

INDIAN PRIVATE CORPORATE SECTOR: SOME CHARACTERISTICS AND TRENDS

K.S. Chalapati Rao *

In the wake of new economic policies, the corporate sector has been assigned the role of the main leader of the growth process. Joint stock companies occupy an important position in organised economic activity. They account for almost sixty per cent of gross output and net value added and nearly half of the employees in the factory sector of the country. In small scale sector too they play an important role. While in terms of numbers, companies accounted for only 2.01 per cent of registered small scale units at the end of March 1988, their share in production and exports was about 22 per cent. Functioning of the corporate sector has important implications for the economy. The number of companies in the country increased from 2,24,000 at the end of 1990-91 to 4,09,000 by the end of 1995-96. The corresponding figures of paid-up capital were Rs. 75,000 crores and Rs. 1,61,000 crores respectively. At present, the number of companies at work is reported to have exceeded 4.5 lakhs thus within a span of six years, the number has doubled.

Companies Act being an important piece of legislation governing the incorporation, management, administration and winding-up of companies, the government sought to replace the existing **Companies Act, 1956** to enable the sector to discharge the role of prime growth agent. A new Companies Bill was introduced in the Parliament in the just concluded Monsoon Session.¹

The Background

There is a context within which the reform of corporate legislation should be viewed. In the words of R.C. Dutt:

The twin problems of corporate morality and corporate efficiency constitute the basic objectives of Company Law. ... The contents of Company Law at any given point of time, and also the day to day policies of administration of the law must naturally depend on the prevailing context in which the law is framed and administered. Both law and its administration must take into account the prevailing standard of behaviour, and provide for and concentrate on the means for its improvement².

The initial tightening of the Indian Companies Act was largely a response to the ills identified with the Managing Agency system and the Dalmia-Jain affair.³ In the early 'eighties, the attempt to take over DCM and Escorts by Swraj Paul raised certain issues regarding the role of financial institutions and family managements. During the early and mid-'eighties, Reliance Industries was in the news on more than one occasion whether it was the NRI investments, bank loans or the attempted take over of Larsen & Toubro (L&T). The issue of corporate democracy was raised in the context of Reliance take-over of Larsen & Toubro. L&T affair also brought to focus the problems with professional managements. Professional managements further came under suspicion with the ITC and Shaw Wallace affairs breaking out.⁴ The manoeuvres associated with the merger of Escorts Tractors and Escorts Ltd⁵, de-subsidiarisation by LMW, inter-corporate investments of the Kalyani group⁶, investments by group companies in Tata Sons, Reliance share switching affair and the subsequent reports on Income-Tax investigations, crashing down and exposure of many upcoming groups, revelations in case of sick companies like Incab, Hoist-O-Mech, SLM Maneklal and J.K. Cotton indicated the darker side of the Indian private corporate sector.

The Indian capital market started playing an increasingly important role after the introduction of new economic policies in 1991. The number of issues and amount raised from the market reached unprecedented levels. However, it has been alleged that the promoters failed to utilise the funds raised for the stated purpose leading the market to a slump. Also, in a policy vacuum, managements, especially foreign ones, raised their stakes in companies under their control by questionable means and at prices substantially lower than the market prices. Following the exposure of CRB group, a number of unsavoury facts about the operation of non-banking financial companies came to light.⁷ Given the enthusiasm of the Indian public to participate in the capital market especially till a couple of years back, companies' reliance on public financial institutions got

* Associate Professor, Institute for Studies in Industrial Development, New Delhi.

This paper is based on an ongoing study at the Institute. The author is grateful to Prof. S.K. Goyal, Director, ISID, for his encouragement and advice and to Prof. K.N. Kabra, Prof. D.D. Narula, Shri Arun Goyal and other colleagues at the Institute for their helpful suggestions. The views expressed and the conclusions arrived at in the article are those of the author in his personal capacity and neither the Department of Company Affairs nor the organisation where the author is employed are responsible for the interpretations and opinions expressed.

reduced substantially and in many cases the question of monitoring by the public financial institutions does not arise. SEBI's efforts at streamlining the takeover code, entry of foreign institutional investors in the Indian stock exchanges since 1993 and enlarged scope for foreign direct investment have increased the take-over threat for the domestic industrialists.

Liberalisation of the Companies Act is being attempted in the background of the happenings cited above. In the following we make an attempt to bring out some of the broad contours of and developments in the sector over the past fifteen years or so, which, we feel, have important lessons for framing new company law. The emphasis here is on number of companies rather than on their size. This is because, the effort is mainly to understand the characteristics of small companies which outnumber the larger ones to an overwhelming extent and which are now proposed to be freed from stricter company law norms.

Exploding Numbers

The number of companies in the country experienced a quantum jump during the past one and a half decades. From about 56,000 at the end of 1979-80, the number of companies at work reached 4 lakhs by the end of 1995-96. (See Table I) During the fifteen years (1979-80 to 1994-95) nearly 3 lakh companies were added compared to the addition of just 30,000 during the preceding fifteen years (1964-65 to 1979-80). 1994-95 itself witnessed the birth of a little less than 48,000 companies which number is almost equal to those existing in 1977-78. New company registration scaled further heights with more than 56,000 companies getting registered in 1995-96. This increase in numbers is due mainly to registration of new non-government companies, more particularly non-government private limited companies. Average yearly registration of government companies has been negligible compared to the non-government companies. At the end of 1995-96 there were 1,216 government companies which accounted for just 0.3 per cent of companies limited by shares at work in the country.

Table I: Number of Companies at Work: 1959-60 to 1995-96

Year end	No. of Companies at Work*
1959-60	27,000
1969-70	29,000
1979-80	56,000
1984-85	1,09,000
1989-90	2,02,000
1994-95	3,53,000
1995-96	4,09,000

* Rounded off to the nearest thousand.

Source: INDIA, Department of Company Affairs, *Fortieth Report on the Working & Administration of the Companies Act, 1956*.

Within the non-government sector, private limited companies have a share of 86.1 per cent. Further, within the public limited companies it is reasonable to assume that companies whose shares are listed on the stock exchanges will be in minority. For instance, the total number of companies listed on the Bombay Stock Exchange is in the vicinity of 6,000. The International Finance Corporation placed the number of listed domestic companies in India in 1995 at 7,985.

New registrations generally peak in the month of March every financial year as was observed for the period 1987-88 to 1994-95. Almost invariably there will be a sudden fall in the subsequent month i.e., April. One wonders whether this financial year-end phenomenon signifies the use of companies for certain book transfers, adjustments and tax-planning.

Dominance of Small Companies

It is the small private limited companies which dominate new registrations to an overwhelming extent. Generally the authorised capital follows slabs of investment like 1 lakh, 5 lakhs, 10 lakhs, etc. Going by this experience, it can be seen that companies with up to Rs. 5.00 lakhs authorised capital accounted for nearly two-thirds of all non-government private limited companies registered in 1995-96. If those with Rs. 10.00 lakhs authorised capital are also treated as small ones, the share of small companies would be as high as 86.7 per cent. Even if public limited companies are also taken into account, the corresponding share still turns out to be high at 81.8 per cent.

Table II: State-wise Distribution of Non-Government Companies at Work at the end of March 1996

State	No. of Companies	Share in Total (%)
(1)	(2)	(3)
Maharashtra	88,467	21.69
Delhi	73,084	17.91
West Bengal	58,580	14.36
Tamil Nadu	35,878	8.80
Gujarat	27,754	6.80
Sub-Total	2,83,763	69.56
Total Incl. others	4,07,926	100.00

Source: See Table - I.

Dominance of a Few States and Urban Centres

Heavy concentration of companies in a few states is yet another feature of the Indian corporate sector. Only three states account for more than half of the total number of companies at work and the share of top five states -- Maharashtra, Delhi, West Bengal, Tamil Nadu and Gujarat -- was a shade less than 70 per cent at the

end of 1995-96 (See Table - II). On the other extreme are states like Tripura, Manipur, Nagaland, Arunachal Pradesh, Meghalaya and Mizoram which could together attract just 52 companies in a total of about 56,000 non-government companies registered during 1995-96.

Another important feature of company location is concentration within a few districts in many states. In a number of cases just three districts account for a massive share of company population within the respective state. For instance, in the case of Maharashtra, Greater Bombay (81.43%), Thane and Pune accounted for 92.75 per cent of the companies registered in the state at the end of 1992-93. The situation is equally acute in the case of West Bengal where Calcutta (88.01%), Howrah and Hooghly had a combined share of over 93.33 per cent of all companies in the state. Such high levels of concentration exist in many other states also. In the case of Andhra Pradesh, three-fourths of the companies at work had their registered offices in Hyderabad (twin cities) and the neighbouring Ranga Reddy districts. Seventy eight per cent of the companies in Karnataka were registered in Bangalore District; Madras accounted for nearly two-thirds of the companies in case of Tamil Nadu; Jaipur and Ahmedabad accounted for a little over half of total registrations in case of Rajasthan and Gujarat respectively. It is obvious that these districts also happen to cover metropolitan cities and major urban centres. Thus, just sixteen districts with more than 2,000 companies each accounted for nearly three-fourths of the non-government companies existing in the country at the end of 1992-93. This may not be surprising because, Bombay was practically representing Maharashtra and Calcutta the State of West Bengal. Delhi for all practical purposes is a single district. Indeed, these three city/districts, accounted for almost half of the companies in the country.

Increasing Share of Finance and Trading Companies at the Expense of Manufacturing Sector

Yet another development since the 'eighties is that the share of manufacturing sector in new company registrations has been declining (see Table - III). In 1979-80 the share of the sector stood at 56.83 per cent which by 1989-90 dropped to 47.42. It further declined to 27.43 per cent by 1995-96 or to less than half its share in 1979-80. More importantly, in the wake of substantial increases in yearly registrations, the manufacturing sector did not attract larger number of companies. In all the years till 1993-94, the annual registration of manufacturing companies was below the 1988-89 level. Trading, investment, real estate and business services gained at the expense of the manufacturing sector which lost both in relative as also

absolute terms. In 1995-96 finance related companies alone accounted for as much 35 per cent of the companies registered during the year. In all, more than half of the companies registered during the year were classified under trading and investment related activities. This clearly goes to show the growing importance of these two categories of companies. Declining share of manufacturing sector, however, need not imply a genuine growth of the services sector. In view of the importance of trading and investment companies, the questions of who promote them, where from they get their capital, where do they invest and what do they trade become important.

Table III: Share of Manufacturing Sector in New Registrations of Non-Government Companies

Year	Share of Manufacturing Companies (%)
1979-80	56.83
1984-85	51.43
1989-90	47.42
1994-95	28.03
1995-96	27.43

Source: Various issues of the Annual Report on the Working & Administration of the Companies Act, 1956.

While the significance of Maharashtra in company location could be due to its commercial and industrial importance, the fact of Delhi and West Bengal occupying the next two positions seems somewhat puzzling. Delhi may possibly be acting as a proxy not only for many neighbouring northern states but for other locations as well. A number of foreign companies incorporated their subsidiaries and affiliates in Delhi using the services of local solicitors, auditors and consulting firms. Obviously, location of a registered office does not mean location of the manufacturing unit as well. One can shift the office once the company starts its operations or continue to have the registered office there if the place happens to be group head quarters. An attraction of Delhi could also be that it is an important administrative centre, being the capital of the country. This factor may have influenced many industrialists, more so those belonging to Northern India, to make Delhi their base.

Developments in West Bengal (or more precisely Calcutta)

The case of West Bengal, however, is more intriguing because it is well known that the state has been losing its importance in Indian industry for quite some time. There are also no indications as to the compensatory growth in commercial activity to justify the state's prominent position in company registration. The State continued to maintain its high rank in company location, accounting for about 14 per cent of all non-

government companies at work at the end of 1995-96. Relating registrations with the activity classification might give some clues as to what is responsible for the high share. It has been seen in the above that trading and investment companies have gained importance during the recent years. To these categories one may add construction companies also (hereinafter the three categories are referred to as TIC -- Trade, Investment & Construction -- companies⁶). The top five states had a 77.8 per cent share with the top three together accounting for 62.4 per cent of the TIC companies registered in 1994-95. West Bengal led the group with as much as 23.3 per cent share in the national total of TIC companies registered during the year. Most of the TIC companies are small as nearly two-thirds of them had Rs. 5 lakhs or less of authorised capital. Since the subscribed capital will generally be much less than the authorised capital and in any case it cannot exceed the authorised capital, the smallness of TIC companies becomes more clear.

A striking feature of registrations in West Bengal during 1994-95 was the overwhelming share of 85.3 per cent for TIC companies in the total 7,900 companies registered in the state. The corresponding share for Delhi was 64.6 and for Maharashtra it was 61.5. Sixty one per cent of the TIC companies in West Bengal had sought an authorised capital of Rs. 1 lakh or less. If one takes Rs. 5 lakhs authorised capital, the corresponding percentage works out to 77. The tiny nature of TIC companies in the state thus becomes quite evident.

What strikes one most when going through the new registrations in the state is the phenomenon of common addresses and the manner in which company names were formed. For instance, in March 1995 as many as 83 companies were registered at 23A N.S. Road, Calcutta. Another 33 had their registered offices at 23 N.S. Road. 9/12 Lal Bazar Street, another favourite location, became home for 42 more companies. While in one month certain addresses turn out to be prominent, in another some other ones get the pride of place.

Even a quick look at new monthly registrations reveals the extent of mockery in company registration in the state. The formula appears to be as follows: take an existing word or coin a new word and start adding terms like 'COMMODEAL', 'DEALCOM', 'NIRYAT', 'VYAPAR', 'COMMERCIAL', 'SALES', 'MARKETING' and the like and go on creating 'new' companies. Another formula is to roughly retain the second word and start prefixing it with different forms of a name. 43 private limited companies were thus registered in May 1995 in Calcutta at 98 Christopher Road with an

authorised capital of Rs. 5 lakhs each and industry code 82 (real estate). Generally the first part of the word indicating Ganesh and the second part 'Properties'. Another set of 35 'Properties' companies each with Rs. 5.00 lakhs authorised capital and 82 industrial code were registered during July - August 1995 at HMP House, 4 Fairlie Place, Calcutta -1. While the first part of the name was invariably HMP or HMP Snehalata, the second constituted a city name or a locality in the city. Even if one assumes that for operational convenience, separate companies were promoted to deal with properties in different cities, one fails to understand the need for 4 companies for properties in Hyderabad.

While the phenomenon of repetitive registrations at certain locations in itself is important, probably a more worrisome factor is the possibility of inter-linkages among many such addresses. For instance, SCIFICET Commercial, SCIFICET Commosales, SCIFICET Dealers, SCIFICET Sales all with Rs. 1.00 lakh authorised capital and 60 as industry code were registered during the same month. Each of these companies were registered at different places in the city. This suggests the possibility of same group of individuals being involved in these companies despite different registered office addresses. Otherwise it is difficult to imagine how an unusual name like SCIFICET could be thought of by independent sets of people all trying to enter the same activity with the same authorised capital and with similar meaning names and during the same month. Similarly TOPGRAIN with Agency, Barter, Commercial, Consultants, Corporate Service, Distributors, Goods & Services, Marketing, Mercantile, Merchandise, Vincom, Vinimay and Vyapaar produced 13 companies in March 1995. Does it matter if these were registered at 12 different addresses? There is a strong possibility that the brains behind them were the same (see Table -IV for more examples).

The phenomenon of multiple registration seems to have gained more and more importance in the recent years. Many of these companies are quite small when reckoned on the basis of their authorised capital. Given the nature of the registrations, it is difficult to expect that even a few of them have been registered with genuine business considerations. However, there are instances, when one has to suspect the bonafides of companies even when they seek approval for seemingly respectable levels of authorised capital like Rs. 1.00 crore. For instance, three companies were registered on April 24, 1992 at 106 Todi Chambers, 2 Lal Bazar St., Calcutta, with an authorised capital of Rs. 1.00 crore each with the names: Global Financial Markets Ltd., Inter-Globe Finance Ltd., and Transworld Financial Service Ltd.

Table-IV: Illustrative List of Companies Registered in Calcutta during March 1995 Indicating Possible Linkages between Different Addresses and the Total Number of Companies Registered at Such Addresses During the Month

Name of the Company	Registered Office	Industry Code	No of Cos.
Goodhope Advisory Services Pvt Ltd	26 Strand Rd.	60	8
Goodhope Commodities Pvt Ltd	23/24 Radha Bazar St	60	4
Goodhope Consultants Pvt Ltd	36 Ezra St.	60	23
Goodhope Distributors Pvt Ltd	24 Pollock St	60	5
Goodhope Management Pvt Ltd	20 Ezra St	60	9
Goodhope Marketings Pvt Ltd	30 Bentinck St	60	9
Goodhope Merchandise Pvt Ltd	25 N.S. Rd	60	2
Goodhope Suppliers Pvt Ltd	33/1 N.S. Rd	60	31
Goodhope Vinimay Pvt Ltd	55 Ezra St	60	4
Topgrain Agency Pvt Ltd	158 M.G. Rd	60	6
Topgrain Barter Pvt Ltd	46 Ezra St	60	1
Topgrain Commercial Pvt Ltd	2B Grant Lane	60	29
Topgrain Consultants Pvt Ltd	36 Strand Rd	60	26
Topgrain Corporate Service Pvt Ltd	47 N.S. Rd	60	2
Topgrain Distributors Pvt Ltd	15 Noormal Lohia Lane	60	18
Topgrain Goods & Services Pvt Ltd	115 Canning St	60	1
Topgrain Marketing Pvt Ltd	160 M.G. Rd	60	2
Topgrain Mercantile Pvt Ltd	56 N.S. Rd	60	5
Topgrain Merchandise Pvt Ltd	44 Ezra St	60	3
Topgrain Vincom Pvt Ltd	9 India Exchange Place	60	10
Topgrain Vinimay Pvt Ltd	40 Strand Rd	60	22
Topgrain Vyapaar Pvt Ltd	44 Ezra St	60	*
Alexcy Commercial Pvt Ltd	33/1 N.S. Rd	60	*
Alexcy Goods & Suppliers Pvt Ltd	33/1 N.S. Rd	60	*
Alexcy Tracon Pvt Ltd	23A N.S. Rd.	60	83
Alexcy Trade & Commerce Pvt Ltd#	214 Jamunalaal Bajaj St.	60	3
Alexcy Vinimay Pvt Ltd	33/1 N.S. Rd	60	*
Alllike Commercial Pvt Ltd	46 Strand Rd	63	15
Alllike Marketing Pvt Ltd	25 Strand Rd	63	9
Alllike Tracon Pvt Ltd	33/1 N.S. Rd	63	*
Alllike Vyapaar Pvt Ltd	33/1 N.S. Rd	63	*
Baviscon Agencies Pvt Ltd	P-4 NHB App. Rd.	60	19
Baviscon Dealers Pvt Ltd	134/4 M.G. Rd	60	7
Baviscon Distributors Pvt Ltd	134/4 M.G. Rd	60	*
Baviscon Distributors Pvt Ltd#	113 N.S. Rd	60	3
Baviscon Sales Agencies Pvt Ltd	134/4 M.G. Rd	60	*
Baviscon Suppliers Pvt Ltd	134/4 M.G. Rd	60	*
Beatlify Trading Pvt Ltd	172 M.G. Rd.	61	32
Beatlify Commodeal Pvt Ltd	172 M.G. Rd.	61	*
Beatlify Dealcom Pvt Ltd	201 M.G. Rd	61	20
Beatlify Tracon Pvt Ltd	172 M.G. Rd.	61	*
Beatlify Vincom Pvt Ltd	201 M.G. Rd	61	*
Bhrosemand Agencies Pvt Ltd	P-4 NHB App. Rd	60	*
Bhrosemand Commerce Pvt Ltd	23A N.S. Rd	60	*
Bhrosemand Commercial Pvt Ltd	9/12 Lal Bazar St.	60	45
Bhrosemand Commodities Pvt Ltd	P-4 NHB App. Rd.	60	*
Bhrosemand Sales Pvt Ltd	P-4 NHB App. Rd.	60	*
Jhik-Jhik Sales Pvt Ltd	23 N.S. Rd	63	33
Jhik-Jhik Stationery Pvt Ltd	23A N.S. Rd.	63	*
Jhik-Jhik Vinimoy Pvt Ltd	1A Grant Lane	63	29
Jhik-Jhik Vyapaar Pvt Ltd	25 Burtolla St	63	3
Latangi Chemicals Pvt Ltd	1A Grant Lane	63	*
Latangi Merchants Pvt Ltd	5 M.N. Roy By-lane	63	20
Latangi Vinimoy Pvt Ltd	12 N.S. Rd.	63	17
Latangi Vyapaar Pvt Ltd	24 Park St.	63	7
Luckyprime Advisors Pvt Ltd	20 Mullick St.	60	22
Luckyprime Commodities Pvt Ltd	14 Noormal Lohia Lane	60	6
Luckyprime Consultants Pvt Ltd	20 Mullick St	60	*
Luckyprime Dealer Pvt Ltd	30 Bentinck St.	60	*
Luckyprime Distributors Pvt Ltd	219C Old ChinaBazar St	60	17
Luckyprime Management Pvt Ltd	20 Mullick St.	60	*
Luckyprime Marketing Pvt Ltd	219C Old ChinaBazar St	60	*
Luckyprime Merchandise Pvt Ltd	118 N.S. Rd.	60	1
Luckyprime Suppliers Pvt Ltd	219C Old ChinaBazar St	60	*
Luckyprime Tradeink Pvt Ltd	18 N.S. Rd.	61	10
Snehpushp Commercial Pvt Ltd	203/1 M.G. Rd	60	31
Snehpushp Marketing Pvt Ltd	23A N.S. Rd.	60	*
Snehpushp Traders Pvt Ltd	203/1 M.G. Rd	60	*
Snehpushp Vanija Pvt Ltd	203/1 M.G. Rd	60	*

Rs. 5.00 Lakhs authorised capital.

* Indicates that the address was already covered in the Table.

Another relevant case is that of the four companies each promoted with an authorised capital of Rs. 10.00 crores at 31 Netaji Subhas Road, Calcutta. These are: (i) RPG Petrochem Ltd (August 1989); (ii) Dakshin Bharat Petrochem Ltd (December 1989); (iii) Petrochem International Ltd (December 1989); and (iv) Central Petrochem Ltd (January 1990).

Usual norms in name approval also do not seem to be followed in the State. Otherwise one will not find adoption of established company names by small private limited companies in the State. If one goes by the registrations in the state many established groups -- foreign and Indian -- must have set up a trading or a finance company in Calcutta. Some of the striking ones registered in March 1994 were: **Abbott Marketing, Albright Viniyog, Alembic Merchants, Castrol Suppliers, Coats Merchants, Fulford Sales, Intel Sales, Monotype Vinimay, Oracle Consultants, Ranbaxy Niryat, Tanfac Commodities, and Zuari Vinimay.** There are many more such instances in Calcutta. Similarly, it looks as if international banks and financial institutions like ABN Amro, BNP, Goldman Sachs, James Capel, Kemper, Stanchart and Templeton have adopted Assam as their Indian base in September 1994 each with an authorised capital of just Rs. 1.00 lakh. We found as many as 14 companies beginning with **Sony** operating in different parts of the country. Three Suzuki companies and two Toyota companies also find a place among the companies registered in India which we have no reason to believe had any association with the respective TNCs. Given the nature of these companies it looks as if such names were used not to gain any goodwill associated with them but as a quick way out of the need to find names for such large number of companies floated by the operators. For instance, when Exim Scrips were introduced in 1991, a number of companies with the word Exim Scrips in their names immediately sprung up in a few locations in Calcutta.

Roots of the Process in the 'Eighties

Even prior to 'eighties, multiple registrations were taking place. However, the practice assumed a different dimension in the 'eighties. While looking into the phenomenon of proliferation of leasing companies during 1984/85, we noticed about 60 'construction' and 'housing' companies some of them with weird sounding names as if someone twisted them out of shape purposefully, were incorporated in Delhi at 26/15 Najafgarh Road within a span of three months (May-July 1984) with an authorised capital of Rs. 20,000 each. We thought that if the objective was doing genuine business, one single company with an authorised capital of Rs. 12.00 lakhs, which amount was small even by the early 'eighties standards, would have served the

purpose. Subsequently, a study of annual reports and prospectuses of a large number of leasing, investment and trading companies which offered shares to the public in the second half of 'eighties, revealed the involvement of certain individuals, and auditors in floating the companies. In general, names of the companies turned out to be irrelevant. The names may contain 'tea', 'automobile', 'engineering' or 'ispat' but in practice no such activity could be visible from a scrutiny of annual reports. Even if it did, it was nominal trading in commodities as if to justify the name. To our surprise, some of the companies at Najafgarh Road, referred to earlier, figured among the debtors/creditors of such companies. A few constituents of a network reported trading of potatoes through a private limited company, generally at a loss. Going by their investment profile it appears that a significant part of such companies' paid-up capital was made up of intercorporate investments within the network, with each company in the network investing in the rest. In such a situation, raising equity capital through rights issues poses no problem as the same money could be circulated within the net, artificially increasing the equity capital of all the companies involved and in the process meeting any increase in the threshold of issued capital insisted upon by regulatory bodies.

In spite of the fact that it is difficult for non-official agencies to get access to clinching proof on ownership and control of such companies, given the extensive evidence one cannot ignore the existence of the networks. We, however, found it difficult to say whether a few big networks were in operation or smaller independent ones were also in existence. Some of these groups of companies or networks spanned from East to West and to North. It looked as if there was no distinction among addresses even in a single city. For instance, the networks covered a number of addresses in different locations of Delhi and Kanpur. In some cases while the directors gave their Calcutta addresses, the registered office was either in Delhi or Bombay or Guwahati. Very often the auditors and bankers were located in Calcutta. Some times the auditors could be found even in Jaipur or Kanpur. What strikes one most was the manner in which companies in Nagaland, Guwahati, Kanpur, Ludhiana, Bombay, Delhi and Calcutta got related with each other through directors, auditors, signatories to the memorandum, bankers, etc. Calcutta seemed to be the nerve centre of the operators. A few of the companies in these networks, presently listed on the Delhi Stock Exchange, have spread their operations to Madras also. Possible linkages within a city further become evident if companies are traced from their initial registration to the

time they come to the public and subsequent shifting to different locations within the city. In one case even after eight years or so after coming to the public one of the network companies still remained footloose. In another case, three Delhi stock exchange listed companies which offered rights recently, and which were registered initially at different places in Delhi, reached a single address with visible large house connection. It is difficult for us to say, if the large house affiliation was a later day development. A scrutiny of prospectuses of financial service companies which came to the public during the past few years reveal that a number of them also do not have a proper office facility of their own.

We could also trace the linkages of many investment and trading companies registered in Jammu & Kashmir with Large Industrial Houses. It is relevant to note that the six Guwahati-based companies⁹ which got associated with Shaw Wallace, were part of a large network of companies many of which had their Head/Administrative offices in Calcutta while the registered offices were in Guwahati, Manipur, Nagaland, Shillong, etc. If such linkages are taken into account, the actual share of the smaller states would be further lower than what was observed above.

It appears that some of the individuals involved in the networks of the 'eighties have now acquired prominence as merchant bankers, mutual fund promoters,¹⁰ in attempted take over of large companies and promotion of large real estate projects. The case of Sterling Securities, a Class I Merchant Banker registered with SEBI, is relevant here. It was alleged that one Chartered Accountant was responsible for floating as many as 174 public limited companies during 1983 to 1985.¹¹ The paid-up capital of many of the companies which went public was purportedly made up of share applications from fictitious persons. In a few other instances, the tax authorities treated subscriptions to capital as unaccounted income. We have also noted that some of the listed companies paid taxes under protest. Some of them were also involved closely with mega projects of the time. In this context, the Vivian Bose Commission's observation that share capital of some of the Dalmia-Jain companies was subscribed through fictitious names is quite relevant.¹²

Maharashtra & Delhi

Besides being part of the networks referred to above, Maharashtra and Delhi seem to have their own centres where series of companies get floated. Since June 1990 when we noticed the first company to have been registered at 'Commercial Services Centre, 8/33-34 Grant Building., A.B. Road, Colaba, Bombay' and till March 1994, about 350 companies were registered

almost all of them with Rs. 1 lakh authorised capital and with trading/investment as the activity in an overwhelming number of cases. Afterwards, the registration activity came to a stop all of a sudden. There have been many other locations in Mumbai and Delhi which seem to specialise in company registration. In fact, what seemed to have changed over time is that new locations emerged while some old ones appear to have ceased operation or their importance got reduced. It may be that the operators have shifted their location or new operators have emerged on the scene. It could be either way.

Some such companies registered in Gujarat and Maharashtra as part of the clusters, found their place in the lists of 'Reliance Satellite companies' described below. Similarly, two companies ended up as subsidiaries of Tata companies -- Senegal -- now Sabras -- Investment & Trading and Sheba Properties (subsidiary of TELCO). Even Digital Securities involved in the Levers' alliance with Kwality was registered at one such place. The examples can be multiplied.

The phenomenon of mushrooming is not confined to trading, finance and construction companies, though not to the similar extent. Venky group offers an excellent example in this regard. Further, as many as 150 companies with the words 'Shipbreaking' in their names were registered in Gujarat and Maharashtra during the months of September and October 1995. Out of these at least 110 could be traced to a single address -- 7/3658 Rampura Road, opp. Bank of India, Surat. The very fact that so many shipbreaking companies were registered in just two months time gives rise to suspicion. The timing of registration of multiple 'Shipbreaking' companies at other places in Surat, Bhavnagar and Bombay may also suggest a possible relationship among some of them at least. About 25 companies with '06' as the industrial classification and 'Farm'/'Orchard' as part of the names were registered at 1847 Outram Lines, Delhi during July/August 1995. One does not know how to understand the purpose behind such companies if 'Guava Orchards' & 'Guava Estates' and 'Teak Farms' & 'Teak Estates' along with separate companies for tomatoes, water melons and cucumbers are found at the place. Multiple 'Farm' companies were also registered at the same address as that of Sterling Holiday group in Madras. Nineteen Plantation/Agrotech companies were registered during March 1995 at 201 Raheja Arcade, Koramangala. Incidentally, the Sterling Group has a major plantation company by name Sterling Tree Magnum India Ltd. Some other locations in Delhi, Indore, Gwalior, Bombay and Ahmedabad have been favourite haunts for 'farm' and 'plantation'

companies. Probably a large number of such agricultural companies in Madhya Pradesh can be traced to just a few addresses. It is interesting to find three companies namely, Deogarh Alphonso Farms, Sindhu Durg Alphonso Farms and Maharashtra Alphonso Estates to have been registered at Thapar House, 124 Janpath, New Delhi during January 1993 each with an authorised capital of Rs. 5.00 lakhs. It is difficult to foresee the future of 22 companies registered at A-1 Amerchand Mansion, Madam Cama Road, Mumbai during January 1996 all with authorised capital of Rs. 1 lakh and Apple as first part of the name and seeking to enter such varied activities as aviation, fertilizers, diamonds, cement, sugar, textiles and transport or of the 60-odd companies registered in Punjab, Rajasthan and U.P. within a week, all with names like Lasersetter, Typesetter, Graphics, Press, etc. or the eight export companies registered at A-1/10 Lal Quarter, Krishna Nagar, Delhi during Sept./October 1994.

Large & Medium Groups and Mushrooming Companies

The phenomenon of mushrooming companies does not seem to be confined to the networks referred to above. Large houses, probably for different reasons, too seem to have contributed to such growth. One of the early cases of this nature was that of Sarabhais. Alkapuri Investments Pvt Ltd, associated with them, had a number of subsidiaries having the names of mountains, ragas, rivers, etc. most of them investment companies investing in Ahmedabad Manufacturing & Calico Printing Co Ltd.

In the context of issue of duplicate shares and takeover of Kothari Industrial Corp. a number of companies purported to be belonging to Reliance group came into light. Press reports indicate that the Income Tax authorities identified 206 companies related to the house.¹⁹ These are often referred to as 'Reliance Satellite Companies'. It was also reported that the IT authorities disallowed payment of processing charges to two such companies running into crores of rupees. It may be recalled that the Reliance twins -- Reliance Polyethylene and Reliance Polypropylene -- were initially investment companies and when they came to public, two sets of four investment companies were reported to be their promoters with RIL itself and Itochu of Japan being co-promoters. It is important to note that these trading/investment companies acquired substantial reserves within a few years in spite of having nominal paid-up capital.

Following the leads given by the initial registration of the companies referred to above and others which we came across in our investigations, some interesting facts came to light. Certain sets of companies were

registered on a single day with *sequential* registration numbers at *different* locations in Mumbai, with identical industrial classification and authorised capital. One such set turned up as subsidiaries of Mac Investments Ltd. Practically all the 'Texturising' companies registered during September 1989 at various locations in Bombay could be linked to the group.¹⁴ Sequential registration numbers and equal authorised capital are shared by this set too (See Table V). The group's example throws up the possibility of many companies getting related with each other in spite having been promoted at different locations. It is further important to note that none of these 'Satellite' companies were registered under the MRTP Act. Only 15 group undertakings, of which 5 were firms, figured in the list of MRTP undertakings in 1990. This is in spite of the fact that some of the companies notably, Mac Investments and its subsidiaries were termed as promoter associates by the RBI panel which looked into the bank loans to the group in mid-'eighties'.¹⁵ 135 Investment/Trading companies were among the 200-odd companies at two addresses in Pune, where Kalyani Group companies also had their offices. Some of these investment/trading companies appear among subsidiary/investee companies of the group. Similar examples can also be given for other houses like TVS¹⁶, Mafatlal, Piramal and Lalbhai. Among the construction groups mention can be made of DLF and Rahejas. DLF Universal has as many as 44 subsidiaries dealing in real estate, a large number of them carrying the words agro, farming and cultivations. G.L. Raheja, Chairman of the Raheja group is reported to be on the boards of around 50 companies and Mr. C.L. Raheja on 58 companies.¹⁷

When such multiple companies are promoted, particularly if they happen to be related to managements of public listed companies, possible explanations could be that the promoters use these companies as part of their control mechanism, to enrich themselves at the cost of publicly-held companies or to minimise their tax liabilities. Investment companies have been used to the fullest extent to circumvent the restriction on investment limits.

There are many instances where such companies with nominal paid-up capital were advanced crores of rupees for take-overs and strengthening groups' control. It appears that large houses have dozens of them under their umbrella. A quick count reveals that almost 20 per cent of the undertakings registered under the MRTP Act in 1990 were investment companies. To get the real picture, the unregistered ones -- which are not insignificant in number -- should also be taken into account.

Since many such companies are unlisted ones and often private limited in form, it is not easy to get data

on their functioning and financial performance. The **Directory of Joint Stock Companies, 1990**, which sought to provide some minimum information on each of the companies in the country, offered an opportunity to gain some knowledge of their functioning. However, the Directory suffered from a high degree of non-response by companies. Out of a little more than 2 lakh entries for companies with limited liability in the Directory, for as many as 74,000 no financial data was reported, presumably due to non-receipt of annual reports. The explanation offered by the Department of Company Affairs was that the non-response could be due to defunctness. However, nearly two-thirds of the non-responding companies were registered during the 'eighties'.¹⁸ It is, therefore, not possible that all of these were defunct and hence did not report any financial data. Non-response need not always be due to lack of any operation and could even be attributed to management strategy. The non-reporters include both large and

Table-V: Illustrative List of Related Companies Registered Simultaneously at Different Locations

Reg.No.	Name of the Company	Regd. Office in Bombay at the time of Registration
<u>'Promoter/Trade Associates of RIL'</u>		
11-021243	Kedareswar Invt & Tdg	Vasundhara, Block No C-2, Tilak Rd. Ghatkopar (E)
11-021244	Kankhal Invt & Tdg	Navrang Bldg, 330 Katha Bazar
11-021245	Jagadanand Invt & Tdg	Dhanshila, 14th A Rd. Khar
11-021246	Kartikeya Invt & Tdg (now Sanket Comm)	9 Parmeshwar Villa, 4th Road Santacruz (W)
11-021247	Jagdishwar Invt & Tdg	Jagdish Niwas, S.A. Brelvi Rd
11-021248	Bhowmik Invt & Tdg (now Veronica Tdg)	404 Maker Bhawan No 3, 21 New Marine Lines
<u>'Texturising Companies'</u>		
11-053472	Shital Texturising	9/68 Unnat Nagar-2, Goregaon (W)
11-053473	Prime Texturising	216/6 Jawahar Nagar, Goregaon (W)
11-053474	Jeevan Texturising	C/106 Sanket, Ujwal Mandeep Co-op Hsg Soc Ltd, Relief Rd., Malad (W)
11-053475	Kalpna Texturising	6/66 Ram Krishna Nagar, 1st Floor, S.V. Road, Khar (W)
11-053476	Sankalpa Texturising	8/1 Madhurima Soc, MG Rd, Kandivli
11-053477	Monica Texturising	Flat-1, Natraj B Wing, Laxmi-narain Rd., Matunga (CR)
11-053478	Ashita Texturising	A/5 Kailash Nagar, 61 Shankar Lane, Kandivli (W)
11-053479	Sugam Texturising	Flat No. 401, 45/8 Kanti Nagar, Behind J.B Nagar, Andheri (E)
11-053480	Swayam Texturising	3/B-3 Scindia Soc, Sir M.V. Rd, Andheri (E)
11-053541	Deepeeka Texturising	402 Elias Apartments, 4th Floor, Meunni St., M.G.Rd., Kandivli (W)

Note: 1. All the six investment and trading companies were registered on April 30, 1979 with an authorised capital of Rs. 50,000 each. Kartikeya and Bhowmik were referred to as 'Trade Associates' and the remaining four (subsidiaries of Mac Investments) as 'Promoter Associates' of the group by the RBI Committee which looked into the bank loans to the group.

2. The first nine texturing companies were registered on September 14, 1989 and the last one on the 19th of the same month. Each of the ten had an initial authorised capital of Rs. 5.00 lakhs. The report "RBI seeks details on share advance to 27 RIL cos", Financial Express, December 28, 1995 refers to these companies.

3. Registration numbers are as per the Directory of Joint Stock Companies in India, 1990.

small and public and private limited companies. Particularly it cannot be said that large companies and the small companies floated by persons managing large companies are not aware of the statutory provisions. Given the character of the sector as described in the foregoing, one can only expect that non-reporting was either wilful or the companies were made to be defunct after they had served out their purpose.

The inquiry into last year's Calcutta Bank Scam and its suspected extension to Delhi offers a further opportunity to understand the possible use of multiple companies.¹⁹ While this inquiry was going on, the DRI is reported to have identified a number of fictitious Bank accounts in Calcutta, Delhi and Bombay which could be traced to Ganapati Exports.²⁰ It was also suspected that this case has ramifications for the Calcutta Scam. Yet another report suggested that the roots of the Calcutta Scam date back to the 'eighties and not early 'nineties as was originally assumed. It was also reported that due to similar crackdowns earlier, several non-banking financial companies were found shifting their operations from one place to another.²¹ Yet another case is that of PNB's loss of more than 35 crores in its transactions with a certain 'Sajawat' group of companies. Another recent exposure brought into focus how taxes were being evaded through the mechanism of paper transactions with leasing companies in the formation of which auditors played a major role.

Given the type of investment and trading companies that came into existence, and the role played by private limited companies in many a corporate scandal, it needs to be examined whether in the present situation investment companies have any significant role to play. Similarly, the exemptions sought to be provided to private limited companies seem out of place with proliferation of companies with all indications pointing to their ulterior motives. The proposed withdrawal of deemed public companies may also be given a second thought in the light of this evidence. The three categories of companies private, unlisted public and listed public limited companies cannot be treated as independent in nature. While one does not know the precise number of unlisted companies under large houses, an indication to the extent of their significance, albeit a gross underestimate, is given by the fact that out of the 1876 undertakings registered under the MRTTP Act in 1990 as many as 461 were either private limited companies or firms i.e., nearly one-fourth of the total.²²

To Sum Up

It has been noticed that coinciding with the relaxation of controls and liberalisation of the economy since the beginning of the 'eighties, the Indian private corporate sector has grown by leaps and bounds in terms of numbers. From about 56,000 at the end of 1979-80,

the number of companies exceeded 400,000 by the end of 1995-96. Strangely enough, the share of manufacturing companies in new registrations declined sharply from about 50 per cent in 1988-89 to just 27 per cent in 1995-96 with finance, trade and investment related companies gaining importance. The accompanying city-wise concentration and multiple registrations clearly suggest the make believe nature of the growth in number of companies and the distinct possibility of their being used for manipulative purposes. The main purpose can only be to circumvent one or the other regulatory provision or take undue advantage of official incentives. Each one can have his own motive. It could be indulging in transactions with listed companies for personal benefit, insider trading, to capture or initiate a industry/service association, take-over of companies, claim tax advantages, defeat provisions of the Companies Act, improve the chances of allotment in public issues, offer quotations in case of tenders to satisfy the requirement of minimum numbers, as tools in money-laundering, as a back up mechanism when some of the group companies get into tax troubles, to increase the chances of land allotment in industrial estates, circumventing urban land ceiling, etc. The possibilities are quite varied.

In this background, the official finding that the Reliance group has more than 200 companies under its umbrella or the claim that CRB group floated 100 companies do not sound as revelations. Indeed, use of multiple faceless companies is a common feature of many corporate scandals.²³ It should, therefore, not surprise anyone if the authorities now realise that out of the 4.5 lakh companies as many as 2 lakhs do not file returns under the Income Tax Act.²⁴ Indeed, the exposures during the recent past seem inevitable, in view of the nature of growth of the Indian private corporate sector.

While framing company law, it is necessary to keep in focus the characteristics of and practices prevailing in companies of different sizes. Given the characteristics of the Indian private corporate sector, it would be unrealistic to assume that the three types of companies: namely, private, public unlisted and public listed are independent of each other. By all indications the growth of the sector has not been a healthy one. The pattern of registrations suggest that the real purpose of promoting one-fourth to one-third of its constituents is suspect. One needs to know what harm has been done to the economy by such elements. Before a liberal act is put in place, it is necessary to identify and weed out such companies as also prevent the emergence of new ones. Otherwise, the experience may prove costly as has been the case with abolition of Capital Issues Control Act without putting a proper alternative mechanism in place.

It will be too optimistic to expect that the change in circumstances and the changed law will make the sector

mend its ways and improve its performance. One cannot possibly take a stand that the observed behaviour of the Indian corporate sector was a product of excessive regulations because much of the evidence cited above was from the 'eighties when the regulations were progressively getting withdrawn and the 'nineties when the process got accelerated.

The proposed exercise at sending letters seeking explanation for not filing returns by tax authorities to companies not filing returns is a step in the right direction. Given the propensity of smaller companies to shift registered offices frequently it will, however, be sometime before the tax authorities can catch up with all such companies. It is, however, equally necessary to go deeper into the functioning of the large number of companies, including those registered on stock exchanges, which apparently have no productive role to play in the economy even if they have been filing returns. If ultimately a large number of companies were found to be defunct, it is necessary to go into the background of such companies too to find out who promoted them and under what circumstances they became defunct. Steps have also to be taken to prevent the emergence of such companies in future. The experience of the twenties and thirties during which large number of companies had sprung up, though in a somewhat of a different context, seems to be relevant at the present juncture.

Experience has shown that the growth of such companies is fast becoming a menace to the healthy evolution of business life in this country. As a result of the ushering in of these companies, with their short span of life, it has become immensely difficult, ..., to secure capital even for deserving industrial institutions. And in the opinion of Government, matters have come to such a pass that the Legislature is now bound to step in to prevent the formation or continuance of these companies.²⁵

Notes:

1. The earlier attempt of 1993 was abandoned.
2. R.C. Dutt, "The Developing Economy in India and Company Law", in India, Ministry of Finance, Directorate of Research & Statistics, Company Law Board, **Topical Articles on the Working and Management of Corporate Sector in India**, 1964, p. 5.
3. The Vivian Bose Commission's recommendations covered Objects Clause of the Memorandum of Association, Underwriting Commission, Issue and Allotment of shares in the names of fictitious or non-existing persons, dummy directors, loans to companies under the same management/other bodies corporates, appointment/termination of sole selling agents, etc. See India, Ministry of Commerce & Industry, **Report of the Commission of Inquiry (Inquiry on the Administration of Dalmia-Jain Companies)**, 1963.
4. Indian Hotels Co may soon be providing yet another example in this respect.
5. See "Unwise Move", **Financial Express**, September 21, 1996.
6. See "Kalyani group companies: scratching each other's backs", **Financial Express**, October 14, 1996.
7. See for instance, "The BT Special Report on NBFCs", **Business Today**, August 7-21, 1997, pp. 73-101.

8. These cover the industry codes 5 (construction), 6 (wholesale and retail trade & restaurants and hotels) and 8 (financing, insurance, real estate and business services).
9. These were: Kamalakal Ltd., Das Apartments Ltd., Gulmohur Estates Ltd., Manipur Pharmaceuticals Ltd., Raksha Audio Ltd and Pulp Products Ltd.
10. CRB provides a prime example in this regard.
11. "Brain behind 42 cr racket arrested", **Hindustan Times**, December 22, 1994.
12. The Vivian Bose Commission observed that "(a)n instance came to the notice of the Commission where shares of a public company (D.J. Airways) to the extent of Rupees 16 lakhs were applied for on behalf of 114 non-existing shareholders". Report of the Vivian Bose Commission, op. cit., p. 799.
13. "IT authorities 'pierce' through Reliance maze", **Economic Times**, June 26, 1996. On March 31, 1994, these 206 companies were reported to be holding shares of Reliance Industries Ltd whose market value was Rs. 1,900 crore. See "Key documents in RIL switch deal doctored: I-T", **Economic Times**, July 1, 1996.
14. The report "RBI seeks details on share advance to 27 RIL cos" refers to the 10 texturising companies. See **Financial Express**, December 28, 1995.
15. RBI, **Report of the Committee on Advances made by Banks to Certain Borrowers Against the Security of Shares/Debentures of the Reliance Industries Ltd.** 1986.
16. See: Padmini Swaminathan "Business Houses in South India: A Case Study of the Structure and Functioning of the TVS Group", Madras Institute of Development Studies, Working Paper No. 59, September 1985.
17. See, "Raheja brothers divide Rs. 2,500-crore empire", **Financial Express**, December 23, 1996.
18. See: K.S. Chalapati Rao and K.V.K. Fanganathan, "Directory of Joint Stock Companies in India: A Review", Institute for Studies in Industrial Development, August 1992 (mimeo).
19. "Calcutta bank scam report by week-end", **Financial Express**, April 24, 1996.
20. "Ganapati Exports laundered Rs. 100 cr. DRI", **Economic Times**, April 23, 1996.
21. "Bank frauds: probe teams suspect deeper roots", **Business Line**, April 8, 1996.
22. It is relevant here to refer to Mr. K.S. Bhatnagar, the then Secretary, Dept. of Company Affairs, who said:
When we, therefore, wish to have a close look on the subject of professionalisation of management and of the boards, we should not be oblivious of the fact that a major shunk (sic) of private sector enterprises are part and parcel of large business houses in which they exercise control either through equity holding or commonality of directors, or by remote control or otherwise.
See "Professionalisation of Company Boards", **Company News & Notes**, October 1983, pp 1-5.
23. For instance, seven investment companies namely, 1. Treasure Holdings Pvt Ltd., 2. Velvet Holdings Pvt Ltd., 3. Pallavi Holdings Pvt Ltd., 4. Zest Holdings Pvt Ltd., 5. Tozaz Holdings Pvt Ltd., 6. Divine Holdings Pvt Ltd., and 7. Eminent Holdings Pvt Ltd., reported to be associated with Mr. Harshad Mehta and his family members and whose assets were attached in June 1992, were registered with an authorised capital of Rs. 50.00 lakhs each during October 1991 at 1518 Maker Chambers V, 221 Naitan Point, Bombay 20.
24. "I-T deptt plans to track down 2 lakh tax-evading firms", **Economic Times**, August 25, 1997.
25. This is an excerpt from the speech of the then Law Member. See: India, Research & Statistics Division, Dept. of Company Law Administration, **Selections from the Debates on the Reform of Company Law in the Central Assembly and Parliament in 1936 and 1954-55**, 1960, p. 11).