Of Traders, Usurers and British Capital: Managing Agencies and the Dalmia Jain Case

Tyabji, Nasir

2009

8

Of Traders, Usurers and British Capital

Managing Agencies and the Dalmia Jain Case

Nasir Tyabji

The Problem Posed

The years between 1947 and 1966, covering the period from Independence to the end of the Third Five Year Plan, provided the arena for the most acute debates over the content of industrial development. In essence, these controversies centred on the form of ownership and control of the industrial undertakings which were already in operation and those which were to be established. Primarily at issue, thus, were the roles of the public sector and of the private sector on the one hand, and of Indian and foreign capital within the private sector, on the other.

Equally debated at the time was the form of industrial organisation that was appropriate for the private sector under a system of socially regulated industrialisation. In particular, the Managing Agency System, linking a closely held decision making organisation allied to joint stock companies came under extensive scrutiny. This system, originated as an organisational form during the East India Company's retreat from monopoly in India's external trade, and subsequently served as the vehicle for British and Indian enterprise in trade and industry.[1] Though this system had supporters right upto the time it was abolished in 1969, the myriad methods available for financial manipulation it provided had made it the basis for criticism since at least the time from which Indian industry's performance came under scrutiny with the establishment of the Indian Industrial Commission over 50 years earlier.

---

1. See Kling (1966).

The question of the role of the managing agency system is involved in two subsidiary aspects of the debate, both of the roles of foreign capital in development, and of the respective places of public and private enterprise within national capital. In the case of foreign capital, the issue is the contrast between its forms of operation, through managing agencies and as subsidiaries of Transnational Corporations (TNC). Political notice of this second manifestation was evident in the early warnings of the growth of the "India Ltds," and note was also taken of this distinction in the first of the RBI Surveys of foreign capital in the late 40s. Academic awareness, however, was expressed much later in the monographs of Michael Kidron and Matthew Kurien in the 1960s and subsequently in the 1980s by Tomlinson and Goswami in journals.[2] These identified the phenomenon of the parallel and independent growth of transnational subsidiaries after some early attempts at collaboration with the managing agency houses, and the contrasting trajectories of these two forms of operation of foreign capital: a gradual retreat, though marked by sometimes aggressive holding operations by the agency houses, and the increasing presence of TNCs, both through subsidiaries and in joint ventures with Indian capital.

While the contrasting nature of the operations of foreign capital in managing agencies, and in TNCs has received attention, however sporadic, the second of the subsidiary themes mentioned at the beginning of the previous paragraph has been almost entirely ignored. This is the distinction, within national capital between industrial capital on the one hand, and merchant (trading), or usury (money lending) capital when in ownership, control and operation of industrial enterprises. Trading or money lending activities, empirically distinct from manufacturing have, of course, been identified. However, the critical distinctions between these forms of existence of capital, 'when in ownership of industrial enterprises' have generally been omitted from analysis.

Empirically, it is recognised that in the jute industry some entrepreneurial interests, after accumulating capital through trading or money lending, established entirely new jute mills (Birla, J K Singhania, and Sarupchand Hukumchand), while others bought controlling blocks of shares in existing mills and elbowed their way onto the boards of these

2. See Kidron (1965), Kurien (1966), Tomlinson (1981), and Goswami (1989).

companies, and even displaced the incumbent managing agents.[3] These quite distinct ways in which Indian industry grew are representative of equally clear distinctions in processes in political economy. The first embodies the transformation, however partial and slow, of capital accumulated in trade and/or through money lending into industrial capital as the enterprise grows, while the second signifies the phenomenon of the parasitic control of an industrial unit by representatives of unreformed merchant or usury capital.[4]

The problems this would pose for industrial development were not recognised in the early examinations of the planning process, such as those by the National Planning Committee, nor by mainstream academic commentators of the time. Even after independence, there seems to be only one exception in Brimmer's analysis of the "setting" of entrepreneurship in India.[5] In fact, his analysis makes clear that the issue is quite momentous for a serious study of Indian industrialisation. He argued that it was extremely important, if the managing agency system was to be understood, that the nature of the managing agency firm and its relation to the controlled

3. This is evident from the official account of the opaque origins of the Dalmia Jain Group. According to this version, the "Dalmias had an unpretentious beginning, and it was only in 1932 that they came into some limelight by starting the South Bihar Sugar Mills with borrowed capital. Their income tax record for the period 1932-1939 did not even suggest that they possessed big capital; in fact, their assets fell far short of their liabilities during that period. It was asserted by Mr. Ram Krishna Dalmia that in 1935, he made a huge profit of some 50 lakhs in speculation in silver, done through Shanghai in London, but he could not produce any documentary evidence in support of his statement. According to Mr. Dalmia these profits were gradually invested in shares. Thus by 1939, they acquired controlling interest in twelve concerns, the share capital of which was nearly Rs 393 lakhs." [emphasis added] JN Papers, File 81, p. 260, Para 2 of "Gist of the Report by the Income Tax Investigation Commission on the Dalmia group of cases" enclosure to letter No 640-PSF/51, April 20, 1951 from CD Deshmukh, Finance Minister to Jawaharlal Nehru [henceforth JN].

4. An interesting aspect of this tendency was provided by the kinds of manipulations of the depreciation fund. According to then current accounting practices, depreciation charges were not to be excluded from the amount on which an agency's commission was calculated. On the other hand, expenditure on renewals, replacements, and so on, was to be excluded. Thus, in a system of commission on profits, there was a tendency to transfer the maintenance charges to the depreciation fund, thereby increasing the commission. In this way, the depreciation provision, never adequate, was actually reduced still further. Levkovsky (1966), p. 248, quoting Samant, D and Mulky, M (1937): 59-60.

5. Brimmer (1955).

company be fully comprehended. It was to be clearly noted that the managing agency firm 'was the firm' in the sense in which this term was known in institutional economics. If the firm was defined as the institutional setting in which entrepreneurial decisions were made, it was immediately clear why the managing agency firm should be so designated. To achieve their ends of expanding their capital, the managing agents had generally made use of the joint stock form of organisation for the companies launched to undertake actual production and trade. These latter companies were then to be considered as operating units of the central, decision-making unit—the managing agency firm. To understand the substance of economic activity encompassed by the managing agency system, then, it was critical to avoid a preoccupation with the managing agency as a legal entity, so also with the whole system of company law in India.

The implications of this understanding are more profound than may be immediately apparent. If a manufacturing firm is merely an operating unit (or even only one unit of many) of a managing agency, which is itself an organisational expression of an accumulation of merchant or usury capital, then it cannot be held that the capital that is comprised of the agency and associated manufacturing units represents industrial capital. The situation is analogous to the historically familiar case represented by a handicraft establishment subordinated to a trader. The trader in this case, not the master artisan nominally in control of production was the actual entrepreneur. There is extensive discussion in Indian Economic history of whether enterprises of these types represented production of an industrial capitalist form or provided even the "pre conditions" for industrial capitalism. In his work on the development of capitalism in India, Levkovsky discussed in considerable detail the influx of merchant and usury capital, not only in the initial establishment, or the purchase of industrial units, but also their infusion into ongoing processes of capital accumulation.[6] Thus, even the growth of the assets of an industrial enterprise could not be taken to be entirely the result of industrial capital accumulation.

This issue was compounded by developments in the post-war period. It arose from the very substantial amounts of money capital which were acquired by various black market operations during the Second World War.

6. Levkovsky (1966). See, also, Lamb (1955).

These provided the means by which the ranks of Indian "industrialists" were expanded in the post-war period, by the device of buying their way into the sphere of industrial operations by cornering blocks of shares in existing firms, often controlled by British Managing Agencies.[7] The thrust of the argument presented in the following sections of this paper is that these groups were to pose a major problem, both economic and social, to the political executives of the Indian state when planned industrialisation became the proclaimed objective. It is in the context of the necessity of achieving a large task of social engineering that the initiatives of the state should historically be evaluated. This paper examines one particular effort along these lines, the unravelling of the Dalmia Jain Group's mode of operation. It is postulated that the Group represented one of the largest of the concentrations of largely unreformed merchant/usury capital, and that their methods of using the nexus between their managing agency and associated manufacturing firms quintessentialised the behaviour of this form of capital.

The Early Response by the State

The widespread evasion of taxes during and after the Second World War led to attempts by the government to identify the concealed income, and also to levy a special tax on the super normal profits currently being earned by industry. The very first Budget of the interim (Congess-Muslim League) government had, in fact, in February 1947 announced the institution of an Income Tax Investigation Commission.[8] The more general proposals had to be considerably diluted because of concerted opposition led by the Federation of Indian Chambers of Commerce and Industry (FICCI), although it is significant in the context of the discussion to follow that the All India Manufacturers Organisation (AIMO), a conglomerate of

7. Brimmer (1955) characterises the Indian Managing Agencies as "primarily financial in character" (p.558). Further, "...With a few notable exceptions, the Indian agency firms seem to administer the operating companies under their control with a view to obtaining the maximum profit in the shortest possible time...the detractions [to the development of Indian industry] made by Indian agency firms have been made by businessmen still in the process of maturing" (p.559).

8. Chattopadhyay (1988) discusses the Budget proposals and their background. There is a detailed account of the post budget controversy in Tyabji (2002)

predominantly small and medium manufacturing firms characterised this opposition as emanating from 'businessmen' seeking quick profits, and not from true industrialists.[9] The concept of the Investigation Commission survived into Independence and also formed part of the Budget passed in late 1947. However, the Commission trod a very cautious line in estimating the degree of concealed income and estimating the quantum of revenue and penalty payment due to the government.[10] Although it was not explicitly mentioned, it seems clear that the concealed income could be shown to be nominal because of the difficulty in tracing financial transactions between firms that were interconnected through having common managing agents. In other words, the efforts of the Income Tax Investigation Commission, however fruitless in gaining for the government the revenue which was its due, brought sharply into focus the varied methods by which funds could be diverted and excess profits earned without leaving evidence of extra legal practices.

In the meantime, a series of startling disclosures made by the Bombay Shareholders' Association had exposed the loopholes in the 1913 Indian Companies Act.[11] This, together with the absence of an effective organisation to administer the provisions of the Act, had enabled businessmen and financiers to misuse and pervert these provisions to swerve their personal ends.[12] In the case of a large number of companies, the Managing Agency had been used to undertake a variety of corrupt practices. Together with the Shareholders Association, scrutiny by the

9. Bombay Chronicle, 21 March 1947, p.4. The opposition was stridently voiced by both the Birla owned *Hindustan Times*, and the Dalmia Jain controlled *The Times of India*.

10. This was evident from their estimate, in 1951, of the concealed income of the Dalmia Jain Group which amounted to Rs.4.58 crores, over the eight year period from 1939 to 1947. During the same period, the Dalmias increased their controlling interest over share capital in both acquired and new enterprises from Rs 3.93 to Rs. 16 crores. JN Papers, File 81, p.260, "Gist of the Report by the Income Tax Investigation Commission on the Dalmia group of cases" enclosure to letter No 640-PSF/51, April 20, 1951 from CD Deshmukh, Finance Minister to JN.

11. Bombay Shareholders' Association (1949)

12. The account in this and in the following paragraphs is based on Congress Party in Parliament, Indian Companies Bill, 1955 (*mimeo*), note in JN Papers, File 367, pp. 79-113.

Fiscal Commission, the Income Tax Investigation Commission, and the Planning Commission had raised a general discussion on several aspects of Company Law. The main points that were discussed were the following:

1) The manner in which companies were promoted and formed, with particular emphasis on the law guiding the issue of prospectus, minimum subscription and the allotment of shares;
2) The nature and scope of the control exercised by shareholders in company management;
3) The powers and functions of the Directors and the control exercised by them over the companies and their managing agents;
4) The terms of appointment and conditions of service of Managing Agents and their powers and functions in respect to both the Board of Directors, and the General Body of Shareholders;
5) The powers of investigation and inspection conferred on the Government in cases of gross mismanagement of companies;
6) The manner in which books were kept and audited;
7) The position of minority shareholders and the protection they were entitled;
8) The rights of shareholders and creditors in the event of the liquidation of a company;
9) The administration of the Companies Act including the need for an authoritative body to keep a close and continuous watch on investment markets.

In response to these shortcomings, the government initially appointed two officials to examine the question of amendments to the Company Law in 1949. Subsequently, after discussions on the memorandum submitted by these officials, the Company Law Committee established in October 1950, reported in 1952. On the basis of this Report, the government introduced the Companies Bill in 1954 in the Lok Sabha, which after consideration was referred to a Joint Select Committee. While the government itself had replaced the Companies Act Committee's recommendation for a Statutory Authority to administer the Act by a Departmental authority, the Select Committee made other modifications, particularly in relation to managing agencies, and the mechanisms by which companies were to be managed.

Most importantly, the Joint Select Committee inserted a provision by which managing agents could be prohibited in specific industries. Secondly, all new agreements between agents and managed companies were subject to the government's approval.

It was at this stage that the trajectories of company law reform, the role of foreign capital and the specific malpractices of the Dalmia Jain group converged, and the paper now turns to a consideration of these issues.

The Issue: "Straightforward" Tax Avoidance in Industrial Operations vs. Manipulation of Public and Shareholders' Funds through Interfirm Transfers

The general point was stated in a note prepared by the Income Tax authorities. They argued that tax evasion by manufacturing concerns had existed in most countries during and after the war, the least affected being Switzerland and the Scandinavian countries. The problem had in all cases been dealt with by special schemes, which had one common feature which accounted for their success: this was the criminal prosecution of the most glaring cases. Tax experts were unanimous that this was the only possible method as it was not possible to detect more than a handful of cases, and tax evasion would continue unless there was evidence of very severe consequences. The deterrent moral effect of even one serious prosecution would be far reaching. In the Indian case, despite the provisions of the Voluntary Disclosure Scheme of 1951, whose terms implied prosecution of those who did not declare their concealed income, not a single prosecution had taken place by the end of 1955. It was estimated that Rs. 100 crores was evaded every year or an aggregate of Rs. 500 crores during a Plan period.[13]

A year earlier, the Dalmia Group had again provided evidence that the Managing Agency system was capable of allowing operations that even the most skillful financial analyst could not fault. It was a specific Dalmia financial company, Bharat Insurance, that was subject to scrutiny and, in this case, a professional auditor was appointed. On the basis of his report, a

13. JN Papers, File 410, p.197, enclosure to note by MO Mathai, December 31, 1955.

change in management was recommended by the relevant authority, the Controller of Insurance. However, Dalmias appealed for a rehearing of their case with the government and, finally, the matter was resolved by a method that left the Dalmias in an advantageous situation.[14]

At the end of the following year, the Employees Union of the Times of India and Allied Publications presented a representation in which the purchase of the Times of India building by Bharat Insurance, together with allegations of *benami* share transfers from Ramkrishna Dalmia to his son in-law, Shanti Prasad Jain, were again to figure. By this time the government, frustrated by five years of attempts to pin down the details by which Dalmia's financial manipulations were undertaken, had begun to consider an enquiry under the Commissions of Enquiry Act. Equally significantly, the government had recognised that its concerns of sustaining sources of revenue were directly linked to issues of shareholder democracy. Without the disclosure of operational results of firms from the beginning, it was impossible for investigators to trace the means by which company management could manipulate records, set up dummy directors, and transfer funds from publicly held to the promoter's closely held companies. Auditor's reports occasionally provided evidence of these practices but the provisions of civil law, when invoked to identify and collect concealed income, could be challenged. The only control on corrupt practices was through shareholder's vigilance, but the bulk of shareholders were inclined to be apathetic, while company management could win over cantankerous elements amongst them. Thus, shareholder's interests and government revenues could be better protected by changes in company law which would

---

14. There were four charges made against the firm. 1) that the company transmitted large funds from time to time to S P Jain and the Dalmia Cement and Paper Marketing Company for the ostensible purpose of investment but really in order to allow them to make illegal use of the money; 2) that government and approved securities supposedly to be held under the Insurance Act were never actually bought; 3) that large investments were made in related Dalmia enterprises at inflated prices; 4) that property was bought from other Dalmia firms, also at inflated prices. Of these charges, the most critical 1) and 2), which implied straightforward diversion of funds, could not be proved, precisely because of the leeway that the managing agency system provided. In effect, Dalmia's only obligation was the requirement that they buy back from Bharat Insurance, valuable urban property (the Times of India building in Mumbai) within 10 years at the same price at which it had been sold. JN Papers, File 298, pp 83-86, letter No 853-PSF/54 dated April 21, 1954 from the Finance Minister to JN.

require greater disclosure of all operational results. Although the Enquiry would not meet either shareholder's or government's purposes directly or quickly, the public would be educated about the kinds of manipulations that management's engaged in and, equally, allow the government to identify the precise ways in which company law required to be changed.[15]

The essential feature of the devices that the Dalmia group used was of interlocking of companies, clearly through the mechanism of the managing agency system.[16] Thus, Dalmia Jain Airways, a major company in the group was amalgamated with Dalmia Jain Aviation after it had suffered major losses due to mismanagement. Records of the company were subsequently destroyed through a board resolution at which only three board members, all Dalmia employees were present. Dalmia Cement and Paper Marketing Company was entirely owned by Ramkrishna Dalmia, and was used as the clearing house of the group, with all speculative profits accruing to Dalmia while losses transferred to other group companies. Dalmia's personal expenses were also debited to the Company. Shriyans Prasad Jain was appointed to a tax-free salary of Rs. 4000 per month and shortly thereafter, when this appointment was terminated compensation was paid to Jain of Rs. 7 lakhs. The Shapurji Broacha Mills and the Madhowji Dharamsi Manufacturing Company, profitable and well-established firms were cornered by Dalmia, and his closely held companies were made sales agents for them. When these arrangements were ended, a total of Rs. 114 lakhs was paid as compensation by the mills, which accrued to the selling agents. The decision to terminate the selling agencies and payment of compensation was taken by two Directors, both Dalmia employees. Ultimately, the mills were taken into liquidation. Funds of Bharat Insurance were placed at the disposal of Shriyans Prasad Jain and used to acquire or to retain control over other companies, though they had been given for investment in shares and securities.

The general pattern appeared to be the same in all the companies of the group. Funds were not used for the purpose for which the firms had

15. JN Papers, File 392, pp 248-49, letter No O117-PSF/55 dated October 17, 1955 from the Finance Minister to JN. Nehru's concurrence with the proposal to institute a Commission of Enquiry is in the same file, p.250, in his letter No 1945-PMH/55 also dated October 17, 1955.

16. JN Papers, File 443, p. 80, letter No 0365-PSF/56 dated May 15, 1956 from the Finance Minister to JN.

been established, and for which public subscriptions had been enlisted.[17] They were invested in companies of the group. As these shares were not dividend paying, the funds were available free of interest. After a few years, the shares would be transferred to the closely held companies as a security for loans, and an agreement reached between debtor and creditor company that the loans would be repaid without interest, in a number of yearly installments. Sometimes the loans were adjusted against compensation payable to closely held firms to terminate their agency agreements.

The point was that taken by themselves and isolated from the chain of events in the group as a whole, many of the actions appeared within the letter of the law, or at the worst, trivial offences.[18] It was then essential to probe into the affairs of the group as a whole and obtain an overall picture of the state of affairs within the Dalmia Group and the ways in which the investing public had been duped by the opportunities that the interlocking of the group companies had provided to appropriate public funds. However, given that the powers of a Commission were limited to those of a civil court, it was proposed to modify the rules of procedure to give the Commission the powers similar to the Income Tax Investigation Commission.[19]

The Dalmia Jain Group was self evidently not the only group which was known to have evaded taxes on a gross scale. To take the most obvious, there had been protracted correspondence over the Birla Group, in particular, their operations in West Bengal where the State Government was unwilling to concede that the failure of efforts to identify evidence of widely surmised malpractices required deeper investigation using innovative means.[20] More spectacularly, in what the Central Board of

17. *Ibid.* p.79
18. As early as 1949, the memorandum of he Bombay Shareholders Association had pointed to the Dalmia Jain Group, and to other similar cases and demanded an ordinance to prevent interlocking of companies. See Bombay Shareholders Association (1949), pp. 206-211.
19. JN Papers, File 443, p. 78, letter No 0365-PSF/56 dated May 15, 1956 from the Finance Minister to JN. Nehru's concurrence with the procedure suggested is in the same file, p.81, in his letter No 1172-PMH/56 dated May 16, 1956.
20. The controversy was probably initially raised by the distribution of the exposure by Debajyoti Burman, later published as Burman (1953) at the 1950 session of the Congress. Subsequent correspondence between B.C. Roy, the West Bengal Chief Minister and JN is available in JN Papers, File 56, p.237, File 59, pp.271-277, and p.389 and File 65, pp 197-202.

Revenue described as the biggest case of concealment in income in the history of tax collection, the Board of Tata Sons, the managing agents of Tata Iron and Steel, were directly accused of conniving in enormous concealment of taxable income.[21] The argument of this paper, however, is that these were straightforward cases of managing agents using loopholes available in accounting practices to lower the degree of taxable income chargeable to firms in their control. This practice, however reprehensible, is a normal feature of capitalist enterprise and the cat and mouse features of the attempts by the revenue authorities to identify the practices by which evasion is concealed a standard component of actual political life and of fiction. What made the Dalmia Jain practices 'qualitatively' different was that they represented in quintessential form the unreconstructed activities of merchant capital operating through the legal forms of joint stock enterprise and the institution of the managing agency. As the examples of their operations briefly outlined above show, they are characterised by a total absence of concern about the manufacturing operations. Their value lay in the possibilities of access to centralised capital subscribed by the dispersed and managerially ineffective shareholders, the image they had earned as profitable and dividend paying companies, for whom raising further resource would not be difficult, and the safeguards of limited liability which made speculative and extra legal operations within manageable bounds for their owners.

---

21. "An Income Tax Investigation into the affairs of TATAS was started by the top experts of the Central Board of Revenue about three years ago in 1953. Overwhelming documentary evidence of original letters signed by Mr. J.R.D. Tata, Sir A.R. Dalal, Mr. J.D. Choksi and other Managing Agents' representatives and copies of letters of protest addressed by the auditors of the company to the Managing Agents, and other evidence collected by the C.B.R. experts have proved that during the years 1940 to 1946, the Managing Agents of the Tata Iron and Steel Co. deliberately concealed profits amounting to Rs 3 ½ crores and has evaded Excess Profits Tax and Income Tax thereon of about Rs. 2 ¾ crores....This by itself constitutes the greatest single tax evasion case in the history of Indian income tax, discovered long after the Voluntary Disclosure Scheme had lapsed. Nor has such overwhelming documentary evidence in support of a case ever come into the possession of the Government....Powerful pressure has been and continues to be exercised at all levels for hushing up the matter, although it is rendered somewhat difficult by the spreading knowledge of these events among members of Parliament and the Public and the consequences that befell Shanmugham Chetty in a similar in a similar situation." Unsigned and undated note enclosed with M.O. Mathai note to JN dated December 31, 1955 in JN Papers, File 410, pp. 198-99.

It should also be noted that despite the dramatic aspects of the Haridas Mundhra case, his methods of operation presaged those made familiar by the Harshad Mehtas of the post-neo liberal phase of the Indian economy. This meant that the Mundhra operations were stock market speculations, unconcerned even with gaining management control in the short or long-term, let alone like the Dalmias, of squeezing all liquid assets out of operating industrial enterprises under their control.[22] In other words, given the vast array of economic offenses requiring the attention of the Finance Ministry, from political economy considerations, for identifying and prohibiting the parasitical operations of merchant capital in joint stock industrial enterprises, it was the correct decision to focus and examine Dalmia Jain operations.

The decision to appoint a Commission of enquiry, after approval in principle by the Cabinet was referred to a Cabinet subcommittee so as to examine the terms of reference. Interestingly, it was decided that this Subcommittee was to be chaired by the Home Minister, G.B. Pant, with the Ministers of Defence, Works, Housing and Supply, Food and Agriculture, Legal Affairs and V.K. Krishna Menon, then without a portfolio, as members. The composition of the subcommittee is an indication of the seriousness with which the matter was to be taken, with the recommendations to be referred back to the cabinet.[23] After two meetings

22. Starting in the tea export trade, Mundhra kept both the sales proceeds and profits in sterling in London, using this to raise further finance in India. Gradually, he began buying British Indian Companies such as Jessops, Richardson and Cruddas, Duncan and Stratton, the Brahmaputra Tea Company and Oslers Electrical concerns, apart from a few collieries. However. "…the main appeal which he has – as a potential purchaser – in the British market is his preparedness to refrain from general interference with the internal workings of the companies he buys….at least one big insurance company in the United Kingdom is prepared to support him…it is difficult to see how he has been able to do all that he has without the knowledge of the U.K. Exchange Control authorities. The support which the U.K. Exchange Banks give him would necessarily mean at some stage or another a guarantee with the Head Offices of the Exchange Banks for Mundhra's loans in India and for that purpose some kind of approval or acquiescence by U.K Exchange control would be necessary." Letter from the Finance Minister to JN, No. 084/PSF/55 dated September 21, 1955 in JN Papers, File 385, pp. 116-17.[emphasis added] See also, *India* (1958a), *India* (1958b), and *Free Press Journal* (1958).

23. Minutes of the Meeting of the Cabinet held on Wednesday, the 25th July, 1956, at 5.30 pm, Case No. 180/39/56 on item "Alleged Mismanagement of a large number of Dalmia Group of Concerns," in JN Papers, File 457, p.353.

of the subcommittee, the Cabinet approved the terms of reference of the Commission in November 1956.[24]

The Managing Agencies under Scrutiny

Although the managing agencies date from the middle of the 18th century, and the institution of joint stock companies from the Act of 1850, Company Law in India did not recognise the managing agency system until 1936. After the First World War, malpractices indulged in by a number of managing agencies which resulted in the collapse of several companies created so much public resentment that a move for the abolition of the system gained momentum. The Bombay Shareholders' Association, in particular, put forward cogent arguments in favour of abolition, but the government decided in favour of introducing shareholder regulation. In this year the Act then in operation (passed in 1913) was modified to ensure that in future the appointment of a managing agent could only be made after the shareholders had passed a resolution at a general body meeting. After the Second World War, the same malpractices which the 1936 amendments

contd...

However, while it is true that the Home Minister was probably the most appropriate choice, his proclivity to treat corporate misconduct benignly was displayed almost 20 years earlier. In a discussion of the amendments to the Companies Act in the Central Legislative Assembly, Pant had attempted to narrow the grounds under which a Managing Agent could be removed. This was opposed by the Law Member who asserted that the shareholders had the right to dismiss managing agents on any number of grounds and that limiting this would not be in their interests. Bombay Shareholders' Association (1949), p.149.

24. It may be of note that Krishna Menon did not attend either of the subcommittee meetings. Also, neither Nehru nor M C Shah, Minister in charge of Revenue and Civil Expenditure, were informed of the first meeting, though Shah, at Nehru's urging was present at the second meeting. Soon after the Cabinet meeting establishing the Subcommittee, a Lok Sabha question asked confirmation of this fact, which as followed by a letter to Nehru from S P Jain. In this, he declared that after a 1948 split, here was no such entity as the Dalmia-Jain group, and he wished for an opportunity to explain that he was now in charge of the Sahu Jain group that had no links with Dalmia, and he was apprehensive of adverse publicity of the investigation. Nehru instructed Shah to meet Jain and hear his case. JN Papers, File 462, letter no 1702-PMH/56 dated August 5, 1956 and 1707-PMH/56 dated August 6, 1956 from JN to Shah, and letter dated August 5, 1956 from S.P. Jain to JN in JN Papers, File 462, p.42, 132 and 41, respectively.

Minutes of the meetings of the subcommittee are in JN Papers, File 467, pp. 68-70 and File 470, pp.111-113. The Cabinet approval is in JN Papers, File 486, p.120.

were designed to prevent appeared again.[25] Thus, despite this clause, the situation remained such that in 1951 it could be asserted that the managing agency was the active agent and managed joint stock companies merely operating arms of the agency.[26] Although government officials were in favour of abolishing the system, the Company Law Committee which reported in 1952 continued to hold that the system could be reformed. It was then left to the Parliamentary Joint Select Committee which was formed to scrutinise the 1953 Companies Bill, to suggest the first major inroads on the system.

These proposals were passed after strenuous opposition and pressure on the Congress members of the Select Committee. A letter from the All India Congress Committee (AICC) complained to Jawaharlal Nehru that although a compromise had been reached within the Congress after the INTUC leader Khandubhai Desai met the Finance Minister. However, it was felt within the AICC that the managing agency system was the feudal equivalent within industry that *zamindari* was in agriculture. Presumably, the implicit argument was that if one of these had been abolished on political grounds, so should the other be.[27] On the other hand, Amrit Kaur, the Health Minister wrote a hand written letter to Nehru offering a novel argument in support of the managing agency. She said that GD Birla had reported a conversation that he had with Gandhi, where Birla asked what capitalists could do to reduce the hostility towards them. Gandhi reportedly informed Birla that the only means to do this was to work for the country's prosperity. In this context Amrit Kaur appealed to Nehru that the industrialists should be given a chance, presumably in this context by retaining the right to managing agencies.[28] H P Mody asked Nehru to arrange a meeting with the members of the Select Committee, and Satyanarayan Sinha was told to arrange it with the Chairperson and members.[29] The opposition to reform measures also came in the form of reminders that it was the managing agency system that allowed

25. Page 2 of Congress Party in Parliament, Indian Companies Bill, 1955 (mimeo), note in JN Papers, File 367, pp. 79-113.
26. Brimmer (1951), p.
27. Letter dated November 22, 1954 in JN Papers, File 297, p. 46.
28. Letter dated November 23, 1954 in JN Papers File 297, pp. 112-13.
29. JN Papers, File 297, pp.229-230.

industrialists to donate to political funds generously.[30] These were provisions by which the government could prohibit managing agencies in specific industries, and require that all agency agreements would be subject to scrutiny. Finally, the practice by which managing agencies could be inherited was also prohibited.[31]

Significantly, one of the very first influential voices in support of managing agencies came from the British Chancellor of the Exchequer in early 1955. He protested at the generality of the proposals, which were to cover all managing agencies and not merely those engaging in fraudulent activities. The time period before the restrictions were to come into force was also a matter of objection. The most ingenious of the complaints was that the ownership of a Managing Agency agreement was itself a property right (quite distinct to the financial interests that the agreement may have been based on), and the government of India's proposed amendment to Article 31 of the constitution, which ensures property rights was arousing uncertainty amongst would be investors.[32] In his response to these apprehensions, the Finance Minister explained that through his own intervention the new provision of "Secretaries and Treasurers" had been introduced. His explanation is worth quoting in detail:[33]

> They [Secretaries and Treasurers] will not be in a position to control the affairs of companies as managing agents have often done in the past, but will be able to exercise almost all the powers needed to manage the companies in

30. B.C. Roy, Chief Minister of West Bengal linked the Income Tax Investigation Committee and changes in company law to increasing difficulties in raising election funds. JN Papers, File 299, p. 50. Perhaps coincidentally, G.D. Birla repeated the same point in a letter to MO Mathai. The ingenious argument here was that while the Managing Agents were able upto the present time to make contributions for political or disaster related appeals from the funds of a company, they would henceforward have to obtain the agreement of the shareholders in a general body meeting. This was likely to arouse "controversy" and deny any grace to the giving of the contribution. Mathai was asked to bring the "dangerous" move to the Prime Minister's notice, and he was intending to approach T.T. Krishnamachari, then Commerce and Industry Minister, directly. Personal and Confidential letter dated August 9, 1955 in JN Papers, File 369, pp.209-11

31. Congress Party in Parliament, Indian Companies Bill, 1955, p. 35-36. See, also, the note signed by the Finance Minister enclosed with his letter No. 1169/PSF/55 dated April 2, 1955 to JN in JN Papers, File 331, pp.188-190.

32. Letter from R.A. Butler, Chancellor of the Exchequer to JN, dated February 14, 1955 in JN Papers, File 320, pp.159-60.

33. Paragraph 4 of the Finance Minister's note enclosed with his letter 1169/PSF/55 dated April 2, 1955 in JN Papers, File 331, p.191.

> their charge subject to the effective supervision, management and control of directors. In other words, like the managing agents they will be able to place at the disposal of the managed companies all the economies of large-scale management, which have hitherto constituted the principal justification of the managing agency system. The Select Committee did not place any limit to the number of companies which Secretaries and Treasurers, as such, could manage. What it objected to was the undesirable concentration of economic power in the hands of a few managing agents and the provision limiting the number of companies which a managing agent, as such, could manage to ten was designed to secure this object.

Although there is no immediate evidence, it is likely that the introduction of this provision formed the basis of the compromise reached between Khandubhai Desai and the Finance Minister mentioned above. However, this proviso was seen by some Congressmen, emboldened by the declaration of the objective of the Socialistic Pattern of Society by the Lok Sabha, to insist that this was allowing the back door entry, if not perpetuation, of managing agencies. Speculation within the press led to another intervention by the British Government through its High Commission, which sought reassurance from Nehru that the provision of Secretaries and Treasurers would not be diluted. Similar protests had been made by Indian businessmen to the Secretary of the Department of Company Administration but it was the diplomatic initiative, even if informal, that led the Cabinet Secretary to forward the British representation to Nehru.[34]

There is another point worthy of note. If British interests were concerned about preserving managing agencies as institutions as a way of ensuring existing assets, there was little interest in investing in new ventures for which the Second Five Year Plan was to create new opportunities of private investment. However, Indian firms, for whom planned economic growth meant precisely the opportunities of new areas of growth, were directly affected by the new clause by which government could prohibit managing agents in specific new industrial sectors. The paper circulated to Congress members of parliament gave three examples by which this proviso could be bypassed, all through the device of diversifying existing enterprises managed by agencies into these new fields.

---

34. The press report titled "Company Law Changes," in the Times of India of July 16, 1955 was enclosed together with the High Commission representation in the Cabinet Secretary's note dated August 3, 1955 in JN Papers, File 367, pp.223-25.

These were the Jiyajirao Cotton Mills with Birla Bros. as managing agents which had issued preference shares of value of Rs. 1 crore in order to set up a soda ash factory, while the Birla Jute Mills was in the process of constructing a cement factory with an investment of Rs. 2 crores. Darangadhara Chemicals were establishing a soda ash plant with investment of Rs. 3 crores. G.D. Birla, who had managed to acquire a copy of this paper objected that the Jiyajirao soda ash plant had been ventured into at the specific and persistent pleading of the Saurashtra Government. What was interesting in this case was that initially Birla claimed that the problem of raising capital would make the project infeasible. However, when the Saurashtra authorities offered to provide Rs. 1 crore as loan from the Government of India, Birla apparently found no difficulty in raising the capital through Jiyajirao Cotton Mills, for a venture in an entirely distinct field. It is intriguing that neither Nehru nor Mathai apparently grasped the point of the Congress Parliamentary Party paper, that such practices sidestepped possible controls on managing agents in new branches of industry. Both chose to view the objection to be in the nature of nit picking at any manifestation of growth of existing business.[35]

In the context of the distinction between the two organisational forms of operation of foreign capital, the managing agency and the TNC subsidiary, it is important to note that the TNCs were not in favour of agencies even in their joint ventures with Indian firms. This opposition was sufficiently strong to threaten at least one joint venture. In the case of dyestuffs, Imperial Chemical Industries (ICI) refused to agree that the Kasturbhai Lalbhai firm of Atul could continue to be managing agency run, and insisted that the Board of Directors have full powers. This became a matter of concern leading to a swift exchange of telegrams between the Indian High Commission in London and the Minister of Commerce and Industry.[36] Significantly, ICI also refused Lalbhai's suggestion that the powers and remuneration of the managing agency would be restricted by

35. Birla's initial letter of protest, Nehru's chiding letter to the Secretary of the Congress Party in Parliament, Nehru's "no objection" note to Mathai, and Mathai's reassuring response to Birla are in JN papers File 367, pp.114-19.

36. Telegram No. 1855 dated July 23, 1956 from Iengar to L.K. Jha and reply in telegram no. 09236 dated July 24, 1956 in JN Papers, File 457, p.16 and p.71.

the board of directors. It will be recalled that this was the substance of the reforms suggested by the Select Committee on company law reform.

The main issue underlying the opposition to managing agencies was the concentration of capital and, consequently, the economic power for which the agencies provided an institutional framework. The paper circulated by the Congress' Parliamentary Party started its argument by saying that while the Second Five Year Plan placed emphasis on the growth of the public sector, where an investment of Rs. 1000 crores was envisaged in the five years, the private sector was expected to invest Rs. 500 crores. This was placed in comparison with the total investment of Rs. 1400 crores over the entire 150 years which encompassed the entire industrial era in India. The investment was to take the form of either the floatation of new joint stock companies or the expansion of existing enterprises. Thus, the paper argued, given both the constitutional injunctions against the concentration of income and wealth, and the Lok Sabha Resolution on the socialistic pattern, company law should rightfully consider aspects of economic policy, and prohibit those practices of company formation, promotion, management and administration which were conducive to undesirable economic consequences. The chief instrument for this was the managing agency system. By implication, the later lobbying within Congress circles against the provision of Secretaries and Treasurers was on the same basis.

Although this provision did ultimately appear in the new company law, concern over the economic consequences of the interlocking of companies continued to cause concern to the administrators of company law. That they had reason to do so was made evident in a representation that G.D. Birla sent on behalf of fellow businessmen, including Vitthal Chandavarkar, J R D Tata, Modi and others. After a meeting with U.N. Dheber, then Congress President and Morarji Desai, then Chief Minister of Bombay State, the representation was forwarded to Dheber and Nehru, through M O Mathai.[37] The note was suffused with objections to the way in which clauses of the Bill had identified the 'associated' firms and individuals of any given firm, i.e. attempted to pin down the mechanisms of interlocking. According to the note, there were four specific powers likely to be at the disposal of

37. Letter 353-PMO/55 dated August 18, 1955 from Nehru to the Finance Minister, explaining the context of the Mumbai meeting and the note, in JN Papers, File 371, pp.193-94.

government if it chose to investigate the affairs of a company. Firstly, the affairs of an associate could be included in the scope of investigation; secondly, the restrictions on managing agencies holding the right to buy or sell on behalf of the firm applied also to associates; thirdly loans to associates were restricted in the same way as they were to the managing agent; and, finally, when a managing agent was debarred from acting in this capacity, the same prohibition would apply to the associate. Particular objection was taken to the inclusion of first cousins and spouses as 'relatives,' and thus associates.[38] There were numerous other objections, about the institution of 'proxies, who would be entitled to attend company meetings on behalf of shareholders, of government's much expanded powers of intervention, of refusal to recognise managing agents as appropriate, and so on. However, it was clear from the phrasing of the note that the specification of the 'associate,' with all its implications of identifying interlocking arrangements, was the chief feature causing anxiety to business men.

The Denouement: The Final Abolition of Managing Agencies

The Commission of Inquiry appointed by the government to examine the operations of the Dalmia Jain Group reported in 1963, after delays due to court cases filed by the Dalmia Jain group had been heard and dealt with. The report was the subject of extensive debate in the Lok Sabha, where the members generally responded to the revelations contained in the Commission's Report with a degree of resignation. The methods by which the group had defrauded shareholders and the government might have been new in detail, but the MPs were evidently at a loss on how precisely these practices were to be prohibited. Shanti Prasad Jain's plea that his group had only utilised the same procedures that were common to big business operations neatly summed up the situation, although this was not an accurate description.[39] As has been suggested earlier, by using the frame of

38. "Note on Company Law" enclosed with letter dated August 16, 1955 from G.D. Birla to MO Mathai, File 371, pp.1-4.

39. Page 9 and 39 of the petition by Shanti Prasad Jain quoted by Homi Daji, MP, in the course of the Lok Sabha debate on the Motion Re: Report of the Commission of Enquiry into Dalmia Jain Companies on May 6, 1963. Column 14030 of Lok Sabha Debates, 1963, Volume XVIII.

joint stock companies as a means to aggrandisement, the Group had behaved in a qualitatively different way to the "straightforward" cases of tax evasion of Tatas, Birlas, and even the stock market speculation of Haridas Mundhra.

Despite the generalised revulsion of Dalmia Jain business practices expressed in the Lok Sabha debate, the supporters of the managing agency system fought a determined rearguard action.[40] When the Managing Agency Enquiry Committee was announced by the Government in 1966, it was asked to confine its attention to the utility of the system to enterprises in "established" industries. It will be recalled here that ICI had objected to Kasturbhai Lalbhai's insistence on a managing agency for the joint venture with Atul Products. As is well known, almost all the firms in the new industries were formed with foreign collaboration with TNCs which were unlikely to differ from ICI's unwillingness to incorporate the managing agency. The injunction to the Enquiry Committee to confine itself to the established industries is evidence of the perception that the system provided some advantages in these new ventures, situations where uncertainties might be expected to be greater. It is also of some interest that the Committee, having chosen as its traditional industries, cotton textiles, jute textiles, cement, paper, and sugar, decided without explanation that managing agencies should be abolished in all except jute textiles and paper. Even given the residual British interests in jute, it is not overly speculative to conclude that the special attention given to this, one of the two oldest and most well established industries, was due to their continuing influence on industrial policy. However, as a part of the wide ranging reforms in industrial finance, which included bank nationalisation, the Government of India decreed the total abolition of the managing agency system from 1969.

While detailed company level analysis would be required to establish the case conclusively, the extensive documentation over the 40 year period of financial irregularities made possible by the managing agency system, it would seem reasonable to conclude that by the late 1960s, the most backward forms of capital had been removed from control of industrial

40. This was apparent from the publicity given to the special pleading on behalf of the Dalmias, contained in documents such as Mittal *et al.* (1963?).

enterprises The tenaciousness of the struggle waged by it is only an indication of the complexity of the process of development of industrial capital in colonial societies. Equally glaring was the change of rankings of many of the big business groups, notorious from the days of Ashoka Mehta's pioneering pre-war pamphlets, and stable amongst the handful which were synonymous with term 'big business' for the next 30 years.[41] Their relative, if not absolute decline, in the industrial arena was an indication that without the instrumentality of the managing agency system with which to sustain their financial manipulations, they had succumbed to the logic of an industrial economy.

References

Primary Sources

Papers of Jawaharlal Nehru (Post 1947). First Installment, archived in the Nehru Memorial Museum and Library, New Delhi.

Secondary Sources

Basu, Saroj Kumar (1958). *The Managing Agency System: In Prospect and Retrospect.* Kolkata: The World Press.

Bombay Shareholders' Association (1949). *Amendment of the Indian Companies' Act: Memorandum of the Bombay Shareholders' Association on Managing Agents*. Mumbai: Bombay Shareholders' Association.

Burman, Debajyoti (1950). *Mystery of Birla House*. Kolkata: Jugabani Sahitya Chakra.

———. (1953). *Mystery of Birla House: Part Two*. Kolkata: Jugabani Sahitya Chakra.

———. (1957). *TTK and Birla House*. Kolkata: Jugabani Sahitya Chakra.

Chattopadhyay, Raghabendra (1988). "Liaquat Ali Khan's Budget of 1947–48: The Tryst with Destiny" *Social Scientist* XVI(6 & 7): 77–89, 181–82.

Corporate Studies Group (1983). *Functioning of Industrial Licensing System:A Report* (mimeo). New Delhi, Indian Institute of Public Administration.

Free Press Journal, (1958). *Mundhra Inquiry: The Full Story.* Mumbai: Free Press Journal.

Goswami, Omkar (1989). "Sahibs, Babus, and Banias: Changes in Industrial Control in Eastern India, 1918-50" *The Journal of Asian Studies* XLVIII (2): 289-309.

Government of India (1958a). *Commission of Enquiry into the Affairs of the Life Insurance Corporation of India–Report.* Delhi, Manager of Publications.

41. Thus, the Dalmia Jain Group and its offshoots are no longer within the group of the 20 largest industrial houses in terms of assets by the early 1980s. See Table II.2, p.24 of Functioning of Industrial Licensing System—A Report, Corporate Studies Group (1983), which is based on a reply to a Rajya Sabha question of 1981.

————. (1958b). *Report of the Life Insurance Corporation Inquiry* [Vivian Bose, Chairperson]. Delhi, Manager of Publications.

————. (1963). *Commission of Inquiry—Inquiry on the Administration of Dalmia: Jain Companies, 1956—Report* [Chairperson: S R Tendolkar, Vivian Bose]. Delhi, Manager of Publications.

————. (1966) *Report of the Managing Agency Enquiry Committee* [Chairperson: I.G. Patel]. Ministry of Law, Department of Company Affairs. Delhi, Manager of Publications.

Kidron, Michael (1965). *Foreign Investments in India.* London: Oxford University Press.

Kling, Blair B. (1966). "The Origin of the Managing Agency System in India" *The Journal of Asian Studies* (26)1: 37-47.

Kurian, K.M (1966). *Impact of foreign capital on Indian Economy.* New Delhi: People's Publishing House.

Lamb, Helen B. (1955). "The Indian Business Communities and the Evolution of an Industrialist Class" *Pacific Affairs* (28)2: 101-116.

Levkovsky, A.I. (1966). *Capitalism in India: Basic Trends in its Development.* New Delhi: People's Publishing House.

Lokanathan, P.S. (1935). *Industrial Organisation in India.* London: George Allen and Unwin.

Melman, Sofia (1963) *Foreign Monopoly Capital in Indian Economy.* New Delhi: People's Publishing House.

Mittal, G.P. *et al.* (1963?). *Painful Story of Dalmia and the Bose Commission Report* (np).

Muranjan, S.K. (1935). *Modern Banking in India.* Mumbai: New Book Co.

National Council of Applied Economic Research (1959). *The Managing Agency System: A Review of its Working and Prospects of its Future.* Mumbai: Asia Publishing House.

Samant, D. and M. Mulky (1937). *The Organisation and Finance of Industries in India.* Kolkata: Longmans, Green and Co.

Tomlinson, B.R. (1981). "Colonial Firms and the Decline of Colonialism in Eastern India 1914-47" *Modern Asian Studies* XV(3): 455-486.

Tyabji, Nasir (2002). "Jawaharlal Nehru, Big Business and the Liaquat Ali Khan Budget of 1947" in Sujata Patel *et al.* (eds.), *Thinking Social Science in India: Essays in Honour of Alice Thorner.* New Delhi: Sage Publications.