THE MODERN CORPORATION AND THE RULE OF LAW *

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The joint-stock company or the corporation as it is called in some parts of the world is such a pervasive institution in modern society that the authority and powers attaching to it appear to persons who may be concerned with its management or to operators in the market place dominated by this institution as something intrinsically belonging to this form of organization. Yet, the truth is that the modern joint-stock company or corporation has come to its present position only after a long process of historical growth and development, which has not only progressively influenced its structure and behaviour pattern but has also basically determined its changing relationship to the rest of the society in which it has functioned. In order to appreciate fully the role and significance of the modern corporation in present-day society, it is important for enquiring minds to know the main stages in the evolution of the historical process, and to view the developments in this field in their proper perspective.

The concept of the corporation as a self-governing economic organization is basically as old as the trade guilds of the ancient and medieval times. In our country, mention is found of these inchoate trading corporations in the *Arthashastra*, and in some of our other earlier literature on the organization and work of our ancient polity, fragmentary as such reference is. In the Western world, the concept of the corporation appears to have been well-established in law at the beginning of the middle ages, when this concept was applied to ecclesiastical bodies, local civic units like boroughs and to craft and mercantile guilds, which between them embraced the most dominant institutions in the economic organization of society in those days. Later on, the concept was extended to the organization of specialized vocations and professions. By this time, the legal rights and liabilities of the corporation had also been broadly defined. Its principal distinctive features, viz., its right of survival beyond the lives of its members, and its capacity to hold property, to sue and to be sued—

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had become already well-recognized in law and administrative practice, and its right to regulate the affairs of its members had also been conceded. But the exercise of these rights and powers were subjected to careful supervision by the specific terms of the grant of corporation status to these guilds. By the middle of 16th century, this authority to confer corporate status passed on to the representative assemblies, wherever they existed. It was at this time that the corporate form of organization was used for the first time to set up national mercantile organizations of the type of the well-known Chartered Companies of the 16th, the 17th and early 18th centuries of which the East India Company was the best known in this part of the world. This was the real beginning of the modern joint-stock company, for, it was in these Chartered Companies that the old legal concept of the corporation was fused with the economic devices of joint-stock trade. What was formerly only a convenient legal institution created by law to promote and further self-governing bodies primarily concerned with civic, craft or professional business, confined to well-defined territorial limits, became a powerful economic and financial institution whose activities often extended beyond the limits of the incorporating State and which possessed the authority not only to administer the privileges, conferred by royal or parliamentary grants among its members but also the right to use them for the benefit of the institution, within the limits of the charter granting it those privileges. It is not necessary in this context to dilate on the social and economic factors which led to this far-reaching change in the character and dimensions of the corporation. The important point to note is the shift in the centre of gravity of the internal power exercised by these mercantile chartered corporations. Whereas in the case of the old civic, craft or professional guilds, their governing bodies were democratically constituted and were concerned primarily with regulating the affairs of the members of the guilds and their relations with outsiders, the new chartered companies or corporations represented by the national mercantile bodies, which were generally engaged in foreign trade or colonization, were run by a relatively few men, who were the promoters of these bodies and whose main function was to further the objects for which these corporations had come into being, and not so much to regulate the affairs of their members in their dealings among themselves or with outsiders.

Two major factors brought about a further transformation of the joint-stock company or the corporation, both in its internal structure and in its mode of operation. The first was the series of technological revolutions sparked off by the invention of the steam engine at the end of the 18th century and ending with the invention of the internal com-

bustion engine towards the end of the 19th century. The second was the social and political enfranchisement of the middle classes which might be said to have been brought about in most of the Western countries of the world between 1830 and 1960. To cut short a long story, the combined effect of these two major developments in the technological and sociological fields was to alter, basically, the character of the national economies of the Western countries. The autarchic mercantilist economic policies of the 17th, the 18th and the early 19th centuries rapidly gave way to the classical liberal economic policies of which in the socio-economic circumstances of that era, opened the door wide to private enterprise in a manner which could be hardly dreamt of in the earlier centuries. The impact of these far-reaching changes on the growth of the modern joint-stock company and the generalized corporation laws which were to follow was profound. In part, the liberation of the national economies of the Western countries from their earlier mercantilist cast was greatly facilitated by the emergence of the multi-purpose corporation based on the generalized corporation laws enacted in these countries about the middle of the 19th century. The ease with which this form of organization could be set up and the structural elasticity and operational freedom which it enjoyed rendered it eminently suitable for widespread use for carrying on economic activities on a large scale. The momentous legal invention of the concept of limited liability cleared the ground for the increasing financial participation of large numbers of people of relatively limited means in the new enterprises organized through these joint-stock companies. By the second half of the 19th century, the joint-stock company or the corporation had already become the standard and dominant form of organization for carrying on industry and commerce in all the Western countries. As an acute student of the subject has observed: "What had been a rare, privileged entity existing at the will of the sovereign, exercised deliberately for great ends of policy, became in the course of hardly half a century's development, from 1800-1850, a form of organization available almost of right to easily qualified people feeling the need for it. . . . Like its near relative the *contract*, the corporate charter was now freely available on condition that it was used for business or trading purposes."

The rapid rise in domestic trade and industry, leading to an equally rapid rise in the volume and diversity of international trade progressively enlarged the sphere of the joint-stock company and the scope of its activities, so much so that the turn of the 19th century and the beginning of the 20th witnessed the emergence of a large number of international companies or corporations, whose fields of activity crossed

the frontiers of the national states and embraced many different countries. This growth in the size and complexity of the modern joint-stock companies and the progressive extension of their sphere of activity lifted them out of their original, historical economic setting as mere legal institutions for the production and marketing of goods and services, and placed them almost at the centre of the economic life of the modern community. The growth in the scale of business and their complexity also automatically increased the economic power exercised by the corporations. This power was not, by any means, confined to the volume of goods or services which the corporations produced or to the proportion of their turn-over to the national aggregate of goods and services. It extended to wage rates, working conditions, and other terms of labour management relationship not only in individual corporations, but also increasingly in the rest of the organized economic sector of the country where the norms laid down by the big corporations set the pattern for others to follow. Similarly, the price policy of the individual big corporations influenced the course of prices in the industries to which they belonged, and indeed set the general price pattern in all connected industries. The consumption pattern of the community was similarly influenced both by the price and the production policies of these corporations. Likewise, the investment policies of the big corporations through their borrowing programmes and capital issues, to the public affected the responses of the investment markets, while the methods adopted by them for financing and refinancing their investments largely determined the terms and conditions on which capital could be obtained by other seekers of it.

The marketing systems adopted by these corporations affected the work and fortunes of thousands of wholesalers and retailers, who earned their living by selling the products of the industries under the management of these corporations. The ramifications of the economic power of the modern corporation can be easily imagined from this brief recital. The big joint-stock companies or corporations are, indeed, the pace-setters in all these different areas of the organized sector of the economic life of the modern community.

It is usual in current literature on the economics of modern corporations to attempt to quantify their economic power by relating their scope and activity to the entire corpus of the economic activities of the country. The indicators generally used for this purpose are the amount of capital invested in these corporations, the number of share-holding interests in them, their aggregate turn-over; the proportion of this turn-over to the gross national product of the community; the total capital assets of these companies; the share of these assets to the aggregate pro-

ductive capital of the community; the contributions which companies make to the revenues of the State; the number of workers employed by these companies; the proportion of this number to the total gainfully employed population, etc. Figures relating to these indicators are readily available in the technical literature on this subject in the advanced countries of the world. In this country, a detailed factual survey¹ on this subject was made in the former Department of Company Law Administration about four years ago and several subsequent surveys have brought these figures reasonably up-to-date.

In the foregoing paragraphs, an attempt has been made to indicate the nature and extent of the direct and indirect economic power exercised by the modern joint-stock companies or corporations in the organized sector of the society in which they function. Dominant as this economic power is, especially in slowly developing countries like ours, no less significant is the noneconomic power enjoyed and exercised by them, although in popular discussion on this subject, this aspect of the economic power exercised by the modern companies is usually overlooked. As an acute American observer of the corporation scene remarks: "Economic power is not the whole story, however, not perhaps even its most important part. Concern with the modern corporation is intensified to the extent that its activities have necessarily ramified beyond the economic sphere of production of goods and services. . . . Across a widening range of activity, the large corporations have become principal factors. They are the chief agencies of private research. They are the hope of fund raisers for institutions of higher learning and the principal consumers of the products of those institutions. Their advertising supports newspapers and sponsors T. V. programmes. They are a leading, if not the leading, purveyor of influence and pressure on public officials in Washington and state capitals. . . . It follows that in these spheres and others they bear large responsibility for the quality and tone of American life This attribution of responsibility is not a token of hostility to the large private corporation. What has been said amounts to no more than that the great corporation is the dominant nongovernmental institution of modern American life. The university, the labour union, the church, the charitable foundation, the professional association—other potential institutional centres—are all, in comparison, both peripheral and derivative." Apart from the reference to the hope of fund raisers and to the T.V. programmes, discerning observers of the Indian scene will notice how closely this American analysis corresponds to the known

¹ *Vide* "The Corporate Sector in India" published by the Department of Company Law Administration, 1960.

facts about the noneconomic power equally exercised by big corporations in this country. To say this again is not to pass judgment, but to recognize the emergence of a new sociological institution, viz., the modern corporation.

In the Western countries it is only during the last 15 or 20 years that this aspect of the working of the corporations has received any worthwhile notice, and it was not till some nine or ten years ago that the practical businessmen and the operators in the market place in those countries recognized the pervasive quality of noneconomic power which the corporations were unwittingly exercising on the life of the community in which their activities were carried on. In our country, it is only very recently that this fact has been recognized by the theoreticians of our economic system. There is, however, still very inadequate appreciation of this situation even by the most far-seeing of business leaders. Yet, it is on the recognition of the modern corporation, not merely as a convenient legal device for the production of goods and services on a large scale, but in its true present-day character as a new sociological institution, embodying a system of non-governmental power, that any adequate and comprehensive economic and social philosophy about the modern corporation can be built up. It must, nevertheless, be said to the credit of the theoreticians of our economy that shortly before Avadi² they perceived the emergence of this new system of power represented by the modern corporation, and the impact which it was likely to produce on our life and our Government of the day and had the pre-vision to take note of this factor when they formulated their proposals for the enactment of the new Company Law between the years 1952 and 1955. How this recognition, vague as it was, affected the course of our corporation law is a theme which will be developed towards the end of this paper. In the next following section a brief analysis of the broad changes in the character of corporation laws which were brought about in the Western countries by the gradual emergence of the modern corporation into its present position of status and strength from the early days of the medieval guilds follows.

Evolution of the Traditional Corporation

When corporate status was conferred on the medieval civic, craft or trading guilds, the intention was to endow them with some limited powers of self-government. The object of these powers was to enable the guilds to administer the privileges conferred by corporate

² Refers to the Avadi Session of the Indian National Congress at which the famous resolution on "Socialistic pattern of Society" was passed.

status among their members in an equitable manner, to enforce discipline among the members in the exercise of privileges, and to regulate the relationships as between them as well as between them and the outsiders who might have dealings with them. Since the grant of corporate status at this stage was limited to certain specified objectives, the terms and conditions of the grant were relatively simple and easily enforced. The fact that these guilds operated within circumscribed territorial and fairly well-defined functional limits rendered adequate oversight of their activities within the framework of their franchise relatively easy.

The mercantilist corporations of the 17th and the 18th centuries were also entrusted with equally precise functions but these functions had little in common with the functions of the medieval guilds. These functions were basically intended to subserve the ultimate objects of the mercantilist economic policies of the newly emerging national States of that period, and were largely concerned with the development of foreign trade and the exploitation of foreign resources. Partly because of this and partly because the members of these corporations were related to one another primarily as contributors to the capital of these corporations, and not in the integral manner in which the members of medieval guilds were connected with one another, the idea of self-government by guild members as a whole lost its reality. The royal or parliamentary charters which conferred corporate status on these mercantilist corporations were granted only on grounds of high policy after careful scrutiny and assessment of the objects likely to be achieved by the grant of such status in the context of the national economic and social policies of the States concerned. Secondly, severe limitations were imposed on the size and the activities of these corporations. This was sought to be justified by the monopoly rights conferred on them, and also by the political necessity of preventing such corporations from developing into so many *imperia in imperio*. The other provisions of the charters of these corporations usually dealt with their internal organization, but they were not usually spelt out in detail, nor did the regulations provide for any clear cut allocation of authority as between the different organs of the corporations. The dominant principle underlying the charters granting corporate status to the national mercantilist corporations of the 17th and the 18th centuries appeared to have been to hold them to the activities specially authorized by charters. As long as the managers of these corporations kept themselves within the strict limits of the object clauses of these charters, nothing else seemed to matter much. There was little attempt in these charters to regulate the relations of the

members of the corporations *inter se*. This was undoubtedly a source of considerable risk to those who entered into contracts with these corporations, but in the earlier stages of these national mercantilist corporations these risks appear to have been subordinated to the paramount necessity of achieving the object targets set out in their charter.

With the emergence of the corporations formed under the general corporation laws enacted in the Western world about the middle of the 19th century, the basic pre-supposition of the *ad hoc* corporation laws of the earlier medieval and mercantilist periods underwent a major change. At first the general laws of incorporation which supplanted the individual charters of the earlier mercantilist period contained many of the restrictions which it was usual to include in them. In the light of the changed economic circumstances and the prevailing socio-economic philosophy in the middle of the 19th century, many of these restrictions ceased to have any functional significance and were clearly out of tune with the temper of these times. It is not, therefore, surprising to find that these earlier generalized laws soon gave way to the traditional pattern of corporation laws which was evolved in the Western countries in the second half of the 19th century and which were to be eventually copied by countries like ours, which had adopted the Anglo-American model in this field. Basically, this new pattern of corporation laws was evolved round the underlying concepts of the law of contract. Within this theoretical framework, it was primarily for the parties which had combined to set up corporations to determine the limits of their respective duties and responsibilities. This fundamental change in the legal character of the corporation meant the abandonment of the effort to subject business decisions to review by the State either through the processes of the courts or by direct executive control through the restrictive provisions of the incorporating charters as in the case of those constituting the mercantilist corporations of the 17th and the 18th centuries. If one were to make a hurried synoptic survey of the development of corporation laws in the Western countries during the last hundred years, particularly in the Anglo-American segment of it, one might summarise the findings by saying that the three primary sources from which the traditional corporation laws derived their sustenance were:

- (a) first, in the field of law, the law of contract which has been described as the "most powerful stream of the 19th century legal growth";
- (b) secondly, in the economic field, the principles of *laissez-faire* which held sway throughout the Western world from about the middle of the 19th century to the beginning of the 20th; and

- (c) thirdly, in the socio-political field, the model provided by the liberal democracies of the 19th century of the mid-Victorian type in England and of the Jacksonian type in the United States of America.

These different strands of law, economics and politics combined to provide the model for the so-called shareholder's democracy of the traditional joint-stock company as embodied in the generalized corporation laws of this period.

It is not necessary in this context to go into a detailed analysis of the nature of the influence exerted on the concept of the joint-stock company by these three major streams of thought. The practical consequences of the model on legislative and judicial thinking for nearly a century were clear. By and large, it was considered that the internal relations between the members of the joint-stock company or the corporations, and between them and outsiders were governed by the principles of contract, and as long as these principles were observed it was reasonable to assume that the interest of the individual members and the enterprises to which they belonged were well-protected. Agreements or arrangements entered into in violation of these principles would, to that extent, be voidable or void depending on the relevant facts and circumstances, and where guilty intention was established the penal laws would of course be attracted. Apart from these aberrations or deviations, which would no doubt involve civil or criminal liability as the case might be, there should be no reason to interfere with the judgment of "willing buyers and willing sellers," and business decisions were best left to those who were in a position to take them. The so-called economic principles of *laissez-faire* were thought to ensure that "the greatest good of the greatest number" could be secured by agreements and arrangements freely entered into by sane adults, and "the invisible hand of competition" could be depended upon to bring about the necessary adjustment and accord between the activities of corporations and the interests of the society. The political model of the 19th century democracy gave respectability to the concept of the so-called shareholder's democracy. This structure of corporate management was thought to ensure self-government and also to solve the two basic problems of corporate management, namely, its legitimacy and accountability. The managements of the corporations were supposed to derive their legal and moral authority for the powers which they exercised from the fact that they owed their office to the suffrage of the shareholders, and they were also deemed to be accountable to the shareholder-electorate, inasmuch as by the requirement of the corporation laws they had to render an account of their stewardship to

this electorate at least once a year. This was the grand politico-economic model of the self-governing joint-stock corporation which was embodied in the corporation laws of the Western countries for nearly a hundred years from the middle of the 19th century.

Our company law in the past, which was wholly based on the English law, except, in regard to a few topics dealing with some of our special institutional features in the corporate field, was also based on this traditional Western model. The principal legal levers on which the framework of this prototype rested were:

- (1) A set of elaborate provisions designed to ensure the protection of shareholders through a system of disclosure of the so-called "essential" facts relating to the formation and working of a joint-stock company;
- (2) A string of provisions laying down the procedure for decision-making in those areas of management, where the views of the members of a corporation had to be expressed;
- (3) A series of provisions intended to safeguard the rights of creditors and others, outside the corporations who might have had dealings with these companies;
- (4) Several provisions dealing with the so-called accountability of management to the shareholders, through the audit of company accounts by qualified auditors and an *exposé* of the stewardship of the management at the annual general meetings of companies;
- (5) Provisions for investigation into the affairs of companies in certain special circumstances;
- (6) An elaborate system of procedural requirements relating to the dissolution of corporate status, and the disposition of corporate assets and liabilities; and
- (7) Punitive provisions against proved malpractices and offences, involving guilty intention.

As long as the aforesaid objects were achieved, there was little else for the traditional corporation laws to do so far as the regulation of corporate affairs was concerned.

The Modern Corporation as a System of Power

This version of the joint-stock company or the corporation as a self-governing democracy in miniature, functioning within the framework of the provisions of the traditional corporation laws might have had some distant relevance to the small and medium-size companies,

consisting of a relatively small number of shareholders with a significant financial stake in them, and possessing a fairly intimate knowledge of the business of these enterprises which was relatively simple and largely localized. But this version was soon destined to be rendered out-of-date by the emerging reality of the modern joint-stock company. The character of this structural change has been thus described by a keen American student of corporate history:

As scale expanded, the shareholder was less and less the capitalist, risking funds and exercising supervisory authority over a business with whose physical and financial workings he had informed and sophisticated acquaintance. He became an investor, separated in time and understanding, insulated by distance and the proxy machinery from the business activities of the enterprise which used his money. Suffrage was exhausted of reality, since it was neither informed nor organized. Despite the forms of electoral control, management became in all but rare instances, an automatic self-perpetuating oligarchy, in Adolph Berle's phrase. The reality of internal corporate structure had changed from democratic to bureaucratic.

This fundamental change in the internal structure and functioning of the modern joint-stock company or the corporation had rendered the traditional framework of company or corporation laws largely antiquated and otiose. Sociologically also, the emergence of the modern corporation as a system of economic and noneconomic power, from its original historical character as a convenient legal device for the production and marketing of goods and services exposed the inadequacies of the existing systems of corporation laws for dealing with the problems created by the new situation. The new problems which confronted company lawyers, company administrators and the theoreticians of the subject were how to legitimize the use of this rapidly growing volume of nongovernmental power and to subject the exercise of this power to a new concept of the Rule of Law applicable to the use of this type of power. These problems emerged in an acute practical form in the Western countries after the Great Depression of the thirties, and led to a great deal of new thinking on this subject in law, economics, political science and sociology. Our struggle for freedom and our pre-occupation with the militant politics of those years effectively prevented us from participating in this new thinking or from drawing lessons from the legal and administrative reforms in this field which were being attempted in some of the Western countries. Even in those countries, it was not till the end of the Second World War that the full effect of the new thinking was felt in intellectual

circles. Meanwhile, a rapid rise in the standard of corporate methods and practices, largely following from World War II and the growth of a new professional managerial class, which the War effort itself had encouraged and fostered, gave rise to a new philosophy of the social responsibilities of business, which was avidly taken up by the leaders of the trade and industry in the Western countries. This development, in my opinion, largely accounts for the tardy growth of a new system of corporation law based on the new concept of the modern corporation as a system of power. In other words, it seems to me that the urgency of structural changes in the legal and administrative systems relating to the corporations was not felt, because the behaviour pattern of company management which was still functioning within its old legal-administrative framework had undergone a rapid transformation. The manner in which an organization functions often masks the defects of its structure; and it may well be that the growth of a pragmatic social philosophy in the Western countries relating to corporate behaviour may have largely made good the deficiencies of an out-of-date legal and administrative system. But in the developing countries of the world, where the traditional forms of organizations have not yet felt the winds of change, and have not been activated to a new behaviour pattern, as in the Western countries, the need for legal and administrative engineering to supplement the corrosive action of slow-moving ideas becomes urgent. Even in the Western countries, it is being increasingly recognized in academic and other thinking circles that corporation laws must build into their structure a new concept of responsibility in respect of the exercise of power by corporate management. Unfortunately, even in those countries legal and administrative technology has not yet advanced to a stage where it can be used for engineering purposes to rebuild the structure of their corporation laws or to recast the operative provisions contained in them in a manner that could enlist the general agreement of all those who are connected with their administration or enforcement.

The need for a developing law of corporate responsibility is nevertheless urgent—particularly in the developing countries of the world where corporate management and practice, over large areas of the corporate sector, have yet to be modernized and adequately informed by the values of a co-operative and responsible society. In the field of government and constitutional law, where the central problem has been always the control of governmental power, the need for relating the exercise of this power to a broadly accepted conception of the public interest has been well-recognized for well over a hundred years in all the Western democratic countries. In the jargon of consti-

tutional and administrative lawyers this is described as the enforcement of the Rule of Law. For historical reasons, this concept has, however, been used in the past only in the context of the regulation of governmental power. The emergence of the modern corporation as a system of significant nongovernmental power would seem to call for an extension of this concept to the exercise of nongovernmental power not only by the modern corporations but also by other nongovernmental institutions or authorities which may possess similar power and may be in position to use it, in socially significant ways, in large sectors of the life of a modern community. It may be argued plausibly that in many developing countries, the modern joint-stock company or corporation may not have yet become a centre of significant nongovernmental power and that till such centres are recognized and identified in those countries, the need for regulating the powers of the modern corporations or of subjecting them to the new concept of the Rule of Law applicable to them may not arise in practice. As I visualize the new law of corporate responsibility, it must, by its very nature, grow with the development of the society; but the structure of this new law should be such that it can readily absorb the developments in concepts of standards of responsibility. This means that the structure and processes of the new company or corporation laws should be so designed and geared as to offer reasonable assurance that, as soon as a joint-stock company or a corporation becomes a source of a significant power its management would not be free to exercise this power arbitrarily but would be enjoined to use it in a manner that can be rationally related to the legitimate purposes of the society. The major practical problems which would confront the engineers of the new corporation laws would be the contents of the new Rule of Law in its application to the modern joint-stock company or corporation; the nature of the new institutional structures which would need to be built into the existing corporation laws in conformity with the requirements of this new Rule of Law; the instruments of policy which would need to be fashioned in order to enforce this new concept of the Rule of Law. These are some of the basic questions which jurists and administrators would have to answer if the new concept of the Rule of Law in its application to the joint-stock company or corporation is to become as much of a reality as the older concept of the Rule of Law was a reality in its application to the use of governmental power. If one were to speculate on the course of future developments in the field of corporation laws, one might hazard the guess that the developing law of corporate responsibility must contain the following basic elements among others:

- (i) it may have to define the principal "little publics" to which corporate management should be held responsible, besides their traditional constituencies, viz., the shareholders and the creditors. The other "little publics" might include the workers, the consumers and the general public as such;
- (ii) the law should spell out in general terms the nature of the new conception of justice, in the dealings between corporate management and the new "little publics" to which such management might be held responsible in the future. This exercise may involve the incorporation of some substantive provisions, distantly resembling the Directive Principles of State Policy in our Constitution, roughly indicating the nature of the responsibility which corporate management may have to bear in the future in dealing with its new "little publics";
- (iii) the law may have to lay down with some precision the procedure which must be followed in the future by corporate management in their dealings with their "little publics", so that new substantive provisions of the law defining the new conception of justice may be duly enforced; and
- (iv) the law may have to provide for the reorganization and reinforcement of the existing judicial machinery for the administration of the new substantive provisions incorporated in it.

These developments would call for high legal and administrative engineering skill on the part of all those who may be concerned with the making of laws and their administration in this complex socio-economic field.

A New Concept of Corporate Responsibility

In this concluding section of the paper it is now proposed to comment briefly on the subjects underlying the Companies Act, 1956, as amended by subsequent Acts and its broad structure in the light of the analysis contained in the earlier sections.

The Companies Act of 1956 was assailed at its birth from many different quarters. It was criticized as a long, prolix and needlessly complicated document. Fault was found with it because of the alleged involved procedures prescribed in it, the extensive powers given to shareholders and the Central Government with the object of subjecting decision-making by management in several areas to their approval. In particular, exception was taken to several substantive provisions

which not only attempted to regulate the formation and working of companies but also to impose on company management certain "norms" as regards their conduct and behaviour pattern, especially in areas where their interest might come into conflict with their duties to the corporations and the shareholders. Special objection was taken to the provisions of the Act regulating the remuneration of the top managerial *élite*, and several traditional practices regarding company finance and company investment. At the instance of the then Finance Minister (Shri T. T. Krishnamachari) these criticisms were referred to an Expert Committee, presided over by Shri Vishwanath Sastri, an eminent jurist. The report of the Committee showed that many of the structural defects and deficiencies of the Act were exaggerated by people in authority as well as in the market places who were anxious to denigrate the Act, for reasons best known to them. As regards the length and prolixity of the Act of 1956, the Vishwanath Sastri Committee which undertook a detailed examination of this complaint observed: "Though the number of sections in the Indian Act exceeds those of its English counterpart, still it will be found that the volume of printed matter of both the Acts is approximately the same, the English Act having relegated to schedules several provisions found in the body of the Indian Act. It was presumably the intention of the legal draftsman, who drafted the Bill, as well as the then Finance Minister who piloted the Bill in Parliament that the enactment should be a self-contained, complex and exhaustive exposition of the law governing joint-stock companies in India. Whatever might be our view . . . we have, in deference to the unanimous views of those whom this legislation primarily concerns, not attempted to re-write the Act or upset its arrangement of topics dealt with by it." Apart from this fact, the complaint was found to be based on inadequate appreciation of the nature and scope of the new Act. It was overlooked that for the first time in its history the Companies Act of this country had attempted to relate company management and company practice to some of the accepted basic economic and social values of the community, albeit only marginally, as indeed it was enjoined to do by Parliament and the Government of the day. This could not be achieved merely by the enunciation of a string of provisions, containing a recital of aims and objects but also called for structural and procedural changes in company management which had to be broadly indicated in the Companies Act. Be that as it might, the subsequent administration of the Act dispelled many of the earlier fears and apprehensions, and company management in this country has already learnt to live with the Act. Nevertheless, after the lapse of nearly a decade or so, it is

fair to admit that the Act does now appear to have been, essentially, an amalgam of traditional and modern thinking on corporate matters, which, by its very nature, could not be expected to produce a streamlined measure.

The more important of the basic aims and objects underlying the Act were:

- (1) a desire to deal more effectively with large-scale company malpractices; and, in particular, with the malpractices and irregularities of managing agents, an institution which has coloured popular thinking on companies and the Companies Act in this country more than any other feature of our corporate system;
- (2) a desire to ensure to the shareholders of a company a larger and more effective voice in its management. In part, this desire appears have been prompted by the expectation that increasing shareholders' control over company affairs might provide a more effective check on company offences and malpractices. In part, the view was also a reflection of the popular faith in the democratic functioning of joint-stock companies, not only as a pre-condition of widening and deepening the habit of investment in company stocks and shares but also as a good in itself. This trend of thought was part of the folklore of the so-called "shareholders' democracy", which is still disconcertingly widespread not only in this, but also in many of the Western countries;
- (3) a desire to integrate the working of corporate enterprises with the larger social interests of the community. The Act of 1956 did not attempt to indicate the contents of these larger interests, nor to articulate by any positive direction or guidance, the adjustment of company practice, in significant areas with the requirements of social policy. It is, however, possible to discern from several operative provisions of the Act that these larger social interests centred round the problems of (a) reduction in the concentration of the economic power; (b) reduction of inequalities in incomes; and (c) extension of the area of democratic decision-making.

It may be worthwhile to touch on the provisions of the Companies Act of 1956 dealing with these issues. For, it is these provisions which constitute the special features of our new Companies Act, and distinguish it from its predecessors in this country as well as from the traditional pattern of corporation laws in the Western countries. It is in these special provisions that we discover the first faint glimmerings

of the awareness that the modern company or corporation is not merely a legal-economic device for the production and marketing of goods and services but is a new sociological institution exercising a volume of significant nongovernmental power. If this power is not to be used irresponsibly, but is to be related to the legitimate purposes of the society in furtherance of its accepted economic and social aims, it is essential that the use of such power should be subject to a measure of regulation, and should conform to a new concept of justice and responsibility in corporate management, providing the judicial foundation for the new Rule of Law in this field to which I have referred earlier.

Among the provisions of our Companies Act which deal with the problem of concentration of power, reference need be made to only the more important of them. These are Section 89 of the Act which provides for the compulsory termination of disproportional excessive voting rights enjoyed by the management in several companies by reasons of their ownership of certain categories of stocks or shares carrying special voting rights, and prohibits the issue of such stocks and shares in future. Section 275 of the Act provides that no person can be a director of more than twenty companies. Section 293 imposes several restrictions on the powers of directors. Section 316 limits the number of companies of which a person may be appointed managing director to only two. Section 332 provides that no person can be managing agent of more than 10 companies in future. Section 368 for the first time unequivocally places managing agents under the supervision and control of the directors. The powers of the former *vis-à-vis* directors are defined specifically in a schedule attached to the Act. Further power of the managing agents to nominate directors on the boards of the managed companies is regulated in Section 377 of the Act. Several other sections of the Act are designed to control undesirable concentration of economic power at the hands of the management of companies, arising from the inter-company financial transactions carried out either through inter-company loans or inter-company investments. It is not necessary to prolong this list, but the sections to which a reference has been made illustrate the intention of Parliament to reduce concentration of economic power in the hands of the management, and to render the exercise of such power somewhat more responsible in future than it was in the past.

As regards the provisions of the Act intended to reduce inequalities of income through the regulation of managerial remuneration, all that they seek to do is to prevent the management of companies from helping themselves to excessive remuneration at the cost of shareholders, and on a scale which would appear to be clearly out of step with com-

parable levels of remuneration in other fields of activity. Parliament appears to have been motivated by the fact that under the conditions obtaining before the enactment of the Act of 1956, management had virtually a free hand in fixing its own remuneration. Several sections of the Act deal with the subject and constitute a body of provisions, which is perhaps unique in company legislation of any country. Reference need be made only to more operative provisions on this subject. Section 198 of the Act prescribes an overall maximum managerial remuneration coupled with a minimum managerial remuneration in the absence of profits or in the event of their inadequacy. Sections 309 and 310 of the Act impose limitations on the remuneration of paid directors. Section 348 limits the commission earned by the managing agents to a maximum of 10 per cent of the net profits of a company. Power has been taken in all these sections to deal with cases in which strict enforcement of the prescribed maxima might either cause undue hardship or create avoidable disincentives. In conformity with the thinking underlying these sections, Section 356 regulates the earnings of management from other sources, particularly in cases where the services rendered by them are not commensurate with the rewards claimed by them. Similarly, Section 360 of the Act regulates the contracts for the supply of goods and services by the managing agents to the companies under their management. All these provisions of our new Companies Act have been the subject of much comment not only in this country but also abroad. They have been attacked on the ground that it is for shareholders to fix the remuneration of the management of companies and that administrative interference with managerial remuneration may be arbitrary, and may adversely affect the incentives to effort and risk-taking. And yet perceptive observers of the corporate scene in this as well as the Western countries have always recognized the fact that this problem of managerial remuneration or compensation, as it is called in some of the later countries, provides a classic example of the unregulated use of corporate power, in the sphere of decision-making which calls for some effective measures of internal or external control. In a fairly well-publicised and in many ways a standard book on the current methods and practices of corporate management in the U.S.A., called *The American Stockholder*, the financial commentator of a well-known Philadelphia journal attempted an analysis of the social consequences of the inevitable erosion of shareholder power over corporate management. "Executives", he commented, "had become an over-privileged class in a democratic society." The gravamen of his charge was that "with the restraining hand of shareholders atrophied, a tax-sheltered managerial

élite was inexcusably setting its own extravagant compensation, and that the most serious consequences of this policy were not the diversion of corporate funds to personal use, but the impact which unduly high executive reward had upon the rest of society." In the light of this comment from a well-informed and sober critic of corporate methods and practices in this field, the provisions of our Companies Act of 1956 relating to managerial remuneration may well be said to blaze a new trail in thinking on the problems of corporate management in modern society.

On the subject of the democratization of company management, it is not necessary to say much in the present context. This has been the traditional approach of company reformers in this as well as in the other Western countries of the world. In this, they have been influenced, as indeed we were in this country in the years before the enactment of the Companies Act, 1956, by the historical model of the evolution of political democracy. On the assumption that the extension of shareholders' franchise would enlarge their controlling powers over the management, company reformers in many countries have pleaded for greater shareholders' control over decision-making by company management. This was the dominant line taken by the pioneers of the Bombay Shareholders' Association and other comparable organizations which followed the lead of the former in the forties and fifties. To quote the somewhat trenchant observations of a realistic student of corporate affairs, Prof. Bayliss Manning of the Yale University, "They put their faith in what they called Corporate Democracy—a shimmering conception fusing good old American free enterprise with good old American Jacksonianism. Apostles of this ideology offer a fully developed programme to cure our corporate ills. The nostrums of Corporate Democracy have a vaguely familiar quality; more disclosure; greater mass attendance at shareholders' meetings; more policy issues on the ballot for shareholder vote; cumulative voting; more pre-, during and post-meeting reports, preferably in colour; machinery for submitting shareholder proposals to vote, etc. . . ." "Altogether", Prof. Manning concludes, "the tenets of Corporate Democracy have served us little; it is predictable that they will serve us less and less as public stock-ownership grows. . . . 'Peoples' capitalism' and 'Corporate Democracy' are slogans with an inverse relationship. Each expansion of the first undermines the second." This is not to say that shareholders' democracy does not function or that shareholders have no control whatsoever over company management. The disclosure requirements of company or corporation laws, and increased powers to shareholders as in our Companies Act, 1956,

if wisely exercised, may sometimes produce a healthy effect upon managerial conduct. As has been said, "no prophylaxis is so effective as sunlight, and to the extent that corporate democracy implies disclosure, it deserves credit." But it would be unrealistic not to recognize the fact that shareholders' democracy, at best, serves a limited purpose. For, the disclosure of facts, even at regular intervals, is not the same thing as decision-making by a so-called shareholders' democracy. This is not to suggest that the latter exercise is either desirable or feasible, but it is vital for a proper understanding of company processes and of the role of the modern corporation to appreciate this basic fact. Without such understanding, the real character and significance of the modern company or the corporation as a system of power will be missed, and improvisation, so often erroneously confused with pragmatism, will continue to bedevil legislative, administrative and judicial thinking and attitudes towards the corporate sector. Even from the limited technical point of view of long-term corporate efficiency, and the capacity of the modern company or corporation to attain a *sustainable* high rate of economic growth, the place of these intricate, centralized economic-administrative structures in the social and economic set-up of the community must be fully grasped and appreciated by the professional managers who run them, as well as by the organs of the State.

The special features of our new Companies Act to which I have referred in the foregoing paragraphs, clearly indicate that its framers had a reasonably comprehensive, though somewhat imprecise, awareness of the sociological implications of the larger company or the corporation in the Indian context, and that they were grappling with the difficult problem of building up appropriate institutional structures, within the framework of the traditional company law handed down to them. This effort led them to introduce several administrative and legislative innovations into the body of the old law. I am free to admit that these innovations surprised many practical men in business, in the professions and also in administration, and may have caused pain to some of them who could not easily get out of the traditional cast of their thinking on this subject. And yet the fact is being more and more recognized in learned circles in this country and abroad that our new Companies Act was the first to attempt to translate into institutional terms a few of the implications of the modern company as a system of power. The Indian Companies Act may well claim to have been a path-breaker in this still inadequately explored field.

That this is no idle claim will be clear from the fact that, broadly speaking, there are only three ways in which business power in the capitalist societies, whether of the pure or mixed variety, can be regu-

lated and kept controlled as much in its own interest as in the interest of society. First, economic policy and administrative action can help to promote and develop competitive markets. Secondly, voluntary institutions like those in the city of London or official agencies like the Securities Exchange Commission in the U.S.A. or the erstwhile Department of Company Law Administration in India, outside the companies or corporations, can do a great deal to regulate and channelize decision-making along directions that would also subserve the public interest. Thirdly, appropriate institutions can be built into the structure of company and corporation laws, so that they may provide the checks and balances needed for the responsible exercise of power. Whereas in the Western countries, traditionally, policy-makers and administrators have relied more on the first alternative, in the very different circumstances of our country, and in view of our urgent and pressing need for integrated balanced growth and development, we have preferred to depend more on external controls and a network of institutional checks and balances written into our new Companies Act of 1956. Any attempt at comparative assessment of the relative merits of these different approaches is hardly likely to be rewarding. But one thing seems to be reasonably clear. In this country as well as in the Western countries all the three alternative possibilities are likely to be increasingly explored in the future, not in isolation from, but in close juxtaposition to one another. As an American observer has recently pointed out: "A combination of the increase of direct regulation of some of the economic choices of powerful firms, with an increase in public criticism, and perhaps even institutionalized public discussion of the choices which are not explicitly controlled, appears probable. Such a programme will, in effect, do by a formal mechanism and systematically what is currently being done in a somewhat haphazard way by congressional investigations. On the whole it is this which has been the active front. The development of mechanisms, which will change the internal organization of the corporation, and define more closely and represent more precisely the interests to which corporate management should respond, and the goals towards which they should strive, is yet to begin, if it is to come at all." The Indian Companies Act, 1956, has already made such a beginning, and to this extent may justifiably claim to be a piece of pioneering legislation.

This is not to suggest that the Act of 1956 embodies in its corpus all the essential elements of the new concept of the Rule of Law applicable to the corporate field, or that it is a perfectly well-knit and rounded statute. On the contrary as has been already mentioned, there

is much "dead wood" of traditional thinking in several provisions of the Act which needs to be cut out, just as several other sections embody the dogmas and pet nostrums of a bye-gone age. Even so, all in all, the Indian Companies Act, 1956, brings a relatively new outlook and attitude to bear on company management, which is much closer to the reality of the modern company or the corporation as a new sociological institution than any other system of company or corporation law in the Western democracies, of which we are aware.