HOW BIG ARE BIG ENTERPRISES IN INDIA ?

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FORUM OF FREE ENTERPRISE
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"Free Enterprise was born with man and shall survive as long as man survives."

—A. D. Shroff
(1899-1965)
Founder-President.
Forum of Free Enterprise.

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In the last two years big business houses and companies have come under heavy criticism, political as well as economic. The Dutt Committee Report, the Monopolies and Restrictive Trade Practices Act, denial of industrial licences to large houses and companies, the end of the managing agency system, the exercise of management participation by financial institutions through their nomination of directors, etc., have changed the industrial and managerial outlook beyond recognition, especially for the so-called large enterprises.

Under these circumstances, what is their future? Can they look forward to a more active existence and where can they turn to for their growth and development?

In the context of the end of the managing agency system, does the Dutt Committee's definition and analysis of the large business houses still hold good or is it somewhat out of date? Since the concept of large houses is under attack, this is perhaps the first question which calls for an examination.

In its search for a suitable definition of a large industrial house, the Dutt Committee began with a list of 75 large

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houses compiled by the Monopolies Inquiry Commission in 1965.

The definition of a "house" by the Commission was quite broad. It included managing agency companies, their managed companies, subsidiary companies under the same management, and such other companies over which the principal financial and/or management control was exercised by individuals or companies of the business group.

To this definition, the Dutt Committee added some further refinements. Among other things, it included in the '%house-interest" those companies in which a particular house, or a bank belonging to it, owned a third or more of the "effective equity." Effective equity was defined as total equity "excluding" shares held by State-owned or State-sponsored financial institutions or by foreign collaborators and other non-resident shareholders.

Whatever may have been the validity of this definition at the time the report was prepared, the events of the last two years have now made it completely out of date. The 14 major scheduled banks have been nationalised; so it no longer makes sense to include their holdings as that of a business house. The finance institutions and banks are now asked to participate in management and voting; so it is unreasonable not to count shares held by them as part of effective equity.

The managing agency system has been abolished. So long as the managing agency system was in operation, the managed company was linked with the managing agency house by means of a contract, entrusting to it the company's management for a specified period on specified remuneration, linked to profits not exceeding 11 per cent but often on a slab basis of a lower percentage as profits increased.

Further, the managing agency firm had a right to a certain number of ex-officio directorships on the Board of Directors of the managed companies.

When these links are snapped, can we yet say that the concept of a large business house still holds good? It is true that companies are still managed by the same people though in different form through the office of managing or executive directorship with its remuneration fixed in terms of definite salaries, prequisites plus, in some cases, one per cent share in profits, with a fixed ceiling as approved by the Governments.

Normally, the same person is no longer allowed to be a managing director of more than one company. However, management's right to ex-officio directorship has now gone. Management now can hope to remain in the same hands provided it can control substantial voting either by means of large holding or by means of enjoying the confidence of the mass of the shareholders. This position held good even when the managing agency system existed, but today it is all the more real.

The Life Insurance Corporation in particular is now a major shareholder in many companies, while the managing group has been able to retain only a small part of the capital, as these companies have expanded their capital and as the managing families have got sub-divided in their wealth.

If allowance is also made for holdings of such other financial institutions as UTI, IDBI, IFC, ICICI, the control resting with the management is even less. Increasingly company managers have ceased to be proprietors and become paid officials as in Government and other business.

The concept of what was regarded as a large house by the Dutt Committee has thus materially changed and it

would perhaps not seem appropriate to accept the basis of large business houses as defined in its report.

When, therefore, the Monopolies and Restrictive Trade Practices Act refers to large business houses with assets of Rs. 20 crores and over of inter-connected companies and dominant undertakings having assets not less than Rs. one crore and calls it concentration of economic power, the question arises whether this approach has any validity now.

This Act, so far as it applies to restrictive trade practices, will continue to be relevant, but it seems somewhat out of date when applied to a business group as hitherto understood. The definition of the Act, as applying to "inter-connected" companies is anomalous and may require to be altered.

In conditions of licensing where in many modern industries only a few firms are allowed to operate, if all dominant undertakings (defined as a unit producing a third of any product) over Rs. one crore of assets are to be identified as constituting concentration of power, one wonders what would be left out.

The concepts of a large business group and a large company are quite distinct from each other. The Dutt Committee Report has kept these two concepts separate in some places but has generally treated them as one. Such treatment is far from satisfactory. Some business groups are made up of a large number of small companies and the aggregation of their assets would give a false picture about the group and its dominant or monopolistic position. One single large company can be larger than a whole group made up of a number of small units engaged in different industries.

Several business groups control companies covering a

variety of industries. A Calcutta business group having a few jute mills, collieries, sugar factories and tea plantations, is not exactly in a dominant position in any real sense of the word, and in today's conditions does not even enjoy concentration of economic power.

Except that the same family members may be managing these various concerns (though within the family they are different entities for tax and other purposes) there is hardly anything that economically or technologically binds them together. With each new generation these family groups tend to get sub-divided, and often the family members, in fact, and, legally, separate, taking with them management of different companies.

This has actually happened in several groups and often it is a fiction, even from the management angle, to regard them as one group. This trend is bound to accentuate further in the coming years. Many of the large business groups are one only in name, and enterprises are left to the autonomous management of different members of the family who do not even consult one another in the management of their companies.

It would perhaps, therefore, be more appropriate to concentrate on a company or an industrial enterprise, rather than a house, and study its evolution over a period of time. Technological considerations, limitation of finance, the licensing policy, the nature of the market, the capacity of an entrepreneur, and a variety of other considerations determine the size of an enterprise when it is started.

In the private sector, traditionally, an entrepreneur starts a small enterprise and then develops it in course of time. Today, technological considerations play an important part in deciding on the initial size and capacity of the unit.

The optimum economic size has itself changed with technological development.

For example, in the case of the paper industry, a daily capacity of 10 tons was regarded as adequate in the pre-war days. Ten years ago anything less than a 50-ton unit was considered uneconomic; today the opinion is more in favour of a plant capacity of 100 tons if not 200 tons per day. This is equally true of the textile, sugar, cement, engineering and many other industries. In chemicals, and particularly in the fertiliser industry and the petro-chemical industry, even a minimum viable unit costs Rs. 50 crores or more.

With the progress of science, development of technology and rising costs of plant and equipment, the setting up of a competitive and efficient enterprise in the modern sector has today become highly capital-intensive. A paper plant with 100-ton capacity costs no less than Rs. 15 crores. A cement plant with 1,200-tonne daily capacity would cost about Rs. 10 crores.

This is no less true in existing industries and plants. If they are to remain competitive, it is essential to bring up their capacity to the new level and keep them modernised. Many sugar factories in India, which began with a crushing capacity of 500 tons of cane per day, have raised their capacity steadily to 1,000 tons, 2,000, and then to 3,500 tons. At today's costs this involves an outlay of several crores of rupees.

Further, industry in India cannot remain isolated. In order to increase our manufactured exports an industry has to compete with products of similar industry in other countries. International competition and survival necessitate a continuous process of updating plant and equipment to latest technological specifications.

Conditions in India are, of course, different and technology must be adapted to local conditions, but there is no way to escape the logic of industrial and technological development which calls for low-cost non-traditional products which can be produced in large quantities.

All these considerations suggest that in financial terms of assets of so many lakhs of rupees, an enterprise may appear to be large or to have grown large over time. Yet, in real terms, applying just the asset criterion may be entirely inappropriate, if not misleading. This would even be more so if the asset-yardstick were to be applied not to one enterprise but to a heterogeneous group of enterprises under the same management.

If these factors are given their weight, the Limit of Rs. 20 crores given in the Monopolies and Restrictive Trade Practices Act or Rs. one crore for dominant undertakings may well act as a drag on further development. It would help industrial growth if these limits were to be reconsidered for the purposes of the Act. In fact, it is not entirely unlikely that circumstances may ultimately force the Government to do so, but at some sacrifice of industrial development in the interim.

Assuming that this limit is nonetheless retained, one wonders how the Monopolies Commission will be able to regulate the growth of industry to meet today's requirements. What criteria and considerations will weigh with the Commission when it decides not to grant its approval for a new project or for expansion of an existing company?

Considerations in regard to concentration of economic power may be in direct conflict with technological requirements, When a company controls **33** per cent of production or distribution and is deemed a dominant undertaking

under the Act, or when one undertaking (along with two others) controls 50 per cent of production or distribution and is deemed a monopolistic undertaking, even then the Commission may have a hard time holding back its approval.

This may be because in that particular industry there may be a large number of units in operation, or even when there are only a few units at work, the need to meet an acute scarcity, as in the case of soda ash, may require that existing few producers controlling a large share of the output be allowed to expand their capacity.

Similarly, when the Commission looks into a case involving a group of inter-connected companies having assets exceeding Rs. 20 crores, required to be registered with the Commission, what will be the principles which guide the policy of the Commission?

Even in regard to registration under the Act, sharp differences have begun to appear in interpretation. It is one thing to be required to be registered under the Act as a dominant undertaking. It is quite another to know what to do next when cases are referred to it.

It would not be an easy matter for the Government to refer cases to the Commission and it would be even more difficult for the Commission to apply proper criteria in its examination of the referred cases. If the Commission is not able to evolve some working principles to guide its actions early enough, its future work will needlessly get complicated, time-consuming and perhaps ineffective.

One of the objectives of the Monopolies Act is to prevent concentration of economic power. While many other countries also have legislation restricting monopolies, perhaps it is only in India that the legislation also covers

business groups exceeding a certain value limit on grounds of concentration of economic power. This is more of a social rather than economic objective.

It is not easy to conceive what is common between a monopolist or a dominant producer and a group of heterogeneous companies which happen to have aggregate assets (net or gross is not clear) exceeding a certain ceiling. It may be that the Commission itself will arrive at the conclusion, as it gains experience, that this provision has little validity and relevance to today's conditions and may remain on the statute book as a dead letter.

However, apart from the specifics of the Act, the basic question is how can an enterprise be expected to develop in view of multifarious hurdles to its sustained growth. As business enterprises become successful, they grow in size from small to medium, and medium to large. A successful enterprise tends to achieve a self-sustaining growth. Its technological and managerial evolution is self-generating, partly because it generates its own required resources and partly success makes it easy to raise capital from outside, both from its own shareholders and from the market.

Many established and new business houses have become large by a process of evolution, and their growth cannot be held back without stifling corporate initiative.

The manner in which one enterprise, viz., the Delhi Cloth Mills, has, over the years, extended its activities from textile to sugar, engineering, chemicals, plastics and fertilisers is a good example of the self-sustaining development of a single company. The Kirloskar group has achieved a similar growth over the last 20 years but by means of separate industrial companies operating in different engineering fields.

A successful and profit-making company or a group must

necessarily grow, widening the area of its activities either in the same field or in allied fields or even in diverse fields as new industries begin to appear as a result of technological progress.

Many economists have identified the process of development as being essentially one of diversifying from traditional activities into newer fields. Developing countries have traditionally depended on a few primary products and a few simple manufactures like textiles where prospects of growth are limited, both technologically and in export markets. They can grow faster only by diversifying, and this is precisely the objective of all Plans of development.

In India also, growth in textiles has been limited, and textile enterprises have ventured into new fields of dyes, chemicals and man-made fibres, etc. This is healthy and is necessary for country's development, and has been the result of availability of financial resources and managerial capabilities in the enterprises themselves.

The logic of economic progress requires that when such enterprises as Century Mills or Gwalior Rayon generate large surpluses, they should seek new avenues of investment rather than distributing them. If further growth in textiles or man-made fibres is limited, these enterprises will go into other profitable avenues available, such as cement. A large enterprise, therefore, has to grow larger, as the example of Associated Cement Companies shows. When it cannot extend its cement production, it turns to cement-making machinery, the engineering industry and even granular fertilisers.

Similarly, for example, a large enterprise like Scindia Steam, if it is not allowed to grow in shipping, must necessarily turn to other fields in order to employ its surplus earnings and fulfil its obligation to its shareholders who

expect from the management increasing return on their investment.

Notwithstanding the Monopolies Act or other legislation, a competent and dynamic management acting in the interests of the shareholders must go on widening its field of activity in the same or other fields.

The very logic of a joint-stock enterprise is growth and this is true whether the joint-stock enterprise is in the private or the public sector. The example of Hindustan Machine Tools is a case of a public sector enterprise setting up new factories all over the country and extending its operations from machine tools to watches.

Although anti-trust legislation in the U.S. is over 50 years old, business enterprises in that country have grown larger all the time. This is, however, not tantamount to concentration of economic power because enterprises are broad-based in shareholding and management and are less and less under the influence of any particular group, but are managed professionally.

This development is equally noticeable in advanced countries. In recent years, in Europe, as in the U.S., mergers and amalgamations have played an important part in further enlarging the average size of an enterprise. In the U.K., the Labour Government encouraged this trend because it was considered in the national interest and was necessary for efficient production.

The progress of science and technology in the fields of manufacture, distribution and management, etc., leads to only one conclusion, namely, if we are to be industrialised, we have to accept large enterprises as a normal aspect of industrial growth. This is also illustrated by the growth or such financial institutions as banks and insurance companies in all countries.

With decentralised ownership and professional management it is a mistaken notion to believe that growth of firms can be or should be arrested by different types of legislation directed against their natural evolution. This realisation is bound to grow in India as it makes further progress in the field of industry.

Even in India, judging by the size of such public sector enterprises as Hindustan Steel, Heavy Engineering, Ranchi, State Trading, Indian Oil, the majority of private sector concerns are puny. It sounds somewhat odd to talk of concentration of economic power in the hands of monopoly business groups or dominant undertakings which, barring perhaps half a dozen, are really not large at all by current international standards or even Indian standards.

The reason for the current feeling against large enterprises may well be that many of the somewhat larger enterprises in India are not aggressive and lack initiative and drive. While there are certainly some difficulties and obstacles which they are currently encountering, there is no doubt that the management of these enterprises ought to display greater resourcefulness and dynamism in the interest of the country and as well as their shareholders. The progressive among them are already doing so with success.

One hopes that the present negative phase of the Government policy will pass since increased and efficient production is the greatest need of the country. This realisation is bound to come to the Government but sooner it happens the better.

The views expressed in this booklet are not necessarily the views of the Forum of Free Enterprise.

"People must come to accept private enterprise not as a necessary evil, but as an affirmative good."

—Eugene Black

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