

CHAPTER II

GROWTH AND ROLE OF CORPORATION IN INDIA (PART I)

Of the two aspects of a corporate form of business organisation, namely, the legal aspect and the economic aspect, it is the economic aspect that invites attention while discussing the growth and role (which implies nothing but economic role) of corporations in India. The growth of corporate form of business organisation may mean an increase in number, assets and activities of corporations. And the role of corporation may imply the impact of the economic functions of corporations, such as financing, producing, distributing etc. on the national economy of a country.

The growth and role of corporations in a country are governed by a number of factors. Whether a country is mainly agricultural or industrial. Whether a country has already passed through industrial revolution and commercial revolution or not. Also, the Government policy is in no way less important a factor in affecting the scope of the corporate form of business organisation.

Before describing the growth of corporations in India, it would be quite useful to know the different ways of classifying the corporations into different types or groups. On the basis of their lines of activity or purpose, they may be termed as rail-road corporations,

public utility corporations, industrial or manufacturing corporations, financial or investment corporations and so on.

From the point of view of place of incorporation, corporations may be described as domestic or foreign. A domestic corporation is one which is incorporated in the State or country concerned. A foreign corporation is one which is incorporated in an outside country. A foreign corporation may assume the form of a branch or a subsidiary or a minority shareholding company.

On the basis of the relation of the corporations with the State, they may be classified into public and private corporations. Public corporations include municipalities, semi-government and government corporations. A private corporation is usually defined as one which has a limited number of shareholders and which does not invite the public for its shares and debentures. For instance, in India, a private company is defined as one whose articles restrict the right to transfer shares, limit the total number of shareholders to 50 (exclusive of employees) and prohibit an invitation to the public to subscribe for its shares or debentures. A public company is defined as any company which does not meet these conditions.

Private corporations may be of two types, namely, stock corporations and non-stock corporations. Stock corporations which are popularly known as joint stock companies

include business corporations, financial corporations such as banks, trust companies, loan associations etc. Stock corporations have a capital stock fund divided into transferable shares. These corporations work for profit motive.

A non-stock corporation is one which is not authorised to distribute profits to its members. Whereas a joint stock corporation is authorised to distribute its profits to its members in proportion to the number of shares owned by each of the members. To the non-stock companies belong incorporated religious, educational, charitable and social organisations. Such corporations exist in large number in America where private sector has taken up a number of social welfare activities.

On the basis of the principle of "liability", the joint-stock companies can also be divided into public limited companies and private limited companies. The phrase "limited liability" implies that a shareholder's or stockholder's responsibility in respect of the financial risk of his company is limited to the number of shares or value of shares he holds in that company. In this study, mainly the public limited companies and also the private limited companies (whenever data on private companies are available) will be dealt with.

After having known the different types of corporations in general, it would be interesting to discuss

the system of classifying the corporations in India. Though of course the different types of corporations as mentioned above do exist in India; but, for practical purposes, the joint-stock companies are classified on the basis of their activities in the country. The grouping of companies on the basis of their activities has undergone changes three times. Upto 1920-21, companies (or corporations) were grouped under 18 industrial groups. But, after 1921, a new classification was effected. This classification covered 59 industrial groups and comprised totally twenty types of economic activities, namely, banking, insurance, navigation, railways, other transit and transport, trading and manufacturing, tea, other plantations, coal mining, gold mining, other mining and quarrying, cotton mills, jute mills, mills for wool, silk and hemp, "cotton ginning, pressing, baling etc", jute presses etc, flour mills, "estate, land and buildings", sugar (including jaggery), and other miscellaneous.

Again, in 1954-55, a new classification of companies was introduced in the country. The new classification which is based on International Standard Classification, represents totally nineteen different types of economic activities and comprises 230 industrial groups. These nineteen activities are arranged into eight broad groups, namely, agriculture and allied industries, mining

and quarrying, processing and manufacture (which includes sugar industries, tobacco, textiles, leather and leather products, iron and steel, chemical, petroleum and coal, cement), construction and utilities, commerce-trade and finance (which includes trade, real estate, land and similar organisations including agricultural land, insurance, banking)", transport, communication and storage (including water transport, railway transport)", "community and business service", "personal and other services".

In the light of the above discussion, it may be useful to explain the concept of "corporate sector" also. According to the Reserve Bank of India, the corporate sector comprises non-financial Indian joint-stock companies, banks, Industrial Credit and Investment Corporation, non-life Indian insurance companies and also cooperative institutions. Further, the subsidiaries of foreign companies are included in, and the branches of the foreign companies are excluded from, the corporate sector. In this study, eventhough the traditional use of the term "corporate sector" has been resorted to, only the joint-stock companies are discussed. There also, public limited companies, for which alone continuous data are available, have been discussed at length. Therefore, as far as this study is concerned, it would be more appropriate to understand by "corporate sector" nothing but the "company sector".

In the corporate sector of India, since 1957, a new element is introduced. Under the Companies Act of 1956 (Section 617), a distinction has been made between government and non-government companies. Under this Act, a government company means any company in which not less than 51 percent of the share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments. This type of distinction in a sense would certainly destroy the concept of identification of the corporate sector with the private sector as mentioned above. If this distinction will continue, the entire corporate sector will have two broad divisions, namely, the government corporate sector and the non-government (which is not the same as private sector) corporate sector.

The growth of the corporate sector in India cannot be discussed without a reference to the broad phases of the country's economic development which greatly influenced the corporate sector of the economy. Two broad phases of India's economic development greatly influenced the pattern of the corporate sector in the past. The first phase developed after 1850, though of course a beginning was made towards the close of the 18th century when some European planters began the manufacture of indigo. In this phase of the economic development, the extractive and export

industries were tapped and developed mainly by the foreign investors and the managing agents. The plantation industry from its very beginning was owned, managed and controlled by the ex-employees of the East India Company. They became interested in indigo, tea and coffee plantations since they provided easy and high return on their investment.

In the second phase of India's economic development, not only the export and extractive industries but also processing industries such as textiles, chemicals etc. were established. Till the middle of the 19th Century, the foreigners took little interest in all these industries. It might have been so due ^{to} the restrictions on Englishmen for permanently acquiring land in India, the trading monopoly of the East India Company till 1833 and the lack of transport facilities. After 1850, these impediments lost their force. Hence, towards the end of the 19th century, a number of foreign investors and the managing agents began to participate in financing and managing these new industries.

From the above discussion, it can be said that the corporate sector of the country was patterned under the influence of the two broad phases of the economic development of the economy as a whole. Later on, the growth and pattern of the corporate sector got a new

stimulus under the managing agency system. It is interesting to note that the managing agency system has its origin almost at the same time as the birth and evolution of the present day corporate system in India. Those were the days when people were not used to subscribe risk capital. Also, the institutional investors were almost absent. The banking system was underdeveloped. So, banks were neither able nor willing to finance the corporate sector in the country. It was difficult to float a company. It was at that stage that the managing agency system was developed to enable in turn the development of the corporate sector. A managing agency firm popularly known in those days as the industrial house used to purchase substantial block of shares, arranged for working capital and also undertook the task of managing the affairs of the company, by guaranteeing its commitments where required.

Since the managing agency system is claimed to be the bed-rock upon which the growth of the corporate sector has been founded, it is worthwhile discussing briefly the growth of this system. It is difficult to give an exact date on which this system was first introduced in India. Establishing that the East India Company entirely discontinued its trade activities in 1833, Vera Anstey⁽¹⁾

(1) The Economic Development of India, 3rd, Ed., 1936, by Vera Anstey, page 113.

has given the year 1833 as roughly the date for the beginning of this system. John Cave Orr and Sylvester Dignam who organised in partnership a managing agency firm, namely, "Messrs Orr, Dignam & Co. of Calcutta" are credited with the first attempt to formalise the written bond between managing agencies and their managed companies in the second half of the 19th century. Since then, different types of such relationship have been formed.

In course of time, the managing agency system assumed three forms, namely, individual, a partnership firm and a joint-stock company-private and public. A number of managing agents, who had initially adopted partnership form of business organisation, changed over to private limited companies. This happened, because the private companies proved to be more attractive than partnerships in respect of public confidence, State assistance and tax treatment. But, when some stringent restrictions were imposed, say, penalty taxes, on the private companies, again a new tendency of converting partnerships and private companies into public companies arose. This tendency seems to have continued for a long period of time. For instance, Duncan Brothers was organised in 1775 as a private company; but it was converted into a public company in 1948. Gillanders Arbuthnot & Co. Ltd. was incorporated in 1935 as a private company. It became a public company in 1948. So also some

eminent business firms such as Kettlewell Bullen & Co. Ltd., McLeod & Co. Ltd., Parry & Co., Shaw-Wallace & Co., all these had begun as private companies. Later on, they were converted into public limited companies. In recent years, Lever Brothers have also declared the conversion of their company into a public limited company.

When the managing agency system began to show its evils, some restrictions were imposed on it. A beginning of restricting this system was made in 1936. A death blow was given to this system in 1956. To assess the effect of the Companies Act of 1956 on the managing agency system, some facts are presented in the following table:-

(Paid up capital in crores of Rs.)

Overall position of Managing Agencies and the Managed companies (1954-55)

Class of Managing Agencies	Managing Agencies		Total private & public managed companies	
	Number	Paid up Capital	Number	Paid up Capital
Unincorporated Managing Agencies	2522	-	2771	95.2
Private Managing Agency Companies	1238	32.0	1780	255.0
Public Managing Agency Companies	184	44.1	504	115.2
Total	3944	76.1	5,055	465.4

Source:- The corporate sector in India, 1961 Raj.K.Nigam and N.C.Chaudhari of the Dept. of Company Law Administration, Ministry of C.& I., New Delhi, p.55

This table reveals that upto 1954-55, as many as 5055 companies with a total paid up capital of Rs.465.2 crores were under the control of the managing agencies which stood at a figure of 3944.

But, after passing of the Companies Act of 1956 (Section 330), this system began to wane so much so that as on 16th. August 1960, only 1308 companies were managed by them out of which 1105 were public companies and 203 were private companies. The total number of the managing agencies at work in 1960 fell to 919. This shows that almost three-fourth of the control of this system is lost. Now only 5 percent of the corporate sector is covered by the managing agencies.

However, it must be admitted that the credit must go to the managing agency system for organising, strengthening and stabilising the institution of joint-stock companies in India. Practically, every important company dealing in production or manufacture of coal, iron and steel, jute, cotton textiles, hydroelectric, sugar etc. has been started and developed by the managing agents. It is noteworthy that with the waning of this system, the Government has allowed the creation of a new cadre of Secretaries and Treasurers to fill in the gap.

So far, the different types of corporations, the concept of corporate sector, its pattern as influenced by the phases of the country's economic development and the role

of managing agency system are discussed. Now remains the study of the growth of the corporate sector in terms of number of companies, their paid up capital, their regional distribution and other aspects relating to the corporate sector of India. The main difficulty in the study of the actual growth and role of the corporate sector is the paucity of data. The Department of company Law Administration of the Ministry of Commerce and Industry has done a valuable service by compiling the data on the different aspects of the corporate sector.

Since the data furnished by the Department of Company Law Administration are amply used in this study, it will be more convenient to follow their method of discussing the growth of the corporate sector. According to their method, the growth should be studied with reference to four major periods, namely, 1850-1900, 1901-1920, 1921-1940 and 1941-1961. The first period precedes the industrial dawn in the country. The second period covers the first phase of industrial development. The third period is the inter-war period which covers the second phase of industrial development influenced by the policy of discriminating protection. The last period covers the Second World War, post war, post-partition and the period of the Five Year Plans. This is the period of India's industrial revolution and diversification on a planned basis.

The first period covering 50 years is characterised by two important developments in the corporate sector. It was the Companies Act of 1850 which legalised the institution of joint-stock companies. After seven years i.e. in 1857, the Companies Act was passed to introduce the principle of limited liability. These two factors seem to have encouraged the growth of companies. In 1882, there were 505 companies with a paid up capital of Rs.15.7 crores. It increased to a figure of 950 representing the paid up capital of Rs.26.6 crores in 1892. And in 1900, there were 1340 companies with a paid up capital of Rs.34.70 crores. Thus, between 1882 and 1900, the number of companies increased by about $2\frac{1}{2}$ times and their paid up capital by about $2\frac{1}{4}$ times.

But, in this period, the growth of the corporate sector was rather lop-sided. The percentages of concentration of the companies in Bengal, Bombay and Madras were of the order of 43.2, 42.3 and 7.2 respectively. About 86 percent of the total capital invested in the whole of the British India had concentrated in Bengal and Bombay alone. During this period, the number of liquidations was also very large. It has been pointed out that, "on an average, during the nineties of the last century, 150 companies were set on foot every year; whereas there were 61 liquidations in a year"⁽²⁾.

(2) Progress of joint-stock companies in India, 1955, by Dept. of Company Law Administration, Ministry of C. & I., New Delhi, page 3.

During the second and the third periods i.e. during 1900-1940, thanks to the pioneering spirit of some foreign investors and managing agents that the number of companies rose to 2216 with a paid-up capital of Rs.61 crores in ten years (1901-1910). From 1911 to 1914, the number of companies and their paid-up capital rose to the figures of 2744 and Rs.77 crores respectively. This comes to more than 100 percent growth of companies in this period. Besides the influence of foreign investors and the managing agents, the other factors responsible for such a rapid increase in the number of companies were two. The Swadeshi Movement of 1907-08 increased the demand for goods of Indian industries. Further, the Government changed her policy with regard to the purchase of stores and materials which were purchased from abroad and now in India. Though during the period of the First World War, owing to the difficulties of imports, the corporate sector could not make much headway, after the war period the number of companies increased from 2668 in 1918 to 5189 in 1922. So also, the paid-up capital increased from Rs.99 crores in 1918 to Rs.231 crores in 1922. The World Depression of 1930 brought forth a set back to the corporate sector. Separation of Burma was another factor which retarded the growth of this sector. The result was a fall in the number of companies and amount of paid-up capital by 2.6 percent and 8.2 percent respectively. Before the Second World

War began, India had totally 11,114 companies with a total paid-up capital of Rs.290 crores.

Though there was rapid growth of the corporate sector during 1901-1940, the trend of concentration of companies in few regions continued, for the simple reason that the eminent industrial, financial and trading centres were situated in these regions, namely, Bengal, Bombay and Madras. As regards the liquidation of companies in this period, it may be pointed out that on an average there were 177 new floatations of companies and 81 liquidations. Despite the uneven growth of this sector during 1901-40, the policy of discriminating protection led to the strengthening of the foundation of the basic industries and thereby the corporate sector too.

In the last period covering twenty years or so, some important events such as Second World War, achievement of the political independence accompanied by the partition of the country and the implementation of Five Year Plans took place. Eventhough partition proved to be a temporary set back to the growth of the corporate sector, on the whole this period saw an accelerated growth of this sector. During the Second War and post-war periods, the companies increased to 14859 with a total paid-up capital of Rs.389 crores. During the period 1948-55, more than 7000 companies with a paid-up capital of Rs.413 crores were added.

For the period 1956-60 which covers the Second Plan period, the following table gives the data on the trends in the corporate sector:-

Number of companies at work and their paid-up capital during 1956-60

(Paid-up capital in crores of Rs.)

Year ended the 31st March	No. of cos. at work	paid-up capital
1956	29874	1024.2
1957	29357	1077.6
1958	28280	1306.3
1959 (Provisional)	27479	1509.8
1960 (Provisional)	26921	1593.1

Source:- The corporate sector in India, 1961, Raj and Chaudhari Dept. of Company Law Administration, Ministry of C. & I., New Delhi, page 9.

This table reveals that during the Second Plan period, the number of companies has fallen by 2953; whereas their paid-up capital has increased by Rs.569 crores at the end of 1959-60. In other words, on one hand the number of companies has gone down by about 10 percent; on the other hand, the amount of paid-up capital has increased by about 55 percent.

The fall in the number of companies is not due to liquidations alone; the more important factor is the action

taken by the Department of Company Law Administration to eliminate the inactive and moribund companies which unnecessarily gave an inflated picture of the corporate sector. Of course there were liquidations too. During 1940-44, there were 1182 new registrations as against 662 liquidations. After 1951-52, there has been a tendency of fall in the new registrations. Whereas, the liquidations on the whole have not shown any regular tendency of increase. As regards the problem of concentration of companies, during the Second Plan period, as a result of the Government policy of dispersing the industries in the underdeveloped regions of the country, in recent years there has been less overcrowding of companies in those areas which in the past represented the bulk of the companies in the country.

Further during the Second plan period, there has been a significant widening of the activities of the companies. This is mainly due to the structural changes in the country's economy, especially in the sector of industry and trade. It should be added that the corporate sector, during the period 1951-60, has been made to grow on a planned basis. The recent amendments and reforms in the Company Acts are a lurid illustration of the fact that there has been a planned effort to regulate the growth of the corporate sector.

After having discussed the growth of the corporate sector in terms of number of companies, their paid-up capital and their regional distribution, there remain to be studied the industrial pattern and structural pattern of this sector. For the study of these patterns, long term data are not available. Therefore, only the general trends will be analysed.

The industrial pattern can be studied in relation to the number of companies and their paid-up capital in a few important industrial groups. But, it is already pointed out that the industrial groupings have undergone big changes three times. Therefore, the data of the past (say, upto 1953-54 when the final grouping of the different industries and hence of the companies could be made) have lost their significance in explaining the trends in the industrial pattern of the corporate sector. Only about the trends in the first two plan period, some general observations can be made. It may be pointed out that as a result of the programme of the Five Year Plans, there has been a shift in the industrial pattern. This shift has been evidenced by the prominence of the basic industries. With the top priority given to industries in the Second Plan, there has been a shift in favour of basic and manufacturing industries. This explains in short the emerging industrial pattern of the corporate sector in India.

Then comes the problem of structural pattern under which two things invite attention. One is the relative importance of the big sized and the small sized companies. Second is the relative importance of the public and the private companies. As regards the position of the big and the small sized companies, on 31st March 1958, the total number of companies stood at 29,593 of which 28,280 were limited companies and 1313 were associations not for profit. From the point of view of the relative importance of the big sized companies with a paid-up capital of between Rs.50 lakhs and Rs.1 crore and the giant sized companies with a paid-up capital of Rs.1 crore and more, they accounted for 11% and 46% respectively of the total paid-up capital of all companies at work in 1958.

The position of the public and the private companies can be explained by the fact that the public companies represented about 85 percent of the total paid-up capital of all companies upto 1920, and 70 percent in 1956 and 51 percent in 1961. This shows a steady decrease in the contribution of public companies in terms of paid-up capital and a corresponding increase in the paid-up capital of the private companies.

Since the beginning of the Second World War, private companies have shown steady increase in their paid-up capital. This has been mainly due to the organisation of big sized and giant sized private companies during the period of the two Plans. If the paid-up capital of government companies is excluded from the two broad classes of public and private

companies, the ratio of the paid-up capitals of the remaining public and private companies comes to 70:30 in 1960-61. This shows that excluding the government companies, the role of public companies becomes more important. But in terms of number, the trend has been in favour of the private companies. The ratio of the number of the public and the private companies stood at 10:2 upto 1920. This ratio changed to 10:7 in 1946, 12:16 in 1951, 10:20 in 1956 and 7:20 in 1960-61. This has been the case due to the fact that during the period of the Plans, some very large sized companies, such as the Hindustan Steel Company Ltd. which has a share capital of Rs.300 crores, are organised as private companies in the public sector. The result is that the number and paid-up capital of private companies have in recent years increased, though of course by their nature, the public companies have not lost their strong hold on the corporate sector.

The government companies have steadily increased year by year. They were 61 in number in 1955-56. This number rose to 125 in 1959-60. So also their paid-up capital showed a substantial increase from Rs.66 crores in 1955-56 to Rs.468.4 crores in 1959-60. This figure of Rs.468.4 crores represents about 29 percent of the total paid-up capital of all companies, both government and non-government at work as on 31st March, 1960. Of the 125

government companies, 35 were public companies and 90 were private companies. The total paid-up capital of public and private government companies accounted for about 3 percent and 57 percent respectively of the total paid-up capital of all public and private government and non-government companies at work at the end of March, 1960. This shows that after five years of the passing of the Companies Act of 1956, the government companies have more than doubled and their paid-up capital has increased by eight times the original amount.

Thus the growth of India's corporate sector is discussed in relation to those aspects which may help the study of taxation of corporations. The growth of corporate taxation cannot be discussed logically without studying the growth of the corporate sector. In a sense growth explains the role also. But in order to assess the possibility of tax reforms, it would be essential to explain the role of the corporate sector in terms of capital formation, financing etc. These problems will be discussed at length in the next chapter.

Summing up this chapter, it can be pointed out that the credit of developing the corporate sector mainly goes to the managing agency system and the foreign investors. During the Plan periods, there has been considerable widening of the activities of the companies. This has brought about

shift in the industrial pattern of the corporate sector. Increasing State participation in the corporate activity is reflected in the increase in the number of government companies and their share in the paid-up capital. On the whole, the growth of the corporate sector in the country has been satisfactory.