CHAPTER VI
INTER-CORPORATE INVESTMENTS AND LOANS

*A* *A*

(A) Introduction
(B) Restrictions
(C) Some Problems
(D) Advantages and Disadvantages
(E) Remedial Action
(F) Inter-corporate Investments and Loans and Cotton Textile Mills of Ahmedabad

*A* *A*
(A) Introduction

Inter-corporate investments and loans play a significant role in the development of an economy by satisfying the need of capital of the corporate sector. Inter-corporate investments mean investments by one body corporate in the shares and debentures of another body corporate. The shares mean any type of shares - either equity or preference. The point to be noted is that, if a company invests in some Government securities, the possession of such securities certainly is investment, but it cannot be referred to as an inter-corporate investment. Similarly, inter-corporate loans mean lending by one corporate body to the another corporate body. The loan may be a short term one or long term one. But what we are concerned here is mainly the long term loan given in the form of cash. A loan given to an employee will not come in our scope because an employee is not a body corporate.

According to Section 370(1B) of the Indian Companies Act, 1956:

(i) Two bodies corporate shall be deemed to be under the same management:

(a) if the managing director or manager of one body is managing director or manager of the other body, or

(b) if a majority of the directors of one body constitute, or at any time within six months immediately preceding constituted, a majority of the directors of the other body, or
(c) if not less than one-third of the total voting power with respect to any matter relating to each of the two bodies is exercised or controlled by the same individual or body corporate, or

(d) if the holding company of one body is under the same management as the other body corporate within the meaning of clauses (a), (b) or (c), or

(e) if one or more directors of one body corporate while holding, whether by themselves or together with their relatives, the majority of shares in that body corporate also hold, the majority of their shares in the other body corporate.

(ii) Nothing contained in sub-section (1) shall apply to any loan made or any guarantee given or any security provided -

(a) by a holding company to its subsidiary, and

(b) by a banking company in the ordinary course of its business.

(iii) Nothing in this section shall apply to a book debt unless the transaction represented by the book debt was, from its inception, in the nature of a loan or an advance.

(iv) For the purpose of this section, any person in accordance with whose directions or instructions, the Board of Directors of a company is accustomed to act shall be deemed to be a director of the company.
The general techniques followed for building up the empires is of inter-company investments, loans and advances. "The controlling families in most cases make some relatively small investments in a principal company or companies which initiate a breeding process in some groups that takes the form of nearly all subsequent controlling of investments of significance without calling for the further substantial investments from the families." *

Thus, the funds of group companies are invested to purchase the shares of newly floated or existing companies with a view to bringing them in the control of the group.

Dr. Hazari ** has mentioned that "Inter-company investment is a powerful instrument in the hands of those who control corporate activity".

The study of Reserve Bank of India regarding the pattern of ownership indicates that 33% of paid-up value of shares of large and medium sized public companies under study in 1965, was held by joint stock companies. These companies held 52% of the share in large sized blocks.

Previously in the early stage of corporate movement, such investments and loans were considered as ultra vires unless under all circumstances, such activities were a necessary and reasonable means to carry out the corporate objectives. However, as the time passed, the trend changed and such activity started to be looked as a normal

* Mahalonabis Committee Report, 1964; p. 43.

course of business in almost all the countries. But this uncontrolled activity had led to many evils because of which many countries introduced restrictions. Of course, the severity and the kind of the restrictions differ from one country to the another.

(B) Restrictions

The Companies (Amendment) Act, 1960, gave a final touch to the sections regarding inter-company investments, which were originally incorporated on the basis of the Bhabha Committee's recommendations. They apply to public limited companies and their subsidiary private limited companies also. The main points of these relevant sections - Section 370 and Section 372 - to be operative from 28.12.1960 are compressed in Table VI.1.

<table>
<thead>
<tr>
<th>Investments in 'Same Group' companies</th>
<th>Investments in outside the 'Same Group' companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Investing company can invest in shares and debentures upto 10% of the subscribed share capital of the Investee company.</td>
<td>Investing company can invest in shares upto 10% of the subscribed share capital of the investee company. Debentures are outside the purview of this limit.</td>
</tr>
<tr>
<td>2. The aggregate of such investments should not exceed 20% of the subscribed capital of the investing company.</td>
<td>The aggregate of such investments can go up to 30% of the subscribed capital of the investing company.</td>
</tr>
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</table>
The restrictions on inter-company investments **apply** in case of direct investments by the company itself as well as by an individual or association of individuals in trust for it or for its benefit or on its account. Moreover, it had been clarified by the Department of Company Law Administration that investments which are held by companies as a part of stock-in-trade will also be hit by the restrictive provisions of Section 372. The statutory limits of 10%, 20% or 30% as the case may be, apply to all investments by a company in the shares of any other body corporate, irrespective of whether such shares are held for short or long periods or as long-term investments or for sale or purchase. The limit of 30% will, however, not apply to an Investment company whose principal business is purchase of shares, etc.

The term 'same group' is being explained by Section 370. For the purpose of calculating the prescribed limit of 10% of the subscribed share capital of the 'investee' company, the full nominal value of the shares is to be taken, whereas for the purpose of calculating the prescribed

<table>
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<th>Investments in 'same Group' companies</th>
<th>Investments in outside the 'same Group' companies</th>
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<tbody>
<tr>
<td>3. The above limits of 10% and 20% also apply to an investment company whose principal business is acquisition of shares, stocks, debentures or other securities.</td>
<td>The above limit of 10% applies but the limit of 30% does not apply to an investment company whose principal business is acquisition of shares, stocks, debentures or other securities.</td>
</tr>
</tbody>
</table>
limits of 20% or 30%, the actual cost of the investments in the 'investee' company and not the nominal value of the shares to be purchased or subscribed is to be considered.

Let us understand the situation by an example:

Suppose A & Co. is an investing company whose balance sheet shows the following investments:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Face Value</th>
<th>Market value at which purchase is made</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. 3% Loan 1980</td>
<td>Rs. 10,000</td>
<td>Rs. 9,500</td>
</tr>
<tr>
<td>2. 12 year N Plan Savings Certificates</td>
<td>Rs. 5,000</td>
<td>Rs. 5,000</td>
</tr>
<tr>
<td>3. 6½% debentures in X &amp; Co. Ltd.</td>
<td>Rs. 20,000</td>
<td>Rs. 20,000</td>
</tr>
<tr>
<td>4. 7% Preference shares of Rs. 100/- each in Y &amp; Co. Ltd.</td>
<td>Rs. 1,00,000</td>
<td>Rs. 97,000</td>
</tr>
<tr>
<td>5. Equity shares of Rs. 10/- each in Y &amp; Co. Ltd.</td>
<td>Rs. 1,00,000</td>
<td>Rs. 4,00,000</td>
</tr>
<tr>
<td>6. 2,200 equity shares of Rs. 10 each in Z &amp; Co. Ltd.</td>
<td>Rs. 22,000</td>
<td>Rs. 35,000</td>
</tr>
<tr>
<td></td>
<td>Rs. 2,57,000</td>
<td>Rs. 5,66,500</td>
</tr>
</tbody>
</table>

Suppose further that the subscribed capitals and debentures of various companies are:

<table>
<thead>
<tr>
<th>Preference shares of Rs. 100/- each</th>
<th>Equity shares of Rs. 10/- each</th>
<th>Debentures Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>A &amp; Co. Ltd. 10,00,000</td>
<td>15,00,000</td>
<td>5,00,000</td>
</tr>
<tr>
<td>X &amp; Co. Ltd. 1,00,000</td>
<td>25,000</td>
<td>25,000</td>
</tr>
<tr>
<td>Y &amp; Co. Ltd 25,00,000</td>
<td>25,00,000</td>
<td>50,00,000</td>
</tr>
<tr>
<td>Z &amp; Co. Ltd.</td>
<td>3,50,000</td>
<td></td>
</tr>
</tbody>
</table>
In terms of the data given above, A & Co., Ltd., cannot make investments exceeding Rs. 7,50,000 (30% of 10,00,000 + 15,00,000) in shares of all other companies excluding debentures. It has already made investments in shares of Rs. 5,32,000 (97,000 + 4,00,000 + 35,000) and therefore it can further invest in the shares of other companies upto Rs. 2,18,000/-. Its investments in Government securities, municipal loans, and debentures shall not be taken into consideration for the purpose of considering this limit. There is no restriction placed on investments in Government securities, loans, properties, etc.

Now, in considering 10% limit, we must exclude consideration for A & Co., Ltd.'s investment in X & Co., Ltd. as, investment in debentures except for the same group companies can be of any magnitude. Investments in Y & Co. Ltd. can be upto shares of the face value of Rs. 5,00,000 (10% of 25,00,000 + 25,00,000). The present investment of A & Co. Ltd. is Rs. 4,97,000/- in shares, involving face value of Rs. 2,00,000. So the further investment can be made upto the face value of Rs. 3,00,000 irrespective of the market value of the shares, subject to over-all limit of 30% as discussed above. Similarly, investments in Z & Co. Ltd., could be upto the face value of Rs. 35,000, subject to the said overall limit of 30%.

Now, assume that Y & Co. Ltd., is the company under the same group and that this is the only company of the same group in which investments have been made.
Then, A & Co. Ltd's total investments in this company cannot exceed Rs. 5,00,000 (20% of Rs. 10,00,000 + 15,00,000). The total investments of A & Co. Ltd., in preference and equity shares of companies under the same group is Rs. 4,97,000 which is within the limit. If there would have been any investment in the debentures of the said Y & Co. Ltd., these would have also been taken into account for the purpose of calculating the 20% limit. There is thus left an amount of Rs. 3,000 for investment in the shares and debentures of companies under the same group.

(C) Some Problems

The restrictions give rise to some operational problems. We shall discuss them here, in brief:

(i) **Bonus shares and rights shares**: Suppose, the investing company is on 10%, 20% and 30% limits and the investee company issues bonus shares or rights shares. Then the allotment of bonus shares does not affect the limits of inter-corporate investments because there is simply an addition to the number of shares held without any increase in the monetary investment. So far as 10% of the subscribed capital of the investee company is concerned, there is a corresponding proportionate increase in its share capital.

So far as subscription to the right shares is concerned, the limits of 10%, 20% and 30% do not apply. However, if further investments are
made after right shares, all investments existing at the time of further investments, including the right shares acquired, should be taken into account for calculating various percentage limits.

(ii) Subscription to the Memorandum of Association of New Companies: While computing the 10% limit of the 'subscribed capital' of the new company, the total number of shares, agreed to be taken up by all the signatories to the memorandum of association shall be taken as its 'subscribed capital'. Suppose, there are seven subscribers to the memorandum and out of them, one or more are body corporate. In the beginning, it is thought that each one should take no more or less than one share each. Because of Section 372(2), the body corporate cannot take even one share because it would exceed 10% of subscribed capital of the new company. The circular to this stated that the difficulty can be got over if some of the signatories sign for more than one share, thus enabling the body corporate to purchase one share.

(iii) Investment by a holding in its subsidiary: Suppose, the holding-subsidiary relationship is already established and the holding company wants to invest in the subsidiary company. This can be done without any problem because Section 372 specifically exempts such investments. However, as per the
clarification issued by the department, the 20% or 30% limits do apply. It means that the holding company's investments in its subsidiary will go to reduce or extinguish the investment potential of the holding company in other bodies corporate. Suppose, the holding-subsidiary relationship is yet not established, and the company wants to have a subsidiary. This is possible by getting approval from the Central Government in this regard.

(iv) **Subsidiary's investment in the holding company**:

As per the Companies Act, 1956, the subsidiary cannot hold shares in its holding company. However, there are two points to this: (a) A company may be holding shares in the other company and subsequently becomes its subsidiary, then the subsidiary is allowed to retain those shares but is debarred from exercising any voting rights in respect of such shares. (b) A subsidiary might have acquired shares in its holding company prior to 1.4.1956. Then it is allowed to retain those shares but is debarred from exercising any voting rights thereof.

(v) **Excess Investments** : In case of old excess investments, i.e., excess investments possessed prior to 28.12.1960, the company need not dispose off the excess investments but while making further investments, the old investments will have to be
considered for computing various limits. In case of new excess investments, i.e., the excess investments made after 28.12.1960, the company should pass an ordinary resolution in its general meeting and the approval of the Central Government should be obtained. The Central Government would approve on the basis of guidelines prescribed, e.g., liquidity of the company, impact on overall healthy corporate growth, purpose behind excess investment, etc.

(vi) **Company as a trustee**: If a company happens to hold shares as a trustee of an outside beneficiary, then such holdings do not come under the purview of the limits prescribed by Section 372.

(vii) **Inter-company investments and taxes**: Section 80 M of the Income Tax Act, 1961, deals with this point:

(a) Where the recipient of the dividend is a foreign company and the company paying the dividend is a domestic company, a deduction of an amount equal to 65% of the dividend is allowed in computing its taxable income.

(b) Where the recipient is a domestic company, the deduction allowed is equal to 60% of such dividends.

The remainder of the dividend income in both the above cases is subject to the tax at the ordinarily applicable rate.
(c) If the domestic company gets a dividend from a company, formed and registered under the Companies Act after 28.2.1975 and such company is engaged in the manufacture or produce of some of the items in the ninth schedule of the Income Tax Act, the whole of the dividend is allowed as deduction, i.e., such income is totally deductible. Some of the items specified are fertilizers, paper, pulp, vegetable oils, cement and pesticides.

Now, let us turn to the restrictions on the inter­corporate loans. Section 370 stipulates that prior approval by special resolution of the company shall be necessary for:

(i) making any loan to a company under the same management,

(ii) giving any guarantee or security for any loans made to or by any body corporate, whether under the same management or not, and,

(iii) making loans to companies not under the same management, where the aggregate of such loans exceed 10% of the subscribed capital and free reserves of the lending company.
Moreover, in the following cases, not only the special resolution but also the prior approval of the Central Government shall be necessary where the aggregate of the loans made to all bodies corporate (i) not under the same management as the lending company, exceed 30% of the aggregate of the subscribed capital and free reserves of the lending company, (ii) under the same management as the lending company, exceed 20% of the aggregate of the subscribed capital and free reserves of the lending company.

(D) Advantages and Disadvantages

Advantages: The role and advantages can be viewed from various angles:

(i) From the viewpoint of industrial and economic growth:

(a) Helpful due to corporate savings: If the economy wants to have 8 to 10% of annual industrial growth, the corporate savings should necessarily be fully exploited. Economic growth is primarily dependent upon the rate of capital formation which in turn depends upon the nation's capacity to save. The nation's saving is the sum total of savings by individuals, corporate undertakings and the Government. The stringent income and wealth tax measures leave little investible
resources with individuals in which case, it is the corporate savings which play significant role. In past, consortium investment and financing by three or four companies had led to launching of gigantic projects like Zuari Agro Chemicals, Modi Rubber, Sriram Fibres, etc. According to a RBI Study of large and medium sized companies working in 1965, it was found that about 33% of the paid-up capital was held by joint stock companies. 62% of the capital was held in large sized blocks, out of which 52% was held by joint stock companies.

(b) Diversification: From the viewpoint of the company, industry as well as, the economy as a whole, diversification helps in facing various risks and fluctuations. It gives more strength against economic as well as political fluctuations and dangers. One of the easiest way is to diversify through inter-corporate investments. The big houses like the Tatas and the Birlas have diversified to such an extent that their overall position is hardly affected by temporary ups and downs at one time or the other. Such position is desirable for stable industrial and economic growth.
(c) **Characteristics of Indian capital market**: In this country, the investing public have come to have confidence only in a few names or so. The Indian capital market is such that it is much easier to raise share capital of a new company if an existing company in which the shareholders have confidence invests in the same. It has often been seen that the main consideration before the investors is the nature of the management of a company before subscribing to its shares. Similarly, while lending, the financial institutions do look at the management constitution, investing and lending groups etc. Thus, intercorporate investments and loans help in optimising the availability of the capital and credit.

(ii) **From the view point of the company** :

(a) **Better use of accumulated surplus**: The basic objective of any private enterprise is maximisation of profit. When the company has got accumulated earnings, the company would try to invest it outside under two basic situations. One, when further ploughing back in the same business is not possible because of infeasibility of expansion. Second, when the yield from the outside investment
more than the yield from the business. In such situations, if the company is not allowed to make investments, the earnings will uneconomically remain in the business and thus, economical industrial growth will be limited.

(b) **Help in crisis:** Suppose, one company faces temporary liquidity problem. If another company is having separable surplus, it can easily lend to the company in difficulty and thus the problems can be smoothly solved. Thus, such internal adjustments become possible if inter-corporate investments and loans are freely allowed.

(c) **Optimum utilisation of resources:** When the companies come close to one another, flow of managerial and technical skills, materials, etc., become possible and everyone gets benefits of such things economically. Thus, the main advantages of the business combinations arise out of the effect of what may be called as 'synergy'. Synergy means that in many situations the combined effect of two or more co-operative acts is greater than the effect if the actions were taken independently. Thus, if two companies work independently, the sum of the results produced by each of them individually would not be as substantial as
when both of them are combined. This is because of the great opportunities which business combinations present for research and development, cost reduction, economy of scale, managerial talent etc. Such synergy not only benefits the company individually but also helps in healthy and speedy industrial and economic growth.

(d) **Diversification and the company** : As stated earlier, most of the companies try to diversify rather than to go for the same line of business. Such diversification gives more strength to the company against economic fluctuations, e.g., the cotton textile units which have already diversified in other lines are less worse off than those which have not diversified at all. So if this way of reducing risk by inter-corporate investments is restricted, the company's capacity to stand during various fluctuations will be reduced.

(iii) **From the viewpoint of the end-users and the society as a whole** :

If the above mentioned advantages are attained, then the natural consequence of it will be steady and enough supply of goods and services which will help in raising the standard of living of an average man. Here, as a special consideration,
let us take two types of units - sick units and the closed units. Existence of both types of units is one type of national wastage of productive capital. In such cases, revival of such units is very essential. But the banks and other financial institutions hesitate in granting the needed financial help to such units due to absence of security and uncertainty in repayment problems. Moreover, in such cases, general public is also unwilling to subscribe for additional capital. So it is generally the help from other companies in terms of inter-corporate investments and loans which encourages and accelerates the revival process of such units.

Disadvantages and Misuses:

(i) **Concentration of economic powers**: Free inter-corporate investments give rise to empireing and pyramiding which leads to virtual control over the economy in the hands of a few. Pyramiding is the process whereby a company at the top gets direct or indirect but virtual control over a number of companies:
In pyramiding, a family gets control of one company by investing in it. The company tries to get shares of another by raising bank loans on the security of such shares and by raising fund by issuing debentures and non-voting shares. The second company does the same thing from outside loans and gets control over some other company. Such a process goes on and the family at the top controls large magnitude of assets. Standard Gas and Electric Company of America pyramided until an investment of less than 1 million dollars controlled approximately 370 million dollars of invested funds.
Concentration by itself is not bad. But when due to it, a group gets improper and disproportionate advantages for themselves it becomes a menace and the public suffer. The Vivian Bose Commission brought into light some instances of misuses.

(a) In some cases, influential persons of the group were appointed as manager or secretary on salary basis for an unusually long period of time and then compensation was paid to these persons for earlier termination of their services. This happened in the case of Dalmia Cenent and Paper Manufacturing Co. Ltd., which was required to pay Rs. 7 lakhs to Mr. S. P. Jain in 1950 by way of compensation for early termination of his appointment as manager of that company in spite of the fact that the company was unable to pay dividend from 1941 onwards.

(b) Sometimes, the device of non-declaration of dividends was also adopted for the purpose of depressing the value of shares. Then the directors purchased a large number of shares from market at reduced prices. After this, the company would declare the dividend and the accumulated profits of the company go into the pockets of the group leaders and all this happened at the cost of the general public.
(c) In the case of inter-corporate loans, the companies were borrowing from banks, general public etc. and lending the same to the another company of the same or the other group. Thus, inter-company loans were made not because the companies had the surplus funds with them but because the group companies wanted to pool the resources from various concerns for becoming stronger and for the benefits of the leaders of the group; e.g., Dalmia Cement & Paper Manufacturing Co. Ltd., borrowed huge sums solely with the objective of lending and investing major portion of them in group companies, so much so that in 1947, 1948, and 1950, the total investments in group companies were above 400% of its paid-up capital and the lendings were even much higher than this.

(d) It was not that only intragroup investments took place. The inter-group investments were also significant. Due to this, the overall grip of a few hands on the national economic resources became quite firm and they could create any type of situation they liked by controlling supply, prices etc. This had very serious impact on the healthy industrial and economic growth of the country.
(ii) **Neglecting original business**: In many cases, it is found that the main business of the company is not given due attention and the management spends its time on investment only. To quote an extreme example, Dalmia-Jain Airways Limited used not a single pie for the airways business for which it was floated. Instead, the whole of the subscribed capital was either deposited with Dalmia Cement & Paper Manufacturing Company Ltd., or was invested in the shares of sister companies. Moreover, these investments were not yielding high return. Thus, neither own business is efficiently carried on nor the investments are done efficiently. This means that the public monies are not utilised efficiently and thus the process of healthy and speedy industrial growth is slowed down.

(iii) **Liquidity**: It so happens that a company, in order to have more income or gain from speculation or to gain control, invests in another company. But investments and lendings without planning may lead to the liquidity problems for the investing company itself. In such situations, it has to dispose off its investments at loss or take loan from the financial institution at comparatively higher rate of interest. So to check such types of unplanned and uneconomical investments and lendings, it is necessary to have some controls on such activities.
(E) Remedial Action

To avoid the widespread misuse of free inter-corporate investments and loans, the restrictions were imposed, first by the Companies Act, 1956 and then by the Companies (Amendment) Act, 1960. The main objectives behind the restrictions were:

(i) to protect the interest of shareholders of the investing company,

(ii) to direct or redirect investment in accordance with the priorities laid down under the planned economy, and,

(iii) to prevent anti-social uses of the opportunities available.

It is doubtless that for economic growth, particularly in a developing economy like ours, corporate savings play quite a significant role. However, restrictions are justified due to misuse of such free flow. A trade-off is necessary between the two. In other words, emphasis should shift from control-oriented policies to development-oriented policies.

Recommendations: The existing restrictions are in respect of "subscribed" capital. But actually, this should be 'paid-up' capital. On a careful reading of the section, it appears that a company having paid-up capital at 10% of its subscribed capital with no reserves, can invest upto 20% of its paid-up capital in the same group, without
any permission, e.g. Suppose a company's subscribed capital is Rs. 1 crore and the paid-up capital is Rs. 10 lakhs. But it can invest 20% of subscribed capital, i.e., Rs. 20 lakhs in the same group companies. This is highly unconvincing. A company's basic capacity to invest and lend is dependent upon its paid-up capital and not the subscribed capital. Under the present situation, the companies will be interested in keeping their subscribed capital as high as possible and the paid-up capital as low as possible. To avoid this, the limits should be linked up with paid-up capital rather than subscribed capital.

In the case of inter-corporate investments, limits are linked up with subscribed capital. But subscribed capital as such has nothing to do with the investing capacity of the company. The company's capacity to invest is largely determined by its capacity to generate resources and the accumulated earnings. So the limits should also be linked up with the free reserves. Otherwise, the present provision does not distinguish between a newly established company having no free reserves and a very established company of the same subscribed capital but with huge accumulated earnings at its disposal.

It was complained before the Working Group on Company Law Administration set up by the Administrative Reforms Commission, that the sanction of inter-company investments beyond the prescribed limits even in cases where such investments were otherwise fully justified
was highly delayed. And the funny thing was that an overwhelming majority of the applications got approved. If majority of the applications are to be approved, then why to unduly delay it for long? To this, it can be suggested that maximum time limits for approval or rejection should be prescribed for various sizes of investments.

Against the argument of what the company will do of its accumulated earnings existing even after investing and lending to the fullest extent, some suggest that such spare funds should be compulsorily deposited with the Government. But this will be a remedy worse than the disease. Moreover, it is not always that the companies keep their spare funds in cash. The solution to this can be that the companies should be allowed to diversify and invest in and lend to the priority industries without any or with liberalised restrictions.

The Monopolies Commission stated in its report that they could not mention any specific instance of misdirection of investment resulting from concentration of power. "...that the question of concentration of economic power is wholly outside the scheme and purpose of the above provisions (Section 372). We do not think therefore, it would be right or proper to use the power of Government under that section for the purpose of controlling concentration". Thus, there is nothing wrong if the limits of 20% and 30% are increased to, say 40% and 50% or the like. Then only, better utilisation of the corporate savings will be possible.
As per the Company Law Board's interpretation, while calculating the limits of 20% and 30%, investments in subsidiaries should also be considered. However, when Section 372 exempts the investments by the holding company in its subsidiaries, it is unfair to include such investments for the purpose of calculating various limits.

There exist certain guidelines for approval of the applications for excess inter-corporate investments. However, there are no such guidelines for approval of inter-corporate loans beyond prescribed limits. So, if some guidelines are framed in this context, it will be helpful to the sanctioning authority as well as the lending company. The lending company will get an idea as to which way to lend.

One of the most important recommendations of the Sachar Committee concerning inter-corporate investments is that the capacity of the investment company to invest in shares or by way of loans should be related only to its 'free reserves' (including that part of paid-up capital which is represented by capitalisation of profits made after the commencement of the Amendment Act incorporating these suggested changes) and not to subscribed capital or net worth as at present. Subscribed or paid-up capital which should normally be invested in its own fixed assets can not really form the basis for making investments or loans.
As per section 370 of the Companies Act 1956, the aggregate of the loans made to all bodies corporate shall not exceed without the prior approval of the Central Government:

(i) 30% of the aggregate of the subscribed capital and the free reserves of the lending company where all such bodies corporate are not under the same management.

(ii) 20% of the aggregate of the subscribed capital of the lending company and its free reserves where all such bodies corporate are under the same management as the lending company.

Further, the investment in preference shares and debentures (the latter in case of the companies under the same management) which are at present included within the perview of section 372 should be excluded. The debentures and deposits, should, however, be included for the purposes of inter-company loans. This means that the restrictions should mainly be applicable in terms of investment in equity shares and loans to borrowing companies.

In addition to this, the Sachar Committee has recommended that inter-company investments should be restricted to the following:

(i) Promoting a new company either independently or jointly with any person.

(ii) Taking over a sick unit, and,
(iii) Taking over an existing company after making an offer to buy shares from all the shareholders of such a company on terms and conditions equally applicable to all of them and after obtaining the approval of the Company Law Board.

The limit prescribed by the Committee is likely to reduce further the scope of inter company investments in the cotton textile mills of Ahmedabad, the level of which was already low during the period of this study.

(F) Inter-corporate Investments and Cotton Textile Mills of Ahmedabad

My study of the Balance-Sheets of the 50 cotton textile units of Ahmedabad during 1966 to 1975 has revealed the information relating to inter-corporate loans and investments as exhibited in Table VI.1, Table VI.2, and Table VI.3.
<table>
<thead>
<tr>
<th>Sr.No.of investing or lending textile unit</th>
<th>Form of investment at the end of 1975</th>
<th>Average Investment (Rs. lacs)</th>
<th>1966-70</th>
<th>1971-75</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>25</td>
<td>2863 Equity shares &amp; 51C9 Preference shares</td>
<td>0.74</td>
<td>0.15</td>
</tr>
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<td>46</td>
<td>196 Equity shares</td>
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<td></td>
<td>8</td>
<td>5 Equity shares</td>
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<td>40G Preference shares</td>
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<tr>
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<td>6</td>
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</tr>
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<td>43</td>
<td>44</td>
<td>25155 Equity shares</td>
<td>19.39</td>
<td>31.98</td>
</tr>
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<td></td>
<td>25, 7.7% - Debentures</td>
<td>25.00</td>
<td>5.00</td>
</tr>
<tr>
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<td></td>
<td>Total</td>
<td>44.39</td>
<td>36.98</td>
</tr>
<tr>
<td>27</td>
<td>29</td>
<td>Loans</td>
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<td>0.71</td>
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<td>Total</td>
<td>0.20</td>
<td>0.71</td>
</tr>
<tr>
<td>26</td>
<td>6</td>
<td>100 Equity shares</td>
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<td>Total</td>
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<td>14535 Equity shares</td>
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### Table VI. 2

<table>
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<th>form of investment made by lending textile units</th>
<th>Average Investment (Rs. lacs)</th>
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<tr>
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<td>1966-70</td>
</tr>
<tr>
<td>1. Equity Shares and Preference Shares</td>
<td>83.62</td>
</tr>
<tr>
<td>2. Debentures</td>
<td>25.00</td>
</tr>
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<td>3. Loans</td>
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<td><strong>Total</strong></td>
<td><strong>108.82</strong></td>
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### Table VI. 3

<table>
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<tr>
<th>Sr. No. of the borrower textile units</th>
<th>Borrowings from other units (Rs. lacs)</th>
<th>%age of total funds</th>
<th>%age of non-Proprietorship funds</th>
<th>1966-70</th>
<th>1971-75</th>
<th>1966-70</th>
<th>1971-75</th>
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<tr>
<td>2</td>
<td>62.90</td>
<td>62.90</td>
<td>16.73</td>
<td>12.02</td>
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<td>00.17</td>
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<tr>
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<td>00.01</td>
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<tr>
<td>10</td>
<td>00.40</td>
<td>00.40</td>
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<td>00.13</td>
<td>00.29</td>
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<tr>
<td>25</td>
<td>00.74</td>
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<td>00.62</td>
<td>00.08</td>
<td>00.70</td>
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<tr>
<td>29</td>
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<td>00.71</td>
<td>00.09</td>
<td>00.19</td>
<td>00.12</td>
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<td>44.39</td>
<td>36.98</td>
<td>16.00</td>
<td>06.25</td>
<td>21.86</td>
<td>08.50</td>
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<tr>
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<td>00.18</td>
<td>00.11</td>
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<td>00.14</td>
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</table>
The following observations can be made on the basis of above data:

(i) Out of the 50 cotton textile units of Ahmedabad, only 8 textile units had borrowed funds or accepted investments from the other textile units. There were only 6 textile units which had made this inter-corporate investment possible during the whole period of 1966-75.

(ii) The inter-corporate investments in terms of equity shares and preference shares had increased by 14.50% from Rs. 83.62 lacs during 1966-70 to Rs. 95.79 lacs during 1971-75.

(iii) The inter-corporate investment in the form of debentures had declined drastically by 80% from Rs. 25 lacs during 1966-70 to Rs. 5 lacs during 1971-75. The general unpopularity of debentures as a form of investment seemed to be the major factor responsible for such a decline.

(iv) Although the total amount of inter-corporate loans was very small during both the periods, the same had increased from 0.20 lacs during 1966-70 to Rs. 0.71 lacs during 1971-75.

(v) The total inter-corporate investments and loans had marginally declined from Rs. 108.82 lacs during 1966-70 to Rs. 101.50 lacs during 1971-75.
(vi) From the viewpoint of the absolute amount of investments made or loans given, the unit No. 22 was the largest lending during 1966-70 as well as, during 1971-75. It was equal to about 60% of total investments made by all lending companies. In addition to this, this unit had invested in one unit only, i.e., unit No. 2. Both of them were managed by the same set of persons.

(vii) The inter-corporate borrowings were confined to only 8 textile units. The maximum benefit was taken by unit No. 2, during both the periods. However, it may be noted that the borrowings had declined both as a %age of total funds and as a %age of non-proprietorship funds during the latter period.

(viii) In the case of unit Nos. 6, and 8, the borrowings were negligible when compared with their total funds or non-proprietorship funds during both the periods.

(ix) The largest decline in borrowings was found in the case of unit No. 44, both as a %age of total funds and as a %age of non-proprietorship funds. This position can be explained in terms of the following factors:

(a) Its earning capacity had improved during the latter period. With a restrained declaration of dividends, conservation of more profits was possible. The share of reserves in total
funds had increased from 12.10% during 1966-70 to 16.20% during 1971-75.

(b) It had obtained larger borrowings from banks and financial institutions during the latter period. The share of total secured loans in total funds had increased marginally from 27.10% during 1966-70 to 28.30% during 1971-75.

(c) It had obtained larger trade credit during the latter period. Its share in total funds had increased from 22.40% during 1966-70 to 31.21% during 1971-75.

It may be concluded that on the whole, the intercorporate investment and loans were a very minor source of finance for the borrower units. If we consider all the fifty units of Ahmedabad, it may be said that the contribution made by this source of finance was only negligible during both the periods and that, their share in total funds as well as non-proprietorship funds had actually declined during the latter period of study.