Company Law*

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The Indian private corporate sector has been gaining importance over the past few years, especially since the introduction of liberal economic policies in 1991. With the policy emphasis shifting away from securing commanding heights of the economy for the public sector, the share of private sector in the paid-up capital (PUC) of India's corporate sector more than doubled from 27.16 per cent at the end of 1990-91 to 56.79 per cent in 1996-97. (See Table -1) Its share would have been far higher but for the incorporation of new large government companies some of which were set up for acquiring the *existing* operations of government enterprises. Since the beginning of the 'nineties, relative importance of the manufacturing sector reduced for public sector. Between 1990-91 and 1995-96, the share of Metals, Chemicals, Machinery & Equipment, etc. in PUC of government companies declined sharply from 46.22% to 34.13% while that of Electricity, Gas & Water increased from 4.40% to 21.80%. The latter accounted for more than 53% of the increase in paid-up capital of government companies during this period. (See Table -2)

The scope for private sector can be expected to increase rapidly in the coming years due to (a) throwing public sector reserved areas open to private sector and (b) proposed large scale divestment of equity by the government in government companies. The possibility of privatisation has increased substantially with the announcement in the 1998-99 budget that "in the generality of cases, the government shareholding in public sector enterprises will be brought down to 26 per cent". Another important development during the past few years is the fast increasing number of stock exchange listed companies. Their number increased by almost 60 per cent from 6,229 at the end of 1990-91 to 9,890 at the end of 1996-97. But for the continuing sluggishness of the stock market, the number of listed companies would have by now considerably exceeded 10,000. Though a degree of unreliability surrounds the estimates of both paid-up capital of the corporate sector and of the listed sector, available data indicate that the share of listed equity capital in paid-up capital of the corporate sector increased from about one-sixth in 1990-91 to about half by the end of 1995-96. A comparison with paid-up capital of all public limited companies places listed companies' share in 1995-96 far higher at more than three-fourths.

Thus, two things are apparent. One, the role of private sector has enlarged significantly after liberalisation. And two, stock market has acquired an important position and can be expected to play a larger role in the coming years. This is the background in which the prolonged effort at revamping of the Company Law should be examined.

Table -1
Changing Relative Position of Public and Private Sectors Since Liberalisation

As on 31st March	Number of Companies		Paid-up Capital (Rs. Cr.)			Share of Non-Govt. Cos. In PUC (%)
	Government	Non-Government	Government	Non-Government	Total	
1990-91	1,167	2,23,285	54,485	20,313	74,798	27.16
1991-92	1,180	2,49,181	57,911	26,731	84,642	31.58
1992-93	1,190	2,75,664	61,163	32,892	94,055	34.97
1993-94	1,203	3,04,422	67,380	46,441	1,13,822	40.80
1994-95	1,199	3,52,093	73,300	62,719	1,36,019	46.11
1995-96	1,216	4,07,926	76,963	87,125	1,64,088	53.10
1996-97	1,220	4,49,730	79,735	1,04,808	1,84,543	56.79

Source: Based on *Annual Reports on the Working & Administration of the Companies Act, 1956.*

Table - 2
Changing Sectoral Pattern of Government Companies' Paid-up Capital (PUC)

Sector	Paid-up Capital (Rs. Cr.)		Share in Total (%)		Share in Increased PUC (%)
	1990-91	1995-96	1990-91	1995-96	
Agriculture & Allied	293.86	400.89	0.59	0.52	0.39
Mining & Quarrying	15,900.96	17,485.23	32.17	22.78	5.79
Foodstuffs, Textiles, Wood Products, Leather Products, etc.	1,611.42	3,027.69	3.26	3.94	5.18
Metals, Chemical Prod., Machinery & Equipment, etc.	22,841.82	26,197.78	46.22	34.13	12.27
Electricity, Gas & Water	2,174.82	16,738.18	4.40	21.80	53.26
Construction	2,599.81	5,047.15	5.26	6.57	8.95
Trade, Restaurants & Hotels	2,814.09	743.92	5.69	0.97	
Transport, Storage & Communication	535.22	2,230.57	1.08	2.91	6.20
Finance, Insurance, Real Estate, etc.	566.69	4,733.30	1.15	6.17	15.24
Community, Social & Personal Services	85.71	161.81	0.17	0.21	0.28
Total	**49,424.40**	**76,766.52**	**100.00**	**100.00**	**100.00**

Source: Based on Annual *Reports on the Working & Administration of the Companies Act, 1956.*
Note: There does not seem to be a valid explanation for the decline in the PUC of Trade, Restaurants & Hotels sector in 1995-96 and may be attributable to the general poor state of corporate sector data.

Ineffective Regulatory System

While in India regulation of private companies had acquired certain ideological overtones, the fact is that in developed countries, company managements' commitment to work in the best interest of non-managerial shareholders is not taken for granted. A number of safeguards and disclosures have emerged in those countries over time to protect shareholder interests. In spite of the 'highly regulated' tag India had carried, a 1996 National Bureau of Economic Research (NBER) study placed India way below US in terms of antidirector rights of shareholders. While US had an index of 5 (maximum possible value), for India it was only 2. Australia, Canada, New Zealand, South Africa and UK had an index of 4. The only other country in the group of 17 countries (having their legal origin in English Law) which had an index of 2 (the lowest for the group) was Sri Lanka. The important aspects which went into construction of the index were: (i) Proxy Voting by Mail, (ii) Cumulative Voting for electing Directors, (iii) Existence of an Oppressed Minorities Mechanism, and (iv) Minimum Percentage of Share required to call Extraordinary General Meetings.

A study by the international consultants Ernst & Young (E&Y) is reported to have noted that India has a low rate of fraud perpetrated by company insiders (*The Economic Times*, May 19, 1998*)*. Worldwide, company employees accounted for 84 per cent of company resources defrauded. In India only a little over half of such frauds are perpetrated by employees. An implication of this is that controlling interests keep a close watch on their employees compared to large professionally managed companies. However, lower rates of employee fraud do not mean that Indian company managements are more honest and that shareholders get a better deal in India than elsewhere. More importantly, and in the context of the present discussion, E&Y also finds that in India company insiders with privileged access to information indulge in rampant insider trading for personal gains rather than to benefit shareholders. Therefore, the obvious conclusion drawn by *Economic Times* was that the controlling interests *and not the employees* who take the shareholders for a ride.

While in India certain attempts have been made over time to safeguard shareholder interest (following major corporate misdeeds or to address to certain prevailing practices), these suffered from the absence of an effective mechanism to properly follow up the provisions. At times even the provisions themselves were weak. For instance, criteria for identifying companies under the same management are so ridiculous many large companies could easily remain outside its ambit. Similarly, auditor's qualifications, many a time, were neglected by the managements while they were duty-bound to explain the deviations and discrepancies. That monitoring by the government is lax is evident from the fact that even the Secretary, Department of Company Affairs, admitted that 'the time had come for the Government to take serious note of the auditors' qualifications in the annual reports'. He also expressed his displeasure about the functioning of the boards of companies and explained that in various instances, even institutional directors do not attend the board meetings and added that the Government was giving serious thought to tackling the directors of fly-by-night companies. Another important facet of poor monitoring of the Indian corporate sector is that even the status (where they are and what they do) of more than half of the nearly 5 lakh companies is not known as they do not file their annual reports with the Registrar of Companies.

Coinciding with the relaxation of controls since the beginning of the 'eighties, the Indian private corporate sector grew by leaps and bounds in terms of numbers. From about 56,000 at the end of 1979-80, the number of companies now reached about 5-lakhs. (See Table -3) This growth has been fuelled by small non-manufacturing private limited companies (finance, trade and investment) and was accompanied by concentration in a few large cities like Bombay, Calcutta and Delhi. Even within these cities companies were found to have been promoted in clusters. There is thus a high degree of artificiality in the growth of companies and a distinct possibility and ample evidence about the smaller companies being used for manipulative purposes -- to circumvent one or the other regulatory provision, to take undue advantage of official incentives or to siphon-off funds from public companies for personal gains. Such companies performed quite varied roles: from stock scam to diversion of funds and from 'front' companies to thwarting hostile take-overs. Historical evidence as also press reports on corporate scandals and our own research reveal the existence of such companies within the fold of many large houses and business groups.

Table - 3
Number of Companies at Work: 1959-60 to 1997-98

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
1997-98	4,88,000

* Rounded off to the nearest thousand.

While the number of companies is so large, the applications for specific permissions under the *Companies Act* were far too few. In 1997-98, the position was like this: number of applications for approval of sole selling agents - 40; loans to directors and relatives - 91; contracts in which directors are interested - 468; inter-corporate loans - 42; and inter-corporate investments - 622. In spite of large number of companies not filing annual reports, the number of prosecutions launched during 1996-97 were only 1,507. Newspaper reports indicate that the government becomes active and launches prosecutions against companies not filing annual reports only when a group gets involved in some major scandal.

Revamping of the Companies Act, 1956

While recodifying (rewriting the Act instead of merely amending the existing provisions) the Companies Act which provides the legal framework for corporate form of business management was talked about even at the beginning of the year, the process got underway with the beginning of liberalisation in the middle of 1991. The effort was to get the Company Law revamped to reduce the complexity, bureaucratic interference and discretion and to leave company managements and shareholders free to take decisions in the best interest of the company.

The enactment is getting delayed due to one reason or the other. The delay could be as much due to the frequent changes in the Central Government as to subtle private sector pressure. The first concrete attempt of 1993 was abandoned and the 1993 Bill was replaced by a new Bill in 1997 by the United Front government. The Companies Bill, 1997 was preceded by a Working Group report and a working draft, which were circulated for public debate. The criticism that followed due to their one-sided and pro-management approach and the coming into open of the CRB affair and activities of other non-banking financial and plantation companies and to an extent the Chhabria group's revelations, led to tightening of the provisions in the Bill much to the discomfiture of the private managements. The UF Government referred the Bill to a Standing Committee on Finance. With the dissolution of the Lok Sabha and holding of fresh elections, the process has got stuck once again.

While the recodifying exercise has been going on, the original Act rules were subjected to a few amendments. Important among these include relaxation of the limits on managerial remuneration, simplifying the procedure for altering the Memorandum of Association and tightening the provisions relating to acceptance of deposits, etc. The latest in the recodifying drama is that after the Prime Minister’s announcement at the annual general meeting of FICCI on October 24 1998, an Ordinance was issued to allow buyback of shares, free inter-corporate investments from government control, permit issue of ‘sweat equity’, set up Investor Education and Protection Fund, etc.

Why did none of the restrictive provisions of 1997 Bill namely, (i) appointment of a Chief Accounts Officer by listed companies having paid-up capital of Rs. 3 crores; (ii) need to obtain a Compliance Certificate from a Company Secretary; (iii) vastly enlarging the scope of Officer-in-Default; (iv) mandatory constitution of Audit Committee by every public company with a paid-up capital of not less than Rs. 5 crores; (v) compulsory retirement of auditors every five years; (vi) allowing proxies to vote in a show of hands and to speak at shareholder meetings; (vii) prescribing minimum paid-up capital for companies; (vii) empowering the Central Government to appoint a Director General of Inspection and Investigation, (viii) postal ballot, etc. merit a place in the Ordinance is an important question. Official announcements indicate that a revised Companies Bill will be introduced in Parliament in the Winter Session of the Parliament and passed in the Budget Session that follows. If this is the case, where was the need to announce major relaxations through an Ordinance now and why did the Ordinance confine itself to relaxations keeping out all the restrictive provisions of the 1997 Bill?

Buyback

Since the private sector persistently demanded the introduction of share buyback and relaxation of inter-corporate investments, and the government has finally acceded to the demand through an emergency measure, we shall examine these provisions in some detail. First the buyback. Buyback means that a part of the share capital of the company will be purchased by the company itself from individual shareholders who are willing to sell their shares. The consequent reduction in capital will help listed companies to increase their share prices although neither the physical performance nor profitability of operations may have improved. Profits generated are compared against a smaller amount of owners’ capital and hence the possibility of increase in share prices. Ostensibly, buyback helps companies in relieving idle surplus funds, as companies, instead of investing in unrelated and high-risk expansions, can use the funds to increase shareholder value. It is argued that buyback provides liquidity to listed companies, which are not well traded, and brings a degree of momentum to their share prices. It is also said that both the sellers and those who hold on to their shares will benefit from buybacks. Because of these expectations, on its part, the Government could be hoping that buyback will revive the capital market that has been languishing.

Due to liberalisation, several Indian company managements are under threat of take-over since many of them hold very little stake of their own. Indian industrialists must also be feeling disadvantaged compared to foreign-controlled companies listed on Indian stock exchanges as many listed TNCs are either subsidiaries of their foreign parent companies or the foreign companies have substantial shareholdings in them. While seeking a parallel with TNCs, managements of large Indian companies should, however, realise that in their developed home countries, listed TNCs are not controlled through majority holdings.

Limiting management's shareholding is necessary because if the managements have unassailable control over the companies under their charge, they are less likely to bother about minority shareholders. It is easier for them to get through whatever they wish by bulldozing AGMs. The Indian industrialists also wish to achieve such a position through buyback without investing any money from their personal wealth through jettisoning of other shareholders. It may be noted that the Companies Bill, 1997 aims at empowering AGMs and Boards and withdraw discretionary powers from the government. Any move, which inhibits the proper functioning of AGMs will, therefore, be harmful. Far from enabling Indian managements acquire majority shares in the companies managed by them, there is indeed, a case for limiting the maximum shareholding of controlling interests in listed companies. Only then the qualification of 'widely-held' for listed companies will be appropriate and the objective of resource mobilisation through stock exchanges meaningful. In addition, in the new policy regime, TNCs are keen to increase their holdings in their Indian affiliates and subsidiaries. Cash-rich TNCs may increase their already high shares without bringing in additional capital by taking advantage of the buyback provision.

Since the immediate use of buyback will be as a shield against hostile take-overs, it goes against the very logic of stock market discipline. Take-over threat is one major characteristic of the stock market which forces managements to act in the overall interest of shareholders instead of taking decisions purely on personal profit motives. Since buyback will blunt that disciplining characteristic of the stock market it is obviously undesirable from the point of developing a healthy stock market. It is argued that buyback provides liquidity to listed companies, which are not well-traded, and brings a degree of momentum to their share prices. At this depressed stage of the market, it will be a distress sale for the small investor and an opportunity for the managements to further consolidate their holdings at a lower cost.

It is also argued that buyback is an efficient way of relieving companies of their surplus funds. How should one define surplus? If a company does not spend on R&D and/or does not export, can one say that it has no avenues to invest? Unfortunately, many large Indian companies do not spend on some of the essentials like R&D. Instead of investing in unrelated activities, why can't the companies invest in R&D, improve productivity and develop export markets which will improve their long term potential? There are also other ways of disposing off surplus funds -- by retiring costly debt and/or distributing dividends. Even from this perspective, encouraging buyback at this stage does not seem desirable. Importing ideas may be good but that should be done taking into consideration the prevailing ground realities. The concept of share buyback may be relevant for mature economies but the same cannot be said of a developing one like India's.

Next is the government's perspective. It seems the government was convinced of the fact that buyback would revive the market and the market index would look up. Unfortunately, the government too has a vested interest in the market appearing buoyant; even for a short period. It can make use of such bullish sentiment to kick-start its public sector divestment programme. Given the reality of the market such a move unfortunately cannot be differentiated from the manipulation of market prices by private promoters before going to the public -- to charge a higher premium or even to see an issue through. In that respect, the government will be emulating the private promoters in trying to make a quick buck.

Buyback as announced by the government has the following main features:

(i) a special resolution has to be passed in general meeting of the shareholders;
(ii) buyback should not exceed 25 per cent of the total paid-up capital and free reserves of the company;
(iii) the post-buyback debt equity ratio should not be more than 2:1;
(iv) a declaration of solvency has to be filed with SEBI and ROC;
(v) the shares bought back should be extinguished and physically destroyed;
(vi) the company should not make any further issue of securities within 2 years (except bonus, conversion of warrants, etc.); and
(vii) the buyback should follow SEBI guidelines.

SEBI while allowing different modes of buyback, placed a restriction that promoters should not participate in buyback through the stock exchange mode. While the private sector seems to be unhappy with the limited freedom allowed to them, it is worth noting that this restriction of SEBI does not have much relevance. In the context of buyback being expected to be used to strengthen managements' control over the companies by using company resources, the managements cannot be expected to reduce their holdings by selling their shares to the company. Secondly, SEBI has an elaborate definition of a promoter and places obligations on listed companies to continually disclose promoter shareholding. For instance, every company whose shares are listed on a stock exchange, has to make yearly disclosures to exchange the changes, if any, in respect of the holdings of the persons holding more than 10 per cent of the holdings of the company and also holdings of promoters or person(s) having control over the company. It should be illuminating to know how many companies file these particulars with the respective stock exchanges. Given the tendency of corporates to conceal information for obvious reasons, one can judge the extent of information filing and its quality only if it is available publicly. In also relevant to find how this information is monitored and by whom because this has implications for curbing insider trading. In this context, it may be noted that the Bombay Stock Exchange (BSE) placed the shareholding pattern of only about 900 companies on its website and a personal visit to BSE last year could get us the shareholding pattern of only about 3,500 companies out of more than 5,800 companies listed with the Exchange. For more than 500 of these companies the information was dated and refers to 1995 or earlier. This is in spite of the fact that listed companies are obliged to file share distribution schedules with the stock exchange.

While these are the practical matters concerning buyback, the very logic offered as a justification for buyback is flawed in the present context. Will a temporary increase in share prices triggered by buyback bring the small investor back to the market? After all, what is the depth of trading on Indian stock exchanges? Just a handful of companies account for bulk of the value traded at BSE. Increase in share prices of companies buying back their shares is unlikely to affect the index in any meaningful way. Market capitalisation cannot be expected to go up substantially after buyback since the increase in prices will be accompanied by reduction in capital. It is the market capitalisation that determines share price indices. More importantly, that the temporary upward swings or even booms in share price indices have failed to enthuse the small investor is now common knowledge. Performance of listed companies and managerial discipline and not artificial increases in earnings per share would decide the long-term strength of the market. The investor should feel confident that the promoters would put his money to best use and reward him better than other avenues of investment. It should not be forgotten that in the first instance, the primary market went into deep slumber due to absence of proper regulations. It was as if one moved from 'licence-permit-raj' to 'freedom-to-loot-raj'. Given the deep morass the stock market is in, and the continuing fluid political situation, no amount of artificial support will help. This has already been proved with the Sensex recording a sharp increase (105 points) following the buyback announcement and falling back to the earlier position even before the end of November -- 2783.1 on November 27th against 2784.5 for 23rd October. Incidentally, these are the year's lows so far.

Inter-corporate Investments, Loans, etc.

This is another provision with respect to which the private industry has been demanding full freedom. The salient features of the Ordinance in this regard are:

(i) companies can give loans, guarantees or invest up to 60 per cent of the paid-up share capital and free reserves or 100 per cent of its free reserves, whichever is more;

(ii) for exceeding the limits the company should get the authorisation of the general meeting through a special resolution.

(iii) investment, bank, insurance companies, etc. are exempted from the ceilings;.

(iv) loans cannot be made to other companies at lower than the prevailing bank rate of interest;

(v) all loans, investments and guarantees should be approved unanimously by the members of the company's board present in the meeting; and

(vi) if any term loan is subsisting, prior approval of public financial institutions is essential.

By implication, the provisions suggest that non-investment companies after getting necessary approvals can invest all owned funds in other ventures keeping no owners funds with themselves. In such a situation, one wonders whether the purpose of such companies will be to invest in other companies or to do business of their own. Even the revised limit of 60 per cent of paid-up capital and free reserves is so high that unscrupulous managements can easily siphon-off funds. Once the money is invested, the investing company's board can have no control over the manner in which the amount is put to use. The unanimous agreement of the directors present can easily be circumvented by selective absence of directors who do not wish to be a party to such a decision. The stipulation that companies should seek approval of public financial institutions in case of subsisting term loans is welcome and is understandably being resisted by the managements. It is reported that to avoid delays a maximum time limit for their approval is being thought of.

The main point, however, is that in order to avoid government intervention, the private sector has been overemphasising the effect of the existing provisions in restricting industrial growth. First of all, the rate of rejection of applications for investments is far too low to justify this. On top of this, business houses circumvented this measure through floating multiple subsidiaries and investment companies. A ridiculously weak criteria made a mockery of the concept of companies under the same management. On the other hand, reckless and fraudulent investments ruined the health of many public companies even within the existing system.

How some industrial houses used the mechanism of inter-corporate investments through circular and cross-holdings should also not be forgotten. In the desperate attempt to fortify their positions, business houses cannot be expected to exercise restraint and are likely to resort to such mechanisms in a big way. In a classic example, each of three foreign tea companies issued shares to the other two as part of FERA dilution strategy. The Department itself has been guilty of allowing cross-holdings. For instance, a number of Kirloskar house companies were allowed to acquire each others shares, all in a single month. Each of the companies were to invest in shares of the other company whose value was almost equal to the share it was taking in the former. Such investments give managements disproportionate control over the companies they manage and make a mockery of 'shareholder approval'. Since their own real risk and stake are low, managements will be less interested in the health of the companies and would not hesitate to enrich themselves at the expense of public companies. The expectation of inter-corporate

Box
Circular and Direct inter-locking of Investments

House	Remark
Birlas	So far as inter-corporate investments, which constitute the bulk of controlling investments are concerned, the group relies not upon direct inter-locking of equity

	but substantial holdings by investment companies, ***supplemented by circular chains of investments which return to their starting points***, …
Bangurs	The large number of finance companies ***practically own one another***,…
Juggilal Kamlapat	Inter-corporate investments take the form of joint subsidiaries, ***direct inter-locking of companies***, and investments by industrial companies in finance, banking and insurance companies, which in turn, own the equity of industrial companies, ***to bring about a circular pattern of equity holdings.***
Thapar	Resorts to frequent direct inter-locking of equity.

Source: R.K. Hazari, **The Structure of the Corporate Private Sector**, Asia, 1966.

investments contributing to growth is relevant in case of support to new investments for expansion, setting up new companies for implementing projects and reviving sick companies. If it is a question of mere holding of equity for controlling purposes -- which is the main aim of the managements at the present juncture -- there is no case for freeing inter-corporate investments.

Consolidation of Control is the Real Motive

Finally, the main point here is not whether the conditions attached to buyback and inter-corporate investments are restrictive or not or even whether private managements will indulge in manipulations or not. The recent measures -- buyback, inter-corporate investments, sweat equity, enhancing the limits for creeping and substantial acquisitions -- are all aimed at enabling managements to consolidate their control. The other measures in the Ordinance -- nomination facility, setting up of Investor Education and Protection Fund and National Advisory Committee on Accounting Standards -- appear by way of palliatives. The real purpose of the policies is further clear from the manner in which buyback will be permitted even in the midst of a hostile take-over attempt. Unfortunately, even sweat equity, a useful instrument, acquired a new meaning in the present context, due to its timing, with fears being expressed that controlling interests may issue themselves cheap or even free shares.

If the shareholder meeting is given such an importance, it is difficult to understand why efforts were not made to make the meetings more representative by at least allowing postal ballot. Is it known that in a vast majority of companies, especially the smaller ones, the financial institutions have very little stake? An examination of share distribution schedules filed with the BSE for the period 1996 and 1997 reveal that out of the 2,938 companies, for as many as 2,130, the combined shareholding of term lending institutions, insurance companies, government and government companies, etc was less than 10%. 1,100 of the companies studied had less than Rs. 5 cr. equity capital. In their case, the corresponding shareholding was less than 1 per cent in 670 companies and less than 10% in 930 companies. The smaller companies were also characterised by high level of individual shareholding. In 600 companies individual holding is more than 40%. In such a situation, it will be wrong to depend on the financial institutions to play a balancing act or to expect wide shareholder participation.

Following the criticism launched by the managements, comments in the press attributed to officials indicate that the restrictive provisions of the Ordinance and the rules may be diluted when the Ordinance takes the form of a Bill. Since the managements have won the first round, they may now target their energies on getting non-voting shares, group resource companies, share buy-outs and decrease in the number of relatives for purposes of Company Law. According to press reports Assocham has already come out with a suggestion that the threshold limit for buying out minority shareholdings should be lowered from 95% to 75%. Companies can then easily eliminate the remaining small shareholders. One should not be surprised if some of these find a place in the ensuing Amendment Bill. In sharp contrast, the silence of private sector on the corporate governance front is deafening. Indeed, the managements should have at least made a beginning by voluntarily adopting the code announced by themselves with much fanfare, and on that strength demanded the enactment of the other provisions of the 1997 Bill. Looked from a different angle, if measures are announced in a piecemeal manner what will a Standing Committee of Parliament or an expert committee appointed to examine the comprehensive Bill would do? It will be difficult for such bodies to over turn the already approved provisions.

The Companies Bill 1997 Needs Improvement

Protecting investor interest cannot be limited to monitoring of (i) whether the capital raised is deployed for the stated purpose or (ii) deposits are being repaid regularly along with interest or (iii) board meetings are being conducted as per the provisions of the Act, etc. The real issue is how to deal with managements' proneness to enrich themselves at the cost of ordinary shareholders. This is truer in case of companies with public shareholding and the problem need not necessarily be confined to listed companies. There are a number of ways in which managements can enrich themselves at the cost of non-managerial shareholders. Some of the better-known ones are:

- Siphoning off funds in sale and purchase transactions and provision of services;
- Investing in companies in which the managements are interested not caring for their worthwhileness;
- Paying themselves, their close relatives and associates high salaries and perks (who could also be allies in perpetrating frauds);
- Booking personal expenses to company's account;
- Insider trading in company shares; and
- Fixation of prices at the time of mergers, take-overs and unit/share transfers to suit their interest.

The Companies Bill, 1997 addresses to these problems only to some extent. Unfortunately it has, instead of improving the provisions, liberalised some of them to such an extent that managements will have greater freedom to achieve their objective unless the associated mechanism is strengthened. The Bill seeks to reduce the number of relatives. The Bill also expects that it will be enough if the shareholders are aware of the existence of certain information. Filing of information with the registrars does not serve much purpose unless systematic and easy access is possible. As long as managements cannot be effectively challenged and disclosures reach the shareholder as a matter of routine, approvals in shareholder meetings cannot be expected to protect their interests. Listed companies' performance and managements' role in it should become public knowledge. Until these become a reality, one needs to tread a careful path. Interestingly, the Bill leaves the scope of postal ballot (which improves shareholder participation) to be defined by the Government. The least it could have been done is to clearly specify certain situations like mergers, asset sales, buyback, etc. where postal ballot has to be followed and give the government powers to further enlarge its scope. Even the earlier little-used proportional representation on the Board has been left as such without making it mandatory. It needs to be emphasised that maximising shareholder wealth, the maxim for corporate governance, in the case of foreign companies can only work to the best advantage of foreign owner rather than the Indian subsidiary. The Bill does not take note of this reality.

The need for self-regulation by the corporate sector cannot be disputed. Managements would no doubt like to have freedom first. But consider the present state of affairs. Whether it is the small and medium companies or Indian large houses or TNCs, the promoters do not hesitate to pursue their own interest at the cost of other shareholders disregarding ethics or public criticism. In the recent past this took the form of raising money from the public and vanishing afterwards, increasing promoter's stake at below-market prices, consolidating control through cross-holdings, adapting blatant pricing norms while de-subsidiarising, paying royalties to family-owned firms or indulging in insider trading.

Protecting Indian companies from take-overs should not mean that the managements should be allowed all manner of freedom so as to retain control and that too in the name of 'enhancing shareholder wealth' and 'reviving the stock market'. No doubt Indian companies' bargaining power has to be increased in the context of hostile take-overs from abroad. For this the appropriate remedy is to tighten the take-over and monopolies regulation and placing limits on foreign equity in different sectors. On the contrary, the present provisions are more likely to be used against internal take-overs which is not desirable. What one probably should aim is to create conditions for local control of companies, brands and retain scope for technology development. Because in spite of all support given to Indian businessmen, ultimately there is nothing to prevent them to throw in the towel if the going gets tough.

In this background, the government should have put effective safeguards in place before granting the private sector freedom. Freedom to managements without making the General Meetings meaningful, directors accountable, decision making broad-based and minority shareholders' rights strengthened would amount to license to indulge in mal-practices. This is all the more imperative because of the growing importance of private sector and stock markets. Now that freedom has been granted would the government show the same alacrity in bringing restrictive provisions? Luckily for the private managements, the country has entered yet another politically unstable period. For the harsher provisions we may probably have to wait much longer.

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