The Monopolies and Restrictive Trade Practices Act, 1969 (MRTP) is an important piece of economic legislation designed to ensure that the operation of the economic system does not result in the concentration of economic power to the common detriment. The authority for this is derived from the Directive Principles of State Policy contained in Article 39 of the Constitution of India, which enjoins upon the State to secure that

> "the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment".

The Act was promulgated on the patterns of Nehruvian-Mahalanobis model leaning towards the establishment of a socialistic pattern of society. Monopoly law in India as in any other country was based on the presumption that big business is not only harmful to distributive justice, but also results in monopolistic tendencies which could be misused to the detriment of the public at large and consumers in particular.

> MRTP Act had a tinge with it-ushering in socialism.

The Act came into force from 1st June, 1970, and has been amended in 1974, 1980, 1982, 1984 and 1991. The Act applies to the whole of India except the State of Jammu & Kashmir.

Amendments made in 1991, is significant in as much as the philosophy of the Act underwent a total change. With the growing complexity of industrial structure and the need for achieving economies of scale for ensuring high productivity and competitive advantage in the international market, the thrust of the industrial policy of Central Government (announced in Parliament on 24th July 1991) has shifted to controlling and regulating the monopolistic, restrictive and unfair trade practices rather than making it necessary for certain undertakings to obtain prior approval of the Central Government for expansion, establishment of new undertakings, mergers, amalgamations and takeovers.

OBJECTIVES

> Being a consumer legislation, MRTP Act seeks to regulate monopolies, in addition to regulating trade practices harmful to public interest.

The Act had two objectives before the amendment in 1991, *viz.*

- Regulation of monopolies and prevention of concentration of economic power and
- Prohibit monopolistic, restrictive and unfair trade practices.

After the amendment, the first objective has become irrelevant as the relevant provisions to achieve the objective have been deleted. The objectives now are:

- Controlling monopolistic trade practices, and
- Regulating restrictive and unfair trade practices.

REGULATION OF TRADE PRACTICES

The main objective of the MRTP Act, that is, the regulation of monopolistic, restrictive and unfair trade practices, is sought to be achieved through the instrumentality of the MRTP Commission, a quasi-judicial body, set up by the government for the purpose of the Act. The Commission is empowered to inquire into any monopolistic, restrictive or unfair trade practices. In matters relating to monopolistic trade practices, the Central Government can pass an appropriate order after the Commission, on inquiry,

came to the conclusion that the practice operates against the public interest. In matters relating to restrictive and unfair trade practices, the Commission is empowered to pass a *cease and desist* order, where it is of the opinion that the practice is against public interest.

Thus, the concept of public interest, which includes consumer interest, permeates the entire regulatory framework provided for the prevention of concentration of economic power, control of monopolies and regulation of monopolistic, restrictive and unfair trade practices. Public interest and consumer protection serve as the goal as well as the touchstone for evaluating the consequences of monopolies and trade practices.[1]

Monopolistic Trade Practices (MTPs)

In order to maximise profits and to increase market power, certain business firms tend to charge unreasonably high prices and prevent competition in the production and distribution of goods, by adopting unfair trade methods or deceptive practices. They tend to lower the quality of goods supplied, limit the capital investment or technical development for the production purposes; or increase the cost of production of goods or the charges for the provision of services and increase their profit unreasonably.[2]

These business practices tend to create monopoly and often harm the public interest through the exploitation of consumers and bring about economic imbalance in the country. Monopolistic trade practice is an aspect of monopolisation, and the effective control of monopoly should be the first priority of any effective economic legislation. Monopoly occurs when a dominant undertaking raises prices or excludes competitors. In order to bring about a balanced economic growth coupled with consumer welfare, it is necessary to curb these practices.

The statutory provisions relating to monopolistic trade practices and their regulations are contained in the MRTP Act. While Section 2(i), 10(b), 31, 32 and 37(4) of the Act are exclusively devoted to monopolistic trade practices, many other sections of the Act and the Rules and Regulations framed thereunder, contain measures pertaining to the regulations of these practices. They include Sections 12A, 12B, 12C, 14, 15, 27, 50, 55 and 61.

Meaning of MTP

A monopolistic trade practice is essentially a trade practice which represents the abuse of the market power in the production or marketing of goods, or in the provision of services, by charging unreasonably high prices, preventing or reducing competition, limiting technical development, deteriorating product quality or by adopting unfair or deceptive practices.

The concept of monopolistic trade practice, as used in the MRTP Act, is very wide and complex. The 1984 amendment to the Act has further widened the concept of monopolistic trade practices. Monopolistic trade practices have been defined under Section 2(i) of the amended MRTP Act as follows:

Any trade practice which has, or is likely to have, the effect of:

- maintaining the prices of goods or the charges for services at an unreasonable level by limiting, reducing or otherwise controlling the production, supply or

distribution of goods of any description or the supply of any services or in any other manner;

Any trade practice which seeks to prevent competition and which results in high prices is an MTP.

- unreasonably preventing or lessening competition in the production, supply or distribution of any goods or in the supply of any services;
- limiting technical development or capital investment to the common detriment or allowing the quality of any goods produced, supplied or distributed or any services rendered in India to deteriorate;
- increasing unreasonably:
  - the prices at which goods are, or may be sold or re-sold or the charges at which the services are, or maybe provided or
  - the profits which are, or may be derived from the production, supply or distribution (including the sale or purchase) of any goods or by the provision of services:
- preventing or lessening competition in the production, supply or distribution of any goods or in the provision or maintenance of any service by the adoption of unfair methods or unfair or deceptive practices.

Two tests will determine whether a trade practice is an MTP or not: abuse of market power and unreasonableness in any practice.

Thus, following are the MTPs:

- maintaining the prices of goods or charges for any services at an unreasonable level.
- limiting technical development or capital investment to the common detriment.
- unreasonably preventing or lessening competition.
- allowing quality of goods produced, supplied or distributed or any service rendered to deteriorate.
- increasing unreasonably the cost of production of any goods or charges for provision or maintenance of services.
- increasing unreasonably the selling price of goods or charges at which the services may be provided.
- increasing unreasonably the profits that are derived from the production, supply or distribution of any goods or the provision of any services and
- preventing or lessening competition in the production, supply or distribution of any goods or in the provision or maintenance of any services by adopting unfair methods or unfair practices.

Regulation of MTPs

As per Section 31 of the MRTP Act, where it appears to the Central Government that the owners of one or more undertakings are indulging in any monopolistic trade practice, the Central Government may refer the matter to the MRTP Commission for enquiry and report thereon. Such an enquiry may be conducted by the MRTP Commission on its own initiative or on information available to it. On the basis of the report, the Central Government may pass an appropriate order for:

- regulation of production and fixing the terms of sale(including prices);
- prohibiting any action that restricts competition and
- fixing standards for goods produced.

Restrictive Trade Practices (RTPs)

In order to maximise their profit and gain more market power, traders are often tempted to indulge in certain trade practices which restrict, reduce or prevent competition in the market and thereby harm the consumer interest. Such practices are referred to as restrictive trade practices. Because of their adverse effect on the consumer and public interest, they are sought to be regulated in almost every country of the world. In our country, such regulation is sought to be exercised through the MRTP Act.

A restrictive trade practice has the effect of preventing, distorting or restricting competition.

Broadly speaking, a trade practice which restricts or reduces competition may be termed as a restrictive trade practice.[3] As defined under the MRTP Act [Section 2(0)], a restrictive trade practice means, a trade practice which has or may have, the effect of preventing, distorting or restricting competition in any manner, and in particular, (i) which tends to disrupt the flow of capital or resources into the stream of production or (ii) which tends to bring about the manipulation of prices, or condition of delivery, or to affect the flow of supplies in the market relating to goods or services in such manner as to impose on the consumers unjustified costs or restrictions.

It may be stated that, the terms trade and trade practice are quite wide. The term *trade* is understood to include any trade, business, industry, profession or occupation relating to the production, supply, distribution of goods and includes the provision of any services. Trade practice is understood as any practice relating to the carrying on of any trade and includes (i) anything done by any person which controls or affects the price charged by or the method of trading of any trade or any class of trades and (ii) a single or isolated action of any person in relation to any trade.

Thus, a restrictive trade practice is not limited to trade alone. It would cover a practice followed in the production, distribution or supply of goods or in the provision of services. A restrictive trade practice can be adopted by a manufacturer, distributor, dealer, supplier of goods, or by one who provides any services or carries on any profession or occupation.

The following are the RTPs as described by Section 33(1) of the MRTP Act:

- *Refusal to deal with persons or classes of persons* - Any agreement which restricts or is likely to restrict by any methods, the persons or classes of persons to whom goods are sold or from whom goods are bought.
- *Tie-in sales or full-line forcing* - Any agreement requiring the purchaser of goods, as a condition of such purchase, to purchase some other goods.
- *Exclusive dealing agreement* - Any agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those of the seller or any other goods.

- *Collective price fixation and tendering* - Any agreement to purchase or sell goods or take out tenders for the sale or purchase of goods only at prices or terms and conditions agreed upon between the sellers or purchasers.
- *Discriminatory dealings* - Any agreement to grant or allow concessions or benefits including allowances, discounts, rebate, or credit, in connection with or by reason of dealings.
- *Re-sale price maintenance* - Any agreement to sell goods on condition that the prices to be charged on re-sale by the purchaser shall be the prices stipulated by the seller unless it is clearly stated that prices lower than those prices may be charged.
- *Restriction on output or supply of goods* - Exclusive distributorship, territorial restriction and market-sharing.
- *Control of manufacturing* process.
- *Boycott* - Any agreement for the exclusion from any trade association or any person carrying on or intending to carry on, in good faith, the trade in relation to which the trade association is formed.
- *Price control* arrangements.
- *Governmental recognition* of practice as restrictive.
- *Residual restrictive trade practice* - Any agreement to enforce the carrying out of any such agreement as is referred to in the foregoing classes.

Under the Act, restrictive agreement must be submitted to the Registrar for registration within 60 days from the date of entering these agreements. Here the onus is on the company or the undertaking.

Regulation of RTPs

The MRTP Commission is empowered, under Section 37 of the Act, to conduct an enquiry into any RTP. If after the enquiry, the Commission is of the opinion that the practice is really restrictive and is prejudicial to public interest, it (the Commission) may, by order, direct that:

- the practice shall be dicountinued or shall not be repeated. This is called the cease-and-desist order and
- the agreement shall be void and shall stand modified in such a manner as may be specified in the order.

Division of Undertakings

Section 27 of the MRTP Act provides that if the Central Government is of the opinion that the working of a registered undertaking is prejudicial to public interest or has led, or is leading, or is likely to lead to the adoption of any monopolistic or restrictive trade practices, it can refer the matter to the MRTP Commission for an enquiry.

Further, if in the opinion of the Central Government, the continuance of inter-connection of an undertaking is detrimental to:

- the interest of the principal undertaking;
- the future development of the principal undertaking;

- the steady growth of the industry to which the principal undertaking belongs or
- the public interest,

it may refer the matter to the MRTP Commission for further enquiry.

The MRTP Commission shall conduct the necessary enquiry and recommend divisions, if necessary, subsequent to which the government may order the splitting of the concerned undertaking.

Unfair Trade Practices (UTPs)

It is said that the consumer needs no special protection and everything can be left to the market forces. The perfectly competitive market is an economist's dream and consumer sovereignty is a myth. In real life, products are of great variety, many of them being complex and the consumer has imperfect product-knowledge. Moreover, the supplier often has a dominant position against the buyer who has less bargaining power in the market. There has been a growing realisation for not depending on the old doctrine of *caveat emptor* - let the buyer beware. The consumer, therefore, needs legal protection against certain trade practices and business methods.

It is not the consumer alone who needs protection. Even an honest businessman needs legal protection from unscrupulous and dishonest competitors.

Several countries across the globe have adopted statutory measures for the control of unfair trade practices to protect the consumers. Names which come to one's memory in this context are UK, Australia, Canada and the USA.

In our country, the need for the protection of consumers is all the more great because the large majority of consumers are illiterate, ill-informed and possessing limited purchasing power, where there is a perennial shortage of many goods and where growth with social justice is the guiding principle. MRTP Act seeks to provide protection in this case.

Before the 1984 amendment, the MRTP Act contained no provisions for the protection of consumers from unfair trade practices, such as deceptive and misleading advertising, hoarding of goods and the supply of unsafe and hazardous products. The Act was directed against restrictive and monopolistic trade practices and the consumers' interest was sought to be protected by promoting competition and curbing of anti-competitive activities of manufacturers and dealers. However, the consumer needs protection not only from restrictive and monopolistic trade practices but also from unfair and unethical practices which are adopted by unscrupulous businessmen to maximise their profit and sales at the expense of the consumer.

The major provisions are contained in Sections 36A, 36B, 36C, 36D and 36E which have been inserted in the MRTP Act by the 1984 amendment, which became effective from August 1, 1984. Other provisions relevant to the regulation of unfair trade practices are contained in certain other sections of the Act, which include Sections 12A, 12B, 12C, 14 and 61.

Concept of Unfair Trade Practice

Broadly speaking, any trade practice which is considered unfair and harmful to the consumer is an unfair trade practice.

The genesis of unfair trade practice is human greed which leads to the exploitation of the consumer by the trader. Mahatma Gandhi said that the rich must act as the trustee of the poor for their wealth and that all must have bread before some have cake. It is breach of this dictum that initiates unfair trade practices.

> Any trade practice which results in loss or injury to consumer becomes an unfair trade practice.

As defined under the MRTP Act, unfair trade practice refers to any of the five trade practices specified under clauses (1) to (5) of Section 36A, which are adopted for the purpose of any services, and which cause loss or injury to the consumer. Briefly stated, these trade practices are:

- Misleading advertisement and false representation;
- Advertising of bargain price (or bait advertising) and switch selling;
- Offering of pseudo gifts or prizes and conducting of promotional contests, lottery and games of chance or skill;
- Supplying of unsafe or hazardous products, and
- Hoarding or destroying of goods, or refusal to sell goods, resulting in a price increase.

The loss or injury to the consumer may arise by eliminating or restricting competition or otherwise.

Thus, the definition of unfair trade practice is not a general definition but is confined to the above mentioned five trade practices. While the definitions of a monopolistic trade practice and a restrictive trade practice, as given in the Act, are general in nature and any trade practice falling within the respective criterion may amount to the monopolistic trade practices, is a specific one in the sense that no practice other than the five practices specified for the purpose can be taken to be an unfair trade practice. Neither the MRTP Commission nor any other authority is empowered to include any other trade practice within the definition of an unfair trade practice.

Any trade practice would, therefore, amount to an unfair trade practice under the following conditions:

- The practice falls within one or more of the five trade practices mentioned above.
- The practice is adopted for any of the following purpose:
  - — promoting the sale, use or supply of any goods or
  - — provision of any services.
- The practice causes loss or injury to the consumers of the relevant goods or service.
- The loss or injury to the consumers may be caused by eliminating or restricting competition or otherwise.

To be specific, the following are the UTPs:

* The practice of making any statement, whether orally or in writing or by visible representation which:
  - falsely represents that the goods are of a particular standard, quality, grade, composition, style or model.
  - falsely represents any re-built, second-hand, renovated, reconditioned or old goods as new goods.

- falsely represents that the services are of a particular standard, quality or grade.
- represents that the goods or services have sponsorship, approval, performance, characteristics, accessories, uses or benefits which such goods or services do not have.
- represents that the seller or the supplier has sponsorship, approval or affiliation which such a seller or supplier does not have.
- makes a false or misleading representation concerning the need for or the usefulness of any goods or services.
- gives to the public any warranty or guarantee of the performance, efficacy or length of life of a product or of any goods that is not based on an adequate or proper test thereof.
- makes to the public representation in a form that purports to warranty or guarantee of a product or of any goods or service or a promise to replace, maintain or repair an article or any part thereof or to repeat or continue a service until it has achieved a specified result. If such purported warranty, guarantee or promise is materially misleading or if there is no responsible prospect that such warranty, guarantee or promise will be carried out.
- materially misleads the public concerning the price at which a product or like products or goods or services have been or are ordinarily sold or provided and for this purpose, a representation as to the price shall be deemed to refer to the price at which the product or goods or services has or have been sold by sellers or provided by the supplier generally in the relevant market unless it is clearly specified to be the price at which the product has been sold or services have been provided by the person by whom or on whose behalf the representation is made.
- gives false or misleading facts disparaging the goods, services or trade of another person.

* Permits the publication of any advertisement, whether in any newspaper or otherwise, for the sale or supply at a bargain price of goods or services that are not intended to be offered for sale or supply at the bargain price, or for a period that is and in quantities that are reasonable, having regard to the nature of the market in which the business is carried on, the nature and size of business and the nature of the advertisement.
* Permits: (a) the offering of gifts, prizes or other items with the intention of not providing them as offered or creating the impression that something is being given or offered free of charge when it is fully or partly covered by the amount charged in the transaction as a whole, (b) the conduct of any contest, lottery, game of chance or skill, for the purpose of promoting, directly or indirectly, the sale, use or supply of any product or any business interest.
* Permits the sale or supply of goods intended to be used or are of a kind likely to be used by consumers, knowing or having reasons to believe that the goods do not comply with the standards, prescribed by a competent authority relating to performance, composition, contents, design, construction, finishing or

packing as are necessary to prevent or reduce the risk of injury to the person using the goods.

* Permits the hoarding or destruction of goods or refusal to sell the goods or make them available for sale, or to provide any service, if such hoarding, destruction or refusal raises or tends to raise or is intended to raise the cost of these or other similar goods or services.

Regulation of UTPs

The MRTP Commission may enquire into any UTP:

- Upon receiving a complaint from any trade or consumers' association with a membership of 25 or more;
- Upon a reference made to it by the Central or State Government;
- Upon an application made to it by the Director-General;
- Upon its own knowledge or information and
- With the latest amendment to the MRTP Act, upon a application from any member of public.

If the enquiry proves that the UTP does exist and it is prejudicial to the public interest the Commission may direct that:

- the practice shall be discontinued or shall not be repeated and
- any agreement relating to such an UTP shall be void or shall stand modified in such a manner as may be directed by the Commission.

THE COMPETITION ACT, 2002

Like its counterpart (discussed in the previous chapter), the MRTP Act also came into sharp criticisms. The MRTP Act, for example, was disparaged for having come in the way of industrial progress. It was also criticised for having failed to protect interests of consumers, though the Act was supposed to be a consumer legislation.

One by-product of economic reforms is the shift in focus from regulating monopolies to promoting competition.

The economic reforms initiated from the beginning of 1990 necessitated a shift in the focus from regulating monopolies to promoting competition. Competition, if encouraged, would improve productivity, increase quality and reduce quality-all benefiting consumers. The Competition Act precisely seeks to achieve this.

Objective of the Act: The preamble to the Act says that the Competition Act seeks to provide, in view of the economic development of the country, for the establishment of a Commission to prevent practices having adverse impact on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade. In short, this is an Act designed to promote and sustain competition and thereby protect the interests of consumers.

The Competition Act seeks to promote and sustain competition to protect the interests of consumers and to ensure freedom of trade.

The Act runs into 66 sections, divided into nine chapters. It extends to the whole of India except Jammu and Kashmir.

Provisions

The Act seeks to establish Competition Commission of India. The Act also provides for the appointment of Director General (and additional, joint, deputy and assistant directors), advisers, consultants and officers to assist the Commission in conducting enquiry into any offences. The Act empowers the Commission to appoint a Registrar and other staff for the efficient performance of its functions.

Any person, consumer, consumers association, trade association, statutory authority, a state government or central government may lodge a complaint with the Commission. The Commission is empowered to act suo moto.

Any of the sources, stated above, can lodge a complaint with the Commission (the Commission can also act on its own) on the knowledge of anticompetitive agreements being entered into. It is unlawful, under the act, for any enterprise or persons to enter into an agreement in respect of production, supply, storage, distribution, acquisition or control of goods or provision of service, which causes adverse effect on competition.

Complaint can also be lodged when an enterprise indulges in the abuse of dominant position. An organisation has dominant position when it can operate independently of competitive forces prevailing in the market, or it can affect its competitors or consumers in its favour.

On receipt of a complaint (or on its own knowledge), the Commission shall conduct an enquiry.

After enquiry, if the Commission finds that there exists an agreement which is detrimental to competition or there exists an enterprise which is abusing its dominant position in the market, it may pass all or any of the following orders, namely:

(a) direct the enterprises or persons involved in such agreement, or abuse of dominant position to discontinue and not to repeat such activities;

(b) impose penalty on the offending parties. The fine shall not exceed 10 per cent of the average of the turnover for the previous three financial years.

The Commission has also power to regulate mergers, provided such conditions are likely to be detrimental to the growth of competition.

The Act empowers the Commission to award compensation for an individual who has suffered damage or loss from the use of a good or service. The compensation to be paid by an organisation that has caused loss or damage.

QUESTIONS

1. What are RTPs? How are they sought to be regulated?
2. What are UTPs? How are they sought to be regulated?
3. Why is MRTP Act criticised?
4. Give the objectives of the Competition Act. What are its main provisions?

REFERENCES

1. D.P.S.Verma, *Monopolies, Trade Regulation and Consumer Protection*, p.12.
2. *Ibid*, p.181.
3. *The Hindu*, July 8, 1989.

CHAPTER 15

From Foreign Exchange Regulation Act, to Foreign Exchange Management Act

CHAPTER OUTLINE

Objectives of the Act
Provisions of the Act
Some Reflections on the Act
Do We Need FERA?
Amendments to the Act
From FERA to FEMA
FEMA, 1999

LEARNING OBJECTIVES

After reading this Chapter, you should be able to:

1. *Understand the objectives of FERA*
2. *Detail main provisions of FERA*
3. *Comment on FERA*
4. *Doubt about the relevance of FERA*
5. *List the various amendments to FERA*
6. *Detail main provisions of FEMA*

OBJECTIVES

The principal objective of the Foreign Exchange Regulation Act (FERA) is to prevent the outflow of Indian currency and to see that the foreign exchange legitimately due to India should be received.

In detail, the objectives of the Act are as follows:

- To regulate certain payments.
- To regulate dealings in foreign exchange and securities.
- To regulate the transactions indirectly affecting foreign exchange.
- To regulate import and export of currency and bullion.
- To conserve the foreign exchange resources of the country and to utilise the same in the interests of the economic development of the country.
- To regulate holding of immovable property outside India.
- To regulate employment of foreign nationals.
- To regulate acquisition, holding, etc. of immovable property in India by non-residents.
- To regulate foreign companies.

The Act applies to the whole of India, to citizens of India outside India and to branches and agencies outside India of companies or corporate bodies registered in India. The Act came into force with effect from 1st January, 1974.

The objectives of the Act are sought to be achieved through certain provisions contained in its 50 plus sections. The important provisions are discussed below.

PROVISIONS

A. Regulation of Dealings in Foreign Exchange

FERA authorises only RBI to deal with foreign exchange transactions.

Under the Act, the Reserve Bank of India (RBI) is the only authority to regulate foreign exchange transactions. Section 8 provides that except with the previous permission of the Reserve Bank, no person, other than an authorised dealer, shall conduct a foreign exchange business with any other person who is not an authorised dealer. However, the sale and purchase of foreign exchange between any person and a money-changer in India will not be hit by restrictions imposed in the section. The section further provides that except with the previous permission of the Reserve Bank, no person shall enter into any transaction which provides for the conversion of the Indian currency into foreign or *vice versa* at rates of exchange other than the rates authorised by the Reserve Bank.

B. Restrictions on Payments

Section 8 of the Act also lays down restrictions on certain payments. It provides that unless authorised by the Reserve Bank, no person in India or no person resident in India shall:

(a) make any payment to or for the credit of any person resident outside India;

(b) receive, otherwise than through an authorised dealer, any payment by order or on behalf of any person resident outside India;

(c) draw, issue or negotiate any bill of exchange or promissory note or acknowledge any debt so that a right, actual or contingent, to receive a payment is created or transferred in favour of a person resident outside India;

(d) make any payment to or for the credit of any person by order or on behalf of any person resident outside India;

(e) place any sum to the credit of any person resident outside India;

(f) make any payment to or for the credit of any person or receive any payment for or by order or on behalf of any person as consideration for or in association with the receipt by any person of a payment or the acquisition by any person of property outside India and the creation and transfer in favour of any person any right, actual or contingent, to receive payment or acquire property outside India and

(g) draw, issue or negotiate any bill of exchange or promissory note, transfer any security or acknowledge any debt, so that a right, actual or contingent, to receive a payment is credited or transferred in favour of any person as consideration for or in association with any matter.

C. Restrictions Regarding Assets Held by Non Residents and Import and Export of Certain Currency and Bullion

Restrictions on Import-Export of Currency: Section 13 provides that no person shall, except with the permission of the Reserve Bank, bring or send into India any gold, silver, foreign exchange or Indian currency. Similarly, no person shall, without the permission from the Reserve Bank, take or send out of India any gold, jewellery, precious stones, Indian currency or foreign exchange other than foreign exchange obtained by him from an authorised dealer or money-changer.

D. Duty of Persons Entitled to Receive Foreign Exchange and Payment for Exported Goods

(i) *Persons Entitled Receive Foreign Exchange*: Section 16 lays down that no person who has a right to receive foreign exchange shall delay receipt of such foreign exchange without prior permission from the Reserve Bank.

(ii) *Restrictions on Export of Goods*: Section 18 lays down that the Central Government may, by notification, prohibit export of any goods unless the exporter furnishes to the prescribed authority particulars relating to the full export value of goods. The Central Government may also, by notification, specify that the goods shall not be sold at less than the declared value except with the permission of the Reserve Bank.

Sub-Section 3 of Section 18 provides that if the exporter does not receive payment for export within the prescribed period, the exporter is presumed to contravene the provisions of Section 18 of the Act.

Sub-Section 4 of Section 18 further lays down that if the prescribed period expires and the export proceeds have not been received by the exporter, the Reserve Bank may issue directions for receiving payments if goods have been sold or re-import of goods into India, if the exported goods have not been sold. The Reserve Bank may also authorise and issue necessary direction to the effect that the unsold goods or the right

have been assigned to the Government of India so that it can take steps to recover the same.

What is the *modus-operandi*? There is no simple legal forum or a court to recover the same and one must have recourse to International Commercial Arbitration which is worthwhile only if enormous amounts are involved and perhaps it would have been desirable that the Government should have applied at the diplomatic level and at the level of International Law to have a simplified procedure for recovery of dues.

4. It is pertinent to note that substantial changes are purported to be made by FERA in regard to property law. The principal enactment which covers the core of property law is the Transfer of Property Act, 1882. That Act completely defines transfers and encumbrances that could be validly created over property and one wishes that these provisions of FERA, namely, Section 24, 25 and 31, which deal with the acquisition, holding and settlement of properties, had been incorporated in that major Act, because it is natural that persons are seeking accurate information or advice on:
   (a) the capacity of foreigners to hold property in India;
   (b) the transfer of property by an Indian to a foreigner or to a non-resident Indian; and
   (c) the capacity of an Indian to acquire property abroad would automatically look into that Act for guidance. They would justifiably think that the Foreign Exchange Regulation Act would not deal with immovable property in India.
5. Government agencies have created the impression that foreign exchange is something precious and must be protected at all cost. So, we have the FERA which contains stringent provisions. FERA violators are treated as criminals; the frenzy is so much that an entrepreneur was once arrested for being in possession of Rs.450 in foreign exchange even though it was what was left over from a journey abroad, undertaken with exchange money properly sanctioned by the Government.

Paradoxically, the same government agencies waste vast sums in foreign exchange in the name of 'policy.' A case in point is paraxylene, an input in the manufacture of DMT. Paraxylene was imported at a cost of more than $700 a tonne. Bombay Dyeing applied, way back in 1979 itself, to the government for permission to manufacture paraxylene. Permission was denied to the applicant on the grounds that paraxylene was reserved for the public sector.

6. There have been repeated demands of late, that FERA should be abolished, more particularly, after the corporates find themselves confronted by serious allegations of violation of the Act. Some people are of the opinion that since India has almost an 18 billion dollar foreign exchange reserve position and as there is no scarcity of foreign exchange, the Act must be done away with. Yet another school of thought prevails, which opines that the Act is outdated, draconian and needs to be either re-written completely or totally overhauled so as to keep in tune with the Government's avowed policy of de-regulation and economic globalisation.

Generally speaking, after the 1991 Industrial Policy was announced, the aim of which was to decontrol industrial activity in general (excepting a few) and de-bureaucratise the working of economic legislation in particular, it appears that much

needs to be done to bring the FERA in tune with the current thinking, both in governmental and corporate sectors and the need of the economy as it stands today. Many experts state that since India has qualified for Article VIII under the articles of association of IMF, the rupee is deemed to be convertible on current account and hence FERA must be further liberalised. Corporate sector is generally of the opinion that restrictions on current account transactions imposed under the FERA virtually preclude transactions in foreign exchange by residence without the permission of the RBI. They are also of the view that international trade and cross border operations are impossible without free foreign exchange availability and freedom to utilise the available exchange for promoting legitimate business interests.

7. It is felt that piecemeal reforms of the FERA which have been attempted time and again, through the issuance of notifications by the Government and RBI, may not serve the purpose. Further, there is no harmony between FERA and direct tax laws in many respects. For example, the basic definition of 'resident/ non-resident' in both legislations are dichotomous and totally different. It has also been the experience of the Government that FERA violations are driven by exchange rate and tax distortions. Hence it is imperative that the only effective check would be capital account convertibility. As one of the industrialists is reported to have said: *'A crime involving foreign exchange is treated as akin to murder.'*

For the foregoing reasons, it appears that the time has come to usher in a new policy and legislation to manage foreign exchange resources rather than control foreign exchange transactions through a maze of regulations.

Precisely for these reasons, the Finance Minister in his 1997-98 budget speech announced that FERA would be replaced by a more progressive and growth friendly legislation which might be called Foreign Exchange Management Act (FERA).

DO WE NEED FERA?

Box 15.1 seeks to answer this relevant question.

Box 15.1

Running out of steam

In the light of the reforms introduced, do we need the Foreign Exchange Regulation Act (FERA) of 1973? After all, the precursor to FERA was originally introduced by the British during World War II. Consequently, the logic behind the introduction of the legislation is perhaps no longer valid now.

To a large extent, the Preamble to an Act describes the scope of the Act and the problems that the legislation is designed to handle. The Preamble to FERA is the following: "An Act to consolidate and amend the law regulating certain payments, dealings in foreign exchange and securities, transactions indirectly affecting foreign exchange and the import and export of currency and bullion, for the conservation of foreign exchange resources of the country and the proper utilisation thereof in the interests of economic development of the country." The focus is therefore on conserving foreign exchange and controlling its use, a demand management sort of exercise. Surely, this logic has very limited validity now.

Let us consider some example of FERA violations, instances where there have been prosecutions under FERA. The question to ask is would we like such instances to be violations

This section, as it was originally worded, covered apart from joint ventures, the acceptance of directorship in overseas companies by Indian nationals staying in India and required all applications to be made to the Government of India for specific permission in individual cases. Moreover, there was scope for interpretation that even association with overseas concerns for carrying on certain activities in India fell within its purview. There had been a large number of representations for deleting this section as it was very restrictive and had not served much purpose. Hence, it has been deleted.

Section 28: Restrictions on the appointment of certain persons and companies as agents or technical or management advisers in India.

It has been decided to take FERA companies outside the purview of this section in regard to the acceptance of appointment as an agent or technical management adviser or for the use of trademarks to which they were entitled. Restrictions on appointment as technical or management adviser and for the use of trademark with respect to other categories of persons or companies covered under this section have also been done away with. Therefore, restrictions under this section would henceforth, apply only to foreign companies, foreign citizens and non-residents with regard to their acceptance of appointment as an agent in India, of any person or company.

Section 29: Restrictions on establishment of places of business in India.

This section has been amended, exempting FERA companies from the prohibition imposed under clause (a) and (b) of sub-section (1) on the establishment of a branch office or a liaison office even when the non-resident interest in such company exceeds 40%. Such companies will also be allowed to acquire whole or part of any undertaking in India, of any person or company carrying on trade, commerce and industry, excepting agriculture and plantation activity. It is also clarified that restriction with regard to activities of companies registered outside India and foreigners would continue to be regulated under this section.

Section 30: Prior permission for foreign nationals before taking up employment in India.

Since the RBI or the Department of Economic Affairs do not wish to regulate the employment of foreign nationals any more after the employer had decided upon it, this Section has been amended accordingly. Ministry of Home Affairs will, however, continue its control through the grant of visas.

Section 31; Restriction on the acquisition, holding etc. of immovable property in India.

Henceforth, FERA companies do not need to take the permission of RBI for acquiring, holding, transferring or disposing of by sale, mortgage, deed, lease, gift, etc., any immovable property situated in India. However, restrictions on foreign companies and citizens will continue as at present.

Section 32: Regulation of booking of passages outside India and restrictions on foreign travel.

Airlines and shipping companies, travel agencies etc. will no longer be required to obtain a licence from the apex bank for carrying on the business of booking passages for travel abroad. Besides, 'P' form restrictions, most of which had already been done

away with, have been completely removed. This section under FERA thus stands deleted.

Possession of foreign currencies

Under Section 71, the burden of proof for keeping foreign currency in excess of the equivalent value of Rs.250 was with the individual. This limit now stands raised to Rs.15,000 which is equal to $500 approximately.

Submission of returns/statement by ADs

A new Section 73A in the Act will be added to give enabling powers to the Reserve Bank of India to impose a penalty not exceeding Rs.10,000 and recurring penalty upto Rs.2,000 per day against authorised dealers etc. to ensure strict compliance with the directions given to them, particularly on the submission of periodical returns. Promotional and regular submission of returns has become imperative with large-scale delegation of powers. Earlier ADs/money changers were required to submit such returns under executive instructions.

Apart from the above changes, the Foreign Exchange Manual will be updated by the RBI and all the changes made in the FERA either through this ordinance or the notification/circulars issued earlier, will be incorporated in the new Manual. It is also intended that the powers of enforcement under FERA will be delegated to somewhat higher levels. The notifications on this will be issued by the Department of Revenue.

Major changes effected between the years 1991 to 1996 in the FERA and in Reserve Bank regulations:

1. Restructuring policy guidelines regarding foreign and NRI investment and investments by overseas corporate bodies (OCBs - i.e. companies incorporated abroad, wherein non-resident Indians have more than 60% stake in the beneficial interest and voting pattern of the company).
2. Removal of entry barriers for foreign capital in high-tech areas including hotels and tourism related industry, export oriented industries, computers, import substitution sectors, shipping etc.
3. Re-defining the restrictions for activity with respect to real estate development for NRIs and OCBs.
4. Permitting returning Indians including those of Indian origin (NRIs) to hold assets abroad without restrictions apart from permitting them to make fresh investments abroad out of their savings retained overseas.
5. Permitting foreign companies to have branches in India, where that would mean developmental assistance to Indian industries and assist in infra-structural development.
6. Permitting NRI and OCB investment on non-repatriation without the RBI approval.
7. Opening up of the financial sector of the economy for FIIs (foreign Institutional Investors).
8. Permitting foreign technicians to visit India for turnkey and start-up operations.

9. Permitting certain well defined categories of persons to own and hold exchange earners' foreign currency account, exporter's foreign currency account and under a scheme called resident foreign currency account, for returning Indians.
10. Liberalising regulations *w.r.t.* import of gold and silver subject to certain conditions which included amendment of Section 13 of the FERA.
11. Removal of several restrictions on export and transfer of securities.
12. Opening up areas for overseas joint ventures and wholly owned subsidiaries abroad by removal of major barriers for domestic industry to enter foreign markets as investors and collaborators.
13. Removal of ban on foreign brand name usage.
14. Introducing full convertibility on current account in transactions of foreign exchange through authorised dealers.
15. Providing for access by domestic industries to foreign currency loans in the form of external commercial borrowings (ECBs), where foreign lenders are prepared to advance finance to Indian business.
16. Opening up housing and real estate development activity to NRIs and OCBs.,
17. Permitting NRIs to promote companies in India.

It may however be noted that no foreign investment is permitted in agricultural land or activity related thereto. NRI and OCB investment in the said line of business is not permitted. NRIs are also not permitted to own agricultural land, or plantations or form houses. Also Indian companies with more than 40% non-resident equity holding, cannot engage directly or indirectly in agricultural or plantation activity or purchase shares in companies engaged in such activity.

FROM FERA TO FEMA

On August 4, 1998, finance minister introduced the Foreign Exchange Management Bill (FEMA) in the Lok Sabha. FEMA seeks to repeal the Foreign Exchange Regulation Act, 1973 (FERA).

The statement of objectives and reasons for FEMA states that FERA has outlived its utility on account of significant developments since 1993 such as substantial increase in foreign exchange resources, growth in foreign trade, rationalisation of tariffs, current account convertibility, liberalisation of Indian investments abroad, increased access to external commercial borrowings by Indian corporates and participation of foreign institutional investors in the stock markets. Keeping in view of the changed environment, FEMA aims at simplifying, consolidating and amending the law relating to foreign exchange with the objective of facilitating external trade and payments, and for promoting the orderly development and maintenance of foreign exchange markets in India.

FEMA, in a radical departure from FERA, has not only simplified the definition of a person resident in India but has also delinked it from the citizenship aspect to denote a person residing in India for more than 182 days during the course of a period of 365 days immediately preceding the date on which such a period is reckoned; any person or body corporate registered or incorporated in India; an office, branch or agency in India owned or controlled by a person resident in India/outside India.

Sections 8 to 31 of FERA reveal a labyrinth of regulations and restrictions ensnaring multifarious foreign exchange transactions to the point of stifling economic growth. FEMA, in contrast, seeks to establish a more liberal and orderly regulatory framework conducive to economic growth by limiting its ambit to:

(i) Current account transactions, such as payments due in connection with foreign trade, other current business, services and short-term banking and credit facilities in the ordinary course of business; payments due as interest on loans and as net income from investments; remittances for living expenses of parents, spouse and children residing abroad and expenses in connection with foreign travel, education and medical care of parents, spouse and children.

(ii) Capital account transactions, i.e., a transaction which alters the assets or liabilities, including contingent liabilities outside India, of persons resident in India or assets or liabilities in India of persons resident outside India.

(iii) Export of goods and services.

(iv) Realisation and repatriation of foreign exchange.

(v) Exemption from realisation and repatriation in cases like possession of foreign currency or foreign coins by any person upto such limit as the Reserve Bank of India (RBI) may specify; foreign currency account held or operated by such person or class of persons upto the limit the RBI may specify; foreign exchange acquired or received before 8 July, 1947 or any income arising or accruing thereon which is held outside India by any person in pursuance of a general or special permission granted by the RBI.

There is no gainsaying that FEMA, on enactment, would usher in a more liberal, transparent and orderly regulatory framework, conforming to the postulates of justice and fairness-essential pre-requisites for promoting further economic liberalisation and growth.

FEMA ACT, 1999

The FEMA Bill became an Act

The main objective of this Act is to consolidate and amend the law relating to foreign exchange with a view to facilitate external trade and payments and for promoting the orderly development and maintenance of the foreign exchange market in India.

> The main objective of FEMA is to consolidate and amend the law relating to foreign exchange with a view to facilitate external trade

The Act extends to the whole of India. The main provisions of the Act are as follows:

Section 3 Dealing in Foreign Exchange

No person shall deal in or transfer any foreign exchange or foreign security to any person; make any payment to or to the credit of any person resident outside India in any manner; receive any payments by order or on behalf of any person resident outside India in any manner; and enter into any financial transaction in India as consideration for or in association with acquisition, creation or transfer of the right to acquire any asset outside India by any person, without permission from the Reserve Bank.

Section 4 Holding of Foreign Exchange

No person, resident in India, shall acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India, without permission from the Reserve Bank.

Section 5 Current Account Transactions

Any person may sell or draw foreign exchange to or from an authorised person if such sale or drawal is a current account transaction.

Section 6 Capital Account Transaction

Any person may sell or draw foreign exchange to or from an authorised person for a capital account transaction.

The Reserve Bank may, in consultation with the Central Government, specify any class or classes of capital account transactions which are permissible and limit upto which foreign exchange shall be admissible for such transactions.

Section 7 Export of Goods and Services

Every exporter of goods or services shall furnish to the Reserve Bank details regarding the export value of such goods or services.

Section 8 Realisation and Repatriation of Foreign Exchange

Where any amount of foreign exchange is due or accrued to any person resident in India, such a person shall take steps to realise and repatriate to India, such foreign exchange within a specified period of time.

Section 9 Exemption from Realisation and Repatriation

The following are exempted from the operation of Section 4 and Section 8:

(a) possession of foreign currency or foreign coins by any person upto such limit as the Reserve Bank may specify;

(b) foreign currency account held or opted by such person or class of persons and the limit upto which the Reserve Bank may specify;

(c) foreign exchange acquired or received before the 8th day of July, 1947 or any income arising or accruing thereon which is held outside India by any person in pursuance of a general or special permission granted by the Reserve Bank;

(d) foreign exchange held by a person resident in India upto such limit as the Reserve Bank may specify, if such foreign exchange was acquired by way of gift or inheritance from a person referred to in clause (c) including any income arising therefrom;

(e) foreign exchange acquired from employment, business, trade, vocation, services, honorarium, gifts, inheritance or any other legitimate means upto such limits as the Reserve Bank may specify and

(f) such other receipts in foreign exchange as the Reserve Bank may specify.

QUESTIONS

1. What are the objectives of FERA?
2. Bring out the provisions of FERA.
3. Comment on the operation of FERA.
4. Explain the major provisions of FEMA.

CHAPTER 16

The Companies Act, 1956

CHAPTER OUTLINE

Evolution of the Company
Meaning and Definition
Classification of Companies
Company Formation
Company Law
Company Law Administration
Observations on the Act
Companies Amendment Bills

LEARNING OBJECTIVES

After reading this Chapter, you should be able to:

1. *Trace the evolution of the company form of ownership*
2. *Give the meaning of the company*
3. *Classify companies into different types*
4. *Bring out the main provisions of the Companies Act and describe how the Act is administered*
5. *Comment on the operation of the Act*
6. *Point out the salient features of the Amendment Bills, 1993 and 1997.*

Company is not mere pattern of ownership of business enterprises but an institution vested with the responsibility of transforming the socio-economic fabric of a country.

The Companies Act, 1956, is a control measure used by the Government to regulate the functioning of the corporate sector in India. This chapter is devoted to a brief description of the provisions of the Act and their shortcomings. The discussion is preceded by a brief explanation of the nature of company and its types.

Company is an important form of ownership. Also called a corporation, a company is not a mere form of ownership, but it is considered to be an institution vested with the responsibility of transforming the socioeconomic environment of our country. Writing about corporations, John Kenneth Galbraith asserted thus:

"The institution that most changes our lives we least understand or more correctly seek most elaborately to misunderstand. That is the modern corporation. The modern, corporation lives in suspension between fiction and truth".[1]

EVOLUTION OF THE COMPANY

Company form of ownership dates back to Roman Empire.

The company form of ownership existed as early as the days of the Roman empire. In England, it was formed prior to 1600. In our country, a form of joint-stock company had come into existence in the middle of the 17th century in South India, understandably, as it was here the Indians first came into contact with the European merchants. During the 17th century, there was a considerable expansion of trade between India and Europe and European companies were competing with each other in South India to buy Indian merchandise of which cotton textiles constituted a very important part. So far, the European companies had followed the practice of procuring supplies through individual Indian merchants who were paid advances. The Indian merchants in turn advanced money to weavers to secure the output. In a period of expanding trade, it was natural that the European companies had to deal more and more with a greater number of smaller merchants to procure supplies. This necessarily increased the cost of supplies as well as created uncertainty with regard to the quality and quantity of the goods supplied. Recovery of debts became a great problem. It was primarily to overcome these difficulties that the European companies seem to have fostered among the Indian merchants the idea of organising joint-stock companies. The small merchants of the Coromandal coast who were often badly hit by their own competition, eagerly accepted the idea, but the wealthy Surat merchants did not really favour it and secretly competed with their own joint-stock companies in buying goods from the market.

Generally, a joint-stock company consisted of between five and ten merchants who together subscribed an amount varying from 10,000 to 1,50,000 pagodas (gold coins current in South India at that time). From the 1660s, many such companies are mentioned in the records of the English and the Dutch East India Companies. Their number began to decline after about 1720, until they disappeared almost completely by the end of the 18th century.[2]

Then came the East India Company in the latter part of the 18th century. From then onwards, there was no going back and as times went by, numerous companies with huge capital investments came to be registered.

MEANING AND DEFINITION

A company may be understood as an association of individuals united for some common purpose, permitted by law to use a common name, and to change its members without winding up the association.

Chief Justice John Marshall of the US Supreme Court defined a corporation as '*an artificial being, invisible and existing only in contemplation of the law*'.

A second reading of the above paragraph reveals some essential features of the company form of ownership. These are:

Company is an artificial and invisible being recognised by law and created to pursue business objectives.

(a) *Separate Legal Entity*: Unlike proprietorship and partnership, a company is legally separate from its owners. A company is considered to be a legal '*person*' and can continue to exist even though its ownership may change many times. Since it is a legal person, a company can own property, take legal action and enter into contracts. A company has a domicile but is not regarded as a citizen either under Article 19 of the Constitution of India or under the Citizenship Act. It cannot ask for the enforcement of those Fundamental Rights which are exclusively available to the citizens. In the words of Hidayatullah,J. (afterwards C.J.), "....if all of them (the members) are citizens of India, the company does not become a citizen of India and more than that, if all are married, the company would be a married person". (*State Trading Corporation of India Ltd. v.* C.T.O.A.I.R. 1963 S.C.) (Also See Box 16.1).

The concept of legal entity cannot be used by the members of a company to defeat public convenience, justify wrong deeds or defend crime.

(b) *Limited Liability*: Another feature of the company is that the liability of its members is limited to the extent of the nominal value of shares held by them. A member cannot be held personally liable for the debts of the company except when provided by the statutes, e.g., when false and fraudulent representation is given in the prospectus, misdescription of the name of the company, etc. Courts can hold the members personally liable for debts arising out of such practices.

(c) *Transferability of Shares*: The shares of a company are transferable unless it is a private or a government company. If a member is unwilling to continue or is in the need of money, he/she can transfer the shares for a consideration to others. Such transfers can be affected without taking consent of other members or without causing a closure of the company.

(d) *Continued Existence*: A company enjoys relative permanence. If a shareholder sells his/her shares or the chairman of the company resigns, it will probably continue. It is the relatively stable existence that attracts the confidence of shareholders, goodwill of customers and the loyalty of employees.

CLASSIFICATION OF COMPANIES

Companies are of different classes as explained below:

- Public company;
- Private company;
- Foreign company;
- Company with liability limited by guarantee;
- Government company;
- Unlimited company; and
- Holding and subsidiary companies.

1. *Public Company*: The meaning of a company as given earlier relates to a public company. In other words, in a public company members are at liberty

Box 16.1

Supreme Court on Company's Personality

About separate juristic personality of a limited company, the Supreme Court has observed (AIR 1970 SC p.82) as under:

"...that obviously cannot be said of a company incorporated under the Companies Act whose constitution, powers and functions are provided for and regulated by its memorandum of association and the articles of association. An incorporated company, as is well known, has a separate existence and the law recognises it as a juristic person, separate and distinct from its members. This new personality emerges from the moment of its incorporation and from that date the persons subscribing to its memorandum of association and others joining it as members are regarded as a body incorporate or a corporation aggregate and the new person begins to function as an entity. (cf.Saloman Vs.Saloman and Co., 1897 AC 22). Its rights and obligations are different from those of its shareholders. Action taken against it does not directly affect its shareholders. The company in holding its property and carrying on its business is not the agent of its shareholders. An infringement of its rights does not give a cause of action to its shareholders. Consequently, it has been said that if a man trusts a corporation, he trusts that legal person and must look to its assets for payment; he can call upon the individual shareholders to contribute only if the Act or charter creating the corporation so provides. The liability of an individual member is not increased by the fact that the sole person is beneficially interested in the property of the corporation and that the other members have become members merely for the purpose of enabling the corporation to become incorporated, and possess only nominal interest in its property or hold it in trust for him. (cf. Halsbury's Law of England, 34d Ed. Vol. 9, p.9). Such a company even possesses that nationality of the country under the law of which it is incorporated, irrespective of the nationality of its members. The company so incorporated derives its powers and functions from and by virtue of its memorandum of association and its articles of association. Therefore, the mere fact that the entire share capital of the respondent company was contributed by the Central Government and the fact that all its shares are held by the President and certain officers of the Central Government does not make any difference. The company and the shareholders being, as aforesaid, distinct entities, the fact that the President of India and certain officers hold all its shares does not make the company an agent either of the President or the Central Government. A notice to the President of India and the said officers of the Central Government, who hold between them all the shares of the company would not be a notice to the company; nor can a suit maintainable by and in the name of the company be sustained by or in the name of the President and the said officers".

to transfer their shares without affecting its continuity. Liability of members is limited. Company has relative permanence. This company is called public or open company because it invites the public to subscribe to its share capital.

2. *Private Company*: A private company has some distinct features which make it different from a public company. Table 16.1 brings out the difference between the two. Incidentally, the meaning of private company can be made out from the table itself.

Multinational corporations (MNCs) are the best examples of foreign companies.

3. *Foreign Company*: A foreign company is one which is registered outside India but has a place of business in India.

Table 16.1

Difference between Public and Private Companies

Factors	*Public Company*	*Private Company*
1. *How many members?*	Minimum seven and no limit to maximum	Minimum two and maximum 50
2. *Is transferability of shares allowed?*	Allowed	Not allowed
3. *Who can become members*	Public	Members of a family or friends
4. *How many directors*	Minimum three	Minimum two
5. *What should be in name?*	Word 'Limited'	Words 'Private Limited'
6. *When to start business?*	After obtaining certificate to commence business	After obtaining incorporation certificate
7. *Whether listed on the stock exchanges?*	Yes	No

4. *Companies Limited by Guarantee*: Here members agree to pay a sum, in addition to the amount of shares held by them, if the need arises, to pay off the creditors of the company. The additional amount to be paid is laid down in the memorandum or articles of association. A guaranteed company maybe with share capital or without share capital. Where the company is without share capital, it raises the needed funds through entrance fees and subscriptions. Where the company has a share capital, liability of the members extends to the additional sum guaranteed when the company is wound up. A company limited by guarantee is generally formed to promote art, science, religion or charity.
5. *Government Company*: An enterprise becomes a government company when it has the following major characteristics:
   - It has most of the features of a private limited company;
   - The whole of the capital or 51 per cent or over if it is owned by the government;
   - All the directors or majority of them are appointed by the government;
   - It is created under the provisions of the Companies Act, 1956; and
   - Its funds are obtained from government and in some cases, from private shareholders and through revenues derived from the sale of its goods and services.
6. *Unlimited Companies*: A company not having any limit on the liability of its members is called an unlimited company. The members of an unlimited company are like a sole proprietor or partners of a firm, liable for its debts without any limit.

The concept of unlimited liability does not conform to the corporate concept which necessarily postulates limited liability. Hence, unlimited companies are rare but not extinct.

The concept of unlimited liability is [illegible]

7. *Holding and Subsidiary Companies*: Any company that buys a sufficient number of shares in another is called a holding company and the acquired one is called the *subsidiary*. The acquiring

company is known as the *parent* company. Some holding companies own all the shares of their subsidiaries. But owning of not less than half of the shares is enough to call the owing company a parent company.

Table 16.2 reveals the number of companies and their amounts of paid-up capital for a period of four decades.

Table 16.2

Number of Companies and their paid-up Capital: 1950-51 to 1991-92

	Number of Companies			*Paid-up Capital (Rs.Cr.)*	
Year	*Govt.*	*Private Indian*	*Foreign*	*Govt.Cos.*	*Non-Govt. Cos.*
1950-51	36	28496		26	749
1960-61	142	25438	569	547	1272
1970-71	214	29465	543	2064	2439
1980-81	851	64406	300	11443	4914
1988-89	1134	178774	420	42572	15131
1989-90	1160	200499	469	47451	17193
1990-91	1167	222796	489	54485	20313
1991-92	1180	248674	507	56482	22415

COMPANY FORMATION

Formation of a company is an elaborate, time consuming, frustrating and expensive affair.

Company formation is an elaborate, time-consuming and an expensive affair. A typical formation involves three stages, *viz.*: (a) registration; (b) capital raising and (c) commencement of business.

Registration: The Registrar of Companies is the appropriate official to register companies. Before registration, the Registrar expects the promoters to submit a list of names of the proposed company, memorandum of association, articles of association and a list of directors.

The memorandum of association, as is well-known, is an important document. It contains such details as the name of the company (earlier approved by the Registrar of Companies from a list submitted to him), the purpose of the company, the place of its registered office, the fact that the members' liability is limited and the capital of the company. The memorandum should be printed, be divided into suitable paragraphs and be affixed with stamps worth Rs.120.

The articles of association contain details about the way in which the internal affairs of the company are to be carried out. To be specific, it contains such details as types of shares; procedure for conducting meetings; powers, duties, rights and qualifications of directors; procedure for the declaration of dividends and capitalisation of reserves; maintenance of accounts and their audit; and winding up of the company. A private company and a company with liability limited by guarantee must have their own articles. A public company may or may not file its own articles. If it does not do so, it is understood that the public company follows the articles as given in Table A of the Companies Act, 1956. It is advisable to follow Table A as the articles provided therein are beyond all doubt.

As in the memorandum of association, articles of association should be printed and must be submitted to the Registrar after affixing stamps worth Rs.250.

The Registrar will scrutinise all documents submitted to him and will ensure that all formalities are complied with. The Registrar will then enter the name of the company in the register maintained by him for the purpose and will issue a certificate of incorporation. On registration, the company becomes an independent person in the eyes of law. For registration, the Registrar will charge a fee which depends on the authorised capital of the company. For an authorised capital of Rs.1 lakh, the registration fee is Rs.750. For a capital of Rs.3 lakh, the fee is Rs.1,750 and for a capital of Rs.1 crore, the fee is Rs.18,500.

B. *Raising of Capital*: The next step in company formation is the raising of capital. A public company raises its capital by inviting the public to subscribe to its share capital. The steps involved in raising capital are:

(a) Obtaining SEBI clearance.
(b) Entering into an agreement with the underwriter.
(c) Applying to the stock exchange for listing of its shares.
(d) Inviting the public to subscribe to its share capital through a prospectus.
(e) Allotment of shares.

C. *Commencement of Business*: A private company can commence its business immediately after it is incorporated. But a public company cannot commence its business unless it obtains a certificate for the purpose. To obtain a certificate, the following statement must be submitted to the Registrar:

> A public company should wait for a certificate to commence the business but a private company can do so immediately after it is formed.

- A declaration that a copy of the prospectus is filed with him.
- A declaration that minimum subscription has been received.
- A declaration that the directors have taken up the qualification shares and have paid for them.
- A certificate issued by a director or secretary to the effect that all conditions for the commencement of business have been fulfilled.

The Registrar then issues a certificate to commence business, following which a public company can now commence its chosen activity. The stage of formation of a company apparently comes to an end. What has been described so far is only a part but not the whole of the formalities to be observed in forming a company. It is said that as many as 21 clearances are required before setting up a company.

Before the new company commences its business, a team of people who can manage the company must be constituted. It is one of the characteristic features of the company that its owners do not manage its affairs. Management is entrusted to directors, who are collectively called the Board of Directors (BoD)or simply the Board. The first directors are appointed by the promoters. In their, absence, signatories to the memorandum of association will act as directors. The first directors, whether appointed by promoters or signatories to the memorandum acting as such, shall hold office till the first general body meeting, after which all of them must retire. The directors will then be elected by the shareholders.

COMPANY LAW

Companies in our country are governed by the Companies Act, 1956, as amended up-to-date. The Companies Act is one of the biggest legislations with 658 sections, 13

> The Companies Act is one of the biggest legislations. Recently, the Irani Committee recommended pruning of the Act substantially.

schedules, 32 rules and 107 forms with several guidelines and hundreds of clarifications issued by the government from time to time.

The Act extends to the whole of India and applies to all classes of companies, i.e., public companies, private companies and associations not trading for profit. It also contains certain provisions relating to companies incorporated outside India, but which have an established place of business in India.

Objectives of the Act

While moving the Bill in the Parliament, C.D.Deshmukh, the then Finance Minister, declared the following as the main objectives of the Act:

- Minimum standard of business integrity and conduct in promotion and management of companies;
- Full and fair disclosure of all reasonable information relating to the affairs of the company;
- Effective participation and control by the shareholders and the protection of their legitimate interests;
- Enforcement of proper performance of their duties by the company management and
- Powers of intervention and investigation into the affairs of the companies where they are managed in a manner prejudicial to the interest of shareholders or to the interest of the public.

Speaking on behalf of the Supreme Court in *Delhi Cloth and General Mills Co.Ltd. vs. Union of India and Others (1983),* Justice D.A.Desai observed thus:

"The Companies Act of 1956, to some extent, also attempts to translate into action Arts.38 and 39 in Part IV of the Constitution, by which the State was directed that the ownership and control of the material resources of the community are so distributed as to subserve the common good and the operation of the economic system does not result in concentration of wealth and means of production to the common detriment. Further, Art.46 mandates the State to promote economic interest of weaker sections of the people from all forms of exploitation. A *fortiori*, every provision of the Companies Act must receive such interpretation as to suppress the mischief and advance the object for which it was enacted; as also to achieve and translate into action, the underlying intendment of the enactment for the realisation of the constitutional goals as set out in Part IV of the Constitution."

The arm of the Companies Act is quite long and touches every aspect of a company's existence. While it is unnecessary to describe the provisions of all its 658 sections, it is enough to say that they cover all aspects of the company's life, from its cradle to its grave. Be it the formation of the company, its management, holding meetings, maintaining accounts, declaring dividends, any action that is contemplated must be strictly in accordance with the provisions of the Act.

COMPANY LAW ADMINISTRATION

The provisions of the Companies Act are administered through a three-layer administrative machinery. At the top is the Company Law Board, charged with the

overall responsibility for company law administration. The board facilitates administrative coordination with other related statutes concerning corporate enterprises.

> The Company Law Board is the statutory authority which administers the provisions of the Act

The Board has the following powers:

(a) Alteration in the memorandum of the company;
(b) Power to authorise issue of shares at a discount;
(c) Power to order a general meeting and
(d) Power to accord approval wherever it is required under the provisions of the Act.

Next to the Company Law Board are four Regional Directors at Calcutta, Mumbai, Chennai and Kanpur. The Regional Directors form a link between the Registrars and the Central Government as well as between the Central Government and the State Governments and they keep the Company Law Board informed of all relevant matters.

Below the Regional Directors are the Registrars. In each State capital, there is a Registrar with whom companies can be registered. The functions of a Registrar are as follows:

(a) Collect and preserve vital documents relating to all companies in the respective States. These documents are available for inspection by members of a company and general public;
(b) Ensure proper functioning of the company by insisting on the prompt submission of reports and returns and
(c) Scrutinise the contents of the returns to determine whether they have complied with the law. If the Registrar suspects anything wrong with the affairs of the company, he can call for further explanation from the company, consult Regional Directors, or refer the matter to the Company Law Board for the purpose of investigation by inspectors.

SOME OBSERVATIONS ON THE ACT

The Companies Act deserves full credit for its lucidity, comprehensiveness and endurance. *"The discipline of the company law is a good thing for managements,"* wrote S.S.Khera, in his outstanding book *Government in Business*. *"It is a statutory discipline imposed by the law directly...A large number of articles, a large number of sections, well over a hundred sections of the Companies Act, prescribe disciplines, breach of any of which exposes the director to penal action under the law...These disciplines are very healthy. These are disciplines prescribed for all people who handle other people's resources, whether they be in the private sector or public sector"* (p.118).

> The Companies Act deserves credit for its comprehensiveness, lucidity and endurance. The Act preaches discipline to the managers

However, certain flaws in the Act deserve serious consideration by the concerned authorities. The following are the major deficiencies:

1. It has all along been held that the workers or their trade unions have no right to be heard in the liquidation proceedings of a company. The Companies Act does not provide for any such right. Then came the landmark judgement delivered by the Supreme Court in the *National Textile Workers' Union vs. P.R.Ramakrishna, 1983, which read:* "It is not only the shareholders who

The Act has been criticised as it contains no provision for allowing representatives of employees to be heard in a legal dispute over the closure of a company.

have supplied capital who are interested in the enterprise, which is run by a company, but the workers who supply labour are also equally, if not more, interested because what is produced by the enterprise is the result of labour as well as capital, while the shareholders invest only a part of their money(s), the workers invest their sweat and toil, infact their life itself. The workers, therefore, have a special place in a socialist pattern of society. They are not mere vendors of toil, they are not a marketable commodity to be purchased by the owners of capital. They are producers of wealth as much as capital, nay, very much more. In view of the Preamble, the Directive Principles of State Policy and particularly the introduction of Article 43-A, it is idle to contend that the workers should have no voice in the determination of the question whether the enterprise should continue to run or be shut down under an order of the court.

The *audi alteram partem* rule which mandates that no one shall be condemned unheard is one of the basic principles of natural justice and if administrative proceeding involving adverse civil consequences, it would a *fortiori* applied in a judicial proceeding such as the petition for winding up of a company. (AIR, Supreme Court, 1983).

The provisions of the Companies Act show that only the company, the official liquidator, creditors, contributories and the Registrar have statutory rights to participate in the winding up of proceedings. The workers or their trade unions have not been given any such right. In the light of the Supreme Court Judgement, it is necessary that a provision for conferring the right of participation on the workers or their trade unions is incorporated in the Act.

The applicability and limits of the principle of "piercing or lifting the corporate viel" needs to be clarified.

2. There is an acknowledged concept of law, namely, the ability of the courts to lift or pierce the corporate veil of entity in order to understand the true nature, identity and composition of a company as first declared by the House of Lords in the UK in *Daimler vs. Continental Tyre Company*. This concept has been borrowed by the Indian courts and frequently utilised to prevent evasion of taxes as in the case of Meenakshi Mills, etc. It is suggested that this concept adopted by the courts appears to have developed on an ad hoc basis and requires to be clarified by the legislation itself about its applicability and limits.

Transfer of shares is often done at the sweet will of directors.

3. One of the characteristics of the companies is that their shares are freely transferable. The Companies Act explicitly makes provision for transfer and registration of transfers also. In practice, transfers and their registration are effected at the sweet will of the directors. This practice is a clear discrimination of the worst and pernicious kind.

A share is like any other property and when a person buys it, it should be registered in his name. Registration should not be made depending on the person who has bought it.

Share transfers are not registered by the directors, if they suspect that the purchaser would pose inconvenient and embarrassing questions at appropriate forums.

Though there is a power vested in the purchaser of shares and whose registration has been refused to seek remedy in a court of law, it is generally illusory. This is because the courts in the exercise of their jurisdiction have very limited authority which is supervisory only and not all-embracing.

It is time that provision is made for compulsory registration of transfer of shares.

4. The Act mandates companies to maintain proper records and books of account which should disclose full information about the business affairs. In practice, though records and books of account are maintained, they fail to disclose full information. For example, the corporate annual reports published in accordance with Schedule VI of the Act only mention the total profit the companies have made. Division-wise profit is not made available. Naturally, information provided is utterly incomplete, even misleading, if the division-wise position is not disclosed. "The aggregation of financial information", says S.K.Bhattacharya, Chief Executive of Management Structures and Systems, "in one balance sheet and profit and loss account, when the organisation is multi-product, multi-location, multi-technology company operating in many sectors of the company, transforms financial analysis into almost a make-believe game. How does one make any sense out of this *pot-pourri* which passes off as an appetising dish when it is entirely possible that the windfall profit in one product group is sustaining major inefficiencies in others? How does one interpret 'net' profit which is an amalgam which turns into gross? How does one derive any insight regarding funds required for generating future profits from the disparate 'business' reported in one balance sheet?"[3]

Accounts and statements do not disclose required information adequately.

"....Only one has to glance at the balance sheet of any American company to see the difference. The Federal Accountancy Standards Boards (FASB) in the USA prescribes exhaustive guidelines on disclosure, which companies have to scrupulously follow. This is essential, considering the dominant presence of conglomerates in the USA involved in diverse activities. Unless division-wise profitability is disclosed, it is next to impossible to gauge the performance of a company. The Board of Directors are expected to disclose their stake in the company and inside trading is a criminal offence".

"None of these provisions is applicable in India. As one chartered accountant admits, Indian balance sheets are great works of fiction. The good news is presented in the Chairman's statement upfront and the bad news is pushed into the footnotes."[4]

5. Section 166 of the Act lays down that the companies should hold annual general meetings every year and the period between two such successive meetings should not exceed 15 months. In practice, this provision is often violated and the punishments for infringement are mild, involving a fine of a few hundred rupees. During 1984-85, in all about 442 companies did not bother to hold annual general body meetings.

That a company should hold its annual general body meetings regularly is flouted with impunity.

6. Where annual general body meetings are held, they turn out to be big pompous shows not serving any real purpose. Theoretically, an annual general body meeting is supposed to be a platform where shareholders can question their directors about the way the company's affairs have been managed. Practice is far from theory. In the first place, shareholders seldom attend general body meetings. They are mainly interested in ensuring that cheques for dividends come regularly and share prices zoom in the share market every day. Secondly, shareholders who care to attend such meetings evince more interest in receiving gifts, discount coupons, and relishing a sumptuous lunch and snacks. Thirdly, when a well-informed

Where such meetings are held, they turn out to be big pompous shows not serving any real purpose.

shareholder puts embarrassing and inconvenient questions, his voice is silenced by evasive replies and mayhem.

Thus, cynics are not wrong when they say that the annual general meetings are a big farce. This malady is not peculiar to our country. It is so everywhere. About annual meetings held in the USA, Galbraith wrote thus: "As stock-holders cease to have influence, however, efforts are made to disguise their nullity. Their convenience is considered in selecting the place of the meeting. They are presented with handsomely printed reports, the preparation of which is now a specialised business. Products and even plants are inspected. During the proceedings, as in the report, there are repetitive references to *'your company.'* Officers listen with every evidence of attention to the highly irrelevant suggestions of wholly uniformed participants and assure them that these will be considered with greatest care. Votes of thanks from women stockholders, in print dresses, owning ten shares, for the excellent skill with which you run your company-are received by the management with well simulated gratitude. All present show stern disapproval of the critics. No important stockholders are present. No decisions are taken. The annual general meetings of a large American Corporation is, perhaps, the most elaborate exercise in popular illusion."

There are however, exceptions. Annual general body meetings of some companies turn out to be stormy scenes wherein the directors are grilled by the enlightened shareholders for disappointing performance. Peico Electronics and Electrical Ltd. is one such example. In its annual general body meeting held in Calcutta on May 13, 1987, the management of the company was subjected to heavy criticism by its shareholders following slump in the company's profits to Rs.47.19 lakh (before tax) for the year 1986 from Rs.4.8 crore in the previous year. Dividend declined from 15% in 1985 to 10% in 1986.

7. Tribunals are a trend in every sphere of organised economic activity. Before 1976 there were tribunals to which an aggrieved party, be it a shareholder, director, employee or consumer, could make an appeal seeking redressal. But the tribunals were abolished under the Companies Tribunal (Abolition) Act, 1976. It is time the tribunals are revived.

True, there is the Company Law Board to which appeals can be made. But like any other government agency, the Company Law Board is known for red-tapism and delays.

8. Many people feel that the maximum number of shareholders in a private limited company should be increased by at least five times. There seems to be no justification for granting exemptions from the provisions of the Companies Act to a private company only for the sake of fifty shareholders. Perhaps, the rationale for putting a ceiling at fifty was to confine the private company to the members of a family. This has lost its relevance because large families have now become extinct. Therefore, private companies are now being formed by a homogeneous group of people cutting across families. Besides, today's business demands huge investment and it may be difficult for just fifty people to mobilise the required funds. Hence, the need for increasing the maximum number at least by five times.

There is an urgent need to lift the ceiling of 50 membership imposed on a private company.

COMPANIES (AMENDMENT) BILL, 1993

On May 14, 1993, the Minister of State for Company Affairs introduced in the Parliament the large, delayed and long-deferred Companies Bill, 1993.

The Bill clearly reflects the emerging trends in corporate law in the Commonwealth countries, particularly UK and the public awareness of the need for transparency in the dealings of the companies by the management, and the protection of investors, creditors and the members of the public at large are the guiding stars for the new enactment. At the same time, commendable efforts are made to liberate those in charge of company management from government regulations and bureaucratic delays, in the process throwing into the dustbin time-consuming and irritating paperwork.

The changes sought to be made in the Bill may tempt other countries to emulate the example of India.

The arrangements of the sections and the schedules have undergone a tremendous change which may for a short time cause confusion. Those dealing with company law, knowing by rote the numbers of important sections of the Act of 1956, may have to struggle for a while to clear their transitory cobwebs but by and large, such regrouping has logic and clarity.

The provisions of the Bill are as follows:

(1) The procedure for incorporating a company has been simplified. Some of the 'inherent powers' of a company are set out in a schedule (Schedule II), so that these may not be set out at length in the memorandum of association. It will be open to a company to modify these 'powers' in its memorandum-the result will be that now the companies, instead of elaborately setting out the normal and routing powers, adopt the provisions of Schedule II with such modifications to suit the company's particular requirements. This approach is similar to a company adopting Table-A of the Schedule (with modifications, if so desired) to avoid having to print lengthy articles of association.

(2) If a company wishes to alter its clause of the memorandum, all that is required to do is pass a special resolution, at a meeting of the members and not seek the approval of the Company Law Board. This change recognises the rights of the owners of the company, *viz.*, the members, under the Act of 1956. The Company Law Board, while granting approval, stipulates conditions or cuts down the effect of the alternation without sometimes appreciating the effect thereof. This will also enable the companies to diversify without interference of the Company Law Board.

(3) Now the Debenture Trust Deeds will be uniform, according to the prescribed format. The company will be under an obligation to ensure the execution thereof within the statutory period. It will also spell out the functions and duties of the debenture trustees. Very often, depositors do not receive interest from companies in time, either because of postal delays, or the companies deliberately delaying posting of interest. To overcome this situation, it is suggested that along with the deposit receipt, companies must be asked to send post-dated interest as in case of IDBI bonds.

Box 16.2

Plus and Minus of the Bill 1993

Plus points

1. *Companies can now change the objects clause of the memorandum of association without the prior permission of the Companies Law Board.*
2. *Endorsement by government authorised agencies is not required for share transactions of nominal value.*
3. *Cost auditors no longer to be appointed by the Union government. This power has been given to shareholders, in the same manner in which statutory auditors are appointed.*
4. *Prior approval of the government not necessary for the payment of minimum remuneration to managers in the event of a company not making adequate profits.*
5. *Prior approval of the government not required for the payment of remuneration to the managers of loss-making companies.*
6. *Government approval necessary only if the strength of a company's board of directors exceeds 15, and not 12 as at present.*
7. *Liquidation proceedings can be conducted by professionals like lawyers and auditors. Court-appointed liquidators are no longer mandatory.*
8. *Voluntary liquidators now allowed to file misfeasance proceedings against directors of companies, without seeking prior permission of the Registrar of Companies.*
9. *Credit rating mandatory for companies intending to issue debentures or invite fixed deposits.*
10. *Shareholders approval now required for fixing rights issue premia. Earlier this was confined to public issue premia.*
11. *Unclaimed dividends, which earlier went into the government exchequer, will now go into an investor fund.*
12. *Stringent norms have been set for investor protection, accompanied by stiff fines and jail terms for those who dupe investors.*
13. *Greater transparency and uniformity in balance sheets.*

Negative developments, controls retained

1. *The ceiling on managerial remuneration has been retained.*
2. *Restrictions on inter-corporate loans and investments to continue.*
3. *Industry's pleas that non-voting shares carrying higher rates of return be created have not been accepted.*

   The bill is voluminous. No real attempt has been made to substantially reduce the size.
4. *The sections imposing restrictions on dominant undertakings, which are transferred from the Companies Act to the MRTP, have been reintroduced in the bill - although chapter 3 of the MRTP Act, which dealt with the concentration of economic power, was deleted in 1991.*
5. *The section in the Companies Act which provides for the conversion of government loans into equity has been retained, even though the financial institutions have given up the practice of convertibility. Moreover, it will come into force even before the bill becomes law, and regardless of whether loan agreements include such a provision.*
6. *The minimum qualifying age for appointment as managing directors or wholetime directors has been in creased from 25 years to 30 years, while the*

upper limit has been reduced from 70 to 65 years.

7. *There are contradictions between some provisions of the bill and certain other laws already in force:*

   (a) *SEBI required debenture trust deeds to be completed in three months, but the Bill says this can be done in 18 months.*

   (b) *SEBI says that merchant banks can underwrite issues upto the extent of five times their net worth, while the restrictions on inter-corporate investments (clause 389 of the Bill) stipulate that one company can sub scribe to another's equity only to the extent of 30 per cent of its paid up capital. In the event of development, there will be conflict between the two.*

   (c) *SEBI guidelines specify that if a new company is being set up by existing companies, it will be free to price its issue on its own only if the promoters hold at least 50 per cent of the new company's equity. However, Clause 389 of the bill imposes a limit of 25 per cent.*

(4) The companies which have defaulted in the repayment of deposits and interest thereon, will no longer be allowed to accept fresh deposits or to renew the existing ones and moreover, they will not be able to lend monies to other companies.

(5) The depositors will now be able to nominate a person of their choice to receive the repayment of deposits in case of death, thus avoiding the need for obtaining legal representation to the estate of the deceased.

(6) The unclaimed dividends remaining unpaid for seven years will be transferred to an 'investors protection fund' to be untilised for payment to investors who have lost their deposits due to inability of the company to repay their deposits. This change appears to be more a populist move rather than a measure of genuine relief. What is needed is some kind of insurance cover to be available to the small depositors, say upto Rs.10,000. The premium for such insurance can be collected from the companies receiving deposits. A small percentage of the amount of deposits collected by the companies cannot prove an enormous burden on the resources of the companies.

(7) The rights of companies to refuse transfer of shares and debentures are restricted to only specified grounds.

(8) Private companies will not become 'deemed public companies' only on the ground of turnover.

(9) Under the new dispensation a 'relative' of a director cannot be appointed auditor of the company, nor should an auditor be indebted to the company. This is to ensure independence of the auditors.

(10) Some of the provisions of the prospectus are made more stringent to ensure transparency and to give a fair deal to intending investors in shares and debentures of a company, and a format of 'abridged prospectus' is being prescribed to ensure all material disclosure.

(11) The companies will be required to disclose in their annual account, significant accounting policies and to make a statement that the published accounts are in conformity with the established accounting standards.

(12) The procedures for liquidation of companies is being simplified, and instead of the court liquidator, professionals (such as lawyers, auditors) can be appointed as liquidators. This will expedite the conclusion of liquidation proceedings, which at present ran into years and years, and in the meantime, the creditors may forget that they have any claim to recover.

(13) The companies will now be liberated from the cumbersome procedure of filing various (and sometimes, meaningless) returns with the Registrar of Companies. Instead of over 80 returns now required to be filed, only two or three returns will now be filed (See Box 16.2 for merits and demerits).

The Companies Bill 1997 and the recently promulgated Ordinance on Companies (Amendment) Bill 1997 have amended several provisions of the Act and introduced new provisions incorporating internationally accepted corporate governance practices aimed at strengthening corporate democracy, protecting the interests of minority shareholders, and providing increasing flexibility to the companies in responding to the market needs. Among these, the amendments that have made headlines are permitting companies to buy back shares and the liberalisation of inter-corporate investments.

QUESTIONS

1. Define a company. What are the various classes of companies?
2. Describe the stages in the formation of a company.
3. Critically examine the operation of the Companies Act, 1956.

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CHAPTER 17

Public Sector Enterprises

CHAPTER OUTLINE

Definition and Objectives
Evolution of the Public Sector
Growth and Role
Performance
What Needs to be Done?
Reforms in Public Sector Enterprises
Bureau of Public Enterprises
Ownership Pattern of PSUs
Industrial Policy Statement 1991 on Public Sector

LEARNING OBJECTIVES

After reading this Chapter, you should be able to:

1. *Define a public sector unit and list out its objectives*
2. *Trace the evolution of public sector*
3. *Explain the growth and performance of central government undertakings*
4. *Suggest ways of improving PSUs*
5. *Bring out the PSU reforms initiated by the government*
6. *Detail the functions of Bureau of Public Enterprises*
7. *Explain the ownership pattern of public sector enterprises*
8. *State the implications of 1991 policy on public sector*

Also called state enterprises or government enterprise, public sector undertakings constitute a major segment of the industrial activity in our country. Born as the outcome of the conscious policy of the government to speed up the industrialisation of the country with a view to giving added impetus to economic growth as well as to achieve certain socio-economic goals as enunciated in Industrial Policy Resolutions of the government, these undertakings today cover a wide spectrum of activities in basic and strategic industries like steel, coal, minerals and metals, petroleum, heavy engineering, chemicals, pharmaceuticals and fertilizers on the one hand, and consumer goods, trading and marketing activities, transportation services, contract and consultancy service, tourist services, financial services and development of small-scale industries, on the other. While some of these enterprises are operating under monopoly/near-monopoly conditions, there are others working under competitive conditions. There is yet another segment of the public enterprises, *viz.*, sick units taken over from the private sector in order to protect employment. Thus, public enterprises comprise units engaged in different spheres of industrial and commercial activities, some capital-intensive-long gestation, low-profitability enterprises; while some others are low-risk and high-profitability enterprises. Added to this basic diversity in the composition of units is the multi-dimensional objectives of public enterprises which should be considered in appreciating the role these units have played in our economy.

DEFINITION

A public sector enterprise is an undertaking owned and managed by government.

In simple terms, a public sector enterprise is an industrial, commercial or other economic activity owned and managed by the Central or State Government or jointly by both. A comprehensive definition of a public sector unit is given by experts at the International Centre for Public Enterprises (ICPE), Yugoslavia. To quote the Centre:

"*A public enterprise is an organisation* which is:

- owned by public authorities including Central, State or local authorities, to the extent of 50 per cent or more;
- is under the top mangerial control of the owning public authorities, such public control including *inter-alia*, the right to appoint top management and to formulate critical policy decisions;
- is established for the achievement of a definet set of public purpose, which may be multi-dimensional in character;
- and is consequently placed under a system of public accountability;
- is engaged in activities of a business character;
- involves the basic idea of investment and returns
- and which markets its outputs in the shape of goods and services".

OBJECTIVES

The following are the objectives of public enterprises:

(i) Help in the rapid economic growth and industrialisation of the country and create the necessary infrastructure for economic development;
(ii) Earn returns on investment and thus generate resources for development;
(iii) Promote redistribution of income and wealth;

(iv) Create employment opportunities;
(v) Promote balanced regional development;
(iv) Assist the development of small-scale and ancillary industries;
(vii) Promote import substitution, save and earn foreign exchange for the economy;
(viii) Act as a countervailing force and put up an effective competition to undertakings in the private sector and
(ix) Gain control over the commanding heights of the economy.

EVOLUTION OF THE PUBLIC SECTOR

Public sector undertakings date back to 11th and 12th centuries.

Though the public sector was started with greater vigour only after 1947, the idea of State-owned undertakings was there long before. In South India, great dams and anicuts were built across the river Cauvery by the Chola Kings of the 11th and 12th centuries. They are magnificent testimonials to the wisdom and foresight of the Cholas. That is repeated in very many parts of the country. India was not merely a country of temples. There was a good deal of economic development by the State, directed towards sustaining the life of the community. And these dams and anicuts which were set-up by the State for the benefit of the people are testimony enough to acknowledge the evolution of the public sector.[1] Started by the great Chola Kings, the public sector went through periods of steady expansion until our country became a free nation. After 1947, the public sector became inevitable as the government realised that rapid economic development could be achieved only through State intervention in economic activities. The Industrial Policy Resolutions of 1948 and 1956 clearly reflect the need for expanding the public sector. The public sector has now grown tremendously and has become a leading light of our economy.

Rationale for State Owned Enterprises

Government control is necessary to produce certain goods which private sector will not do and to fix prices of goods and services at cheaper rates.

There are several reasons for the creation and maintenance of public sector enterprises. First, there is persistence of monopoly power in many developing countries. Direct government control may be required to ensure that prices are not set above the marginal costs of producing the output. Moreover, certain goods that have a high social benefit are usually provided at a price below their costs or even free; hence the private sector has no incentive to produce such goods, and the government must be responsible for their provision.

The second rationale for creation of state undertakings is capital formation, which is particularly important at the early stages of development, when private savings are very low. Investment in infrastructure at this point is critical to lay the foundation for further investment. Public sector undertakings remain important at later stages in industries that require massive funds. (1(a))

The lack of private incentive to engage in promising economic activities because of factors such as uncertainty about the size of local markets, unreliable sources of supply, and the absence of technology and skilled labour is a third major motivation for creating public enterprises. Governments of developing countries may also seek to expand employment and facilitate training of their labour force by engaging in public production. They may desire to increase export earnings by

Government undertakings have justification to exist because of
(i) private sector does not come forward to invest in certain areas
(ii) government wants to retain control over sensitive areas.

creating export industries, particularly those that might otherwise be unable to compete. For reasons of income distribution, the government may seek to locate enterprises in certain regions, particularly in backward regions and areas where there is no private incentive for creating such economic activity.

Other reasons for the creation of PSUs include the desire of some governments of developing countries to gain national control over strategic sectors of the economy such as defense, over MNCs whose interests may not coincide with those of the country, or over key sectors for planning purposes. Finally, ideological motivations may be a factor in the creation of government undertakings.

GROWTH AND ROLE

Government undertakings have, over the years, proliferated in terms of number, turnover, number of people employed, investments involved, and areas of activities covered. Table 17.1 reveals the phenomenal growth of these enterprises.

Table 17.1 contains data relating to manufacturing and non- manufacturing enterprises owned and managed by the Central Government. Banks and departmental undertakings such as railways, post office and telecommunication systems are excluded from the data. The figures are indeed awesome.

Table 17.1

Growth of Public Sector Undertakings

Period	*Total Investment (Rs.Cr)*	*No.of Enterprises*
I Plan	29	5
II Plan	81	21
III Plan	948	47
Three annual plans	2410	73
IV Plan	3897	84
V Plan	6237	122
VI Plan	18150	179
VII Plan	42673	215
VIII Plan	186445	246
IX Plan	193121	242
X Plan	274114	233

The table includes undertakings owned by the Central Government. If the figures relating to undertakings owned by various State Governments are added, the figures will be staggering.

These undertakings account for one-fourth of our GDP (Gross Domestic Product). They account for one-third of our exports. They have made significant contributions to import substitution. Industries like steel, aluminium and other non-ferrous metals, fertilizers, heavy engineering and oil have helped us save substantially on imports. Government undertakings account for more than 70% of the workers employed in the organised sector. They have greatly reduced imbalances in regional development and

have laid a strong base for the rapid development of our economy. Together with the undertakings in the private sector, government enterprises have greatly contributed to the transformation of our so called poor and traditional economy into a fast developing and fairly industrialised (we now rank among the top 20 industrialised countries in the world) country. Not to be ignored is the fact that some of our government undertakings have earned reputation for excellence at the international level. Some names to be quoted in this context are Bharat Heavy Electricals Ltd. (BHEL), Oil & Natural Gas Commission (ONGC) and Air-India. And some giants among public sector units, i.e., Indian Oil Corporation (IOC), Steel Authority of India Ltd. (SAIL) and ONGC figured in *Fortune International's* 500 large companies in 1998 (See Box 17.1). Over the years, the public sector undertakings have built up a huge reservoir of managerial talent in our country.

Box 17.1

Large PSU's

Six Indian Public Sector companies figure in the latest list of the 500 biggest industrial corporations, released by Fortune International. They are:

Name of company	Ranking (Out of 500)
Indian Oil Corporation	144
ONGC	278
SAIL	332
HPCL	371
Coal India Ltd.	371
Bharat Petroleum Corp.Ltd.	474

Of the Central PSUs, 161 are engaged in manufacturing while 75 are in the services sector including the financial sector. Four PSUs are in the construction sector. Together, the Central PSUs have a combined capital base of over Rs.2,74,114 crore as on March 31, 2001. Despite debilitating controls, contradictions and the imminent threat of privatisation, quite a few PSUs have emerged as islands of excellence. The public sector oil, telecom and power companies have consistently excelled in their performance and generated surpluses.

The following points highlight the role played by the PSEs in developing our economy:

1. Share in National Income

As stated above, Public Sector Enterprises (PSEs) account for one-fourth of our GDP. During the period of 42 years (1960-61 to 2001-02), these units together have practically doubled their share in the GDP.

2. Commanding Heights of the Economy

More than their share in the GDP, the versatility of PSEs is amazing. The sector is in command in almost all the strategic sectors of the economy like coal, oil-refining, electricity, telecommunications, iron and steel, paper, newsprint and the like, where

it controls more than 80 percent of the total installed capacity. In all, it holds a dominating position in the production of 50 types of industrial commodities and services which are of decisive significance for the economy[2]. Only agriculture, wholesale and retail trade and small scale units have remained in the private sector.

3. Share in Capital Formation

Another important role of PSEs has been in respect of capital formation as revealed in Table 17.2. After having reached the peak during the Fourth Plan, the share of PSEs in total investment in each of the plans has, however, been on the decline.

Table 17.2

Share of Public Sector in Total Investment(%)

Plan	Public Sector	Private Sector
I	46.40	53.60
II	54.60	45.40
III	63.70	36.30
IV	60.30	39.70
V	67.60	32.40
VI	52.90	47.10
VII	47.80	52.20
VIII	36.50	63.50
IX	34.70	65.30

Another angle to study capital formation is to consider market capitalisation of companies. Table 17.3 shows the data of five of the public sector undertakings.

Table 17.3

Companies an their Market Capitalisation

Company	Market Capitalisation in Dec 2004 (Rs cr)
Oil and Natural Gas Corporation	1,13,680
Indian Oil Corporation	50,177
SAIL	19,766
GAIL (India)	16,606
BHEL	15,453

(**Source**: *ET500*, Dec, 2004)

An important point to remember in this context is the types of capital which are being formed and the use of which they are being put. Investment in the private sector producing luxury goods should be evaluated lower than the similar type of investment in the public sector which makes basic infrastructure available to the economy as a whole. This is true even though profitability of the private sector is rated high. Viewed from this perspective, it may be stated that capital formation in the public sector is highly significant[3].

4. PSEs and Employment

One of the evils of our economy has been growing unemployment. It goes to the credit of the PSEs that they have gone a long way in minimising this problem. As is well

known, the organised sector contributes to 10 percent of total employment and 90 percent is accounted for by the organised sector. Out of the contribution of the organised segment, PSUs account for a lion share of 78.08 (in 1995) and the private sector's share is 21.92 percent. This trend is also evident from the compound rates of employment during a period of 20 years, i.e., from 1961-80. The average annual compound rate of employment growth in the public sector was 4.3 percent, whereas it was two percent in the private sector. During the eighties, the growth rates were: public sector two percent and zero in the private sector. However, during the first half of nineties, the trend was reversed. Growth rate of the public sector during 1990-95 was just 0.89 percent, whereas in the private sector, it was 2.89 percent. But, both public as well as private sectors have made equal contribution to the employment generation during this period. (see also Table 17.4).

Public sector has vastly contributed to the growth of employment in the country.

Table 17.4

Growth Rate of Employment in Organised Sector during 1990-2001

(in %)

Year	*Public Sector*	*Private Sector*	*Total*
1990	1.71	1.83	1.78
1991	1.52	1.24	1.44
1992	0.80	2.21	1.21
1993	0.60	0.06	0.44
1994	0.62	1.01	0.73
1995	0.11	1.63	0.73
1996	-0.19	5.62	1.61
1997	0.67	2.04	1.09
1998	-0.09	1.74	0.46
1999	-0.02	-0.57	-0.19
2000	-0.68	0.97	-0.17
2001	-0.90	0.10	0.60

(**Source:** *Economic Survey*, 2002-03)

As seen from Table 17.4, the growth rate of employment in public sector slowed down considerably and became negative since 1996. But growth rate accelerated in private sector during 1990s. Table 17.5 gives details about actual number of jobs generated both in public sector as well as in private sector. Data in Table 17.5 tell the same story as told by Table 17.4.

Public enterprises have done remarkably well in acting as a model employer. In a country, where millions of employable people are without jobs, the role of government undertakings in providing jobs and ensuring decent level of living to those employed, is really commendable.

There are over two million employees in government undertakings and the average emoluments per annum amount to more than Rs.50,000 each. Besides paying higher salaries, public enterprises assure job security, good working conditions, attractive incentive schemes, participative management, high degree of safety and adequate training facilities.

Table 17.5 *Employment in Public Sector and Organised Private Sector*

(in millions)

	Public Sector	*Private Sector*
1990-91	19.06	7.68
1991-92	19.21	7.85
1992-93	19.33	7.85
1993-94	19.45	7.93
1994-95	19.47	8.06
1995-96	19.43	8.51
1996-97	19.56	8.69
1997-98	19.42	8.75
1998-99	19.41	8.70
1999-00	19.31	8.65
2000-01	19.14	8.65
2001-02	18.77	8.43

(**Source:** *RBI, Handbook of Statistics on the Indian Economy*, 2003-04, p.28)

Public sector undertakings are known as model employers.

The public sector undertakings are good pay masters as Table 17.6 indicates. Six of the top 10 spenders are owned by the Central Government. It is true that banks are not covered in this Chapter, but the fact that State Bank of India and Punjab National Bank are owned and managed by the Government of India cannot be denied.

Besides the in-plant facilities, public enterprises provide infrastructural facilities like housing, medical, educational and transport facilities to their employees. Conservative estimates show that SAIL has spent over Rs.1,500 crore on setting up huge infrastructural facilities at its plants from the time of its inception. During 1985-86 alone, SAIL spent Rs.120 crore on these facilities. The present thinking of the steel monolith is gradually to farm out these functions to other agencies without

Table 17.6 *Top 10 Paymasters*

Rank by Staff Cost	*Company*	*Staff Cost (Rs.Crore)*
1	State Bank of India	6,093
2	TCS	5,138
3	SAIL	4,758
4	Infosys Technologies	2,366
5	Punjab National Bank	1,654
6	BHEL	1,640
7	MTNL	1,619
8	IOC	1,589
9	TISCO	1,350
10	Satyam Computer Services	1,338

(**Source:** *ET500*, Dec.2004, p.21)