office allowance" evidently came in fashion during the booming years of war and has remained with us and promises to go on unabated until such time as the legislature chooses to put a stop to it. The Tariff Board report has taken proper notice of it and I cannot do better than quote their opinion in their own language:—

"The contention that office allowance should be regarded, as the phrase implies, as an allowance towards expenses incurred in maintaining the office and not as a form of remuneration is entirely incorrect. We have known of instances where the office allowance is regarded as an additional remuneration for the managing agent while all expenses in connection with the head office are separately debited to the company. The correct conception of "office allowance" is that it is usually meant to cover head office accommodation, rent and taxes, thereon, lighting, fans, Managing Agents' establishment (clerical) share of services of despatch, enquiry and cash departments in several instances, part time services of a Senior Accountant and the Secretarial staff, and in several cases also all postages, stationery, telegrams and menial staff. Office allowance accordingly is a recovery by the Managing Agents of their estimated out of pocket expenditure on behalf of the Company."

This represents the best definition of office allowance and should, we think, be enforced as such at law. The idea which prevails among some managing agents that the "office allowance," or some portion of it, may be regarded as an additional remuneration for the agents should be deprecated.



### **Multiple Directorships.**

The other defect in the organisation of joint stock companies which has grown largely through the operation of the managing agency system and its tendency to conserve vested interests, is that a large number of directorships get accumulated with a single individual who is in one way or other connected with agency firms or agency directorates. These gentlemen, who are the fortunate recipients of these honours, are either those who have not much of business experience to be able to efficiently guide and assist in the management of companies, or if they are in business, they are overburdened with the working of large organisations of their own and in addition are taking active part in public life. Considering that the capacity of a human being is limited, they can hardly be expected to devote adequate time as directors of a number of companies. This practice has tended in concentrating the directorships in the hands of a very limited number of men. The result is that their attention to their duties is irregular and inefficient. Many of them look upon these directorships as a mere sinecure for the purpose of making some extra income. Youngermen are discouraged to find that they are studiously kept out of directorship in spite of their superiority and ability to devote more time and attention to this work. An amendment of law with a view to restrict the number of directorships by laying down the maximum number of directorships that could be held by a single individual is most desirable to be considered in this connection, though all sorts of imaginary difficulties may be conjured up by interested parties against this idea.

### **Lack of Responsibility Among Directors.**

One usually finds among the directors of joint stock companies in this country lack of the idea of the responsibility which their position entails. They consider their occupation to be more or less formal and take it for granted that everything in the natural order of things should be looked after by the managing agents who are virtually their masters. The managing agents on the other hand also know fully well that as long as they take care in the initial stage to get a special clause engrafted in the

Articles of Association, commonly known as the "Indemnity Clause," they are on safe side. This clause virtually lays down to the effect that directors, managers, managing agents and officers of the company are exempted and free from liability for any losses that may result to the company through any cause whatsoever except in case of fraud committed by any of them. Thus as long as they do not commit fraud, they can manage, mismanage, or neglect the affairs of the company without incurring any responsibility, or without being called upon to pay damages. This fact was forcibly brought to the notice of Green's Commission appointed to consider the amendment of English Companies Act and in the opinion of that Commission a "director who accepts office does not conscientiously do so upon the footing that he may be as negligent as he pleases without incurring liability. It is only when he has been negligent and the company has suffered a loss that he is content to take shelter behind the article. It is, moreover, in our opinion fallacious to say that a shareholder must be taken to have agreed that their directors should be placed in this remarkable position. The articles are drafted on the instructions of those concerned in the formation of the company and it is obviously a matter of great difficulty and delicacy for shareholders to attempt to alter such an article as that." Thus articles such as this create a feeling of irresponsibility and encourage negligence, deliberate or otherwise, to the great detriment of industries in general and company organisation in particular. Hence under the new English Companies Act of 1929 Articles of Association of this character are declared to be void and inoperative. We badly want an amendment on same lines with a view to save our own companies from similar negligence. The recent trouble in connection with a group of companies has brought this point into great prominence, because almost all these companies had taken care to have indemnity clauses engrafted in their articles exonerating the directorate and the officers in all cases except for "wilful misfeasance or fraud" or some such other non-provable cause.

In this plea for amendment of our Act with a view to prohibit the operation of the indemnity clauses, I am fortified

also by a decision of the Bombay High Court in the famous Sholapur Bank case, where the Chief Justice expressed himself as follows :—

“I would also like to add that in my opinion this appeal shows the desirability of some amendment of the Indian Companies' Act, 1913, so as to nullify the wide indemnities given by such Articles of Association as Articles 98 & 99 in the present case. In this connection I would draw attention to section 152 of the New English Companies Act, 1929, which in effect makes articles of that nature void.”

### **Woeful Ignorance of Salesmanagership.**

The Managing Agents are there, according to all expectations of the man-in-the-street, in the company's office to “manage” the company. In actual practice that is a delusion in most cases. In case of Cotton Mills, for example, the mill is managed by a special manager who is paid for separately by the company, i. e., the Shareholders. The purchase of cotton, ginning, baling and bringing of same to the mills is mostly entrusted to outsiders called “Purchase Agents” who are, of course, paid separately by the company. When the yarn or cloth is ready it is simply handed over for sale to “Sale Agents”, again a separate set of individuals, who make their own income for that service from the company. Thus the so-called “Managing Agents” actually do nothing here, beyond carefully recording the invoices and account sales and that too for the fabulous remuneration in various forms we have dealt with above. To make it still worse these “Selling Agents” are mostly old-fashioned bazaar merchants entirely ignorant of modern methods of scientific salesmanagement.

### **Monopolies to Ignorant Selling Agents.**

During my investigation and research of this branch of our cotton textile Mill Organisation, I came across a good many cases of this type of ignorant Selling Agents, who are largely responsible for the failure of our cotton textile industry to compete on equal footing with foreigners. These Selling Agents are generally given monopolies for sale of whole of the production of these mills. They run shops, the expenses of

which are in good many cases paid by the mill companies over and above their commission on sales. They have neither the desire nor the ability to push the goods by bringing into operation modern scientific selling methods. Publicity in any form is an item unknown to them. Scientific problems of market research, sales organisation, sales control, planning and directing production according to the changing requirements of the markets, so essential to modern requirements, are like so many closed books to them. Is it any wonder that this old and out-of-date machinery when put into operation against nations who have developed their Sales Organisation to highest scientific perfection, moves slowly, making a lot of jarring noise, stopping short at the psychological moments and frequently breaking down leaving behind its track misery and suffering through the great loss of capital which the patriotic spirited inhabitants of this country have laid out in these companies under the hope of building up national industries?

### **Large Losses Through Out-of-date Production.**

During my researches and investigations I have come across numerous cases where large figures of losses were written off in account, due to the sale at rock bottom prices of large quantity of stock which had gone out of fashion and had become unsaleable. Proper sales organisation would never have allowed this accumulation and overloading by giving a timely indication to the mill manager as to the falling off of demand of a certain quality. Here the incompetent sales agents are generally fast asleep and either do not realise that stock is accumulating to the detriment of the company, or deliberately allow that to be done. I have been repeatedly told by traders in this line of business that it pays these selling agents to allow the stock to be accumulated. According to them there are many of these agents with accommodating conscience, who make money through the buying in of these out-of-date goods at fabulously low prices in the name of their friends and making a margin of additional profit for themselves at a tremendous loss to the companies they pretend to be serving. Even granting that the number of this type of dishonest Selling Agents is

limited, the proverbial inefficiency of these men is enough to condemn the system which makes their employment necessary.

### **This Old System Must Go.**

Any system of Management which cannot control and direct sales departmentally in these days and that too on scientific lines so essential to present-day market requirements has no place in the modern world's economic organisation. To continue to run any industry in this country on a system which did some service in the times of our grandfathers is equivalent to deliberately sounding its death-knell. I have had occasions in course of my discussions on behalf of Shareholders to impress this factor on many Mill agents working hand in glove with these old-fashioned selling agents. They admitted in almost all cases the force of my contention, but tried to riggle out on lame excuses, such as want of time for specialisation on sales, want of efficient finance, pre-occupations in other walks of life, etc.—factors which could easily have been got over through one simple determined effort. Under these conditions is it worth while to continue an industry—particularly a heavily protected industry—under these “won't learn and can't learn,” unchecked or uncontrolled by proper legislation, is the question which an average citizen may well ask. The answer is obvious.

### **The Modern Conception of Salesmanship.**

If we look around us with a view to cast a cursory glance over the system in application in the Sales Organisation in countries of our competitors we are surprised to find how hopelessly backward we happen to be. I am particularly making a reference to this factor briefly, in the hope that the ideas I am enunciating may catch the public eye to the benefit of our country. In Europe, America & Japan every large manufacturing concern, or Sale Agency Firm, has in operation a series of carefully laid out plans along which they work with vigilance and almost unerring methods. The Salesmanager of these organisations is a highly talented individual with a specialised education and experience. He has under him the publicity department, with

experts in that line, who apply the latest methods of scientific advertising to the sales problems that arise daily in connection with the business. This publicity has for its foundation the principles of psychology, which are applied to the drafting of all copies for advertisements, circulars, sales letters, catalogues and similar sales literature.

### **Special Departments.**

The drafts of the sales literature are prepared under the direction of the salesmanager. A special department made up of an army of travelling salesmen regulates the sales campaign all over the world according to the peculiar requirements of each province, district town, country or locality. One other department looks after what is known as market research. The objective here is to investigate in specifically chalked out localities by repeated researches as to the changing wants and requirements of products and manufactures in which the company is interested, in order to ascertain the reason why other brands are more popular than ours, to warn the management in time as to any new prejudice that may be arising against their own wares, to give him timely hints as to where a competitor is losing ground so that his customers may be captured, to suggest new lines which are likely to widen and expand the scope of business, etc. These researches are conducted among dealers called "dealer research" as well as among consumers, known as "consumer research." Special shops are opened under assumed names, keeping the public in the dark as to the real owner being the manufacturer himself, called "laboratory shops", where wares of all manufacturers in the same line of business as well as those of the company are sold. The object here is not to make profit but by a scientific application of sales methods, through specially engaged experts in charge of those shops, to make a close record in form of statistics as to the nature of demand for each brand, the class of customers buying same, the quantity in demand by each class, the quality in demand, etc. Through tactfully conducted conversations, a good many points are collected from customers which are arranged in proper order and indexed for guidance of the Salesmanager at the Head Office. How many

of our Managing Agents, or our Sales Agents, have the slightest conception as to these modern methods of sales management in active operation in other countries, which are so successfully applied against them by their foreign rivals?

### **England's Experience.**

When I was last in England in the middle of 1932, I was handed a copy of a Report which was just then published. This Report was published by a Special Committee, or Commission, appointed by the British Government to investigate and report on the question of scientific salesmanagement. The British manufacturers found themselves beaten gradually out of many of their important markets, both within and out of the Empire, through the superior Sales Organisation methods of other countries. In order to check this setback and if possible to recapture lost ground, this investigation was conducted under the able Chairmanship of Sir Francis Goodenough, one of England's best businessmen. The result of this investigation was that a great emphasis was laid on the fact that Salesmanagement and Organisation under modern conditions was a profession which required highly talented men with specialised scientific training. The lines along which this training should be directed were actually indicated in some detail and a special syllabus and Diploma of Salesmanagers were ultimately evolved. Under these conditions, what chance is there for these old-fashioned Managing Agency Organisations, or their much less efficient sales agents, to keep their head above water, even if spoonfed by protective tariffs at an enormous cost to the nation? The only course open to our industrialists, if they wish to prevent our industries from being wiped out through foreign competition, is to introduce departmental organisations for sales in these companies, do away with out-of-date sales agencies, and study the methods of our rivals with a view to take measures in order to meet them on equal footing. For this purpose an army of efficiently trained youngmen would be necessary and this country has never shown any lack of talent in this direction, which I can vouch from my experience extending over thirty-five years.

## **Agency Inefficiency In Production.**

We have considered the inefficiency of the Agency system in Salesmanagement. We shall now proceed to consider some items of their woeful inefficiency in connection with production.

There is hardly any cotton mill which maintains a modernised system of cost accounts by which the actual cost of production at every stage of manufacture can be continuously measured. This living touch with the fluctuating cost, due to market conditions, applies to raw material, as well as to cost of labour, efficiency, or otherwise of machinery and plant, so essential to modern conditions of keen competition being absent, our company management is hopelessly at sea when asked as to what the finished stock as produced from time to time has actually cost them. The cost under the present unsatisfactory conditions is arrived at on a more or less haphazard basis and in many cases it is valued at market price. Cost Works Accounts in Europe and America form a highly specialised science with which an ordinary Chartered or qualified Accountant is unable to cope, but to practice this specialised profession a band of specialists has been formed there. It is time that our manufacturing companies took note of this vital factor and took steps to introduce this system under experts.

## **Our Labour Conditions.**

Our labour conditions are also a handicap to the well-being of our industry. In the countries of our rivals in industry, labour is highly intelligent owing to the spread of education. Our illiterate labour, though sufficiently intelligent as far as their illiterate condition would permit, is a great handicap. The fault, of course, here lies with the State which has neglected the call for free and compulsory primary and industrial training for so long. In other countries labour being sufficiently enlightened appreciates the advantage of a high standard of living, and is led by men drawn out of its own ranks, who know exactly where the shoe pinches and where the shortcoming and strength of their own class lies. They are able to appreci-



ate the fact that higher wages can be paid by an industry, only if the labour efficiency warrants same, and being drawn from working class, are able most effectively to impress this factor on their comrades, whose confidence they command to an exceptional degree, due to their peculiar position as real labour leaders. It has been repeatedly pointed out that the world famous Mr. Ford of the Ford Motor Car Company of U. S. A., pays the highest wage in the world and at the same time, produces the cheapest motor car on the world's automobile market. This paradox is explained by the fact that this establishment is under the direction of the most efficient scientific Management, assisted by world's most efficient labour and machinery. This organisation offers the highest wage, and thereby secures services of the most efficient labour which flocks to this factory in preference to others in the same line of industry. Unless, therefore, our labour responds to the call for efficient and large production at the lowest cost, by satisfactorily working the most up-to-date machinery and conscientiously making all efforts to produce manufactured articles at the same cost as the workmen in Japan, Lancashire or U. S. A., we cannot expect the industry to flourish or expand to the advantage of all concerned.

### **Labour-Saving Machinery.**

I do not here forget that good many of our managing agents are not taking effective steps towards introducing efficient machines; but the fact must be admitted by all true lovers of industry that, in cases where attempts have been made to introduce latest innovations, such as automatic looms, etc., our labour unfortunately has not responded to it as it should have. This attitude is due either to their lack of education which makes it difficult for them to understand the economic factor involved, or to the want of proper lead by those who guide them. No doubt there is natural inclination on the part of labour in all countries not to take kindly to labour saving devices, lest their scope of employment may be reduced and their compatriots be thrown out of work. The alternative is wiping out of the industry altogether in competition with outsiders, whose labour responds to

the labour-saving machinery which unfortunately is lost sight of. Experience of countries where this labour-saving machinery is in work has shown that though in early stages labour did suffer a small setback, the ultimate result was cheap production, more orders for manufactured goods, expansion of industry, much larger employment of labour than before and over and above all these much higher wages paid to the more efficient labour. In fact labour here is always able to successfully demand higher share of takings in form of wages, bonuses, etc., from a flourishing and efficient industry. An inefficient industry which has to be maintained by artificial stimulants in form of protective tariffs can hardly be expected to do that. Efficiency in management thus constitutes both able organisation at the office and factory, as well as efficiency of labour. It is thus necessary that both the State as well as industry should provide better facilities for education and training of young work people, than that provided for at present. Our labour leaders should particularly concentrate their attention on this demand, so essential to the building up of efficient labour, which alone can bring us nearer the day when we can claim to compete on equal footing with other industrially advanced countries.

### **Diet and Labour Efficiency.**

There is one other factor which plays an equally important part in influencing the efficiency of labour, viz., diet. In this connection the excellent paper on "Dietetics, Food and Race," by Prof. D. D. Kanga, I. E. S., of Gujarat College, is of absorbing interest to all interested in the labour problem. The learned Professor shows how diet has influenced the low physique of workmen in Bombay and explains why those who hail from Kathiawar, Rajputana, Punjab, etc., are blessed with better physique by reason of their dietary. In Japan scientific kitchens prepare and distribute food among industrial workers with excellent results, as health physique and the power of work-people to resist fatigue and produce more efficient work so largely depends on their diet. Have our Industrial Managers ever allowed this factor to enter into their calculation? Have they ever thought of consulting our own experts like Prof. Kanga?

## **Application of Science to Industry.**

There is one more factor which has played so important a part in the economy of all industries and that is the application of science to it. An old friend (a very high educational officer), who has devoted a life-time to the study and research in this line, handed me the other day a booklet containing a lecture by Principal Wheeler of our Royal Institute of Science, in which the subject of application of science to our Cotton Textile Industry has been so ably treated. This lecture was published more than a year ago and I wonder if our Mill agents have had time to study carefully and consider the propositions of so great practical value to the industry, as enunciated in this lecture. Principal Wheeler shows how a scientific burning of coal results in great economy in fuel and in the corresponding cost of production. The scientific treatment of water, so largely used in the industry for the purpose of steam raising for various processes in the treatment of cotton and for dyeing and the great economy resulting therefrom, is particularly emphasised by him. He shows the great necessity of getting purchases in stores such as oil for lubrication, dyes and colours, analysed with a view to test their purity, as well as for making sure of getting a standard quality that would surely guarantee the highest producing results. In the process of bleaching, as well as in the regulation of the standard of humidity in spinning of cotton, etc., supervision and control of a practical chemist is so urgent. The same is the case in connection with sizing and finishing.

## **Laboratory And Research Work.**

It is here suggested that each mill, if not each group of mills, should have a properly fitted laboratory for analysis and research. This would not only keep a good number of chemical graduates of our University employed, but would also serve to economise the expenses of production, improve its quality, and above all help the industry largely through researches which the laboratory experiments succeed in making—researches which may, as has happened in other countries, revolutionise the whole position of our Indian industries. This is not a new idea, but is one that is being applied in practice with great success

in advanced countries such as Germany, England, America and Japan, to almost all industries, to the great benefit of the countries concerned. When will our Mill agents, and particularly our Mill-owners' Association, wake up and make a beginning by starting at least one Central laboratory in which its members can get the assistance of experts employed out of a common fund ! As soon as the advantages offered by this course are realised, each industrial concern may soon see the advantages of having such laboratories on their own. If the Mills were run under an independent Managing Director with an independent Board, this innovation could be introduced with greater ease than is the case with hereditary Managing Agency, with its vested interests in conflict with this idea of analysis of stores used, or perhaps through sheer want of imagination and initiative on the part of those with minds cristalised with old-fashioned notions.

### **Technical Training and Scientific Inventions.**

I should particularly urge this idea on those connected with industries in this country because, Bombay University has now, at great cost, introduced a Department of Technology which will soon produce science graduates with a specialised technical knowledge. If these men are not employed and taken full advantage of by our industrialists, public money spent will have been laid out in vain and those in charge of Management of our Industrial concerns will most deservedly earn the contempt of the Indian public. Considering that our textile cotton industry purchases stores and materials running into crores, one has to use very little imagination in order to be convinced that the application of science, as indicated above, would save lacs of rupees to the industry, not to say anything about the tremendous effect of some exceptionally great invention which our Indian talent in course of time may bring out through this encouragement in research. The example of German invention of the synthetic production of analine dyes, as against the natural dyes, used in good old days, may only be cited as an illustration of what such an invention may do for the country of its origin. The other illustration is that of Messrs. Lyon & Co., of England, who are large caterers, The idea of recruiting scientific assistance

for their business seems to have occurred to them. They began with one small laboratory and one chemist in 1919. This experiment proved so successful that they at present employ nearly 80 well paid chemists, working in their laboratory in both analytical and research branches. This problem cannot thus be too strongly emphasised and it is hoped that the facts and ideas I am putting forward in this connection and in connection with Scientific Organisation, of sale and production, would circulate among our Indian businessmen and bear fruit to the benefit of our country.

### **Restriction on Transfer of Shares.**

The Managing Agents, who are generally promoters of companies they manage, take care to get a clause introduced in the Articles of Association by which absolute discretion is given to the Board of Directors to refuse to effect any transfer of shares that may be brought forward at their Board Meeting. This restrictive clause also specifically provides that "they shall not be bound to assign any reason for such refusal." This power has been repeatedly exercised most arbitrarily in order to keep out an inconvenient person who is in the habit of attending meetings and asking rather embarrassing questions in the exercise of his rights as a shareholder. The justification for the reservation of a power of refusal of a transfer may be urged with some show of reason in case of partly paid shares, on the ground lest the same may be transferred to a party without means, but one finds no excuse for refusing a transfer of fully paid shares. According to the decided cases if any reason is assigned by the directors for their refusal, the Court would go into it with a view to ascertain the equity of it, but where no reason is assigned and the Articles are worded as we have seen above, the Courts refuse to compel directors to disclose reasons. We should, therefore, get a sub-section added to Section 34 of the present Act to the effect that any clause in the Articles which gives power to the directors to refuse to register a transfer of fully paid shares without assigning reasons is void and that refusal should only be allowed in case of fully paid shares, assigning reasons. This is but just, because the share in a company represents property rights, both of voting and

sharing in the companies profits and there is no reason why the holder of such a share should be unnecessarily fettered with obstructions in the exercise of his right to sell or dispose off this property.

### **One Other Undesirable Obstruction.**

The present Companies Act [Sec. 76 read along with Sec. 131 (3)] lays down that the Balance Sheet and the Report of Directors with the notice of the Annual General Meeting ought to be sent to the member, or shareholder at least seven clear days prior to the meeting. The Managing Agents generally provide in the Articles that if a person wants to vote by proxy, the said proxy should be lodged at the company's office at least four days prior to the date of the meeting. Now supposing that the accounts and Report disclose some glaring irregularities and a group of shareholders want to take concerted action in order to have a investigation committee appointed, or for some other equally important purpose, they have only three days, or even less, left open after receiving the Report, etc., for inspecting register of members and obtaining names and addresses of present shareholders, circularising their propaganda and obtaining and lodging proxies. The Managing Agents on the other hand generally secure in advance their proxies, anticipating trouble. In other words, by this subterfuge of leaving a very short time in the hands of shareholders, Managing Agents make it impossible for shareholders to exercise their valuable rights. I have felt this difficulty personally, repeatedly, when trying in co-operation with my colleagues of the Bombay Shareholders' Association, to secure and lodge proxies in time when we wanted to take some action at a meeting of shareholders. It is thus necessary to make at least a fifteen days' notice of Annual General Meeting compulsory and at the same time to limit the time for lodging the proxies to two days.

### **A Juggle with Votes.**

The Companies Act (Sec. 79) makes provision for one vote for one share, but at the same time it lays down that this rule

is subject to any provision to the contrary in the Articles. This leaves the door wide open to the Managing Agents and the promoters of companies, because here there is nothing to prevent them from providing that a particular class of share, such as the Preference or Ordinary share, shall not have any vote. It is also open to them to state, for example, that there shall be one vote to every hundred shares held. This is not an imaginary theoretical supposition because I was myself a victim of a banking company which failed many years ago, having its head office in Burma and Branches in this country. Until the date of its failure its shares were quoted on the Bombay Stock Exchange at thirty-five per cent premium, based on the assumption of roaring business supposed to be done by the bank according to its Balance Sheets from year to year. When the sudden and unexpected crash came, like the bolt from the blue, a hasty meeting was held of shareholders and the creditors in Bombay. A suggestion was put in to collect proxies for the meeting of the company which was to be held in Burma, where a voluntary liquidation was to be resolved upon and which we wanted to prevent and convert into a resolution to wind up compulsorily by the Court. The initial difficulty was that none of us shareholders had a copy of the Articles of Association of the company. In fact, there was none available in Bombay. When one was ultimately obtained, we discovered that none of us were qualified to vote as none of us had one hundred shares. It will thus be seen that with Articles like these limiting the voting power and at the same time one other article providing for a refusal to register a transfer without assigning any reason, a Board of Directors under an intriguing Managing Agent, can easily see that none held a hundred shares, except the partners or the henchmen or nominees of Agents themselves. It is thus imperative that this Sec. 79 should be amended so that one vote is carried compulsorily by the holder for each share he holds.

### **Minutes of Shareholders' Meetings.**

Our Act (Sec. 83), does not contain a specific provision by which a shareholder can call for the inspection of the minutes

of previous meetings of shareholders. One should have thought that under the ordinary principles of the common law of meetings a shareholder would be entitled to get this inspection. There was some doubt as to the position of law in this respect and in actual practice such an inspection was refused in case of some companies in Bombay. The English Act of 1929, however, now specifically provides that such an inspection must be given, a failure to do so was subject to a fine and a similar addition to our act is most essential.

### **How to Centralise Supervision Effectively in the Hands of Shareholders.**

We have already in a previous article seen how irresponsible are the directors. The selection and approval of directors is in theory of law assumed to be the primary function of shareholders. In practice very little is left to these real proprietors of the company. The first and original directors are the nominees of promoters, generally the Managing Agents. There is nothing in law which empowers the shareholders to remove directors. If they are to do so, Articles of Association must give them the necessary powers (which in practice are seldom given). One cannot expect the authors of the Articles to provide a weapon for the shareholders to decapitate them. The retirement by rotation is provided for generally, but it is a safe provision. It is very seldom that shareholders can use as we have already seen, this power within the seven clear days' notice with about three days' interval to lodge proxies effectively unless they work for this in anticipation of the Report and Meeting, the dates of which are fixed at the entire discretion of the directors and Agents. The modification of law here is suggested from the Canadian Banking Act, which though it applies to Banking companies may well be considered in case of all Joint Stock Companies. Here the shareholders can regulate at general meeting by bye-laws (as distinct from the Articles which can be altered by three-fourth votes only) matters affecting appointment and removal of directors, their share qualifications, the time for lodging of proxies, the



quorum at directors' meetings, method of filling in vacancies in the office of directors, amount of loans (if any) that can be made to directors. Every five years the bye-laws have to be presented to the shareholders for approval or alteration. This is an excellent arrangement as it gives great control to the shareholders on the management of a most healthy character, which would prevent a good many abuses practised at present under our Act. The other alterations of the Act as applying to directors should be:—(1) directors should be prohibited from soliciting proxies as against shareholders; in practice it is a common practice of directors and Agents to collect blank proxies without any meeting within sight and use same as and when required; (2) it should be made compulsory to state the number of board meetings held during the year; (3) as to share qualification of a director it should be provided that shares held by him should be his personal property and not held as a trustee, and mortgaged shares should not be allowed to be counted in same; (4) a person should not be a director in more than a certain number of companies (at present some persons hold as many as 80 directorships); (5) when vacancies in the office of directors are filled in, in the midst of the year, the shareholders should be specifically empowered to remove this nominee of directors or agent and replace him by a director of their own choice. At present under the present state of case law, this cannot be done, unless there is a power in the Articles of Association to this effect which the Agents and Directors are not so obliging as to provide; (6) in case of Managing Agency Companies the Act should provide that at least three-fourths of the Board of Directors is made up of independent persons, i. e., not connected directly or indirectly in business with the Agents; (7) it should also be provided that when a contract is being considered in which a director is interested, the interested director should not be present. The present Act only provides that he should not vote and should not be counted in the quorum; but the case law has laid down that this interested director has a right to be present when this contract is being discussed. This naturally puts the other directors in an embarrassing position.

### **Assignment of Office of Directors should be with the Consent of the Company.**

Under the present Act the office of a director or manager can be assigned by him in case the Articles of Association allow that being done. This assignment can, of course, be made without the consent of shareholders under the circumstances. This practice is, in the opinion of Green's Commission for Company Law Amendment in England, most undesirable. The reason assigned in the Report of the Commission is "when such a provision is in force, the company is deprived of all effective control over its directors and managers and the holder of office is in a position to force upon the company for his own benefit any person whether suitable or not who is willing to pay a price. This reason cannot be improved upon and applies to Managing Agents' Agreements, particularly where such powers are provided for. The result is that the British Parliament accepting this recommendation has now added a Section in the English Companies Act of 1929, being Sec. 51 providing as follows:—

"If in case of any company, provision is made by the Articles or by any agreement entered into between any person and the company for empowering a director or manager of the company to assign his office as such to another person, any assignment of office made in pursuance of the said provision shall, notwithstanding anything to the contrary contained in the said provision, be of no effect unless and until it is approved by a special resolution of the company." This is, no doubt, an excellent section worthy of incorporation bodily in our Act.

### **Punishment to the Delinquent Directors.**

Under the present Act when the delinquent directors or officers are, in course of liquidation, found to have committed fraudulent or other criminal acts, the liquidator has to launch a prosecution at the expense of the company itself. The result is that the creditors and shareholders object to the assets, which may have been left over after this mishandling of the companies affairs,

being further wasted on prosecution expenditure for the fruitless purpose of vindicating wrongs through getting these delinquents punished. They generally clamour for division of as large a dividend out of these assets left over as possible, with the result that the delinquent directors and officers are not troubled in the matter *i.e.*, they go scot free. In the English Act of 1929, a section has now been added on recommendation of the Green Commission, under which it is laid down that if during the course of liquidation it appears either to the liquidator in voluntary or compulsory liquidation, or to the Court, that an offence has been committed by any officer or director of the company, they should send up the papers to the director of public prosecutions with instructions to take action on it. This prosecution, of course, would be conducted at public expense by the public prosecutor if he is satisfied that a *prima facie* case has been made out. We should have a similar section inserted in our Act. It may be mentioned, however, that some years ago the late Justice Sir Dinshaw D. Davar sent up a case for prosecution of a company officer on his own, acting under the inherent powers of the Court, but this course has never been followed since, as evidently there is some doubt on the subject in absence of a clear legislative sanction such as contended for above.

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Printed by Mr. G. G. Bhat at the "Advocate of India" Press,  
9, Bakehouse Lane, Fort, Bombay, and published by  
Principal Sohrab R. Davar, at Davar's College,  
80, Esplanade Road, Fort, Bombay.

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