CHAPTER - IV

HISTORICAL BACKGROUND OF CORPORATE MANAGEMENT AND MERGERS IN INDIA
India's unique contribution to the field of Industrial Organisation has been mainly due to the wide prevalence of the Managing agency system. This institution of managing agency firms, was born out of peculiar historical, geographical and economic circumstances prevailing in the later part of the last century and has resulted into managerial and administrative integration of the firms belonging either to one or different industries. Even though the functional and legal entity of the firms remains untouched, the advantages of integration and combination are gained on account of this peculiar system of management. It was a time when institutional subscribers were not functioning and banking system had not much developed. The banks were then not prepared to give financial assistance to new ventures. No new company could be floated without the backing of an Industrial House.

The process of growing control of the managing agents in and across the industries has been well described in the pioneer study, by Dr. N M Mehta, who points out that "The most striking feature of the Institution of Managing Agency is that it represents features of both horizontal and vertical forms of expansion and combination. The success achieved and the experience gained in floating pioneer concerns prompted the managing agents to promote new concerns and expand their business activity in newer channels.

In an industrially undeveloped country like India, they found unlimited scope for expansion of their business activity. The
fabulous profits which they made out of the lucrative foreign trade were all employed in the expansion or floating of new concerns. From one line of business they turned to another not merely because the produce of one could be easily utilised by the other as raw materials or semi manufactured goods. The institution of managing agency has thus offered a type of organisation which could secure for all the individual units under its jurisdiction, the economics of vertical and horizontal forms of expansion without depriving them of their legal and functional independence. The ultimate result of this typical process of growth has been that "a handful of managing agents dominate almost every sector of country's economic life, each controlling a wide range of industrial enterprises from tiny ginning and processing factories to gigantic iron and steel works, hydro electricity projects and mammoth ship building yards with crores of rupees sunk in them and employing thousands of industrial workers". This process has been said to have resulted in an increasing degree of industrial concentration. Managing Agency went through a number of stages in course of its long historical evolution. Originally, a family concern or partnership, in its latest phase it generally took the form of a limited company, private or public. In the early phase, the managing agencies used to draw a commission on the production or sales of the managed companies till it was replaced under the amending act of 1936 by a commission on the net profits, supplemented by a fixed allowance for office expenses.
In its essence, the managing agencies were holding companies having varying proportions of investments in the managed companies, but fortified by legal agreements in the first instance valid for 20 years and renewable afterward, they were responsible for the promotion and management of later. The similarity of this system to and its affinity with the form of trusts in the advanced capitalist countries are admitted by even the accredited spokesmen of Indian big business. For instance, the Federation of Indian chambers of Commerce and Industry said in a letter to the Government of India.

"In this connection, the committee would like to point out that the system of managing agency is not so peculiar and unique to India as it is thought to be. No doubt it does not obtain in other countries in the form in which it exists in India. Yet there is an underlying identity in all the systems and what obtains in other countries are only variants to suit the conditions of each country. It is usual in the United Kingdom and USA, for example, for huge countries of Industrial enterprises to set up a central organisation equipped with financial, technological, organisational and administrative personnel and to lend to their numerous companies, the services of the personnel, thereby relieving each of the companies much of unnecessary expenditure. In other respects also, the essentials of management do not differ very materially in India and other countries which do not have the managing agency system."
In its heyday, i.e. on the eve of the comprehensive amendment to the Indian Companies Act in 1956 which imposed a number of restrictions on the system, the managing agency had come to occupy a predominant position in the industrial and economic way of the country.

It may be noted that managerial integration, vertical and horizontal integration were achieved by the managing agency system.

From the study of the cotton textiles, Jute, Sugar, Cement and other selected industries showed the preponderance of managerial integration in our economy. There were very few instances of actual integration of companies as revealed by the following table:

**Actual integration of companies in Indian Industries:**

1. Ahmedabad Mfg & Calico Printing Company  
   Acquiring of Jubilee Mills in 1940

2. Bangalore Woolen - Cotton and Silk Mills Co Ltd.,  
   Purchase of property and plant of Kasier-Hind Woolen, Cotton Silk Mills Limited in 1939.

3. Elgin Mills Co Ltd  
   Purchase of CCM Branch of British India Corporation in 1960.

4. Madura Mills Co Ltd.,  
   Absorbed Coral Mills Co Ltd., in 1924  
   Tinnevelly Mills in 1927 & Pandyan Mills in 1929

5. Sri Venkatesha Mills Ltd  
   Purchase of Sri Padma Silk Mills Ltd in 1954-55
6. Standard Mills Co Ltd

7. Western Indian Cottons Ltd
 Purchase of Aaroon Spinning and Weaving Mills Limited

8. Surat Cotton Spinning and Weaving Mills Limited
 Absorption of Mahalsabai Cotton Mills Limited

9. New Central Jute Mills
 Absorbed Albion Jute Mills and Lothian Jute Mills in 1954

10. Raza Buland Sugar Co Ltd
 Amalgamation of Buland Sugar Co Ltd., and Raza Sugar Co Ltd., in 1955.

11. Associated Cement Co Ltd
 1. Indian Cement Co Ltd
 2. Katni Cement & Ind Co Ltd
 3. Bundi Portland Cement Ltd
 4. Okha Cement Co Ltd
 5. Gwalior Cement Co Ltd
 6. Punjab Port Land Cement Co Ltd.
 7. United Cement Co of India Limited
 8. Shahabad Cement Co Ltd
 9. Coimbatore Cement Co Ltd
 10. Dewarkhand Cement Co Ltd
 11. U P Cement Co Ltd.

12. Indian Iron & Steel Co Ltd
 Absorbed Steel Corporation of Bengal in 1953.

SOURCE: INVESTOR'S ENCYCLOPEDIA 1960 (KOTHAR & SONS)

The formation of Associated Cement Companies Limited and absorption of Steel Corporation of Bengal by Indian Iron and Steel Company Limited are the two major examples of actual integration in the Industrial history of India. The number of consolidations has been thus very small in our country. Amalgamations and mergers therefore, cannot be said to be a
characteristic feature of our corporate sector. Our
industries in fact, are characterized by a high degree of
managerial integration. The preference for this type of
combination through the agency of managing agents as against
their actual integration has been studied in detail by Prof.
S K Basu and he comes to the conclusion that only vertical
integration of this sort can be economically justified. As he
puts it, "In short it is the personal interests of the
managing agents themselves, rather than the interests of the
company which act as the dominating force towards horizontal
integration. While vertical integration through managerial
integration rather through the vertical expansion of the same
legal unit can often be supported on economic grounds, the
economics of horizontal integration, however, substantial,
did not offer any economic justification for the managing
agent's preference for horizontal integration rather than
horizontal expansion of the same firm".

Vertical integration by starting separate units under one
managing agency house was justifiable on account of
differences in the techniques and scales of production.
Similar reasons can not be advanced for starting of separate
units in the same line of manufacture under a single managing
agency house. The main motives for this type of horizontal
expansion seemed to be spreading of risks over a wider field
and retaining higher level of earnings through management of a
large number of companies. Moreover, the well known argument
that horizontal integration has been mainly due to cut throat
competition among the combining units is not on the whole true of our industries. Barring the cases of horizontal integration like the Associated Cement Companies Limited and others, horizontal integration i.e. control of similar units through one management was achieved from their very inception.

MERGER EFFORT IN COTTON TEXTILE INDUSTRY

During the depression decade (1929-39) attempts at integrating some of the cotton mills in Bombay were made but they bore no fruit. The aim of this horizontal integration was to form a big organisation with a "view to securing a grouping of mills for specialisation in particular kinds of (both joint buying and marketing, writing down of capital and cooperative efforts in all directions". Even the valuation of assets of the amalgamating companies and modes of payment (Block to be paid in ordinary shares and stocks in cash) were agreed upon. In 1910, a meeting of Mill Agents representing thirty-one mills agreed to appoint a Manchester Expert for working out the details of the consolidation. Even though the expert completed his task, the scheme did not materialise mainly on account of unwillingness on the part of managing agents to surrender their managing agency rights which involved a loss of their remuneration when the managing agents of the companies found that the new company was to be run by a board of six competent directors without any managing agents. They withdrew their support. This might have resulted in the best form of cooperation, but it has been
frustrated mainly by the unwillingness of some of the managing agents to join the proposed merger scheme.

IRON AND STEEL INDUSTRY

As mentioned earlier, the formation of Associated Cement Companies Limited and absorption of Steel Corporation of Bengal by Indian Iron & Steel Company Limited are the two major examples of actual integration.

In the case of Indian Iron and Steel Company Limited, integration was achieved through agreements with Steel Corporation of Bengal in the initial stages, but ultimately this operational integration gave rise to the consolidation of both the units. The steel making furnace of Steel Corporation of Bengal which was floated in 1937 was set up adjacent to the blast furnaces of Indian Iron and Steel Company and an inter-company agreement between these two units was entered into for securing economics of backward integration for Steel Corporation of Bengal and forward integration for Indian Iron and Steel Company. It was easier to enter into such an agreement because of common administration and management of these two units by the managing agency firm of Marlin Burn Limited. Under this agreement, Indian Iron and Steel Company agreed to supply Steel Corporation of Bengal, the hot metal and all auxiliary raw materials and essential services such as Gas, Water, Steam and Electricity for the manufacture of Steel. Indian Iron and Steel Company was thus benefited by certainty of its offtake of hot metal while steel corporation of Bengal was
ensured of continuity of supply of basic raw materials, adequate in quality and sufficient in quantity.

With the passing of time, however, the weaknesses of operational integration was realized. As pointed out by Tariff Board Report of 1951 on the fair retention price of steel produced by TISCO and Steel Corporation of Bengal, it was possible under the terms of the inter company agreement under certain conditions to make greater profits from iron sold to foundries than the profits to be made from iron supplies to Steel Corporation of Bengal. The effect on Steel Corporation of Bengal's operation and earnings of any such failure on the part of Indian Iron and Steel Company to furnish iron in proper quantity or of proper quality might not have been so severe if there were in existence alternative services of raw materials supply either in the form of scrap or pig iron in the country. Unfortunately there were no such alternatives in India. The financial results of Steel Corporation of Bengal's operations were, therefore, greatly influenced by "policies, performances and self interests of Indian Iron and Steel Company". Moreover, Steel Corporation of Bengal's position in this respect was rendered even more precarious by the fact that the penalty clauses in the agreement for failure on the part of Indian Iron and Steel company to deliver iron of the proper quality or sufficient in quantity were extremely weak. Hence, the need for actual integration of these two units was felt for their efficient operation. Moreover, the higher level of cost of
production of Steel Corporation of Bengal as against those of Tata Iron and Steel Company for identical items as well as the recommendations of technical items as well as the recommendations of Technical Mission of International Bank for Reconstruction and Development, which visited India in 1950 to consider the demand for foreign exchange for this industry made this integration inevitable that the cheapest and quickest way to increase the production of Iron and Steel was to merge Indian Iron and Steel Company and Steel Corporation of Bengal.

The merger was, however, held up on account of low level of earnings of Steel Corporation of Bengal as shown below:

<table>
<thead>
<tr>
<th>PROFITABILITY</th>
<th>1940</th>
<th>1945</th>
<th>1950</th>
</tr>
</thead>
<tbody>
<tr>
<td>RATIO</td>
<td>TISCO SCWB</td>
<td>TISCO SCWB</td>
<td>TISCO SCWB</td>
</tr>
<tr>
<td>Net profits as percentage of net worth</td>
<td>12.9 4.6 11.3 7.2 4.8 3.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net profits as percentage of net sales</td>
<td>11.1 10.9 10.4 7.9 3.4 2.2</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

NOTE:
1. TISCO : INDIAN IRON AND STEEL COMPANY
2. SCOB : STEEL CORPORATION OF BENGAL

The merger of the two units was, therefore, effected by the Iron and Steel Companies Amalgamation Ordinance 1952, which was repeated later by the Iron and Steel Companies Amalgamation Act 1952. On 1st January 1953, under the provisions of this Act, the Steel Corporation of Bengal Limited was dissolved and their undertaking was transferred.
to and vested in the Indian Iron and Steel Company Limited.

The following figures show the level of profitability of Indian Iron and Steel Company Limited after the absorption of Steel Corporation of Bengal.

<table>
<thead>
<tr>
<th>PROFITABILITY RATIO</th>
<th>1953</th>
<th>1957</th>
<th>1961</th>
<th>1962</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit as % of net sales</td>
<td>9.0</td>
<td>10.3</td>
<td>8.1</td>
<td>8.4</td>
</tr>
<tr>
<td>Net profit as % of net worth</td>
<td>13.4</td>
<td>11.9</td>
<td>12.3</td>
<td>11.6</td>
</tr>
<tr>
<td>Dividends as % of paid-up capital</td>
<td>7.7</td>
<td>7.5</td>
<td>14.0</td>
<td>14.3</td>
</tr>
<tr>
<td>Dividends as % of net worth</td>
<td>4.9</td>
<td>3.9</td>
<td>5.1</td>
<td>4.7</td>
</tr>
</tbody>
</table>

INTEGRATION IN SUGAR INDUSTRY:

Sugar cane is the main raw material for the sugar industry. The availability of adequate quantity of sugar cane of good quality in time is the main determinant of the profitability of the sugar company. A sugar company always needs fresh sugar cane which has a higher sugar content and it also requires cane continuously in order to achieve economics of large scale production. The advantages of integrating sugar farm with sugar factory are thus immense. It is found from the Investor's Encyclopaedia published by M/s Kothari & Sons that the sugar cane fields of sugar factories are spread onward the factories within a manageable distance. They are able to organise transport of cane on more economical basis.
It has also become possible for them to lay out a net work of trolley lines and to provide suitable wagons and locomotives for transporting cane not only economically but also with the least possible loss of sugar content. In the Uttar Pradesh region, factories are assigned certain zones from which they purchase their requirements of sugar cane. Such arrangements thus serve to a marked extent the purpose of actual backward vertical integration.

OBSERVATIONS:

The analysis of integration in the above industries brings out three significant points. First, there were very few examples of actual integration and consolidation and Indian Industries never experienced any "merger movement" as that in United States of America. This was due to the low level of industrialisation and the existence of unique institution of managing agency system which made possible for integration economics without sacrificing legal entity of the company. Secondly, the Iron and Steel industry in our country is highly integrated. This substantiates the hypothesis that vertical integration is a characteristic feature of this industry. Thirdly, the above industries are capital intensive Viz. Cement, Iron and Steel and Textiles. It is generally believed that backward integration is essential in this type of industries in order to reap economies of large scale products. The analysis of Cement and Iron and Steel industries confirms the same.
EMPIRICAL STUDIES IN INDIA:

Dr. M.M. Mehta in his study on "Combination Movement in Indian Industry", aims at presenting the result of an exploratory enquiry into the concentration of ownership, control and management in Indian industries. In his study, he indicates the degree of concentration in the area of managerial and financial integration, multiple and interventory directorship.

Dr. R.K. Nigam in his study on "Managing Agencies in India, (First Round): Basic Facts" gives an overall and industrywise concentration data for the 17 top managing agency houses having 10 or more companies under their management during the year 1954-55 as measured in terms of paid-up capital. Besides this, the overall concentration of control according to managerial integration is also indicated for 51 more managing agency houses having 5 to 9 companies under their management.

Dr. Sharma's study on "Some Trends of capitalist concentration in India" is mainly concerned with a study of four important industrial group, viz. Tatas, Dalmias, Ambalal, Sarabhai and Kasturbhai Lalubhai. His study has indicated unique characteristics during their course of development, such as concentration of capital, interlocking directorships and price leadership etc.
The degree of managerial integration in Indian industries is mentioned in the studies conducted by:
1. S K Basu on "The Managing Agency System"

Only in the study on "The Managing Agency System", measures the concentration of control for the first three largest managing firms in the cotton textiles, jute, tea and sugar industries on the basis of paid-up capital, net fixed assets and total assets for the year 1956. Integrated statements were prepared for 213 companies in cotton textiles, 62 companies in jute industry, 155 companies in tea industry and 71 companies in sugar industry for finding out the level of concentration for the first three managing agents in these four industries. The composition of the first three is however not revealed. Paid up capital of these companies included for integration purposes as a percentage of paid up capital of all public limited companies worked out as follows:
- Cotton Textiles: 73 per cent
- Jute: 95 per cent
- Tea: 62 per cent
- Sugar: 88 per cent

CONTROL OVER FINANCIAL INSTITUTIONS PRIOR TO BANK NATIONALISATION:

The banking system was controlled by large industrial houses. The bank deposits collected from the general public were almost used exclusively by large industrial houses. The small scale industrial units and agricultural sector were completely ignored by them. It was an accepted fact that commercial banks had played a significant role in the
concentration of industrial empires. Even after the bank nationalisation, the situation has not changed much.

CONTROL THROUGH DIVERSIFICATION AND TECHNOLOGICAL INTEGRATION:

Proliferation of industrial units in different industrial categories is commonly referred to as diversification. On the other hand, combining the various stages of production under common ownership and control is referred to as technological integration. Most of the big industrial houses make use of both of these techniques for increasing their monopoly power.

Tatas for instance, deal in steel as the main product. But along with this Tatas have entered in the production of Iron ore, Coal, other minerals, machine tools, chemical and steel structure to provide for their principal products. Tata's have also started the production of coal mining machinery, drilling equipments and chemical machines.

Similarly, the Birlas specialise in the production of textiles. With the idea of securing vertical integration, they have also undertaken the production of most of the accessories and components received for the principal products of the group. This explains why the Birlas are manufacturing chemicals like Sulphuric Acid, Calcium Carbide, Cotton Textile machineries, Ring frames, Rayon yarn, cotton textile, sugar and sugar machineries.
The Monopolies Inquiry Commission has revealed on the basis of market shares of different business groups, the Birlas control 66% of the production of cars, 75% of textile machinery, 27% of electrical fans and 16% of air conditioners. Similarly Tatas have their net wide spread in steel ingots, special tools, industrial machinery, oil and soaps etc. Not only that, through the process of interpretation of business groups and by collaboration with individual companies or other business groups, the growth of monopoly capital is promoted still further.

GOVERNMENT POLICY:

The greatest responsibility for growing concentration of wealth should lie with the government. As the Dutt Committee pointed out, the government never specified clearly to the Licensing Authority, the objective of preventing concentration of economic power or monopoly. So much so, a few industrial houses were able to take multiple licenses for the same product. Further the government attempted to promote the growth of private industry through extensive tax incentives and the big industrial houses were able to take advantage of them.

PUBLIC SECTOR FINANCIAL INSTITUTIONS:

An another important factor for growing concentration of wealth and economic power is the nature of working of public sector financial institutions. The Dutt Committee on Industrial Licensing pointed out that about 56% of the total assistance provided by special Financial Institutions like
the IFC, IDBI and State Financial corporations have gone to the big industrial houses. The Birlas obtained 25% of the total assistance granted to 20 large houses. 70% of LIC loans and 62% of State Bank of India term loans went to large industrial houses. There were certain industrial concerns which had obtained 60% to 75% of their financial requirements from the public sector financial institutions.