THE FUTURE OF MANAGING AGENCY SYSTEM

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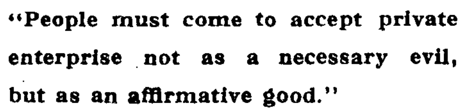

"People must come to accept private enterprise not as a necessary evil, but as an affirmative good."

—Eugene Black

GOVERNMENT'S OUTLOOK ON MANAGING AGENCIES NEEDS RE-ORIENTATION

By

C. C. CHOKSHI*

The present Companies Act has put the managing agents in a straight-jacket. The restrictions placed on Managing Agents are more severe than on managing directors, whole-time directors or managers. A managing agent cannot do more harm to a company's interests than what a Managing Director, a whole-time director or a manager or any other person in charge of the management of a company can do, because of the severe restrictions placed on him. It is, therefore, surprising that in spite of so many restrictions, a managing agent is looked upon with a certain amount of suspicion, doubt and prejudice. The reason is the chequered career of some of the managing agents. Mr. C. D. Deshmukh, while piloting in Parliament the Companies Bill, 1954, made a significant observation that "we cannot in the light of our past experience overlook the fact that abuses in company management which we seek to prevent have occurred not only in companies managed by managing agents but also in companies managed by directors."

The question for consideration is whether managing agencies should be continued.

HISTORY OF MANAGING AGENCY SYSTEM

The Managing Agency system has been the target of attack for the last 30 years, both in the legislature and

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outside. Speaking in the old Legislative Assembly, in 1936, Mr. Ananthasayanam Ayyangar had said that he was against the managing agency system. Referring to the majority report of the Banking Inquiry Committee, he listed some of the misdeeds of the managing agents. The then Government representative, Mr. Sushil Sen, completed the list by reciting seven misdeeds of the managing agents:

(1) Inter-locking of investments. (2) Inter-corporate financing of companies under same management. (3) Wrong methods of financing long-term capital expenditure by short-term loans. (4) Inefficient management—due to heredity or having too many companies under the same management. (5) Unreasonable remuneration. (6) Transferring managing agency to inefficient and incompetent hands. (7) Permanent terms of appointment.

In spite of this, it was generally agreed that the malady was not all-pervading. Mr. Bhulabhai Desai and Mr. Govind Ballabh Pant from the Congress Party agreed with the Government and said that, on balance, the system did not deserve to be ended but should be mended. It was said that controls should be placed on the managing agents so that they did not exploit their position.

POSITION UNDER THE COMPANIES ACT, 1936

To check the misdeeds listed by the Government representative, Mr. Sushil Sen, certain amendments were made to the Indian Companies Act, 1913. These amendments were considered to be adequate at that time although subsequently it was found that they were not. It is possible that the steps then taken were considered adequate because the moral standards in those days were quite high.

Then came the war, between 1939 and 1945, leaving behind its evil effects—lower moral standards. Taking advantage of the unusual times, some of the managing agents played havoc with the funds of the companies under their management during the war and in the post-war period. One gross case of mismanagement was that of the Dalmia Jain

Group of companies. The management of this group was found to have drained the resources of the companies under its control and the Government had to appoint a special Commission of Inquiry in this case.

NEW CONCEPT OF COMPANY MANAGEMENT AFTER INDEPENDENCE

A company, and particularly a public company, is now looked upon as a public trust in which not only the management and the shareholders, but also the workers and the public at large have an interest. The protection of social interest has become an objective of overriding importance which has to be very carefully superimposed over the rights and privileges of other parties directly interested in corporate enterprise. According to Mr. C. D. Deshmukh, the then Finance Minister, the "operation of private enterprise under modern conditions must, however, be subject to the acceptance of broad social objectives and of some recognised standards of behaviour." He laid four objectives for a good company management, viz.: (a) the efficiency of corporate business should be measured in terms of accepted standards; (b) managerial efficiency should be reconciled with **bona fide** rights of shareholders (investors); (c) the interests of creditors, labour and other partners in production and distribution should be adequately protected; and (d) not only trade and industry in the country should develop but the corporate management should help and promote the attainment of our social policy.

THE BHABHA COMMITTEE

The Government appointed an expert committee in October, 1950, popularly called the Bhabha Committee to (a) inquire and report on the working of the Indian Companies Act, and (b) to recommend appropriate amendments so as to improve the management and behaviour of companies generally. The Bhabha Committee went in great detail into the working of the Companies Act and particularly the Management of companies by managing agents. They listed almost the same

points as were listed by Mr. Sushil Sen in 1936: (1) Interlocking of investment in companies under the same management, sometimes to the detriment of the interests of the investing companies; (2) inter-corporate financing and giving of loans to friends and associates of managing agents—sometimes also to the detriment of the interests of the loaning company; (3) inefficient management resulting from heredity or transfer to inefficient hands; (4) personal gains made by managing agents without due regard to the interests of the company by various methods such as selling commission, buying commission, appointment of associates in high executive positions, etc; (5) competing business carried on by managing agents and their associates for their personal benefit, sometimes against the interests of the company managed by them; (6) reducing the position of independent directors to a hopeless minority and sometimes reducing their position to mere guineapigs, by having rights of nomination, etc; and (7) some of the managing agents had too many companies under their management.

The Bhabha Committee, however, did not recommend the abolition of the managing agency system as these defects were found only in a few cases. They, therefore, recommended more severe restrictions on managing agents.

THE COMPANIES BILL, 1954

Based on the report of the Bhabha Committee, a Bill was introduced in Parliament by Mr. C. D. Deshmukh on 10th August, 1954. One of the points contained in the Bill which raised a lot of controversy was the retention of the provisions for appointment of managing agents. The Finance Minister and the Minister of State for Finance had to defend time and again attacks by members on the system of managing agency, and resist demands for its abolition.

Two main reasons were given by the Finance Minister for retaining the system: (a) There was no properly organised capital market in the country and the managing agents performed an important function of promoting and organising

new industrial undertakings, briefly called the enterpreneurial function. (b) In the context of the need for rapid industrial development, a sudden termination of the managing agency system would disorganise industrial management and, therefore, retard new industrial development.

He made it clear that although the Government was inclined to mend and not end the managing agency system, it did not mean that the Government wanted to go to sleep after amending the Act. The behaviour of the managing agents would be kept under constant watch and a review of the system under the amended law would be undertaken in 1960 when the existing managing agencies would expire and come up for re-appointment. It is in this context that severe restrictions were placed on the managing agents in the new Act.

In respect of each one of the items listed by the Bhabha Committee, the Companies Act, 1956, laid severe restrictions on the powers and functions of the managing agents. The managing agents were put in a straight-jacket.

(a) Inter-company investments and inter-company financing cannot be done without Goverment approval under Sections 369, 370 and 372.

(b) The transfers of managing agency to inefficient hands and heredity in respect of managing agency is also controlled by Sections 342 to 346.

(c) Managing agents are placed under severe restrictions from making large personal gains without due regard to the interest of the company under Sections 348 to 360.

(d) Inefficiency in management of companies arising out of too many companies under the same management is prevented by Sections 326 and 332.

(e) A managing agent or his associate is prevented from entering into competing business under Section 375.

(f) Appointment of **ex-officio** directors is restricted by Section 377.

Thus it can be seen that in respect of matters in which the managing agents could exploit their position, the Companies Act controls their powers by making it obligatory on them to obtain the approval of the Central Government.

Although Mr. Deshmukh had told Parliament that the Government would review the reappointment of managing agents on 15th August, 1960, no general action was taken by the Government. However, two further restrictions were placed by the Government, viz.: (a) the remuneration of managing agents was further scaled down from 10 per cent on net profits to slab rate with a ceiling in case of some big companies where the remuneration was likely to be very large even at the slab rate, and (b) the renewal of appointment of managing agents was restricted to five years at a time.

In fulfilment of the promise of Mr. Deshmukh, the Government took action for the first time in January 1965 for reviewing the working of the managing agents under Section 324. The Government appointed a Committee under the chairmanship of Dr. I. G. Patel, popularly called the Patel Committee, and asked it to inquire into the need for continuing or discontinuing managing agencies in the five industries, viz.: (a) cement, (b) cotton textiles, (c) paper, (d) sugar and (e) jute textiles. The question which was asked to the Committee for consideration was whether it was desirable for the Government to take action under Section 324(2). The action contemplated under Section 324(2) is to issue a notification for abolishing managing agencies in certain specified industries and the existing managing agencies would expire after three years from the date of the notification.

The report of the committee was received only in March, 1966 and published in April-May this year. The committee has divided its report into three parts.

In Part I, the committee has discussed in detail the contribution by the managing agents in the past and the present. Their contribution has been divided under three heads, viz.: (a) promotional, (b) managerial, (c) financial. In the past, there has been positive contribution by the managing agents on all these three points, but at present the committee feels that the managing agent has a positive role to play on the first point, viz., on the question of promotional contribution compared to managerial and financial contributions. According to the committee the managerial contribution is in no way higher than that of any other form of management. On financial grounds, the committee has given a mixed reaction and has said that abolition of managing agency may create some financial problems for some of the companies. Therefore, in positive terms, the committee has not advised the Government to take any action under Section 324. In other words, the committee has advised the Government not to abolish the managing agency system in any industry. What the committee has advised is a discouragement of managing agency system in three out of the five industries, i.e., in cotton textile, sugar and cement.

Two reasons have been given by the committee for discouraging managing agency generally and particularly in these three industries. The committee wanted "to discourage the managing agency system in future on wider social and economic grounds." These wider social and economic grounds have not been specifically spelt out, but from a reading of the report it appears that the committee had two grounds in mind, viz., (a) the managing agency system does not allow development of professional management, i.e., vertical mobility of managerial talent is restricted, and (b) the fear of concentration of economic power.

Whether vertical mobility of managerial talent will be facilitated by any other form of management is a moot point, but if managing agencies are abolished from all industries, there will be a shortage of managerial talent and, therefore,

it is doubtful whether it will be a wise step in the present context to create so much disturbance by abolishing the managing agency system. The committee appears to have realised this danger and has, therefore, suggested action under Section 326 and not under Section 324.

With regard to the fear of concentration of economic power, one can say that there is no force because the committee has itself observed that the Government has the power to reduce this concentration of economic power even by retaining the managing agency system.

One of the recommendations of the committee is that the managing agents and secretaries and treasurers should be treated on par and no managing agents should have more than 10 companies under their management either as managing agents or as secretaries and treasurers. This recommendation itself will reduce considerable amount of concentration of economic power wherever it exists. It may also be observed that the Government has the power to refuse appointment of a managing agent for even ten companies under Section 326. That is one reason why the committee itself has not recommended action under Section 324.

The present position is that although the committee has advised the Government not to abolish the managing agency in any industry by taking action under Section 324, the Union Cabinet appears to have decided to discontinue managing agency in all the five industries. Probably, the Cabinet considers itself more well informed than the expert committee or it may be that the Cabinet has taken a decision to abolish managing agency in all the five industries on political grounds rather than on economic considerations. However, a legal question is likely to arise. In the light of the positive recommendation of the expert committee not to abolish managing agency in any industry by taking action under Section 324, is the Government justified in taking such a step?

As a matter of fact, the committee has advised the Government not to abolish managing agencies in at least two

out of five industries, viz., in jute and paper industries. In the jute industry, the committee has pointed out the special role of the managing agents in maintaining the exports of jute textiles. In the paper industry, the committee has found that the managing agents have still a positive role to play in putting further promotional and enterpreneurial efforts.

In Part III of the Report, the committee has emphasised the special role still played by the managing agents in promotional and enterpreneurial activities. It has pointed out that it is possible to bring in new enterpreneurs in the industry through the system of managing agency compared to any other system. In other words, the impression created from the report is that the two main reasons given by Mr. C. D. Deshmukh at the time of the enactment of the Companies Act of 1956 substantially hold good even today and more particularly in the context of the proposed rapid industrial development of our country.

One more point mentioned by the committee is the positive role of the managing agents in case of what is called a Group Management System. It does result into group economies and efficient administration. The most typical case which one can think of is that of the House of Tatas. The question is whether the country should lose the benefit of such positive contribution only on account of vague socio-political considerations or false ideological considerations. In any case, it is necessary to shed the prejudice against the system of managing agency. It should be clear that the Government has enough powers to prevent any misdeeds or short-comings on the part of managing agents. If misdeeds still take place, it will be more on account of the inefficiency of the Government in curbing or controlling such misdeeds, or may be because of improper administration of the provisions of the Companies Act. The question, therefore, is whether the country should lose the benefit of the positive role which good managing agents can perform in these days of shortages.

SHAREHOLDERS DESIRE CONTINUATION OF THE SYSTEM

By

DHIRAJLAL MAGANLAL*

It has been the official view that the **managing agency system has outlived its use** and that in view of the malpractices noticed in certain cases in the past the system need not be continued. It is true that there were various malpractices in the past, particularly between 1947 and 1954, but the introduction of the Companies Act, 1956, has tied the hands of managing agents and placed such restrictions that the management of companies have shown a remarkable improvement. This is a fact which has been acknowledged not only by the shareholders but even by the Government.

The Company Law Committee, in dealing with this aspect, expressed the view that **"shorn of the abuses and malpractices which have disfigured its working in the recent past, the system may yet prove to be a potent instrument for tapping the springs of private enterprise."** Having brought out a number of restrictions on every type of activity of the managing agents—there are eleven type of restrictions on employment, finances, loans, investments etc.—the shareholders expressed the opinion that it was not desirable to change the system. Again, if there is another system, the Act has to be amended again because some restrictions will have to be brought in on the new system also. Why not, therefore, continue the system which is functioning in a healthy way?

It is true that there might have been certain aberrations even after the imposition of various restrictions. But the boundless benefits the system is capable of conferring should not be ignored by unduly emphasising a few malpractices. In an article in "Company News and Notes" (Sept. 1963),

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the author—a Government spokesman—has come to the conclusion that the behaviour pattern of the managing agency system has distinctly improved. He has further observed that there is now a wide-spread awareness among the managing agents that they have to adjust themselves to the new discipline imposed on them all designed to rid the system of its undesirable features and to make it a more efficient instrument of company management.

In addition to the qualitative improvement in the management, it is pointed out that the percentage of remuneration, after the coming into force of the 1956 Act, has steadily fallen from 11.5 per cent in 1956 to 10.2 per cent in 1958 and to around 9 per cent in recent years. In the existing social set-up, it would be appropriate to impose some sort of "ceiling" on the managing agency commission. There are some companies where the managing agency commission is still too high. It would be desirable, for instance, that the Managing Agent should not be paid more than Rs. 5 lakhs on Rs. 1 crore capital and the maximum in any event, should not exceed Rs. 25 lakhs. It is also necessary, in the interests of economy that the subsidiaries of a holding company should have no managing agent because it would amount to double payment to managing agents.

The abolition of the managing agency system would cause several hardships. In the first place, it will deprive the managed companies much of the financial aid which is provided by the managing agents directly by way of loans or by way of the managing agents guaranteeing bank and other loan finance. For instance, there is a textile mill in which the managing agents have given Rs. 65 lakhs in one case and Rs. 25 lakhs in another case. It was given as a normal bank advance. Secondly, fragmentation of the managed companies deprives them of the financial resources which would be normally available and this would seriously impede the progress of any modernisation scheme. Thirdly, it will weaken the existing link which the managing agents supply between the investor and new joint-stock enterprises.

Fourthly, it will react to the detriment of a large number of small middle-class investors who look to the reputation of the managing agents in any prospectus of a new venture before risking their savings. Several recent floatations owe their success to the reputation of the managing agents connected with them. Fifthly, there are several benefits of group management such as centralised arrangement of sales promotion, research etc. and introduction of economies to bring down the costs of production which will not be available in the event of a break-up of companies.

In view of the useful role played by the Managing Agency System in the past and the immense scope for its continued dynamic contributions to the economic development of the country, it is important to continue this well-tested system with a few changes which will eliminate the abuses noticed in its working. The patent fact is that the managing agency system is not inherently bad and it should be continued because it is in the best interests of the country.

PROBLEMS OF TEXTILE INDUSTRY IGNORED

By

R. L. N. VIJAYANAGAR *

The restrictions and regulations already placed on managing agents have turned out to be more than sufficient deterrent to the existing as well as the prospective managing agents. As a result, there has been a pronounced decline in the number of managing agencies and their managed companies, in that "as against 5,055 companies managed by 3,944 managing agents in 1954-55, only 1,236 companies were managed by 860 managing agents as on March 31, 1965, and the total coverage of the private sector in terms of paid-up capital declined from 55 per cent. to less than one-third." In an article entitled, "The Impact of the Companies Act on the

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Managing Agency System" by Dr. Raj K. Nigam, published in "Company Notes and News", dated 2nd September, 1963, he not only averred that as a result of the discipline imposed by the Companies Act, "broad trends of fall in number of complaints against the managing agents and cases of lapses committed by them" have been noticed, but also pointed out that "the strongest of the considerations which weighed with the Government for not taking the drastic step of abolishing the system which has had a long history behind it, was that its abolition was likely to create a void in the present industrial set-up of the country which would hinder expansion of industrialisation."

If the situation in 1963 was as depicted by Dr. Nigam, one wonders whether any material change for the better had taken place since then to warrant the appointment of a Committee on 4th January, 1965, "to inquire into and report on and in respect of the desirability of applying the provisions of sub-section (2) of Section 324 of the Companies Act, 1956 (I of 1956) to companies engaged in established industries or any other industry or business as may be deemed fit by the Committee in this behalf." It is a matter of common knowledge that since 1963 there has been considerable deterioration in the state of the country's economy which had led us to the adoption of the cruel expediency of devaluing our currency. Conferment of colossal powers of control on the administration over economic activity through licences, permits, quotas, etc. has greatly stifled the economic growth due to improper exercise of powers or procedural delays. The revitalisation of the economy, therefore, calls for not the tinkering with the managing agency system but the creation of an atmosphere conducive to the proper functioning of every section of the community so as to enable it to make its due contribution to the economic progress of the country.

Apart from the question of appropriateness of appointing a committee of inquiry into the continuance or otherwise of the managing agency system at this critical juncture of the country's economic development, there is the further question

why a committee of officials alone was appointed to go into the matter. Rule 11 of the Companies (Central Government's) General Rules and Forms, 1956, under which the committee was set up, does not lay down that only the Government officers should be its members.

It is surprising that the statistical data which form the basis of the Committee's conclusions and recommendations relate only to one year and, that too 1963-64, by which time the managing agency system had already been throttled by the enormous regulatory and restrictive provisions of the Act. One would have expected of this Committee some enlightenment on the comparative study of the economic climate under which the managing agency system put our country on the industrial map of the world, and the economic climate under which the system is working at present. If, inspite of the system being bound hand and foot by the Company Law, it carried the respect of the banking and other financial institutions by accepting their personal guarantees practically for all loans granted to the managed companies, it is a testimony to its being a powerful instrument for rapid economic development, if properly regulated.

One would have also expected of this Committee to say something of what is happening in other countries of the world in the field of company organisation and company administration. For instance, in the United Kingdom, the Jenkins Committee was appointed to review and report upon the provisions and the working of the Companies Act, 1948. Our Inquiry Committee could have usefully stated what the approach of the Jenkins Committee was with regard to the managing agency system prevalent in England. Recently, the Economic Commission of the EEC countries had made several recommendations regarding the reorganisation of textile companies in those countries in the form of formidably large combines to combat competition in the international market for cotton textiles. It was thought a Committee like this which sits in judgement on the form of company administration in the country would be outward looking and thus bring home to us and our Government facts

about what other countries are usefully doing for their corporate organisations. But, instead, we find only suave assumptions that finances needed by the corporate enterprise would be flowing from the banking and other financial institutions. If only it had made a detailed study of the part played by the long-term institutions like the Industrial Development Bank, Industrial Finance Corporation etc. in the gigantic task of rehabilitation and modernisation of the textile industry vis-a-vis what is being done in the principal cotton textile manufacturing countries of the world, and called upon those institutions to submit details of the assistance rendered and compared the same with the needs of the industry in the light of the estimates made by expert committees, the Inquiry Committee would probably have written a different report altogether. But, instead, it has only philosophised to the effect that "for an established industry like this, it would be in the general social interest, if it is to turn for its fresh needs of equity capital to a greater extent to the market and to the general public." It has, however, failed to provide an answer to the question how capital can be attracted by an industry whose profitability is proverbially unattractive to the investor.

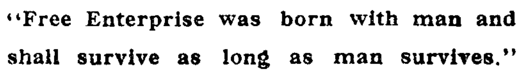
It is straining credulity to think that abolition of the managing agency system would **ipso facto** ensure purity and efficiency in company administration. Companies have got to be managed if they are to continue in business. There must be a person or a body of persons to take the place of the managing agent. In Britain and America, a preponderating number of companies is administered by managing directors. It has been proved that that system of management is as susceptible to unethical practices as the managing agency system. In Britain, many instances of malpractices by managing directors were placed before the Cohen Committee which investigated the working of companies in that country preliminary to the enactment of the English Companies Act of 1948. One of the charges related to trafficking in the office of managing director. The Cohen Committee, which submitted its report in 1945, rightly contented

itself by suggesting suitable remedial measures for eliminating such abuses and did not adopt the extreme course of recommending the abolition of managing directorships.

In our own country, there are a number of undertakings which are not managed by managing agents. For instance, there are co-operative organisations for which there has been an all-out support from the Government. Can it be seriously urged that the administration of the co-operative enterprises is above reproach or in fact superior to enterprises managed by managing agents? According to the statistical statements relating to Co-operative Movement in India 1963-64, issued by the Reserve Bank of India, there were 28,303 co-operative societies under liquidation as at the end of the Co-operative year 1963-64, of which 29 were central co-operative banks, 11,287 were agricultural credit societies, 2,911 were non-agricultural societies, 1,647 were grain banks and 12,429 were non-credit societies. The same statistics also refer to the number of embezzlement cases in co-operative societies which were 2,160 in 1962-63 and 1,749 in 1963-64. The statistics also refer to the cases of suspension of managing committees of societies, which were 513 in 1962-63 and 761 in 1963-64.

In the final analysis, it is clear that the essentials of management of joint-stock company whether in the U.S.A., United Kingdom or India are the same, whatever be the system adopted. There is no known system of management, which is free from abuse. Therefore, the mere substitution of managing agency system by any other form of management is no safeguard against improper practices or unsound management. What is, therefore, required—and this requirement is not peculiar to Indian companies—is that with the growth and development of joint-stock enterprises, it becomes more and more necessary to provide a larger measure of protective and regulatory control over those entrusted with the management of corporate enterprises by inculcating in them a deep sense of social responsibility.

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



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— A. D. Shroff

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