Corporate Sector and Emergong Company Law

In the new economic policies, the corporate sector has been assigned the role of the main leader of the growth process. The United Front government appointed a Working Group and a new Companies Bill drafted by the Group is expected to be introduced in the Parliament soon. However, even before the Report was released to the public for discussions, the government made two important announcements: one, relaxing the limits for inter-corporate investments and loans and second, the introduction of buy-back of shares. The overall thrust of the Working Group's recommendations can broadly be categorised as: (a) lessening government control over corporate affairs and greater reliance on Board procedures and shareholder participation; (b) increasing SEBI's role and incorporating its rules and guidelines into the Act; (c) giving prominence to a few of the disclosures already being made; and (d) dispensing with some of the disclosure and restrictive provisions of the present Act (See Box on Recommendations).

Many commentators have, already, faulted the Working Group for ignoring the interests of the general investors and favouring the management. The approach suggested by the Group raises a number of questions. Has the Group suggested disclosures of a far reaching nature? To what extent is the Group's reliance on improved Board compliance and shareholder participation justified? Or, will the Group's recommendations on "disclosure" norms help the corporate sector "cut corners"?

The Background

There is a context within which the reform of corporate legislation should be viewed. The tightening of the Indian Companies Act in 1956 was largely a response to the Dalmia-Jain affair and the Managing Agency System. In the early eighties the Swraj Paul affair 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. The issue of corporate democracy was raised in the context of Reliance takeover of Larsen & Toubro. Professional managements further came under suspicion with the ITC and Chhabria affairs. The Reliance share switching affair, the crashing/exposure of many emerging groups, revelations in case of sick companies, have all exposed the darker side of the Indian private corporate sector.

Since the introduction of new economic policies in 1991, the Indian capital market started playing an increasingly important role, with the number of issues and amount raised increasing to unprecedented levels. But it has been alleged that the promoters failed to utilise the funds raised from the market for the stated purpose. Managements were found to be raising their stakes in companies under their control by questionable means and at prices substantially lower than market prices. Entry of foreign institutional investors in the Indian stock exchanges since 1993 and increased freedom for foreign companies have increased the takeover threat for the domestic large industry.

The important point to note is that the liberalisation of the Companies Act is being attempted in the background of the happenings cited above. In this context, it may be useful to briefly review the broad contours of developments in the sector over the past fifteen years or so.

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. During the decade (1984-85 to 1995-96) 3 lakh companies were added. There has been a veritable rush for the registration of new non-government companies. At the end of 1995-96 there were 1,216 government companies which

Table 1 : No. of Cos. at Work 1959-60 to 1995-96

Year end	No. of Cos. 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, Ministry of Finance, Dept. of Company Affairs, *Fortieth Report on the Working & Admini-stration of the Cos. Act, 1956.*

accounted for just 0.3 per cent of companies limited by shares at work in the country. (Table 1)

Within the non-government sector, private limited companies constitute 86.1 per cent. Within the public limited companies it is reasonable to assume that companies whose shares are listed on the stock exchanges will be in a minority. 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. Interestingly, it has been noticed that new registrations generally peaked in March of every financial year — as was observed for the period 1987-88 to 1994-95. 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. 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. Nearly 70 per cent of non-Government companies are registered in five States. While this development does not really concern the proposal to amend the Companies Act, it yet reveals the *concentration* of corporate activity in a few areas.

Another important feature of company location is concentration within a few districts in most 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. 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. 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.

Another development since the eighties is the decline in the share of manufacturing sector in new company registrations (see Table 3). Trading, investment, real estate and business services gained at the expense of the manufacturing sector — which lost both in relative

Table 2 : State-wise Distribution of Non-Govt. Cos. at Work at the end of March 1996

State	No. of Cos.	Share in Total (%)
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	**4,07,926**	**100.00**

Source: Same as for Table 1.

Table 3 : Share of Mfng. Sector in New Registrations of Non-Govt. 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 Cos. Act, 1956.	

as well as 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.

Developments in West Bengal

The case of West Bengal is 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 — companies). It was found that 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; nearly two-thirds of them had Rs. 5 lakhs or less of authorised capital. Since the subscribed capital will generally be much less, the small size of TIC companies is evident.

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. What strikes one most when going through the new registrations in West Bengal is the phenomenon of common addresses and the manner in which company names were formed. For instance, in March 1995 as many as 82 companies were registered at 23A N.S. Road. Another 33 had their registered offices at 23 N.S. Road, Calcutta. Next, 9/12 Lal Bazar Street, another favourite address, was home for 42 more companies.

While the phenomenon of multiple registrations at certain locations in itself is important, probably a more striking feature 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. Similar common names abound. This suggests the possibility of the same group of individuals being involved in these companies, despite different registered office addresses.

The phenomenon of multiple registration seems to have gained importance in recent years. Many of these companies are quite small when reckoned on the basis of their authorised capital, and it is difficult to expect that even a few of them have been registered with genuine business considerations. Indeed, one is forced to suspect the *bona fides* 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. 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).

Roots of the Process in the Eighties

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, auditors, and banks in floating new 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. In Delhi, some of the companies at Najafgarh Road, figured among the debtors/creditors of large Delhi based 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 inter-corporate investments within the network, with each company in the network investing in the rest.

It is difficult for non-official agencies to get access to clinching proof on ownership and control of such companies. Yet, given the extensive evidence one cannot ignore the existence of "networks". 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.

It appears that some of the individuals involved in the networks of the eighties have now acquired prominence as merchant bankers, mutual fund promoters, in attempted take over of large companies and promotion of large real estate projects. The case of 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. 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 recently, the tax authorities treated subscriptions to capital as unaccounted income. There is evidence 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.

Maharashtra & Delhi

Maharashtra and Delhi seem to have their own centres where series of companies get floated. Between June 1990 to March 1994, 350 companies were registered at Commercial Services Centre, 8/33-34 Grant Building., A.B. Road, Colaba, Bombay. Almost all of them with Rs.1 lakh authorised capital and with trading/ investment as the activity in an overwhelming number of cases. After March, 1994 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.

The phenomenon of mushrooming is not confined to trading, finance and construction companies. 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 questions as to their authenticity and real purpose. 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. 19 "Plantation"/"Agrotech" companies were registered during March 1995 at 201 Raheja Arcade, Koramangala. 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. Similar examples are available for other activities and locations. It is difficult to understand the precise purpose 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. Similar is the case of 60 odd companies registered in Punjab, Rajasthan and U.P. within a week, all with names like Lasersetter, Typesetter, Graphics, Press, etc.

Mushrooming of Companies

The phenomenon of multiple companies does not seem to be confined to new networks. Some names and addresses referred to earlier, e.g. RPG or Thapar House, Janpath, New Delhi, suggest that large houses, probably for different reasons, have contributed to the mushrooming of companies. 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. These are often referred to as "Reliance Satellite Companies". It was also reported that the IT authorities disallowed payment of processing charges, running into crores of rupees, to two such companies . It may be recalled that the Reliance twins — Reliance Polyethylene and Reliance Polypropylene — were initially investment companies. When they came to public, two sets of four investment companies were reported to be their 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 in a month at various locations in Bombay could be linked to the group. Sequential registration numbers and equal authorised capital are shared by this set too. It is further important to note that none of these 'Satellite' companies were registered under the MRTP Act. 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 the eighties. 135 Investment/Trading companies were among the 200-odd companies at two addresses in Pune, where some Kalyani Group companies also had their offices. Many of these were not registered under the MRTP Act. Similar examples can also be found for other groups like TVS, Mafatlal and Lalbhai.

A number of questions arise when multiple companies are registered in this fashion. It is possible to question as to how one can relate companies on the basis of common addresses, as large commercial complexes in major cities house many offices. Our understanding is not based on addresses alone. Similarities in names, activities, timing of registration, occasional direct evidence, examination of huge number of prospectuses and annual reports of companies which came to the public during the eighties revealed linkages through directors, signatories to the Memorandum, etc. All these are pointers to the developments in the sector.

When such multiple companies are promoted, particularly if they happen to be related to managements of pubic 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. Since many such companies are unlisted ones and private limited companies 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 all 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, as many as 74,000 reported no financial data, presumably due to non-receipt of

annual reports. Nearly two-thirds of the non-responding companies were registered during the eighties. It is, therefore, not possible that all of these were defunct. 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 small, as well as public and private limited companies.

Given the type of investment and trading companies which are being floated and the role being played by private limited companies, it needs to be re-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, given the proliferation of companies with indications of ulterior motives. The three categories of companies — private, unlisted public and listed public limited companies — cannot be treated as independent in nature. One does not know the precise number of unlisted companies under large houses as of now. Out of the 1876 undertakings registered under the MRTP Act in 1990, as many as 461 were either private limited companies or firms — and this is likely to be an underestimate. One can only expect that non-reporting was either wilful or the companies were made defunct after they had served their purpose.

Ineffective Regulatory System

Given the emphasis placed by the private sector for greater operational freedom, it would be relevant to examine the efficacy of certain provisions of the Companies Act. During 1995-96, *64* applications were received by the government for approval of Sole Selling Agencies under Section 294AA (2) & (3). A further *84* applications were received under Section 295 of the Act, which seeks to regulate loans to directors and their relatives. In *409* cases approval of contracts, in which directors were interested, was sought. The Government received *83* applications for inter-corporate loans under Section 370 and *632* applications for approval of inter-corporate investments under Section 372. Out of the 618 applications disposed off during the year for inter-corporate investments, only *19* were for investments in companies under the same management. Further, only *9* of these were refused permission by the government. Those who are familiar with the extremely weak criteria for identifying companies under the same management will, tend to draw different conclusions from the above. In this background, the assertion of the Working Group that "... the current provisions in Sections 370 and 372 of the Act have stifled industrial growth" sounds unconvincing.

It needs to be underlined that 'satellite' companies, 'promoter associates', 'family companies', etc. were not registered under the MRTP Act — thereby implying that even the supposedly stringent criteria under the MRTP Act for identifying interconnection failed to take the corporate realities fully into account. What can then one expect from the criteria for "same management"? Given the large number of constituents of the corporate sector, the small number of applications can be interpreted in two ways. One, the companies are successfully managing to remain outside the purview of the provisions of the law. Two, the provisions are so weak that they are not able to cover a substantial number of situations. Since, in any case, the number of applications was small, where is the merit in dispensing with this scrutiny, which is essential for protecting the interests of shareholders?

The regulations devised for investor protection suffer from a number of weaknesses. We have noted that well known large house companies could claim that there were no companies under the same management, taking advantage of the weak criteria under Section 370 (1-B) of the Companies Act, 1956. Thus the safeguards on misuse of loans and investments in group companies were not effective. Nor is the role of auditors quite definitive in this regard, for the Guidelines state that : *"In determining the reasonableness of the prices, the auditor should take into account all the factors surrounding the transactions of purchase or sale such as delivery period/schedule of implementation, the quality of the product/service, the quantity, the credit terms, the previous record of the supplier/buyer/client, etc."*

It is also significant to note that under the Manufacturing and Other Companies (Auditor's Report) Order, 1988, while the transactions of sale of services are covered, those relating to *purchase of services by the reporting company are not covered.* Such loopholes can facilitate siphoning off of funds for personal gains. Further, the appointment of auditors and their relationship

with the controlling interests leaves much to be desired.

Even before the New Economic Policy of 1991, industrial regulations were being relaxed gradually during the eighties, especially after 1984. Liberalisation, one expects, should have reduced the need for manipulations and circumventing of regulations. Experience has proved to the contrary. In this background, the official finding that the Reliance group has more than 200 companies under its umbrella, is not surprising. Should not this be interpreted as an indicator of the need for greater caution in the matter of further relaxations under the Companies Act?

Recommendations of the Working Group

Officials of the Department of Company Affairs have indicated that the Working Group's Report is only a curtain raiser and that the basic thrust of the exercise has been to cut down governmental intervention and to restore the rights of shareholders. Given the lack of detailed information on the functioning of the Indian corporate sector, a few points based on the Group's recommendations and its overall thrust, are raised below.

It is a common knowledge that many shareholders do not participate in AGMs. The wide geographic spread of shareholders is an important factor in this respect. The Group's suggestion to improve shareholder participation was, however, limited to giving proxies the right to speak and vote in the Meetings. Proxies are collected either by the existing managements, or by those who seek to takeover companies. Going by the poor attendance, the AGMs end up providing official stamp to what the managements wish to do, even if such decisions are detrimental to the interests of other shareholders.

The Group recommended that any member must have the consent of 100 shareholders or of 1% of the voting rights for suggesting the candidature of a director. Further, that demands for poll at General Meetings would be permissible by one or more shareholders holding the shares of the Face Value of Rs.5,00,000 or holding 1% of the paid-up capital of the company, whichever is less. How would individual shareholders be able to come together? There is little possibility of their consulting and canvassing each other before they meet at the AGM. Can recognised shareholder associations be involved in General Meetings?

It is not possible for any one, except nominees of the management or financial institutions to be elected to the Board of Directors. In a large number of listed companies the managements have a comfortable share-holding position. The institutions do not usually intervene in such matters; and of late they are getting to be more passive. This is quite different from the role of bankers in Japan, where corporate managements are changed when bankers find them to be wanting. The quantum of the sitting fee is not a factor in attracting outside talent. For a leading professional it really has no significance. Wives, sons and daughters are appointed on Boards of public listed companies, not because talented persons are not willing to be associated with companies. It is because the controlling interests wish to keep the company affairs within the family fold as far as possible. It is true that the institution of nominee directors has not fully served the purpose for which it was meant. But, studies have shown that the presence of nominee directors on company boards had brought about an improvement in their functioning — since, prior to 1971 many companies did not observe even elementary conventions. Efforts should be directed at making the Boards function rather than merely ensure that statutory requirements are met.

The Report advocates employment of Group Resource Companies (GRCs) to encourage skill formation. The attempt has been dubbed by some as backward entry of Managing Agency system. One may well ask what the contribution of such GRCs would be, and which of those are restricted by the present Act. The present regulations do not prevent the setting up of a common R&D outfit by group companies. Will the existence of such a company leave the group companies freedom to choose technology and consultancy? Given the liberal nature of audit guidelines, it is difficult to expect market pricing the services rendered.

The Report alleges that the present limits on inter-corporate investments have stifled industrial growth. If it were so, we would not have witnessed cross and circular holdings which, without any significant addition to productive capital, enable managements to strengthen their hold on companies and also present healthy debt-

equity ratios. The paid-up capital of smaller companies does not genuinely represent risk capital. Investment companies have been effectively used to circumvent the restriction on investment limits. There are many instances where companies with nominal paid-up capital were advanced crores of rupees for takeovers and to strengthen a group's 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.

Reducing the effectiveness of FERA has enabled TNCs to operate in multiple forms in the country. Besides the erstwhile minority-owned companies, and partially-owned subsidiaries, foreign companies are being allowed to set up wholly owned subsidiaries. Such wholly-owned subsidiaries generally take the form of private limited companies. The proposed changes may effectively close access to information on such companies. Unless certain statutory disclosures are enforced, it may be difficult even for the government to effectively monitor the operations of TNCs in India. Some of these could have been covered under the deemed public limited category. But with the proposed withdrawal of this category, they will further be able to avoid public scrutiny.

The Group expressed its satisfaction over the definition of foreign companies. At present, only banks, liaison offices, foreign air and shipping lines, etc. operate as branches and hence are covered by this definition. The definition has no relationship with popular perception. The suggestion that companies should report on foreign share-holding is welcome. However, there are problems at present with the share-holding particulars reported to the stock exchanges. There is a need to improve this provision, both in terms of clarity and availability of additional information.

In case of TNCs, the concept of director's interest is not effective. The Indian Company Law does not have the reach to cover transactions of TNC affiliates in India with their worldwide associates. For instance, there is very little possibility for Indians — who are on the Boards of TNC affiliates in India — to be directors or significant shareholders of the parent company. Even expatriate directors would be on the Boards of a limited number of foreign affiliates, particularly those located within a specified region. If India is covered by a regional head, based in Singapore, Indian affiliates' transactions with the TNC head quarter, say in USA, or affiliates in other regions are unlikely to attract the existing provisions. This would be so as none of the directors of the Indian affiliate would be on the board of the parent company nor would the "parent" have any *direct investment* in the Indian affiliate. The directors can favour the parent company without attracting adverse provisions of the Company Law. The country is reported to be losing billions of dollars every year through the mechanism of transfer pricing. In the new policy regime, transactions on account of foreign companies have increased substantially. Transfer pricing is not a problem of customs only. This should be covered by Company Law too.

In the wake of equity dilutions under FERA, the use of the provision relating to non-retiring directors came into light. Later, even Indian public listed companies resorted to using this provision to strengthen their control over company Boards. TNCs have even gone to the extent of sanctioning themselves veto rights. One hopes the authorities will take note of this practice.

Instead of withholding information on smaller investments, it should be made mandatory to report such investments as well as to indicate the share of the company in those companies. At times, more than the size of investment, the very relationship becomes important. Those who are aware of the investments of Shaw Wallace & Co. would not even consider provisions allowing withholding of such information.

Share buy-back is a double-edged tool. While, ostensibly, it helps to relieve companies of idle surplus funds, it can also help companies show better earnings per share while in reality there may be no improvement in their physical or financial performance. Managements can also use this tool to protect their wealth or to increase their relative position, in order to protect themselves from hostile takeovers, without caring for the health of companies under their charge. Unfortunately, the limit of FII portfolio investments has already been raised. In the new policy regime, TNCs are keen to increase their holdings in their Indian affiliates and subsidiaries. Cash-rich TNCs may thus increase their stakes without bringing in additional capital by taking advantage of the buy-back provision.

Restrictions on free access to information, by allowing exemptions, defeats the whole purpose of providing for greater disclosure. For instance, Arvind Mills says: "... as per provisions of Section 219 (1)(b)(iv), the Report and accounts are being sent to all shareholders of the company excluding the information relating to conservation of energy, technology absorption and foreign exchange earnings and outgo, and the statement of particulars of employees. Any shareholder interested in obtaining such particulars may inspect the same at the Registered Office of the Company or write to the Secretary for a copy". If this practice is allowed to spread, the suggestions to make the disclosures prominent may lose their relevance.

Instead of repeating certain information both in the schedules and the Directors' Report, it would be useful if selected information is given as a part of the Directors' Report as well as immediately after it and before the Balance Sheet and Profit & Loss Accounts. The information on divisions, for instance, could be incorporated in what is presently being given under capacities, production and sales. To assist public policy formulation and to verify a number of assumptions regarding the industrial sector, there is a need to increase the disclosure content of the Annual Reports. For example, employment is a crucial policy variable. The Act presently does not require companies to report on this aspect. Similarly, information on new products patented, number of meetings of Board of Directors held during the year and proceedings launched against the company and its directors, transactions of directors and persons occupying sensitive positions in the shares of the company, etc. could also form part of the Annual Report. At present, information is not being reported on certain important variables like advertisement expenditure and R&D, taking advantage of the limit of 1% of total revenue for reporting purposes. It would be useful if such exemption is not extended for select items. Similarly, improvements can be made in transactions in foreign exchange to better understand the operations of TNCs. One hopes, with the SEBI getting precedence over DCA in matters of public listed companies, the irritant of abridged Annual Report would be a thing of the past.

There are many other aspects of Company Law — and the recommendations of the Group which call for critical comments. But one must restrict comments here to some major issues only. When framing Company Law, it is necessary to keep in focus the characteristics of, and practices prevailing, in companies of different sizes. A uniform approach may not serve the purpose. Since the abolition of the Managing Agency system, one expects a number of changes in company practices to have taken place. The attempts at overhauling the Companies Act have been going on for almost five years. Instead of doing a rush job or yielding to pressures — and thereby introducing new concepts like non-voting shares, buy-backs and buy-outs — the operation of the Act in all its dimensions, and the behaviour of the sector should have been examined.

The system has been overburdened with fast expansion of the sector. By all indications, the growth has not been a healthy one. The pattern of registrations suggests 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 framing a new legislation it is necessary to identify and weed out such companies, as also prevent the emergence of new ones. "There are good Registrars and bad Registrars. The powers are capable of being misused", said the representative of Indian Chamber of Commerce in his evidence before the Joint Committee on the Companies (Second Amendment) Bill, 1964. It is equally true that there are good managements and also unscrupulous ones. Provisions of the Act apply uniformly to both.

Attempts to make a clean break with the past may sometimes prove costly, as has been the experience in some other areas of economic policy in the post-liberalisation era. At the present juncture it is difficult to visualise that the Indian corporate sector is ready for the extent of freedom proposed to be offered by the new legislation. It will be too optimistic to expect that the changed circumstances and the changed law will make the sector mend its ways and improve its performance. Disclosures by themselves cannot serve the purpose. Even the improvements suggested by the Group could be frustrated in practice, if these are not accompanied by a careful drafting of the legislation and followed up by an effective monitoring mechanism.

Contributed by *K.S.Chalapati Rao*