CHAPTER V

THE ROLE OF SHARE CAPITAL
It has already been observed that the respective acts setting up Public Statutory Corporations in India indicated the sources from where the initial capital was to be obtained by each of them. But, the Central government companies like their counterpart in the private sector, are entitled to obtain their capital from the same sources viz., (1) from the subscription of their equity shares by the government or private parties i.e., individuals or institutions, national or foreign; (II) from borrowings and (III) from internal financing.

In the initial years the corporate undertakings in general prefer equity or ownership capital for financing their activities for avoiding easy liquidation. In consequence, the major component in their capital structures, becomes the share capital that represents the financial capital that they raise by the issue of shares. But the Central government companies, particularly those which were established after the commencement of the Companies Act, 1956, do not seem to prefer majority of ownership capital for avoiding easy liquidation. It has to be considered that at least 51% of the voting shares are owned by the Government in their case which is enough for ignoring a possible liquidation. Accordingly there exists a material difference of the circumstances under which the Central government companies in the Public Sector may go up for majority of
ownership capital in the initial years of their formation.
To be more candid and precise the reasons for Central
government companies' preference for ownership capital is
to be found elsewhere. It was casually mentioned in the last
chapter that this higher proportion of ownership capital at
the initial stage was due, among others, to the fact that
the Central government companies had to make a substantial
investment in capital assets. But before the problem is
dealt with in greater details it is necessary that some
more characteristic features of the financing of Central
government companies are considered.

Central Government Companies and the Stock Market:
In the cases of companies in the 'Private Sector',
their ability to have recourse to the capital market for
raising their required finance by the issue of shares depend
upon their status, i.e., whether they have been incorporated
as Private or Public Limited companies. But though no excep­
tion to this basic principle, has been made for the Central
government companies in the Companies Act itself, nevertheless,
there has been hardly, in the decade between 1960-61 and
1969-70, any instance of the floatation of the Central
government companies by offering its share for sale to the
public in the capital market to the extent of their permissible
limit, viz., 49% even in the cases where the Central govern­
ment companies have been registered as Public Limited companies.
In other words, it means that shares of the Central govern­
ment companies are not dealt in the Stock Exchange barring
certain exceptions as indicated earlier in the discussion. In the circumstances, let it be noted that the impact of financial management on the capital structure of Central government companies cannot be gauged with reference to the market reaction on the prices of the shares of these companies even for the companies which have been registered as Public Limited companies.

It appears that, the conditions prevailing in the capital market, particularly the organised capital market of the Stock Exchange had no influence in giving the capital structure of the Central Government companies a given shape. It is, however, to be mentioned that, as already noted, the proportion of share capital in the capital structure of Central government companies did not remain at the same superior height throughout the period of review. It started to decline. Let the same be studied at greater details now.

The Share Capital and Its Change

Analysis of the break-up of the capital structure of the Central Government companies over the period of the present study, in terms of the respective percentage contribution of the different segments of capital, viz., share capital, borrowed capital and retention showed that the share capital accounted for 63.7% of the total capital in the Central Government companies in the year 1960-61. The same came down to 61% of the total in the year 1961-62. Thus over a period of one year the share of share capital
fell by 4.2% in the total capital mix of the Central government companies. Since 1961-62 this declining trend of the share capital continued unabated throughout the period between 1961-62 and 1969-70 with exception to the years 1963-64, 1964-65 when the share of the share capital among the total capital mix increased by 3.2%, 2.2% respectively. Thus, over a period of 10 years as indicated in Table 11 of previous chapter IV, the share of share capital in the capital structure of Central government companies fell by 37.8% i.e. from 63.7% in 1960-61 to 39.6% at the end of 1969-70.

Another significant point to note in this connection is that the aforesaid decline in the proportion of share capital in the capital structure of Central government companies did not, however, occur at a uniform rate. The rate was rather uneven. The year of largest decrease being 1962-63 when the share of share capital fell by 13.8% and the year of smallest decrease being 1961-62 when the share of share capital registered a decline by 4.2% in the total capital mix of the Central government companies.

The position of the share capital did not only decline in the total capital mix of the Central government companies. It also suffered a fall, as was evident from Table 13 of the previous Chapter IV, in the capital structure of Central government companies when the same is also analysed in terms of the relative contributions of share capital and borrowed capital to the external sources as a whole. In the year 1960-61 the proportion of share capital among external
sources had been 70.4%. The same came down to 44.1% at the end of 1969-70. This meant that over a period of 10 years the proportion of share capital among external sources suffered a shrinkage to the extent of 37.4% though not as already indicated at a uniform rate. The largest decrease occurred in the year 1962-63 when the share of share capital among external sources fell by 21.7% and the smallest decrease occurred in the year 1968-69 when the share of share capital among external sources fell by 3.3%. Further, the aforesaid decline in the relative position of share capital among external sources was not however, uninterrupted one. In fact, there had been reversal trends in the same in the years 1963-64, 1964-65 and again in the year 1969-70 as could be perceived from Table 13 of the previous chapter IV. In these years the share of share capital among external sources increased by 2.4%, 2.2% and 1.6% respectively.

The gradual decline of the share capital among the external sources since 1961-62 coupled with the obliteration of the positive share of retention and its conversion into a negative component of capital mix since 1962-63 brought in its trail another significant change in the composition of the capital structure of the Central Government companies when the same is analysed with a reference to the relative contributions of ownership (i.e. share-capital plus retention) and creditorship capital. In the year 1960-61 ownership capital contributed 73.5% of the total capital mix in the Central Government companies but the same slumped into 39.6% at the end of 1969-70. Thus, over a span of 10 years
Ownership capital recorded a decline by 46.1% in favour of creditorship capital. Ownership capital had been maintaining its edge over creditorship capital though at a declining rate till 1965-66. But from the year 1966-67 it relegated itself to the second place leaving the creditorship capital in the higher command of the capital structure of Central government companies.

The foregoing analysis, however, emphasises the fact that it was a share capital which dominated the capital structure of the Central government companies though with a declining trend in the major chunk of the decade between 1960-61 and 1969-70.

Justification

This relatively high percentage of share capital in the capital structure of the Central government companies was not the outcome of the government desire for majority ownership by share capital, as already stated, to avoid the chances of possible liquidation of the companies in case of their failures. This phenomenon in the Central government companies may be ascribed to a number of factors. First of all, as hinted earlier, financing through ownership capital in the form of equity does not create any fixed charge against the company and thereby imparts a flexibility in favour of the social needs in the operation of the
companies. Secondly, as the Table 14 below indicates, the

Table 14


<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Companies</th>
<th>Gross Block</th>
<th>Percentage of Gross Block in the Total Assets</th>
<th>Year-wise change</th>
<th>Total change</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960-61</td>
<td>26</td>
<td>46.8</td>
<td></td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1961-62</td>
<td>28</td>
<td>47.1</td>
<td>+0.6</td>
<td>0.6</td>
<td>0.6</td>
</tr>
<tr>
<td>1962-63</td>
<td>31</td>
<td>77.0</td>
<td>+63.5</td>
<td>64.5</td>
<td>64.5</td>
</tr>
<tr>
<td>1963-64</td>
<td>32</td>
<td>69.1</td>
<td>-10.3</td>
<td>47.5</td>
<td>47.5</td>
</tr>
<tr>
<td>1964-65</td>
<td>33</td>
<td>69.7</td>
<td>+0.9</td>
<td>48.9</td>
<td>48.9</td>
</tr>
<tr>
<td>1965-66</td>
<td>39</td>
<td>73.1</td>
<td>+4.8</td>
<td>57.5</td>
<td>57.5</td>
</tr>
<tr>
<td>1966-67</td>
<td>44</td>
<td>68.5</td>
<td>-6.3</td>
<td>46.4</td>
<td>46.4</td>
</tr>
<tr>
<td>1967-68</td>
<td>49</td>
<td>66.8</td>
<td>-2.5</td>
<td>42.7</td>
<td>42.7</td>
</tr>
<tr>
<td>1968-69</td>
<td>55</td>
<td>67.3</td>
<td>+0.7</td>
<td>43.2</td>
<td>43.2</td>
</tr>
<tr>
<td>1969-70</td>
<td>68</td>
<td>67.3</td>
<td>N.C.</td>
<td>43.8</td>
<td>43.8</td>
</tr>
</tbody>
</table>


N.C. = No change.

Central government companies had a higher proportion of gross block in their asset structure because of the very nature of the industries they undertook to operate in the period between 1960-61 and 1969-70. Analysis of the proportion of gross block in the total asset structure of the Central government companies as depicted in the aforesaid Table 14 shows that the percentage of gross block in the total asset structure of Central government
companies had been 46.8% in the year 1960-61. Since 1960-61, as the records in the Table 14 indicate, that the percentage of increase of gross block over that of the base year 1960-61 was on the whole of an ascending order as the same went up from 0.6% in the year 1961-62 to 43.8% at the end of 1969-70. The highest single year increase being recorded in the year 1962-63 which amounted to 63.5% of the gross block, of the year 1961-62. This high proportion of gross block in the Central government companies called for a technique of financing that would make possible increased investment in permanent capital goods without enhancing fixed charges against the operation of the companies. Thirdly, in a number of operating enterprises, capital-work-in-progress, including unallocated expenditure, constituted a good percentage of the total assets. For instance, capital-work-in-progress accounted for 14.3% of the total assets in case of Hindustan Steel Ltd., in the year 1965-66. In the same year capital work in progress and unallocated expenditure accounted for 13.3% of the total assets in case of Bharat Electronics Ltd., 7.7% in case of Heavy Electricals (I) Ltd., 15.3% in case of Hindusthan Aeronautics Ltd. Instances can be multiplied.

Quinquennial evaluation* of the composition of the total assets,


* In the calculation of the percentage, figures have been adjusted in respect of assets and capital work-in-progress and unallocated expenditure in the Public Corporations in India in the period under study.
in the running concerns other than Promotional and Developmental undertakings, Public Corporations and Financial Institutions, shows that capital work-in-progress and unallocated expenditure accounted for 22.3% of the total assets in the year 1965-66 and 11.6% of the total assets in the year 1969-70. It is quite natural that under the situation it would be preferable for financing the companies through share capital in the form of equity as it does not create any fixed charge in its use. Moreover the Central government companies, unlike those of the private sector, are not required to maintain the value of their shares by controlling dividend as those shares, as already mentioned, are not dealt with in a Stock Exchange. Even the shares held by the government can not be the subject of private transactions lest the dividend declared at a given a rate may act contrary to social welfare. Fourthly, in many companies township expenditure formed an integral part of the total project cost. This was in sharp contrast with the practices generally adopted in case of the private sector companies. For instance, township cost accounted for 16.9% of the total project cost in case of Mining and Allied Machinery Corporation Ltd., Durgapur, 13.9% in case Bharat Electronics Ltd., Bangalore,


18.4% in case of Indian Telephone Industries Ltd., Bangalore, 21.3% in case of National News Print and Paper Mills Ltd., Nepanagar, and for different units of Fertilizer Corporation of India, it was 11% in case of Sindri Unit, 12.3% in case of Nangal, 7.2% in case of Trombay, 5.9% in case of Gorakpur unit. More instances can be cited in support of this contention.

According to Prof. Laxmi Narain, township outlays on an average worked out to 15% of the cost of the project. This township cost, which was peculiar almost to Central government companies, was a factor that might have contributed to the relatively higher percentage of share capital in the capital structure of Central government companies over a big chunk of the decade between 1960-61 - 1969-70. Finally, it may be recalled that the period between 1960-61 and 1969-70 was the formative stage of Public Sector Undertakings in India. Unfortunately, this period unlike that of the nationalised industries in Great Britain, was too early for the economic and financial obligations of the public sector Undertakings in India being spelt out in clear terms. In consequence, a confusion prevailed as to the objectives and obligations of the Central government companies. A tendency was manifest among hierarchy of management of


5. Profitability and the Public Sector. Transcript of the discussion broadcasted by the Delhi Station of All India Radio on August 21, 1973 reported in Lokudyog, Vol.VII, No.6, September 1973 issue, p.29.
these companies to overemphasize their non-commercial obligations. The prevailing situation therefore warranted a capital structure in which capital free of fixed charges would have a larger proportion of the total capital mix. Share Capital Vis-a-Vis Changes in the Gross Block in Central Government Companies:

It has already been established that for various reasons the percentage of share capital in the capital structure of Central government companies had to be higher, over the period between 1960-61 and 1969-70. But, analysis of the data in Table 15 and 16 of the present chapter display an interesting and palpably high co-relation, between the movement of both share capital alone and also of share capital and borrowed capital on the one hand and movement of gross block in the Central government companies on the other. Table 15 shows that among the total sources of capital, the percentage of share capital was the highest in the year 1960-61, with 63.7% of the total capital to its credit. In the same year, the percentage of gross block in the total asset structure of the companies had been 46.8%. Since 1960-61, as the number of operating Central government companies began to rise, the percentage of gross block in the total assets structure of the companies registered an increase. But the percentage of share capital to total capital showed a trend towards gradual decline in the capital structure of the Central government companies. This is evident from Table 15. It indicates that in the year 1961-62 as against 0.6% increase in the gross block, share capital fell by 4.2%. Again, in the year 1962-63 as
against 63.5% increase in the percentage of gross block, the percentage of share capital registered a decline by 13.8%. In the year 1963-64 compared to 1962-63, the share capital recorded a slight rise by 3.2% as against a fall in the percentage of gross block by 10.3% in the same year. But, compared to the base year 1960-61, the aggregate fall in the proportion of the share capital of the Central government companies, in their capital structure by the end of 1963-64 had been 14.8% as against 47.7% increase in the percentage of the gross block in the asset structure. The slight edge of the percentage of share capital in the year 1963-64 and the fall in the percentage of gross block in the same year, compared to 1962-63, coming as it does, in the face of increase in the number of operating companies, as indicated in column 2 of Table 15 of the present study, implies that with the increase in the number of companies there was no doubt a rise both in the absolute amounts of the share capital and gross block, but the rate of increase in the share capital in the year concerned, exceeded that of the gross block. In respect of the changes what had been the most revealing occurred in the years 1966-67 and 1967-68 as can be seen in Table 15. In these years the decline in the relative share of share capital in the capital structure, was accompanied by a decline in the share of gross block in the total asset structure despite increase in the number of operating companies. Yearwise analysis of the behaviour of share capital in the capital structure of the Central government companies vis-a-vis the behaviour of gross block, as
depicted in Table 15, indicates that over a period of ten years between 1960-61 and 1969-70 as against decline in the percentage of share capital in the capital structure of Central government companies by 37.8% there had been an increase in the percentage of gross block in their asset structure by 43.3%.

This reduction in the percentage of share capital was not the outcome of any liquidation of companies or the reduction in the amount of their share capital at the enterprise level, of the operating Central government companies. Unit-wise study of the absolute amount of share capital in the Steel, Engineering and Shipbuilding, Chemicals and in Other Processing and Manufacturing Industries rather indicates a contrary position. For instance, Hindustan Steel Limited the biggest of the giant companies in the public sector, at the end of 1969-70, registered an increase of its share capital by 85.7% compared to its position in the year 1960-61. In case of Garden Reach Workshop the increase in the amount of share capital at the end of 1969-70 had been 328.5%. Similarly, Hindustan Machine Tools recorded an increase of its share capital by 106.5%, Heavy Engineering Corporation by 50.4%. Heavy Electricals Ltd., 117.4%, Praga Tools Ltd., by 78.8%, Indian Telephone Industries by 28.5%, Hindusthan Insecticides Ltd. by 29.9%, Hindusthan Photo Films by 87.0%, Fertilizer Corporation of India by 143.6% at the end of 1969-70. These are only few

examples. More instances can be cited. Therefore, unit level study of the behaviour of the share capital does not offer any explanation of the declining percentage of the share capital vis-a-vis the upward changes in the percentage of gross block in the Central government companies between 1960-61 and 1969-70.

To get the explanation one has obviously to turn his attention to the data in Table 16 of the present chapter depicting simultaneously the behaviour of share capital and borrowed capital in the context of changes in the percentage of gross block in the Central government companies between 1960-61 and 1969-70. It reveals that, among the external sources of capital, in the capital structure of Central government companies, initially it was the share capital which had the dominant role with relatively lesser proportion of the borrowed capital. This is evident from the fact that in the year 1960-61, among external sources, share capital accounted for 70.4% and borrowed capital only 29.6% as against the percentage of gross block in the total assets to the extent of 46.8%. Since 1960-61, increasingly greater number of companies were brought into operation, as Column 2 of the Table 16 indicates. In consequence, the percentage of gross block in the total assets of the Central government companies also tended to increase. But, strangely enough, the increase in the percentage of gross block in the Central government companies was not accompanied by corresponding increase in the
percentage of share capital as hinted earlier. It was rather accompanied by increase in the percentage of borrowed capital not only among the total capital of the companies as indicated in Table 11 of the previous chapter IV, but also among the total external sources in the capital structure of the Central government companies as would be found in Table 13 of the said Chapter IV and in Table 16 column 5 of the present chapter. This is established by the fact that, as against the percentage of borrowed capital to the extent of 29.6% in the total external sources in the year 1960-61, the percentage of borrowed capital in the same had been 55.9% at the end of 1969-70. This meant that, over a span of ten years between 1960-61 and 1969-70, the percentage of borrowed capital in the total external sources in the capital structure of Central government companies increased by 88.9% with necessary decrease in the percentage contribution of share capital.

This increase in the share of the borrowed capital came in the face of the most significant increase in the amount of share capital, as already indicated, at the individual company level. This only implies that increase in the amount of share capital in the operating companies, in the context of the increase in their gross block, was lesser than the increase in the total amount of borrowed capital in such companies. This was caused mainly by two factors. One of them, was that, in some of the Central government companies there was no borrowed capital in their
capital structure in the year 1960-61. For instance, Bharat Electronics Ltd., Hindusthan Teleprinters Ltd., Praga Tools Ltd., Hindusthan Photo Films Ltd., etc. But after the issue of Government circular in June 1961, requiring the Central government companies to finance their capital requirement by maintaining a debt-equity ratio of 1:1, these companies had to resort to borrowing for financing their capital requirement at such a high rate that they had a huge amount of borrowed capital in their capital structure at the end of 1969-70. Secondly, as a sequel to the aforesaid government Circular, compared to the position prevailing in 1960-61, the amount of borrowed capital increased many times in the capital structure of a number of Central government companies which had already been possessing borrowed capital in their capital structure though in a nominal proportion. Instances on the point are, Hindusthan Steel Ltd., Garden Reach Workshop Ltd., Hindusthan Machine Tools Ltd., Heavy Engineering Corporation Ltd., Fertilizer Corporation of India, National News Print and Paper Mills Ltd., and the like. Compared to 1960-61, in case of Hindusthan Steel Ltd., borrowed capital increased by 65.4%, Garden Reach Workshop Ltd., by 163%, Hindusthan Machine Tools Ltd., by 244.5%, Heavy Engineering Corporation Ltd., by 22373.1%, Fertilizer Corporation of India by 578.1%, National News Print and Paper Mills Ltd., by 556.3% at the end of 1969-70. Cumulative effect of these changes had been

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that, in the face of increasing percentage of gross block in the total asset structure of the Central government companies, the proportion of share capital in the total capital, as well as that in the total external sources of the same, gradually declined. It, therefore, appears that the additional fixed assets that were purchased and thereby increased the proportion of gross block, was mainly financed by borrowed capital instead of share capital. Moreover, it appears that a part of the borrowed capital was utilised for financing the working capital that was necessary as a support for the operation of the additional fixed assets. As a result of the utilisation of the borrowed capital in the latter way a tendency grew in which both the proportion of share capital among total capital or external capital and the proportion of gross block to total assets declined as against a relative increase of the borrowed capital. That is why in the year 1966-67 and 1967-68 the decline in the percentage of gross block was accompanied by a decline in the percentage of share capital.

The aforesaid changes in the proportion of share capital and borrowed capital vis-a-vis the changes in the gross block however, was not the outcome of any manoeuver on the part of internal management to secure optimality in the capital structure at which the cost of capital at the margin would be lowest and equal. It was also not possible as a sequel to any effort on the part of internal management to attain optimality in a given capital structure through adjustment in the operation of the company. In fact the internal
management of the Central government companies had no scope for the same since they were to operate with the aim of having a given ratio of debt-equity mix on the one hand and remain bound by the rigid regulations of their activities by the government on the other. That may, or may not be conducive to the general principles of financing public sector undertakings. This goes to justify enunciating the hypothesis that the nature and change in the capital structure of the Central government companies cannot be expected to be the same as may be warranted in the identical situation in the case of the companies of the private sector.

Appraisal of the Change

It was quite natural for the aforesaid change in the capital structure being not guided by any principle of corporate financing in the private sector. But, it was not due to the observation of the general principle of financing public sector undertakings also.

A reference to the industry-wise distribution of the Central government companies between 1960-61 and 1969-70, with regard to their respective share in the total paid up capital of these companies, as shown in Table 8 of Chapter II previously, indicates that four industries viz., Steel, Engineering and Shipbuilding, Mining and Minerals and Chemical accounted for 91.6% of the total paid up capital and 76.7% of the total investment of the Central government in the +

+ Excludes Shipbuilding from Engineering which was shown together in Table 8.
commercial and industrial undertakings in the public sector. The latter will be evident from Table 10 of the previous chapter III. These industries were in the nature of basic and key industries requiring heavy investment in gross block including expenditure for township in many cases but without having the distinctive advantage of public utilities in respect of rate of return. In other words, it means that, these industries had the basic characteristic of requiring heavy investment on the gross block, on the one hand and low profitability on the other. Consequently, accepted principles of financing public sector undertakings called for a technique of financing which would not impose any burden on their working and as such impair their flexibility of operation. The government, therefore, in its policy of financing the increasing percentage of gross block by fixed cost capital i.e. borrowings, in the Central government companies between 1960-61 and 1969-70, deviated from the accepted principles of financing public sector undertakings. The burden of fixed cost capital resulted in the accumulation of huge deficits in a large number of companies causing thereby not only the erosion of capital but also the problem of over capitalisation in them. For instance, accumulated deficit in the case of Hindustan Steel Ltd., at the end of 1969-70 represented 31% of the paid up capital and 19.9% of the capital employed. In case of Indian Drugs and Pharmaceuticals Ltd., the same

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had been 89.5% of the paid up share capital and 42.5% of the total capital employed. The devastating effect of gradual decline of the share capital in the capital structure of the Central government companies will be more pronounced if one looks into the impact of accumulated deficits on the paid up share capital and capital employed in 28 running companies both unit wise, as well as total, as shown in Table 17. It clearly depicts that accumulated deficits under the impact of increasingly greater proportion of fixed cost capital in the capital structure of these companies among other factors resulted in the erosion of 50% of their total paid up capital and 30% of the capital employed in them. There were number of companies at the end of 1969-70, as Table 17 indicates, in which accumulated deficits had eaten up the entire amount of share capital. In some cases accumulated deficits were even more than capital employed as defined by the Bureau of Public Enterprises.

It has already been stated how the principles of corporate financing cannot be expected to have any hand in shaping the changes in the capital structure of Central government companies. It may nevertheless, be interesting to note how the same might have actually been possible. According to the principles of corporation finance, a higher proportion of borrowed capital or which is something to say a lower proportion of share capital in the capital

+ Bureau of Public Enterprise defines capital employed as net stock plus working capital-excluding capital work-in-progress and unallocated capital expenditure. (Ref.- Letter to the scribe No.BPS(I+N)F31(3)/74, dated 30th August, 1974 from the Joint Director, B.P.E. (Vide Appendix 4).
structure is justified when the gain in terms of reduced
cost of capital because of borrowing is discernable; if
the company concerned is assured of regular return with an
upward trend; and if the management of the company wants to
avoid the dilution of control. In the case of Central Govern-
ment companies any manipulation in their capital structure
for fear of the dilution of control is ruled out, as already
stated, in view of the fact that a company in order to get
the status of a government company is to have 51% of its
equity in the hands of the government. The increasing
percentage of the borrowed capital in the capital structure
of Central government companies can also not be ascribed to
the desire of the government to reduce the cost of capital.
Higher proportion of borrowed capital in the capital struc-
ture of Central government companies can similarly not be
attributed to the desire on the part of the government for
trading on equity, since the concept runs counter to the
principle of Public sector undertakings. Besides, if
considered from the standpoint of collective performance
of the companies, in terms of profit earned, as detailed
out in column 9 of Table 16, it will be observed that
increasing percentage of gross block was financed by borrowed
capital in preference to share capital, even when the
companies were in the red, specially between 1966-67 and
1969-70. Unit-wise analysis also establishes the same trend
in many cases. For instance in the case of Hindusthan Photo
Films Manufacturing Ltd., between 1964-65 and 1969-70,
there was 81.4% increase in gross block, when the percentage of share capital in its capital structure came down from 55.8% to 26.9% and the share of borrowed capital increased from 43.5% to 59.7%, with accumulated deficits at 624.5 lakhs of rupees, as shown in Table 17. Another instance was that of Neyvali Lignite Corporation Ltd. In this case, the percentage of share capital moved down from 93.7% in 1960-61 to 36.3% in 1969-70 and borrowed capital moved up from 1.6% to 43.1% as against the increase in the percentage of gross block by 772.6%, with accumulated deficit to the extent of ₹.2389.6 lakhs at the end of 1969-70.

One can therefore observe, that the declining percentage of the share capital in the capital structure of the Central Government companies between 1960-61 and 1969-70 as a direct sequel to the government policy of maintaining uniform debt-equity ratio was invoked neither in accordance with the principles of financing public sector undertakings nor in concurrence with the accepted principles of Corporation finance. The reluctance of the government, to ascribe its due position to the share capital in the capital structure of the Central Government companies in the period of the present study was as mentioned earlier, seems to have been initiated out of its apprehension that equity method of financing may cause an underestimation of the real economic costs involved in the corporate performances and thereby distort the structure of consequential economic
decisions. This type of reasoning failed to take into account, however, one practical problem that may arise out of it. If insistence on bringing into account all costs of finance lead to the accumulation of heavy deficits, as had been with many of the Central Government companies detailed out in Table 17, it would then create the problem of how to deal with such deficits. In that case, remedies may have to be effected as involved in cash grants, capital reduction, etc. with the possible adverse public reaction on the philosophy of having a dominant public sector in a mixed economy like India. But, under such circumstances of multiplying gross block equity financing has been considered the better course from the point of view of the principles of financing companies not only of the private sector but also of the public sector.

Preference Share and its Role in the Capital Structure in General

The Companies Act, 1956, admits only of the two broad classifications of shares viz., Equity and Preference. As such, it may be observed that share capital of a company may have two segments, namely, equity share capital and preference share capital. A preference share is prima facie cumulative


10. Ibid.

unless the articles either State otherwise or are repugnant thereto. And in accordance with the provision of Section 85 of Companies Act, 1956, preference shares are preferential as to the repayment of capital. The preference dividend may be free of Income Tax and entitle the holders to exercise their voting rights under some conditions.

It may be recalled that preference share capital have semblance both with creditorship, as well as, ownership capital of the companies. The semblance of the preference share capital with the creditorship capital of the company arises from the fact that it involves sharing the income of the company at a fixed rate and enjoys like creditorship capital, priority over equity capital in respect of their repayment, in the event of winding up of the company. Its resemblance with the equity share capital arises out of the fact that like dividend on equity shares, the dividend on preference shares, though payable at a fixed rate is not a deductible expense for the assessment of income tax. Their right to claim dividend depends upon the profit position of the company, and the inclination of the Board of Directors to apply the same profit in the payment of dividend. Again by manipulation in the Articles of Association, preference share capital may be placed on equal footing with equity in


respect of arrear dividends. In view of this semblance of the preference capital with the creditorship capital on the one hand and the ownership capital on the other, preference shares are considered hybrid securities. It has rightly been pointed out by Donaldson that preference share capital is similar to borrowed capital under normal profitable conditions of the company whereas they are virtually identical with equity share capital at times of adversity. This cardinal feature of the preference capital is perhaps the basic cause for its inclusion by the companies in their capital structure despite many problems that are concomitant to the procurement of capital by the issue of this class of shares. For instance, besides being costlier than the borrowed capital, the preference dividend is a non-admissible expense for the purpose of income tax. Once issued, preference shares require a company to earn a high rate of return, for the twin purposes of meeting its contractual obligations both in respect of payment of dividend and repayment of capital. Furthermore, the preference shares are invariably redeemable within ten to fifteen years. Again, however small, it causes not only dilution of control and the equity share


holders' claim over the assets of the company, but also may affect the autonomy of the equity of the company in respect of borrowing powers. It occurs by the presence of the restrictive clause in the covenant covering the issue of the preference shares. Lastly, as already mentioned as per statute, the preference shares are preferential as to the return of capital. As such, unless there is manipulation in the Articles of Association, the presence of the preference shares in the capital structure is sure to impair the creditworthiness of the company. Therefore, the role of the preference share capital in the capital structure of a company depends, first, upon the performance of the company in terms of profit in the past and also upon the prospect of the same in future.

Role of the Preference Capital in the Capital Structure of Central Government Companies:

It has already been observed that preference shares are hybrid securities. As such there may be two possible approaches in the estimation of the contribution of the preference capital in the composition of the capital structure of a company. In case of one preference shares and the capital represented by it are considered to be a part of the ownership capital. Accordingly, it is added to the equity capital. In case of the other approach, preference capital is treated as loan capital. As such it is tagged with loan in the estimation of the role of borrowed capital.

18. Ibid.
in the capital structure of a company. In the present analysis, preference shares are taken to represent ownership capital and as much they are allowed to form a part of the share capital.

In Table 18A given below an attempt has been made to identify the role that the preference capital played in the share capital of the Central government companies over the decade between 1960-61 and 1969-70. It shows that, in the cases of Central government companies in the public sector, the share of preference capital as a part the ownership capital

<table>
<thead>
<tr>
<th>Year</th>
<th>Preference Capital as Percentage of the total Share Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960-61</td>
<td>0.9%</td>
</tr>
<tr>
<td>1961-62</td>
<td>0.8%</td>
</tr>
<tr>
<td>1962-63</td>
<td>0.2%</td>
</tr>
<tr>
<td>1963-64</td>
<td>0.1%</td>
</tr>
<tr>
<td>1964-65</td>
<td>0.1%</td>
</tr>
<tr>
<td>1965-66</td>
<td>0.1%</td>
</tr>
<tr>
<td>1966-67</td>
<td>0.1%</td>
</tr>
<tr>
<td>1967-68</td>
<td>0.1%</td>
</tr>
<tr>
<td>1968-69</td>
<td>0.1%</td>
</tr>
<tr>
<td>1969-70</td>
<td>0.1%</td>
</tr>
</tbody>
</table>

of these companies came down from 0.9% in 1960-61 to 0.1% in 1969-70. This is due to the fact that preference shares formed a part, though in a small proportion, of the share capital of those companies which had existed before the actual separation of the 'Public Sector'. After that no Central government companies was started with preference shares in its capital structure. Therefore, the decline in the share of share capital in the total capital mix as well as in the total external sources, in the capital structure of Central government companies, stated previously, was practically a decline in the share of equity capital.

Causes for the Absence of Preference Capital in the Central Government Companies:

A few explanations can be offered for the virtual absence of the preference shares in the composition of share capital of the Central government companies. One of them is that issue of preference share is a devise to mobilise capital from the cautious investors who do not like to risk their capital. In as much as the Central government companies are supposed to obtain their capital by the sale of shares to the government government's abilities to shoulder risk is considered to be infinite. Secondly, preference share is an easy method to raise capital from the market by the newer and growing enterprises who find it difficult to sell their equities. But the Central government companies, whether

a new one, or an expanding one, had no problem of marketing securities in the capital market for reasons that most of the Central government companies were registered as private limited companies. Even in the cases of the companies which were registered as public limited, barring certain exceptions, as already mentioned, their shares were not dealt in the Stock Exchange. Besides, financing by preference share is also considered a technique of raising capital with least possible dilution of control of the company. But in view of the fact that in the cases of government companies majority shares (at least 51%) are always to remain in the hands of government, there was no necessity for manoeuvring the control of such companies by the issue of preference shares.

Case for Preference Capital in the Capital Structure of Central Government Companies:

But the Government policy to saddle the share capital component of the capital structure of the Central Government companies between 1960-61 and 1969-70 only with equity and no amount of preference share, despite the fact that the latter does not militate against the desired flexibility in the operation of the companies is open to question. This is especially because (a) overloading share capital only with the equity may retard the normal expansion of working capital by self-financing in case of a private sector company. It is likely to happen owing to the fact that
a large amount of cash will be necessary to pay dividend that may be required to maintain competitive market value of shares. Such a possibility of shortage of internal finance for expansion of working capital may, however, arise in case of a Central Government company owing to the rate of profit being very low, if not nil. (b) Secondly, density adjustment in the paid up capital of a company as a remedy to the problem of over-capitalisation, should there be any, with the Central government company, will be rendered impossible by the exclusion of preference shares in their capital structure. (c) Thirdly, the preferred shares, especially when redeemable, enable a company in the private sector to take the advantage of low money market rates, as and when such situation arises. To the extent redeemable preference shares are absent in the capital structure of Central government companies their ability to take advantage of low rate of interest on the loan advanced by the government is impaired. It has already been indicated earlier how the leading rate of the Government varies in sympathy with the variation of the Bank Rate. Fourthly, it has already been observed that the government policy to finance the capital requirement of companies by maintaining a ratio 1:1 between loan and equity does not only make their capital structure rigid, but also leads to other adverse consequences concerning their very capital structure. For, in many cases, in the absence of necessary revenue flow for servicing the loan, either holidays had to be declared in respect of interest
payment or interest charges had to be capitalized. The latter thereby caused an artificial inflation of the capital structure to the detriment of the interest of the company. Even in case of the companies where the necessary revenue flow had started, their operation results had to be much deflated under the impact of heavy interest charges. This could have been easily avoided had the government decided to provide funds by the issue of preference shares by the companies. Initial losses to the exchequers are compensated by the rate of dividend on preference shares which is usually higher than interest charges. Such an arrangement would have also served the purpose of providing as far as possible, an yardstick for the assessment of actual cost of financing a project under Central government companies without creating problems concomitant to the provision of the same in the form of loan in the aforementioned way. Besides, the very assumption on which preference share capital has perhaps been excluded, that is the absence of any limit to the risk bearing capacity of the government, is open to question in a capital scarce country like India aspiring for having a self sustained economy. Accordingly, the feasibility of converting at least a part of loan into preference capital in case of Central government companies gasping under the impact of heavy interest charges may also be worth exploration.
Role of Internal Sources in the Share Capital:

Depending upon the excess of the internal rate of return over the market capitalisation rate a company is supposed to prefer to retain a part of profit within the business and employ the same as additional capital. This phenomenon is commonly known as ploughing back of profit. One immediate effect of retention of profit in an enterprise and its employment as additional capital is to have a tendency of enhancement of future profit resulting from higher utilisation of plant capacity. As a result there is an increase in the earning per share since dividend is declared on the paid up capital of the company as recorded in the past. Again retention of profit causes an increase in the net worth of the business that leads to an enhancement of share value based on asset backing. Under the twin spell of the expected increase of earning per share and increased net worth, retention causes an increase in the market value of shares causing eventually problems for the new issue of shares by the company.

Again, under the traditional accounting based on historical cost while revenue inflows are measured in terms of current prices, costs and expenses that are charged against the said revenue for the purpose of matching are valued on the basis of historical cost. In consequence, at the time of changing price levels, the revenue account

presents a distorted results of operations in as much as profit remains overstated. In the circumstances if dividend is declared at a higher rate on the basis of overstated profit, there will be invariably an erosion of capital.

In the circumstances, retention of profit by the management serves to prevent, conciously or unconciously this erosion of capital. In course of time profit retained in the form of free reserves gets stuck up in the capital of the company either in the form of permanently expanded working capital or in the form of additional fixed assets which eventually contribute to the rise in the profit earning capacity of the firm. It naturally leads to the creation of the problem of under capitalisation in the sense that one is apt to gauge the performance of a company with reference to the amount of paid up share capital employed in the company and not capital collected from other sources.

To get out of the impasse of the so-called under-capitalisation on the one hand and the sufferings of the existing shareholders for the sacrifice of their dividend in favour of retention on the other, a company often resorts to the capitalisation of profit through the mechanism of issuing bonus shares. Normally when shares are issued subscribers are to pay their prices. Under the mechanism of bonus issue, on the contrary, shares are issued to the existing shareholders, on their prices being recovered out

of the retained profit which were payable otherwise in the form of dividend. One immediate effect of bonus share issue is that it goes to increase the number of shares and the amount of paid up capital without affecting the amount of the total ownership capital in the capital structure. Further, since the divisible profit is distributed against the increased paid up capital of the company, the earning per share is reduced without having however, any adverse effect on the total earning per individual share holders. Reduced earning per share causes the market prices of shares to come down facilitating new issue of shares, at prices equal to or very near to their nominal value. Simultaneously it also removes the veil of under capitalisation of the company is indicated earlier.

It is true that bonus share does not change either the net worth or ownership capital or the total capital employed in the business. Nevertheless, it changes the proportion of share capital in the capital structure, such contribution being received from and within the company, as such from internal sources as against the external sources. Naturally, a threadbare analysis of the role of share capital in the capital structure also demands analysis of the contribution of the internal sources to the total share capital of the company.
In Table 18B, given below an attempt has been made to find out the share of internal sources in the form of bonus share in the total share capital of the Central government companies over the decade between 1960-61 and 1969-70. It shows that its share in the total share capital of the Central government companies had been 0.8% in the year 1960-61. Since that year, though there was increase in

<table>
<thead>
<tr>
<th>Year</th>
<th>Bonus share as Percentage of the total Share Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960-61</td>
<td>- 0.8%</td>
</tr>
<tr>
<td>1961-62</td>
<td>- 0.8%</td>
</tr>
<tr>
<td>1962-63</td>
<td>- 0.2%</td>
</tr>
<tr>
<td>1963-64</td>
<td>- 0.1%</td>
</tr>
<tr>
<td>1964-65</td>
<td>- 0.1%</td>
</tr>
<tr>
<td>1965-66</td>
<td>- 0.1%</td>
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<tr>
<td>1966-67</td>
<td>- 0.1%</td>
</tr>
<tr>
<td>1967-68</td>
<td>- 0.1%</td>
</tr>
<tr>
<td>1968-69</td>
<td>- 0.1%</td>
</tr>
<tr>
<td>1969-70</td>
<td>- 0.3%</td>
</tr>
</tbody>
</table>

the share capital of the Central government companies in absolute term, the part contributed by the internal sources in the form of bonus share issued by them, remained static. In consequence the percentage share of internal sources of bonus shares in the total share capital came down from 0.8% in 1960-61 to 0.2% in 1962-63. In the year 1963-64 it came down further to 0.1%. It continued to be the same till 1968-69. In the year 1969-70 however there was an improvement in the absolute amount of the share capital represented by bonus share since the amount of bonus share increased from Rs.66 lacks in 1960-61 to Rs.394 lacks at the end of 1969-70. As a result the share of bonus share in the total capital of the Central government companies increased from 0.1% in 1968-69 to 0.3% at the end of 1969-70.

Causes For The Meagre Contribution Of Internal Sources To Share Capital

The causes for the absence for all practical purpose of the internal sources in the form of bonus shares in the share capital of the Central Government companies are not difficult to locate.

First, in the case of companies in the private sector decision regarding retention and pay out of profit is taken by the internal management as guided by the difference, as already told, between the internal rate of return and the market capitalisation rate. But in the cases of the Central government companies, decisions are to be taken as per government fiat. The Board of Directors are empowered
to undertake capital works up to a specified limit and all cases of expenditure beyond that limit are to be referred to the government. This embargo on the power of the Board serves as a deterrent to its urge for retention of profit and its subsequent capitalisation in the form of bonus issue.

Secondly, in the case of private sector companies, as already discussed, bonus shares are issued for bringing down the prices of shares in the capital market to facilitate the new issue of shares. But the Central government companies have no such problems, since, their shares, barring certain exceptions, are not dealt in the Stock Exchange. As such, there is no question of bringing down the prices of shares in the capital market and facilitating additional issue of shares. Besides, the government in most cases is the sole subscriber of their shares whether it is an issue to finance a new undertaking or expansion of an old one.

Thirdly, government policy on internal financing by Central government companies was neither very explicit nor very encouraging over the period between 1960-61 and 1969-70. Lastly, the poor performance of the Central government companies in terms of gross profit on capital employed and net profit on net worth put off question of bonus issue for consideration in many cases. These aspects will be dealt in greater details subsequently when retention, as such, would be considered a source of capital.

In the circumstances, prima-facie internal sources in the form of bonus share had practically no contribution to the share capital of the Central government companies. And, over the period of ten years, there had been only one singular instance of the issue of bonus share. The company concerned was State Trading Corporation of India Ltd. It increased its paid up capital from Rs. 2 crores to Rs. 5 crores by two bonus issues during the year 1969-70.

Justification for the issue of Bonus shares in some cases:

Present investigation relating to the role of internal sources in the share capital of the Central government companies reveals that, apart from State Trading Corporation, bonus shares could have been issues by certain types of Central government companies. Such issues would have been justified inspite even of low profitability invariably common to Central government companies in general. Those are companies which did not go for dividend payment despite profit, but retained the latter within the enterprise for financing the additional working capital needed for the expansion or other normal requirements of the company. There were also some Central government companies which had accumulated huge reserve and were characterised by the earning of a high percentage of net profit on equity.


that acted apparently as a sign of under capitalisation. For instance Hindusthan Antibiotic Ltd. had, at the end of 1969-70, an accumulated reserve of Rs.564.6 lakhs against a total paid up equity capital of Rs.247.3 lakhs. It was credited with having a constant record of high ratio of net profit to equity. Similarly, Bharat Electronics Ltd., had an accumulated free reserve of Rs.881.6 lakhs at the end of 1969-70 as against a total paid up capital of Rs.594 lakhs with the ratio of net profit to equity going high in its case since 1965-66. The other like companies were Indian Telephone Industries, Minerals and Metal Trading Corporation, Hindusthan Steelworks 24 Construction Ltd. The invariable results that were met with in all these cases were an increasing percentage share of internal sources to the total share capital of those companies. Bonus share thus issued would definitely help build up the images of those companies as public sector units among the people in general and would encourage private participation in the share capital of the Central government companies.

Institutional Holdings in the Capital of Central Government Companies:

The large part of the total amount of securities of the public limited companies in the private sector issued and traded in the market is now owned by institutional

investors rather than by individuals. As the big chunk of the share capital of these companies is now derived from the financial institutions, therefore investment policy pursued by these institutions have some effect on the capital structure of these companies. The principal institutions participating in the share capital of these companies are Banks, Life Insurance and other Corporations, Investment Companies and the miscellaneous joint Stock Companies. The amount of share capital owned by these institutions go by the name of institutional holdings. It is in this sense, the term institutional holding has been used here.

Based on this interpretation of the institutional holdings, an attempt has been made in Column 3 of Table 19 to bring out the role of institutional holdings in the share capital of Central government companies at the end of 31st March, 1970. It shows that institutional holdings in the share capital of 84 Central government companies amounted to Rs. 1360.1 lakhs out of the total share capital of Rs. 188092.4 lakhs. This accounted for only 0.7% of the total share capital of 84 Central government companies at the end of March, 1970. Further, analysis of holdings by the constituents of financial institutions, shows that apart from the very meagre holding of equities worth Rs. 46 lakhs in the Cochin Refineries Ltd. by the Life Insurance Corporation of India, there was no holding of shares of the Central

25 Information Broadsheet on Government companies in India as on 31st March, 1970, Research and Statistics Division, Department of Company Affairs, Ministry of Industrial Development and Company Affairs, Government of India, p.46.

* Total of columns under 3(a) and 3(b) in Table 19.
government companies by the financial institutions. And the share of the financial institutions in the total institutional holdings was only 3.4% of the total. The balance of 96.6% was held by other types of companies. The conspicuous absence of the participation by financial institutions to the share capital of Central government companies can perhaps be attributed to (a) non-availability of the shares of the Central government companies barring certain exceptions in the security market, (b) the feeling of the government that the public sector undertakings are owned by the government and therefore the responsibility of making available the long term finance should be that of the government, (c) Thirdly, the restriction on the Central government companies to obtain capital simultaneously from the Central Government and financial institutions.

Turning one's attention to the question of institutional holding by non-financial companies, analysis of the data in column 3(b) of the Table 19 of the present study makes some interesting revelations in this regard. The first of them is that in between Indian and Foreign companies it was Foreign companies which had the lion's share in this respect accounting for 85.8% of the total equity share held by the companies. The share of the Indian companies had been only 14.2%. Secondly, the holding of share by the Indian companies did not come from any private

sector companies.

The entire holding was by the Central government companies in the capacity of holding company, barring the case of Indian Consortium for Power Projects. In view of the fact that the share capital of those holding companies has been derived from the government sources, epitheting such holding as institutional holding may perhaps be misleading.

Private Participation In The Share Capital Of Central Government Companies:

The provisions in Indian Companies Act 1956 relating to the Government companies as it stand still to day allow private participation of their total equity capital to the extent of 49%. Nevertheless, there has been a lot of controversy centreing round the question whether private participation should be allowed in the share capital of Central government companies. Private participation in the share capital of Central government companies may arise either by the members of the Indian Public or by foreign nationals or both. As such one can make the discussion under two broad headings viz., (i) private participation by Indian nationals; and (ii) private participation by foreign nationals.

+ The share capital of Handicraft Handloom Export Corporation Ltd., and Indian Motion Picture Export Corporation of India is owned by State Trading Corporation as their holding company. The shares of Goa Shipyard Ltd. is owned by its holding company Mazgaon Docks Ltd. The shares in Sanbar Salts Ltd. are held by its holding company Hindustan Salts Ltd.

++ In the case of Indian Consortium for Power Projects its share capital was contributed equally by Bharat Heavy Electricals Ltd., Instrumentation Ltd., Triveni Structural Ltd. and Mining and Allied Machinery Corporation Ltd.
Private Participation by Indians

It has already been pointed out that there has been a lot of controversy over the question whether private participation, in the broad sense, should be allowed in the share capital of Central government companies. Protagonists of private participation advance the following arguments in favour of the same:

(i) It enables the government to spread its limited resources over a wider network of activities than would otherwise be possible;

(ii) Secondly, this process helps the government to have expert business magnets of the private sector on the Board of Directors of 'Central government companies' who may help improve their overall performance;

(iii) It is also claimed that this process will help the Central government companies mobilise the potentially inflationary earnings of the lower income groups, and thereby make these undertakings run effectively under the vigil of a body of shareholders. Besides, the members of the community will take more lively interest in their development being able to participate in the profits of the government enterprises or to share bearing their burden.

Critics on the other hand point out that in many cases the rate of return earned by the government companies

27. V.V. Ramanadham - The Finances of Public Enterprises - Asia Publishing House, p.108.

will be lower. As such, even if private participation is allowed, there will be practical difficulty in making private investors adequately interested. Secondly, in many cases the profit earned by these undertakings are the outcome of deliberate monopolistic and semi-monopolistic conditions enjoyed by them. Company shares and bonds as means of investment are as yet popular among well to do section in the country. If private participation is allowed, and the said profit is enhanced by better performance as expected thereunder, it will mean channelising a part of monopoly or semi-monopoly profit into the pockets of the richer section of our community. This will serve to perpetuate the existing inequality in the distribution of wealth and income. In other words, it will frustrate the role of public sector as an agency for securing better distribution of wealth and income in the society. Thirdly, it is pointed out that profit of the public sector undertakings including Central government companies is taken as a major source of finance for economic planning in the developing countries. If private participation is allowed it will mean diversion of a part of the profit of the public sector enterprises from financing plans to other non-essential sector since there is no guarantee for re-investment of such profit paid to private persons in the newly floated industries under the public sector or utilise for financing the expansion of the old one. Thus, it will cut across the role assigned to
the public sector in the context of economic planning. Fourthly, it is contended that allowing private participation in the capital of Central government companies will no doubt result in the association of successful business magnets of the private sector in the Board of Directors of the public sector enterprises. Nevertheless, the performance of these undertakings may not improve mainly for three reasons viz., (a) such a Director may find himself only an isolated minority in the Board; (b) environment within the Board may not be congenial enough for taking any initiative and enterprise by such a Director; (c) such a Director may induce the Board to pursue a policy which in the long run may be inimical to the interest of the enterprise concerned, particularly when such a Director is interested in similar concerns under private sector. It is also apprehended that Directors appointed from among persons of the private sector being always interested in swelling the profit of an enterprise, the non-commercial obligations of the public sector undertakings may get stifled in their hands. Lastly, it is argued by critics that if the intention of the government is to mop up the inflationary earnings of lower income groups then the same can be accomplished by market borrowings, receiving deposits under small saving schemes and by floating fixed interest bonds, instead of allowing private participation in the equity capital of public sector undertakings like the Central government companies.
The position abroad in this regard has been varied. In U.K. the suggestion of having private participation in the capital structure of State undertakings was rejected outright by the Radcliffe Committee. In Italy, however, State participation in the capital structure of Industrial Reconstruction Institution (I.R.I.) which controls the 29 State enterprises in that country, has been 25%. Private participation can also be seen in the capital structure of public undertakings of many other countries such as Sweden, Indonesia, South Korea etc. In India this specific issue figured in the discussion of different expert bodies from time to time. The Estimate Committee (1st Loksabha) in its 16th Report recommended private participation in the capital of government companies to the extent of 25% with a ceiling on individual holding with a view to avoid group monopolies and other malpractices. The suggestion was also reiterated in the 19th Report of the Estimate Committee 31 (2nd Loksabha). An identical view was also expressed in the Report of the Sub-Committee of Congress Party in Parliament (Krishna Menon Committee) with the suggestion that these share be preferably issued to those who are

engaged as workers in industries, so that they can participate not only in management but also in ownership and operation. In that case a Director can even be drawn from the rank of the investing employees.

Despite recommendation of the Loksabha Estimate Committee and Krishna Menon Committee as stated above the government attitude in this respect appears to be inconsistent. Though it finds no objection in having minority participation in the share capital by the members of the public, but at the same time it realises that shares of the public sector undertakings will not be attractive to the private investors. The latter attitude of the Government seems to have developed from its experience gained in this regard from the working of the capital market. The Bombay State Road Transport Corporation offered a small part of its share capital to private interests, but private subscription fell below expectation as much as that the shares had ultimately to be taken up by the State Government itself. Similarly, in case of Ashoka Hotels Limited the amount of share earmarked for private participation could not be sold for which the government had to change its position from a minority to a majority share holder.

In the circumstances, it is very natural that private participation by the members of the Indian public, in the share capital of Central government companies between 1960-61 and 1969-70 has been only in a very limited scale. That too,

\[33. \text{V.V. Ramanadham - Op.cit., p.110.}\]
in some cases, has been the outcome of the historical reasons of nationalisation. This aspect of the private participation will be clear from column 4a of Table 19. It shows that out of the total 84 Central government companies, as at the end of March, 1970, with a total share capital of Rs. 188092.4 lakhs only 8 had private participation their share capital by the members of the Indian public and that amounted to Rs. 418.6 lakhs. Expressed in terms of percentage of the total share capital in the aforesaid 84 Central government companies, it means that private participation accounted for only 0.2% of the total share capital. Another interesting feature in respect of private participation in the share capital of Central government companies has been that even within the limited scale of participation in their share capital its distribution over the companies involved has not been uniform. This will be evident from column 4(b) of Table 19. It shows that whereas private participation in the case of Triveni Structural Limited had been 49.2% of the share capital, it had been only 17.8% in case of Goa Shipyard Ltd., 7.3% in Praga Tools Ltd. More instances can be cited. Thus, it will be observed that private participation in the share capital of Central government companies over the decade between 1960-61 and 1969-70 varied widely inter the companies, though the total participation as already mentioned, had been only 0.2% of the total share capital in the 84 Central government companies at the end of 1969-70.
Private Participation by Foreign Nationals:

Like the counterpart, there was a lot of controversy over the issue whether private participation by foreign nationals should be allowed in the share capital of Central government companies.

The arguments that are usually advanced against foreign equity participation are: (a) Such a policy may detract public sector undertakings from their basic objectives of serving the national interest. (b) Secondly, in many cases, the profits of the public sector undertakings will be the result of monopoly and semi-monopoly positions enjoyed by these undertakings. As such their profits will be in the nature of taxes borne by the consumers. Foreign nationals should not be allowed to participate in the distribution of such profits even if the same is partly or wholly enhanced by better performance at the instance of those foreigners. (c) Thirdly, it is pointed out that foreign nationals are interested only in the projects capable of yielding high rate of dividend. They do not evince any interest in the projects from which the possibility of recovering their investment within a short span of say five or six years is in the negative. But in a developing country like India, initial plans for industrial developments under public sector are bound to be dotted with the projects that have usually, as already told, long gestation lag and low profit yielding capacity. In the circumstances, prospect of foreign participation in the risk capital of Central government companies cannot be very high.
The role that foreign equity participation can play in the share capital of the Central government companies is, after all, decided by the government policy adopted on the employment of foreign capital in the industrial development of the country. As such a general review of the government policy vis-a-vis employment of foreign capital in the future industrial development of the country will not be out of context here.

The issue whether foreign capital should be well­comed to assist India in her stride for industrial development in which public sector is being given increasingly a larger share, has been considered by different expert bodies. It has been found that foreign capital is essential to supplement not only domestic capital but also to secure foreign scientific knowledge and technical know how which can best be secured along with foreign equity capital. But considering the fact that dependence or reliance on foreign help or assistance indefinitely will not be good for the growth of Indian Industries, the emphasis in India has been on self reliance by stepping up the rate of domestic savings and investment on the one hand, and improving technological competence on the other. In consequence of this, the present policy of the Government has been to permit foreign investment only in the fields of relatively high priority and in the areas where sophisticated foreign technology would become available to the country along with foreign investment. Exceptions are to be allowed only in the cases of export
oriented industries. Where foreign investment takes the form of participation in the equity capital of an enterprise, the present policy of the Government has been to allow such participation at a rate preferably less than 40% provided such foreign participation is found to be essential. Government is even willing to allow majority participation in exceptional cases where the project required sophisticated technology not available in India and, as already stated, where the project is substantially export oriented. Instances to the point are Oil India Limited and Indian Explosive Limited. In case of Oil India Limited, Burma Oil Company has been allowed to subscribe 50% of the total capital of Rs. 28 crores. And in case of Indian Explosives Limited, President of India holds only 12.75% of the equity capital of Rs. 2,141.2 lakhs as on 31st March, 1970. The rest of the capital remains allotted to M/S Imperial Chemical Industries Limited.

From the aforesaid discussions it appears that government is inclined to allow a preferable share of return to foreign investors in regard to their participation in the equity capital of public sector undertakings. Nevertheless, as will be seen from column 4(c) Table 19 that the response from the members from the foreign national to participate in the equity capital of Central government companies between 1960-61 and 1969-70 has been in the negative. This means


that equity participation by the members of the foreign national did not play any role in the share capital of Central government companies. And foreign participation in the equity capital of Central government companies between 1960-61 and 1969-70 has only been institutional, provided financing by companies is taken as constituent of institutional finance. Such institutional participation had to be allowed to get the benefit of advanced technical know-how and expertise at the disposal of such companies in the foreign countries. Absolute absence of equity participation by the members of the foreign nationals in the share capital of Central government companies has vindicated the apprehension of the critics that foreign capital is not interested in the projects characterised by low profitability prospect and long gestation lag.

Conclusion
Foregoing analysis establishes the fact that the government failed to motivate the private investors, both national and foreign, to subscribe to the share capital of Central government companies over the period between 1960-61 and 1969-70. Inconsistent and hesitant government policy, non-availability of the shares of the Central government companies in the Stock Exchange, low rate of return, huge accumulated deficits in the 29 units including Hindusthan Steel Limited even at the end of 1969-70 are perhaps the factors that may be invoked to explain the phenomenon. But experience in the units where private participation
had been allowed to the maximum permissible limit of 49% did not substantiate the apprehension of the critics in this regard. Similarly it is difficult to subscribe to the view that private participation will go to perpetuate, the inequality in the distribution of wealth and income in India or divert investment in the non-essential sectors in view of the fiscal autonomy of the Central Government and existing control over the capital issue. The contrary rather may be true, if attempts are made to inspire the people of limited means to subscribe to the share capital of the Central government companies if necessary by reducing the face value of shares of such companies by way of capital re-organisation. Bonus share issue, in the line suggested previously, will go a long way to build up the image of Central government companies among the investing public and to promote private participation. Further, as has been suggested by one expert, private participation may be encouraged, to start with, on a selective basis in the companies which have been capable of earning an after tax net profit of 25% on paid-up capital and more than 12% on net worth during at least in one of the last three years. Promotional and Developmental companies, Companies producing essential goods and companies having participation by companies as well as by the members of the Indian public

may be kept outside the purview of the scheme. For safeguarding the apprehension of the critics on the issue of the private participation in the share capital of Central government companies, holding of shares of such companies by financial institutions to the maximum limit of 25% may be advocated. This would raise the government holding directly or indirectly to the maximum of 75% leaving 24% for private participation by the members of the Indian public. Substitution of government loan to the Central government companies by the issue of preference share to the private participants suggested earlier in this Chapter may be another bold step in this regard. This will not only reduce the opposing interest burden on the Central government companies but may show better periodical results. It will also release fund for investment in the new companies. To prevent centralisation of the shares of the Central government companies in one hand, ceiling on individual holding or holding by family business may be prescribed.

So far as the question of the participation of the members of the foreign nationals in the share capital of Central government companies is concerned equity capital has been mainly subscribed in the past only by the members of the capitalist countries, where state enterprises are few and far between. In the present socio-economic set up, the prospect in this respect does not seem to be very bright.