CHAPTER SIX

CONCLUSIONS AND POLICY IMPLICATIONS

6.1 *The Treatise in Retrospect.*

The overwhelming importance of an efficient financial system for the development of any economy formed the basis of our entry into the study. Deliberations on the characteristics of financial system highlighted the fact that by definition, efficient use of resources for economic development are ensured by a potent financial system. In this context, while tracing the impact of Indian financial system on its economy, three basic trends were identified, (i) increasing reliance of corporations on funds of financial institutions and internal savings (ii) low dependence on stock market funds and lastly (iii) rise in equity holding of private corporate sector firms by government controlled financial institutions.

In fact gradual rise in institutional investment along with their growing importance in the corporate power structure, inspired us to review the question of role of financial institutions in the private corporate sector. Our objective was to develop a set of guidelines for institutions that would enable them to inculcate element of efficiency in private corporate sector.

The task, as was felt, was arduous, specially in the context of piebald characteristics of the philosophy of mixed economy followed in India. It was prudently comprehended, that, any dictum, if not based on robust objective criteria would unnecessarily drag us into an ideological debate. Thus, the criteria of efficiency was treated as a basic foundation of our study to examine

on an objective basis, the role of institutions in the private corporate sector, both as an investor and development agency. Specifically, the study was posed to delve into the fact whether corporate efficiency in any way was related with insitutional equity holding?Alternatively, the study was an attempt to measure efficiency consequeces of rise in institutional holding in the private corporate sector. Based on the findings of the empirical analysis an attempt was made to solve the basic policy issue of the present study. Thus discussions on the relevance of the present study was the subject matter of first chapter.

For the purpose of empirical analysis, a total number of hundred firms were sampled from a cross-section of industries. These firms had varying degrees of institutional equity ownership. To facilitate comparative analysis, total sample firms were divided into two groups following the provisions of Securities Exchange (Regulation) Act. These two groups of firms were identified as "Institution owned" firms and "others". After a careful scrutiny of various theories of the firm nine financial ratios were selected to discriminate betwen these two groups of firms. Time period of the study was 1981 to 1985 with a subperiod of 1981-83. Second chapter mainly dealt with these methodological issues.

Various non-parametric and parametric univariate tests were used to find out the differences in performance between *financial institution owned and others owned firms.* These tests, in general, revealed that F.I.O. firms were outperformed by O.O. firms in many cases. Specially, statistically significant differences were found in case of variables like profitability, growth, leverage and valuation ratio. Thus, the third chapter, where we

initiated empirical analysis, provided us the first impression that the firms with higher institutional holding were performing relatively inefficiently.

The following chapter, in a multivariate context, disclosed through correlation and regression analysis, that negative relationship existed between institutional holding and performance variables in general, with the exception of debt equity ratio which had significant positive relationships. This corroborated the findings of the third chapter that rise in institutional holding led to corporate inefficiency and risk.

Finally, the last stage of statistical inquiry based on 'Multiple Discriminant Analysis' also revealed the fact that the two groups of firms could be distinguished on the basis of all the variables or combination of related variables. This finding also was in consonance with the findings of the earlier chapter.

Findings of the study have serious and far reaching implications. Funds of financial institutions are in all practical sense public money. When such money is misutilised, institutions cannot afford to be a mere spectator to the whole show. Empirical analysis shows the negative results of involvement of institutional fund on the efficiency of the firm. Underlying reasons of inefficiency are discussed in the next section.

6.2 *Unbridled Management : Roots and Results*

Development of modern corporations obviously helped to meet some of the pressing economic needs of the time, but unfortunately also brought with it the vice of managerial exploitation of owners. Growing dissatisfaction with the

functioning of the boards, both in developed and developing countries speaks eloquently about it. In India, contribution of unbridled management in the inefficient use of national resources is an issue in vogue[1]. Factors contributing to the development of the present situation are briefly discussed below:

(i) Capital market in India can not act as a 'guardian of efficiency' and proper 'allocator of scarce resources'. Under the circumstances of heavy dependence of corporations on 'internal financing' and reliance on 'funds from financial institutions', corporate managers have avenues open for avoidance of "stock market discipline".[2]

(ii) Individual shareowners are disorganised and widely dispersed and have very little, if any, influence on the corporate management. Though technically shareholders are expected to scrutinise the annual report of the directors and approve them by formal motion, in practice diffused shareholders often do not have the capability to match wits with those in power and adoption of the company's accounts by the shareholders at the annual general meeting is merely a formality and often a farce.

(iii) Corporations are managed, in most cases, by families or groups holding insignificant portion of equity shares. Financial institutions, infact, the real owner of the business prefer to remain as passive spectators to many corporate activities. In other words the phenomenon of divorce of corporate ownership from control is not uncommon. Such features of corporate control by families

lead to abuse of managerial position to create family empires with high speed and results in intense managerial exploitation of owners.

(iv) Audit, a tool to protect the interests of shareholders, has become a mere formality. Auditors considers the mangement and not the shareholders as their employers. "The blatant use of financial principles sanctified by professional opinion helps in formulation of accounts in a manner to suit the purpose of managers and keep the real owners in dark". (Thanjavur, 1987).

(v) Though the Companies Act has been amended several times to suitably streamline managerial and other activities, yet it has been, to a large extent, deficient in doing so. Rather, it is felt, that "management in collusion with the Government has resorted to violating the provisions of the Act most blatantly." (Thanjavur, 1987). Serious dubitation is often cast as to whether the harnesses on the processes of issue of prosepectus, financial disclosure, intercorporate investment, managerial remuneration etc. are at all adequate.

(vi) Absence of an assiduous corporate control market and fierce takeover battles like capitalist countries, often permits inefficient Indian managers to walk away even with the most inept feats. Inefficient management is rarely intimidated with possible takeover threats form their counterparts.

Thus, Indian management being quite free from "capital market constraints", "individual shareholders influence", "regulation of Companies Act", "threat of takeovers" and

functioning with tacit support of financial institutions and auditors, have opportunities to show indifferent attitude towards public money. This unbridled management produces results that can by no means be treated as satisfactory. Some of these results are :-

(a) Industrial sickness in India has virtually taken the shape of a rampant plauge. Today more than 16% of the listed companies have been declared as sick. As a result large volumes of funds have been blocked and virtually wasted. World Bank experts after going through the accounts of institutions reported that no less than 35% of the total portfolio of financial institutions are found to have been 'contaminated'.[3] Considering the aggregate assets of the financial institutions, estimated at Rs. 90,000 crores, the bad advances of the financial institutions would by any reckoning be a large amount. Mismanagement and diversion of funds are the main reasons contributing nearly 52 per cent of the total causes of sickness in large units.[4] Industry, banks, government and professional managers periodically participate in ritualistic exercises on revival of sick industry and prevention of sickness. The fact that companies get sick, but not their managers or directors have been brought to light on many occasions, but the Companies Act and legal codes governing the fiduciary responsibilities of directors have never been tested to bring to book corporate management guilty of misfeasance.

(b) Many companies do not pay dividends to the shareholders; the proportion of non-dividend paying companies is nearly 40% now. Even companies after declaring dividends fail to meet their

commitments for long periods of time.[5] This is in gross violation of the statutory obligations of the company directors, where they are required to distribute dividends within 42 days of its declaration. Thus company boards very often fail to discharge their duties towards suppliers of risk capital.

(c) Corporate anomalies have reached such an extent that debenture-holders are also deprived of their interest in may cases. This amounts not only violations of the Companies Act, but also discouraging the suppliers of debt capital.

(d) Companies tend to emphasise much on growth of assets rather than on increasing production. Indian corporate sector has one of the highest capital output ratios among developing countries. It has been hypothesised that "high incremental capital output ratios get liquidated by low productivity of investment". (Desai, 1981). This in many cases is reflected in the Indian corporate sector where scarce resources are wasted by inefficient functioning of managers. Thanjavur observed "even the chairman of a leading financial institution has lamented the tendency of big business to augment assets but not production. What is important is that there are greater personal returns in promotion and not in production".(Thanjavur, 1987)

(e) Lastly, it is to be alleged that corporate managers in the private sector may have lost sight of the eithics of a socialistic economy and a welfare state. Rather than observing the principles of "of the people, by the people and for the people", they have

cultivated practices to meet their own fanciful ends. The theory and practice of management has failed to resolutely address itself to the dilemma between the law of capital accumulation and imperatives of constitutional legitimacy. This has signalled the erosion of the constitutional estate of the democratic and sovereign republic of Indial.

Just a few points have been raised here only to bring to light the ineffectiveness of corporate managements in general. To substantiate the phenomenon several other examples may be cited. However inefficiency of the board system are not the unique feature of India alone. In industrially developed countries like U.S.A. and U.K. the functioning of the board is under severe criticism at present. It is often been felt that declining thrust and productivity in these two countries is to some extent traceable to mismanaged boards.[6]

In modern corporations, ineffieiency of board to an extent stems from separation of ownership from management, Corporations of both developed and developing countries suffer from this evil. However, there are some unique features of India as mentioned earlier that contributed much for the emergence of unbridled management responsible for inefficient use of resources. This situation is by no means comparable with the scenario of developed countries.

A possible remedy to these problems could be active participation in the corporate management by the financial institutions. This aspect was also highlighted in chapter one of this study where it was pointed out that financial institutions by virtue of their large shareholding could discipline existing

management and act as 'guardians of efficiency'. Such action on the part of the institutions can be supported on two basic grounds.

(i) For all practical purposes, institutions with their large equity holding can be treated as the real owner[7] of the corporate sector. In other words, government has become the real owner of the private sector corporations and the theoretical distinction between public and private sector has virtually disappeared. As the real owner, it has in principle the right to interfere into corporate matters to discipline erring management. The issue that we like to emphasise, institutions , who enjoy the privilage of selection and dismissal of managers.cannot be deprived from their right as owners.

(ii) Results of the empirical findings further reinforces the claim that owner of corporate sector must behave like an owner. When there is clear evidence, that greater the involvement of public money more is the inefficiency of the firm. Institution as custodians of public money cannot remain as spectators.

Mr. N.A. Palkivala, eminent jurist echoed our views when he stated "Public financial institutions had the same right as ordinary shareholders public financial institution must exercise its voting power in public interest and also inturest of shareholderes". Lately steps have been taken to ensure direct institutional participation in corporate management. During the last 15 years the nominee director system has been in operation in India. But the issue remains open, how far nominee director system was effective to actieve both corporate and national goal ?

6.3 *Nominee Directors - Expectations and Achivements*

(a) Definition

Before entering directly into critical evaluaion of role of the nominee directors a few introductory words regarding these type of directorships will be in order.

The Companies Act has not defined a nominee director. Specifically, a nominee director is one whose appointment on and removal from the board of directors of a company is the prerogative of the controlling authority - whether it is an individual body corporate or any person.

The Institutional nominee directors in India came into being with the establishment of the Industrial Finance Corporation of India in 1948, which under it's statute retains the right to appoint any number of directors on the boards of it's assisted concerns. Similar rights have also been given to some other institutions under their statues. However during the early years the institutions did not exercise their rights with great emphasis. It was only since 1971, that financial institutions started appointing nominee directors on a regular basis in pursuant to guidelines issued by the government.

(b) Appointment & Withdrawal

Financial institutions impose at the time of sanctioning a term loan or underwriting an issue, that it will have the right to nominate one or more nominees on the board of directors of the assisted units so long as the term loan or interest there on remains outstanding. The lending institution also has the right to remove any of it's nominees and appoint another in his place.

However the basic policy with regard to appointment of nominee directors is as under.

(i) Financial institutions shall appoint nominee diretor(s) on the Boards of all MRTP Companies.

(ii) In respect of non-MRTP companies, financial institutions shall appoint nominee directors on a selective basis, especially in cases where one or more of the following conditions are in vouge.

(a) The unit is facing some serious problem and is tending to become sick.

(b) The institutional shareholding is more than 26%

(c) The institutional stake by way of loans or other investments is Rs. 5 crores.

(iii) The exact number of nominee directors required to be appointed on the board of an assisted cocern would be decided by the institutions after mutual consultation with the concern.

While appointing the nominee directors the financial institution emphasise that the board shall be broad based to represent adequately the interest of various groups.[8]

Regarding the withdrawal procedure, nominees are normally with drawn after a period of 3 years. However a nominee director is generally not subject to retirement by rotation, though in certain cases the institutions may have it's nominee elected as a rotational director by mutual agreement with the assisted company.

From a critical perspective the appointment mode of the nominee by the institutions virtually appear to be quite rational and democratic. Just because they hold large chunks of share they do

not like to show 'big brotherly' attitude and impose on appointing of a large number of directors. The attitude of broad-basing the board possibly reflects to a large extent the democratic approach of institutions in corporate management. Again, appointment of nominees in cases where companies are sick or where their shareholding is more than 26% demonstrates the rationality of the institutions. The first shows the caretaken approach and the second moves in line with the Securities Exchange (Regulation) Act. Further to ensure that expert and qualified people are appointed on the board, there exists provisions of disclosure of particulars of the nominees.

The Government expects that the nominee directors thus appointed should discharge the following duties on behalf of their appointing authority.

(1) Ensuring payment of institutional dues and observance of the loan terms.

(2) Ensuring payment of government dues, including excise and custom dues and other statutory dues.

(3) Ensuring that there is no siphoning of funds and abuse of power by the promoters.

(4) Improving productive efficiency and maintaining dynamism.

(5) Controlling expenditure being incurred by the company or management group.

(6) Looking after financial performance of the company.

Thus, it is expected that the nominee directors would safeguard the interest of government, ensure efficiency of assisted companies and control financial misdeeds of the management group.

In this section, we have simply stated the procedure of appointment and responsibilities of nominee directors. In fact, it is more important to concentrate on the basic policy of public financial institutions towards corporate management which will ultimately decide the nature of relationship between owner and management of the firm.

(C) Changing Outlook of Institutions

Depending on their experiences, public financial institutions on several occassions changed their outlook towards corporate sector. Initially, they lured a policy that by any standard could be deseribed as sufficiently liberal if not fully indifferent. Their tremendous importance in the corporate power structure was neither used to determine characteristics of boards nor to control management of the corporations. They avoided showing "big brotherly" attitude and seldom insisted on inclusion of large number of institutional representatives on the board. On the contrary, institutions were in favour of "broad basing the board"[8] and inspired inclusion of "expert and qualified" persons in the board. Institutions persuaded nominees to act as "friend, philosopher and guide" of the management of assisted companies. Nominees were expected to follow the policy of non-interference in the corporate management and help for the development of a "management team" capable to look after the interest of all concernd. "Skills and specialised knowledge" of institutional representiatives were considered as the dominant reason for their inclusion in the boards.

Thus, very often necessity of inclusion of nominee

directors on the board was justified in the following way- "necessity and desirability of independent outsiders in the board stems primarily from the fact that in todays complex business environment where each organisation is a part of the total system and has to respond to the total environment ; sharing of knowledge and skills with outsiders who do not have vested interest, would be of immense benefit for achieving the corporate busines principles [Bhattacharya 1989].

By definition, thus nominee directors are simply outsiders, not the representatives of real owner of the business. They are merely responsible for imparting their "skills and knowledge" assential for the achievement of corporate objectives. In a true sense, when real owners relinquish their right to "control business either directly or indirectly, it results in separation of ownership from management. Unlike industrially developed countries, passive attitude of the dominant shareholder of the Indian corporate sector was conducive for the divorce of ownership from management. Obviously, it allowed management largely to function free from government control and helped to preserve separate indentity of private corporate sector. In this process, undoubtedly it keeped to preserve the very essence of mixed economy.

However, Indian management was not responsive enough to the liberal attitude of financial institutions. All the vices of separation of ownership from management such as "extravagance, lavish expenditure, diversion of funds" (Gupta 1988), abuse of power resulting in inefficiency of the firm were prevalent in Indian industries.

There was a strong feeling that the whole purpose of setting up public financial institutions were going to be defeated by the present role of the government in the corporate sector. Such instiututions were established with the hope that hence forth "all big business would be borrower from government and government would able to discipline them" (Thanjavur, 1987). This would also provide the government an unique chance to integrate the activities of corporate sector to achieve broader socio-economic goals of the country. Thanks to the non interfering attitude of the institutions, all these hopes were belied and institutions were forced to persue a stiffer attitude towards corporate sector. Very distinctly emphasis was shifted from "advisory" to "watch dog" and "control" functions.

Guidelines issued by the Industrial Development Bank of India emphasized the role of nominee directors as "gurdians of public policy". For a clear understanding of th present attitude of financial institutions we quote a part of the above guidelines. "The nominee directors on the boards of assisted companies are not only to safeguard the interests of the institutions but also to serve the interests of sound public policy. Since the interests of the financial institutions, shareholders and of the company basically converge, interest of institutions will be well served only when the project is implemented within the estimeted cost and time schedule and is run on sound commercial principles and within the policy framework of the government" (IDBI guidelines 1986). This definition specifically asserts that as trustees of public money, nominee directors should look after the commercial viability of the projects. This is essentially a 'watch dog' function and

suits perfectly with the theoretical concept of institution as "gurdian of efficiency". Since the characteristics of financial institutions are conceptualised as 'developmental agencies', it is natural to expect much more from the nominee directors.

Incidentally the government had also emphasized the boards "watch dog" and 'control' functions in view of growing industrial sickness even among large corporations "due to managements ineptitude and larceny with boards as helpless spectators".[Gupta 1988] The emphasis on such functions can more vividly be understood if government guidelines are carefully observed. "The nominee directors should ensure that the tendencies of the company towards extravagance, lavish expenditure and diversion of funds are curbed. With a view to achieve this objective, the institutions should seek constitution of a small audit committee of the board of directors for the purpose of periodical assessment of expenditure incurred by the assisted company, in all the cases where the paid up capital of the company is Rs. 5 crores or more. The institutional nominee directors will invariably be a member of these audit sub-committees" [As quoted in article of Gupta ,1988]. It seems government has a clear understanding of the problems arising out of separation of ownership from management in Indian industries and therfore appears to curb managerial exploitation of owners. In other words, to Government has conceived the idea of introducing sentinels on the board to act as vigilant "watch dogs".

In view of the findings of the present study, it is difficult to refute the relevance of "watch dog" functions of the nominee even if it contradicts the basic philosophy of mixed

economy. In addition, representation of Federation of Indian Chamber of Commerce and Industries to Narasimham Committee,[9] emphasizing the need for maintaining sanctity of private corporate sector in the mixed economy looses its significance inview of our empirical findings. Thus the scope of disputing the recommendation of Narasimham committee that favoured alert attitude of institution toward corporate sector is minimum.

There is many a slip betwen the cup and the lip. In the present context, one cannot afford to forget that the development of a policy and implementation of the same in practice does not necessarily mean the same thing. So there is scope of study to what extent this changed policy has been implemented in practice. Our experience shows very often we formulated high sounding guidelines that were never executed in reality.

(D) Expectations and Achievements:- Need to Bridge the gap.

The study of L.C. Gupta confirms our belief about the possibility of existence of a gap between expectations and achievements. The study observes that most of the nominee directors prefer the role of "friend, philosopher and guide" instead of "watch dog" and "control" functions.[10] The attitude of nominee directors can be simply explained in the way that, it is both naive and safe to play the role of advisor "instead of" guardian", so it is better to follow the soothing way. A "gaurdian" in all essence and principle, is expected to play the dual roles of "advisor" and "watch dog". However this attitude of nominee directors would have often made things unpalatable for corporate managers and they would never converge with the idea of boards

emphasizing on control function, simultaneously with "advisory" functions. Execution of advisory functions only can not under any circumstances be said to be violations of guidelines, however it may be ascribed as a case of circumvention of the main role i.e. "watch dog" function.

It seems proper to mention here that, on the basis of a few stray examples, there are some feeble attempts to show that the nominee directors, merely as an advisor to the board, played significant role in the development of a new pattern of management in Indian industries.To quote an author , "There is no denying the fact that the association of institutions in the management of corporate bodies has considerably facilitaled the process of progressive professionalisation of corporate managements. Institutions have been able to convince the corporate management to appropriately re-orient their organisational structure, personnel policies and planning and control systems. The shareholders of National Rayon Corporation, Kamani Engineering, Sylvania Laxman, EID Parry- to mention a few, recall with gratitude the constructive role played by the financial institutions in safegaurding their investments. While some of these companies had been incurring heavy losses due to inefficient, weak or divided managements, some others had been reportedly bled white by unscrupulous elements. In some other controversial cases like Baroda Rayon or Dharamsi Morarjee, the financial institutions had maintained a more or less neutral role". [Mukhi, 1990].

The proponents of this view select some special cases to prove that nominee directors simply as an advisor also can

convince the management to appropriately reorient organisational structure, personnel policies, planning and control system of the organisation in a way that may produce encouraging results. We refute this argument mainly for two reasons. First, proponents of this argument, very unfortunately, manage to forget a large number of cases where the "advisors" were not even consulted while taking some major policy decisions.

Certain specific examples may be cited to show how controlling group even after issue of different guidelines simply ignored institutional representatives while taking major policy decisions. Escorts where institutional equity holding is roughly 53%, issued shares and debentures of Rs. 15 crore without consulting even the institution before hand. Premier Automobile raised car prices without consulting company's board of which K.B. Punja, Chairman, I.D.B.I. was the nominee director. Most interesting example is Shaw Wallace where there were at all no institutional representatives in the board till 1985 despite 32 per cent collective equity holding of L.I.C. and U.T.I. As a matter of fact, the controlling interest of public financial institutions is generally used merely to takeover of 'sick' units or marginal units saddled with large losses.

Our feeling is there might be a few cases where institutions had been able to discipline management but probably in most of the cases nominees decorated their seats as silent observers. Secondly, findings to the empirical study sufficiently corraborate our above observations. We have found that the performance of F.I.O. firms are lagging behind the others. If the nominees had really been vigilant the resuts would have been

better.

What motivates nominees to act as an "advisor" instead of "watch dog" ? What steps should be taken to turn "passive" nominees into "active" and "vigilant" ones. Thanjavur was partially succeessful to answer first question. The author felt that management aught to be disciplined but nominee failed to do that as the "cultural heritage of professional managers in these institutions" being idential with corporate manager, little could be achieved from them. Vested interests, lack of proper acumen to go deep in to problems, inadequate provisions of Companies Act, questionable audit standards, lack of clear understanding about their roles are also some other reasons leading towards indifferent attitude of nominees in the assisted companies. Instead of stretching further the first question, in the next section, we propose to explain what is to be done to make nominees more vigilant and active. Obviously guidelines have been developed in the background of "watch dog" functions of nominees that are only capable to discipline existing management and ensure implementation of public policy in the present situation.

6.4 *Suggestive Measures.*

At the outset, we prefer to mention some relevant points pertaining to the discussions of the present section .

We suggest two sets of actions:- corrective and punitive. While corrective action denotes remedial measures, punitive action implies removal of existing management. The question of punitive action comes, only when , corrective action fails. Without active participation of real owners in the

management of the corporation, none of these actions can be taken.

All the sugesstions do not necessarily directly implicate institutions. A more or less comprehensive set of sugesstions involving institutions, auditors, Companies Act etc., have been designed. These are expected to facilitate corrective action against management. However, broadly speaking these sugesstions relate to Nominee Directors and amendments of the provisions of the Companies Act. The former is actually dependent on the latter because the the legislations are expected to serve as the broad framework within which the directors are to function.

Finally, the scope of implementing many a sugesstions will depend upon the relevance of institutions in the corporate power structure. With an average equity holding of 26% , it can reasonably be expected that a large number of companies will come under the ambit of institutional corrective and punitive measures.With these few words, we mention below some corrrective steps.

Corrective Actions:-

(A) <u>On Nominees and Boards</u>:

The primary weakness of corporate boards in India stems from their dummy characters. This characteristic is a result of Board appointment being mainly monitored by the controlling group of the company. Boards thus constituted, act as watchdogs of the interests of the controlling group instead of looking after the interest of shareholders at large. Institutions, being the real owner of many enterprises, should urgently take steps to transform boards from "rubber stamp" bodies to very vigilant bodies.

Anomalies of separation of ownership from control and the vices of managerial exploitation of owners can only be avoided if institutions play the lead role in formulating the policies regarding composition of boards, selection of personnel etc.

All the decisions of the institutions towards corporate boards should be guided by the philosophy ,that first step for ensuring corporate efficiency is that an excellent board should be formed. The primary attribute of an excellent board is that it should have on it all the proficiency, competence, adaptability and ingenuity relevant to its work in the context of the companies business. A board's performance is maximised "if it is heterogeneous. For, it has been observed that groups comprising people of markedly different styles and backgrounds produce better solutions and ideas than a homogeneous group." (Mills 1985). Institutions responsible for developing a vigilant board with all the above attributes are urgently required to initiate some actions. The steps relate not only to the selection of their own representatives, but also the other members. Keeping these in mind the institutions should take the following steps:-

* They should select nominees in a manner so as to represent people from different fields of specialisation.

* In addition to the academic and professional qualifications and service experience, the personal attributes of the nominee, such as their aptitude for work, honesty, integrity and personality should be judged in the context of their potential contribution to the board process. It should be ensured that the nominees have the qualities to make their presence felt on the board , rather than

act as" yes men" to the controlling group.

* Institutions must ensure that automatic inclusion of the younger members of the controlling groups and families are stopped. Their inclusion, if necessary, must be subject to a strict review of their attributes and competence.

* Institutions must ensure that the directors appointed under the principle of broad basing the board, should pledge allegiance to the general investors instead of the controlling group of the company.

* Before inducting a nominee director on the board the nominating financial institution should brief him about the state of affairs of the company, i.e., supply him with all information about the activities of the company, name of the directors, latest balance sheet, pattern of shareholding by different parties etc.

* Institutions should establish an information and feed-back system so that the nominees are regularly briefed about the important terms and conditions of financial assistance, changes in them and whether the company is complying with them.

* Institutions must then ensure that the directors after getting adequately trained and oriented attend board meetings regularly. In strict legal sense, there is no binding upon the directors to attend every board meeting; but Institutions should drive home the fact to the nominees, that, according to Section 283(1)(g) of the Companies Act, the office of a director shall be vacated if a director absents himself without leave of absence from three consecutive board meetings or all meetings of the board held within three months- whichever is longer. The nominees should be asked to pay,strict attention to this clause , and be careful so

that the directors of the controlling group cannot use this "legal guillotene" on their necks.

* The nominee directors must ensure that all relevant issues influencing corporate performance and policies are discussed on the board meetings. They should be aware of the fact that "board meetings can become excellent grounds for playing hide and seek games under such conditions where the functional directors representing the entrepreneurs are a determined lot not to give a correct/ clear position to the board about the company's performance, problems, strengths and weaknesses." [Ramakrishnan 1980]. Thus, nominees must be on gaurd to remove these practices.

* Institutions should ask the assisted companies to despatch to them and the nominees, copies of all agenda papers at least 10 days in advance of the board meetings. They should oppose the practice of the company presenting supplementary items on important matters on the day of the meeting.

* Number of directorships that a person can hold at a time must be limited , so that the he can devote sufficient time and effort for each company's meeting. Directors "should be prepared to commit the time needed for the board's work, i.e., doing the homework required for board meetings, attending meetings regularly, being available to serve on board committees, and doing such other work as may be assigned to them by the Chairman of the board." (Gupta 1986).

(B) <u>On Priorities of Functions:</u>

Nominee directors can function more efficiently if the priority of their functions are well defined. Government guidelines

have listed down a long series of duties, with out specifying which ones should be attended with greater care. Thus it is suggested that:-

* Functions like monitoring of timely payment of institutional loans, government dues and taxes by corporations etc,.should in no case be the prime function of the nominees. These should left to the appropriate bodies like , "Recovery Cells of Institutions" ,"Central Board of Direct Taxes" etc.

* Top priority should be given to the 'watch dog' functions of the nominees. Since many proprietory types of malpractices such as extravagant management perqusites, lavish bungalows, foreign cars, vast amount of entertainment allowances, etc., fall outside the ambit of audit, the nominees as 'keepers of corporate conscience' should check these avenues of 'managerial exploitation of owners'.

* In the context of growing industrial sickness, in order of priority, the next duty of the nominees should be to closely monitor the progress of the assisted units. They should flash back in time, the first signals of corporate sickness so that appropriate steps can be taken before it is too late.

(C) <u>On Corporate Accounting And Audit Systems</u>:

Presently in many cases, the system of accounting and audit, instead of catering to the shareholders, have become an effective tool of the management to suit their own desires. These systems should be modified, so that the extra pecuniary goals of the managers at the cost of the loss of the real owners are minimised. In fact accounting has become an art either to camouflage the misdeeds of management or to project a particular

type of image best suited for management.

Because of the vast domain of accounting and audit it would not be possible to elaborately suggest remedies in all specific clauses; however, some sugesstions are made as examples.

* If the net worth of the company is inflated by revaluation of assets, the additional depreciation on the inflated value of the assets should be debited to the profit and loss account. Otherwise, the shareholders will be presented with a distorted picture of the state of affairs.

* Minimum disclosure requirements should be modified for import of capital goods, purchase of components from foreign principals or family organisations etc, At present these type of transactions do not come under the perview of the minimum disclosure requirements of the Companies Act and provides an excellent opportunity to further the economic goal of managers in exclusion of the owners.

* The practice of treating depreciation as a residuary entry, i.e., writing back, writing down, conversion from one rate to another should be strictly restricted. These are only practiced to satisfy managerial needs.

* Audit standards and practices should be suitably modified so that the professional auditors legally and ethically bother about the security of funds of the investing public.

* Steps should be taken so that the nominee directors enjoy the right of free access to a company,s records, accounts and personnel to discharge their responsibilities. Institutions on behalf of general shareholders may also think in terms of sueing the auditors guilty of misconduct for damages which is a common place practice in developed countries.

* Auditors should be asked to ensure that true and fair view of the company should actually be presented to the shareholders. Auditors should be debarred from presenting lengthy reports with a lot of technical jargon in it; this action should be taken only when auditors attempt to satisfy their conscience or escape possible proceedings for professional misconduct. Reports for the shareholders should be easily comprehensible and streamlined.

* Nominee Directors should be instrumental in ensuring that the boaed gives attention to the auditor,s objections , comments and suggestions.

* If Nominee Directors have any doubt regarding the standard of audit conducted by the statutory auditor, they must have the right of formation of the board's audit committee and in which the nominee director will be represented.

* To restore confidence to the shareholders, institutions on behalf of the investors may arrange for some form of supervisory audit by a committee shareholders who are not members of the board.

(D) <u>On Shareholders Participation in Annual General Meetings</u>:

One of the basic characteristics of modern corporations " with stock widely scattered among individuals, investment trusts or institutional investors, who faithfully vote for incumbenty managements and resolutely refuse to participate in its concern" results in "stockholders obeying the management and not the management the stockholders." (Rostow 1959). To check this situation it is necessary that;

* Shareholders should be vigilant and participate in corporate

proceedings. They should not leave the task of vigilance only to the nominees, but should co-operate with them in doing so.

* Well informed shareholders who have the habit of selling the stocks of "not so profitable" companies, should shun the habit of doing so and should engage himself in the debates for remedying managerial shortcomings. Responsibilities for creating such outlooks do not fall within the ambit of the Companies Act or functions of the nominees. Rather it is the task of the Government and the public media to create such awareness.

* To promote interest of the general investors in the corporate activities, Shareholders' Associations should be formed and legally recognised. Management should be directed by law to submit reports to such associations at regular intervals. The Articles of Association of companies can be used to compell the shareholders to participate in corporate proccedings and in the AGMs. It is suggested, " For failure of complying with the obligations of a member, the membership rights and status may be lost if so provided in the articles." (Sen 1971).

* Shareholders associations should be permitted to effectively participate in the AGMs in a representative capacity with a right to speak and vote on behalf of all its members.

* Institutional representatives, who happen to be the best equipped personnel, can act as consultants to the Shareholders' Association and also can also lead the association in its infancy.

(E) <u>On Intercorporate Investments:</u>

When inter corporate investment, are made out of proper surpluses with a view to diversify, keeping in mind the

interest of shareholders, no eyebrows can be raised. However, when these investment are made with other fanciful purposes, institutions should keep a vigil on the following aspects:-

* when institutions are convinced that the purpose of intercorporate investment is to expand family empires, with disregard to the ethics of 'socialistic pattern of society', they should stop the practice by vehement opposition in the board

* Careful assessment of financial viability of proposals of siphoning of funds should be undertaken, so that the investing organisation does not turn sick. It is known that one of the major reasons for corporate sickness is uncontrolled siphoning of funds. Nominee directors should be given ample opportunity to have free access to company's records, accounts, documents etc., so as to help them to take judicious decisions in this respect.

* If the nominee directors have any doubt regarding desirability or otherwise of the investment, in these cases also, they may insist on forming an audit sub-committee from which the chief executive will be excluded. Audit committee should conduct the audit absolutely free from any influence of the company's chief executive.

* Provisions of section 372 of the Companies Act should be enforced and properly administered so that the interests of the shareholders are protected.

* Amendment of Companies Act is necesary to permit shareholders, not the board of directors, to decide upon their representatives in the company where the investment is made. So long board is not properly constituted as mentioned earlier, it will provide some leverage to the financial institutions so far

selection of company representative are concerned. It would obviously discourage existing management from making uneconomic intercorporate investment.

(F) On functioning of the Company Law Board :

The Company Law Board can be instrumental to gaurd against the management and auditor who fail to discharge their duties properly.

The Company Law Board ;

* should be given the right to order investigation into any affair of the corporation.

* should implore auditors to go deep into transactions that 'have a foul smell' and disclose managerial expenses supported by dubious vouchers.

* should direct the removal of auditors who fail to discharge their duties, and debarr them from practice notwithstanding anything contained in the Chartered Accountants Act.

* should keep a liason with the tax authorities, so that the shareholders are informed about legal disallowance of any expenditure incurred by the company.

(G) **Punitive Actions:-**

Let us take a pause at this juncture to have a fresh look at the industrial economic scenario of our country which is flooded with fierce take-over battles at present.[11] In an otherwise, cosy and sedentary business environment, takeover appears as a storm causing a sense of insecurity among Indian

management. Take-over with all its drawbacks is essentially an effective device, widely used in the capitalist countries to improve efficiency of the firm.[12] Constant increase in efficiency is the only means available to existing management to retain control over company amidst take over battles. In this sense, take-over may be considered as a punitive action against existing management who fails to utilise resources efficiently entrusted to them.

A take-over bid in India has different implications than any where else because of the large equity holding of financial institutions. Depending on their attitude towards existing management, they can frustrate of induce take-over attempts. Who will be in driver's seat of any corporation, now largely depends upon the attitude of institution.

Role of institutions defined earlier may be described as "corrective" steps of institutions to streamline the activities of inefficient management. Change of management through direct or indirect support in take-over may be considered as a "punitive" tool available to the institution for replacement of existing management who failed to respond properly against the corrective measure of institutions. We hope this will provide a constant threat on existing management and ensure better utilisation of public money. Narasimham Committee also endorsed identical views,- "An essential aspect of compitition in a modern industrial economy is managerial competition, which implies, among other things, take overs and mergers. The operation of the over-all mechanism governing take-overs and mergers and the discharge by the financial institutions of their functions in this regard, should

be guided primarily by objectives of efficiency". [Narasimham Committee Report]

Before concluding our study, we seek to provide clarification on some essential points to avoid confusion . They are as follows:-

(1) The guidelines have been developed to suit the basic economic philosophy of a mixed economy. It requires a proper blending of managerial autonomy of promoters and watch dog functions of nominees, which seems to be a difficult task.

(2) Some times it becomes difficult to make any finer distinction between "high handed' attitude and "watch dog" functions. While "watch dog" function is welcome, "high handed" attitude is to be avoided. Detailed guidelines will minimize the scope of using discretionary power, thereby high handed attitude of management.

(3) No claim is made that the aforesaid guidelines are exhaustive. In fact, no such fool proof guidelines are possible to prepare. Depending on the situation nominees have to use their skill and intelligence to discharge their duties.

(4) Revision of companies Act, attitude of auditors and shareholders are necessary conditions for successful functioning of nominee directors. Thus, an all out change in the outlook of all concerned are essential to promote efficiency of the corporations.

(5) Lastly, favourable response of the Government is absolutely essential for implementation of the true spirit of the guidelines.

We end with a high hope that these corrective measures

along with the threat of punitive action will help to restore efficiency in the private corporate sector. In future, companies on the basis of their proven efficiency will be in a position to raise required funds from the stock markets. Thus institutions will be largely relieved from financing corporate sector and the Government no more will have to act as a dumping ground of sick units.

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NOTES (CHAPTER SIX)

1) Professor Baxi, Vice-Chancellor, Delhi University, while commenting on Indian management practices said, "the theory and practices of management would assess the soverign pre-rogative of managers and owners to gain exploitative access to unorganised labour, effortlessly and without liability cause industrial hazards, intensity pollution on environment, participate in organised corruption, exploit the vulnerable consumers, cause industrial sickness, obtain immunity for professional crimes (e.g. the amensty provision for FERA violations); subvert the legal profession into it's being the 'hired prize fighler for unfair and unethical business practices, purchase state officials, inflict occupational diseases and fatalities and subvert in all possible ways state regulatory efforts and measures. Clearly the Constitution and legal order of India enjoin that development of management sciences forbid political power in the managerial classes and the owners of the means of production to knowingly or intentionally harm individuals groups or communities. A managerial culture which allows this privelege and power is not merely unconstitutional but anti-constitutional. [Baxi 1991]

2) This aspect was discussed vividly in the first chapter.

3) This word 'contaminated' was actually used by the observers of the developed countries. Independent studies by the Ministry of Finance as well as the World Bank team comfirm that nearly 35% of the funds advanced by financial institutions are locked up in sick units and are the contaminted. (source- The Economic Times, 17th March 1991, Pg. 1)

4) Studies show that mismanagement including diversion of funds, lack of marketing strategy was the main reason for corporate

sickness (in 52% cases). Next, in order of importance was market recession which accounted for 23%. Labour troubles, power cuts, shartages and famely planning contributed the rest 25%. (Source : The Economic Times. 11th September 1988)

5) This is a very common allegation against company directors. Though hundreds of cases can be cited, yet for want for space two cases are cited here for the purpose of demonstration only.

(i) Karan Kumar Taneja (B2C/72A, Janak Puri, N.Delhi) who held shares of Nirman Mechanical Erectors (Ref. folio S-0581 and K-0256) did not receive any dividend or receive the balance sheet of the company, even after dividends were declared in the AGM.

(ii) Sudha Jain & K.K. Jain (G-80 Ashok Vihar, Phase 1 Delhi) held 115 share of Nippon Dendro (Ref. folio 80-2742). The company declared interim dividend at the rate of 15% for which the record date was 16.01.90. Even after three months the shareholder had not received any dividend.

6) This aspect did not escape the attention of Harold Geneen, former chief executive of the International Telephone and Telegraph company of U.S.A. In his words "under present conditions shareholders,whether individuals or institutions have virtually no way of knowing whether or not to manage their company over the years they have grown so soft and ineffectual that most often they are captive of management rather than effective representatives of the company owners." He also argued"... the prime function of a board of directors is to form continous judgements on whether or not the chief executive and his management team are running things properly".Present board system failed miserably in this respect Geneen further opined that the present system of functioning of board, lack of strict regulations to control the management wide

gap between authority and accountability are the main reasons contributing towards ineffective functioning of the board and they decline in productivity of American industry.

[Quoted in the article by L.C. Gupta, 1988]

7) This aspect was vividly discussed in the first chapter. If one moves in line with strict legal interpretations, institutions holding move than 25% of equity shares of a corporation can be said to be the actual owner of the said corporation . Since the average equity holding by Government controlled institutions is 26%, a large number of private sector corporations can effectively said to be owned by the Government.

8) To make the board broad based the institutions, in the case of medium sized projects (4 to 5 crores) determine the composition of the board in the following manner.

Represantatives of :-

(i) Promoters (in case of SIDC joint ventures)-3, (ii) Entrepreneurs-2 (iii) Central financial institutions-3. (iv) Public-3/ Total - 11.

In very large organisations this practice is also followed, but naturally the number of directors are move. For example in the case of Larsen & Tourbo Ltd's, board, financial institutions holding 37% of the stake of the company, had six nominee directors including the chairman. (The chairman was Mr. D.N.Gosh, former chairman of State Bank of India). Another controlling group the Ambanis, holding 25% of the stake had 3 director of the board. This was the position on May 1990.

9) FICCI in their memorandum submitted to the Narasimhanm Committee practically urged the Government to follow two distinct policies regarding takeovers. It stated, "as a general rule the institutions

should support the existing management unless the latter are found to be grossly deficient. This would bring about a compromise between the independence of management and the rights of the institutions as shareholders." [Memorandum to Narasimham Committee, FICCI, New Delhi.]

10) In Dr. L.C. Gupta's survey (conducted in 1982), 191 nominne directors, both official and non official were covered. These directors were requested to rank five specific ways of looking at the board's role, viz:

(a) Providing expert professional advice to the chief executive on specific matters,

(b) Acting as watchdog against managerial abuse,

(c) Acting as friend- philosopher- guide to the chief.

(d) generating pressure to drive the executive management to greater efforts and,

(e) ensuring social responsibility.

The findings of the study were that (a) and (c) were ranked highest by as many as 62.8% of the nominee directors; watch dog and control functions i.e., (b) and (d) were given rank 1 by only 28.9% of the respondent directors.

[Source: L.C. Gupta 1988]

11) Some examples of takeover cases are:- D.C.M., Escorts, Shaw Wallace, Dunlop, Standard Battery, Tiru Tea, Jokai Tea etc.

12) The fact that takeover mechanism can be partly effective to discipline management controllled firms was also stated by Peter Holl in the article " Control Type and Market for Corporate Control in Large U.S. Corporations." [The Journal of Industrial Economics, Vol, XXV, June 1977.]

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