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Evaluation Of Indian Companies Act 1956- Is It Capable Enough To Accelerate The Engine OF Growth?

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Abstract: This *study is to highlight the hassles being struggled by the industry in view of the compliance requirement focusing theimpact of the requirement of prior approval from the Central Govt. under Section 297 of the Indian Companies Act 1956. The impact of the said section on the industrial development is evaluated in this study based on the core issue of opportunity cost involved in this regard.*

I. Introduction:

The Company legislation in India has closely followed the Company Legislation in England. The first legislative enactment for registration ofjoint stock companies was passed inthe year 1850 which was based on the English Companies Act, 1844.

After passing several Acts subsequently, Govt of independent India appointed a committee under the Chairmanship of Sri H C .Bhaba to do into the entire question of the revision of the Indian Companies Act, with particular reference to its bearing on the development of Indian Trade&Industry.This Committee examined a large number of witnesses in different parts of the country and submitted its report in March 1952. Based largely on therecommendations of the Company Law Committee a bill to enact the present legislationviz: Companies Act, 1956 was introduced in parliament. This Act, once again largely followed the English Companies Act 1948.

Though Companies Act covered various aspects of trade and industry to accelerate its growth the said act was not fully conducive to the requirement of the Indian Industry as it largely depending on the situations prevailing in England. There arevarioussections in the said Act creating hurdles in the development of Industry. This Study explains one particular section of Indian Companies Act 1956 ie Section 297 in differentdimensions:

Interested Transactions in a Company.(Sec 297 of the Act)

Majority Indian Companies are family managed Companies and they are managing the same by constituting subsidiaries at different levels. In view of this particular arrangement one business family may constitute several small companies to expand their business in different dimensions .Hence there will be common Directors all round and they arrange the Business in such a way as to ensure the proper supply chain in an uninterrupted manner. In other words there will be transactions of buying and selling between the sister companies. Actually this is only a proper resource management which is one of the bases of the growth story of Indian Corporate.

According to Sec 297 of the Indian Companies Act prior permission of Central Govt. is required in the event a company is entering into any contract with another company wherein any director is interested in the other company.

Section 297 of the Indian Companies Act states that : [108] " In the case of a company having paid up capital of not less than rupees one Crore, no contract falling within the purview of subsection (1) of section 297 shall be entered into except with the previous approval of the Central Govt. vide proviso to subsection (1) which was inserted by the Companies(Amendment) act 1974 with effect from 1-2-1975".

What these interested transactions are-

A contract between two companies is considered as interested contract or interested transaction under the following circumstances.-

- When there are common Directors in both the companies.
- Both the Companies are not public Limited companies.
- The paid up capital of any one company involved in the contract is Rs. 1 Crore or more.

Section 297 of the Companies Act envisaged prior approval from the Regional Director, Department of Corporate Affairs to commence any contract work thatcomes under the orbit of said section or interested transactions.

Sachar Committee set up for proposing amendment in the Companies Act had taken up the issue many times and recommended todelete thesame in view of the fact thatthe said provision is not satisfying any regulatory objectives.

The issues involved in the above regulation can be categorized as Opportunity cost, Cost of escalation. Infringement of constitutional right and Loss of credibility / Goodwill. This study explains the core issue come under Section 297 of the Act which is categorised as Opportunity cost.

Opportunity Cost

Application once submitted can be cleared after consuming 3 – 6 months' time from Regional Director, Dept. of Corporate Affairs and its present office is situated in Chennai for Kerala and Hyderabad for other southern states.Since 80% of the Indian Companies are managed by business families and most of their investment arestructured in the form of Holding- Subsidiary format.

There are common directorships in many of their units and inter Company transactions are indispensable. For instance: A company which is engaged in the field of Textiles. There are different stages in the process of cloth making like Spinning, Weaving, Printing, and Marketingetc. In each stage acute supervision with latest technology is required to ensure the economy and quality in every process. Hence business people may prefer to form each company for taking up each process with specialisation under the same ownership of a person.

There are inter-company transactions between the said companies to coordinate the output in each process. The finished goods of one unit may be the raw material of another unit. When there is provision for prior approval to take up the above transactions it will create a lot of delay in the business transactions. So the present requirement is more or less time consuming without yielding any fruit in view of the regulatory requirements and the opportunity cost involved in this regard is huge. In Hotel Industry booking of Business would bedone in one year advance.

If there is a delay of 6 Months entire business taken will be lost and has to wait one more year to get the new booking. Unfortunately statutory administrators are not bothering these kinds of problems involved in the industry. A delay of one day may create a corresponding delay of 30 days at the end of the last lap and therefore a delay of each day is also very crucial in case of project execution . A study is conducted in 30 companies who are the respondents to the survey based on a Questionnaire to evaluate the impact of section 297 of the Act and the core issue involved in this regard ie Opportunity cost.

Objective Of The Study:

1. To Examine and identify the areas where the reforms are required in the Indian Companies Act 1956.
2. To Evaluate and analyse the prime factor viz: Opportunity cost pursuant to Section 297 of the Indian Companies Act.
3. To make recommendations based on the study.

Hypothesis

To test whether the sample information that we observe holds for the population or really the level of agreement regarding the opportunity cost among the respondents are medium or high we formulate the following Hypothesis.

H1: The Level of agreement regarding the opportunity cost among the respondents is high.

II. Methodology

The Study has been descriptive and analytical in nature based on a survey method .Primary and Secondary data are used for the purpose of study. For primary information, a sample of 30 Companies across the state of Kerala has been selected at random for the purpose of study.Questionnaire method consisting of Linkert method of five point scale has been administered for the collection of data from respondents.

The respondents duly expressed their opinion by stating any one of the five point scale such as strongly agree, agree, undecided, disagree and strongly disagree. The data has been processed with the help of SPSS package software. In further analysis these qualitative grades areconverted intoquantitative terms by using suitable statistical techniques. These include percentages, frequency distribution and "t" test for testing of Hypothesis.

The feedback of the respondents are summarised in the following frequency table.

Frequency Table

Q1

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly agree	1	3.3	3.3	3.3
	Agree	1	3.3	3.3	6.7
	Disagree	15	50.0	50.0	56.7
	Strongly disagree	13	43.3	43.3	100.0
	Total	30	100.0	100.0	

Table-1

As stated, Questionnaire prepared was Linkers five point scale to obtain the feedback of respondent in a minute level. As per the above table depending up on the nature of question they are supporting the view that the provision of previous approval, pursuant to section 297 of the companies Act , is adversely affecting their activities in a big way represented in the table above 90%.

Q_2

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Agree	2	6.7	6.7	6.7
	Undecided	1	3.3	3.3	10.0
	Disagree	17	56.7	56.7	66.7
	Strongly disagree	10	33.3	33.3	100.0
	Total	30	100.0	100.0	

Table-2

Q_3

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly agree	1	3.3	3.3	3.3
	Agree	8	26.7	26.7	30.0
	Undecided	6	20.0	20.0	50.0
	Disagree	10	33.3	33.3	83.3
	Strongly disagree	5	16.7	16.7	100.0
	Total	30	100.0	100.0	

Table-3

Q_4

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly agree	1	3.3	3.3	3.3
	Agree	1	3.3	3.3	6.7
	Undecided	5	16.7	16.7	23.3
	Disagree	14	46.7	46.7	70.0
	Strongly disagree	9	30.0	30.0	100.0
	Total	30	100.0	100.0	

Table-4

Based on the questions asked large majority has responded that they are supporting the view of corrective actions required with regard to the requirement of previous approval under section 297 of the Indian Companies Act 1956. Out of the four questions in all the three cases the positive response is above 70% which vindicated the above view.

RANKING OF FEEDBACK
OPPORTUNITY COST

	Mean	Std. Deviation	Mean % score	Rank
Q_1	4.27	.91	85.33%	1
Q_2	4.17	0.79	83.33%	2
Q_3	3.33	1.15	66.67%	4
Q_4	3.93	1.08	78.67%	3

Table-5

Questions pertaining to the factor opportunity cost which is the prime adverse factor in view of section 297 of the Indian Companies Act is carrying overwhelming response from respondents with first ranking at 85.33% Mean score and even 4th rank is carrying a response level of 66.67%. This indicates that respondents are straining a lot in view of the prior approval provision of the said section of Indian Companies Act.

In order to find out the Group frequency the factor, Opportunity cost the study divided them into three level based on their score of the variables. Those people who scores is less than 50% of the maximum possible score is considered as low level and the score between 50% to 75% is considered as medium level and the respondents who's score greater than 75% is grouped into the high group. The number and percentage of the respondents belong to the opportunity cost group corresponding to the variables is given below.

Opportunity cost-group

		Frequency	Per cent	Valid Per cent	Cumulative Per cent
Valid	Low	1	3.3	3.3	3.3
	Medium	11	36.7	36.7	40.0
	High	18	60.0	60.0	100.0
	Total	30	100.0	100.0	

Table-6

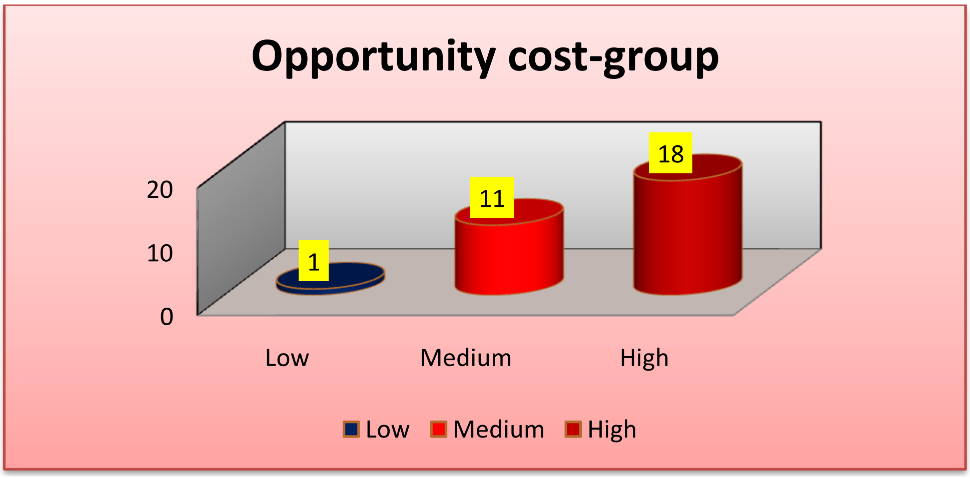

Table-7

On the basisof the above table 60% level of agreement is there which is considered the high rate indicating that out of the 30 respondents 60% are supporting the view that the provision of previous approval is creating a lot of difficulties to the industries and due to which the growth is affected severely.

To find out the level of agreement among the respondents regarding the Opportunity cost the following feedback is used:

	Mean	Std. Deviation	Mean % Score	t	df	P vslue
Total	15.70	2.97	78.50%	6.817	29	<0.001

Table -8

The level of agreement is quantitatively expressed in terms of Mean Score. To test whether the sample information that we observe in the above tables holds for the population or really the level of agreement regarding the opportunity cost among the respondents are medium or it is high, we had formulated the following hypothesis.

H1: The Level of agreement regarding the opportunity cost among the respondents is High

$$\left[\frac{MeanScore \times 100}{Maximumpossiblescore}\right]$$

From the above table the mean % score of the level of agreement regarding the opportunity cost among the respondents is78.50% which shows that level of agreement regarding the opportunity cost among the respondents is high and hence the hypothesis is accepted as correct.

Testing of Hypothesis:

To test the above hypothesis we use one sample t test and the result is exhibited in the above table .The calculated value of 't' is 6.817 which is found to be greater than the tabulated value of 1.699, so the test is significant. Hence we can conclude that the mean percentage score of the level of agreement regarding the opportunity cost among the respondents is high.

During 1991 massive modification were introduced in various economic legislations and this has created a wide range of growth in terms of GDP, Foreign exchange reserve etc. To start removing unnecessary provisions is a big task in Indian scenario as most of the statutes were not developed in Indiansociety and thereby we are unaware of its significance or impact or requirement. Therefore the convenient strategy pursued by the enforcement Authorities is to keep the same without digging in it. At the same time they are not bothering about the damage which is being created by these provisos to the country in terms of growth as well as investors morale.

SUMMARY OF FINDINGS

The legal requirement to obtain prior approval under Section 297 of the Indian Companies Act has created grave difficult situation to the industry in diversified manure.

The response to the survey is very overwhelming as large majority expressed their undisputed positive opinion underlining that they are all suffering acutely in view of these restrictions. All the 30 respondents are limited Companies and are liable to comply the requirements indicated in the said section.

The various aspects involved in the subject have been evaluated in a diversified manner and all which have impact in the functioning of industry and in turn on the economic development.

Opportunity cost involved in the issue has been evaluated through asurvey and its response is very positive and the Mean Score % for the said study has come up to 78.50 which is a clear indication of their mandate. This situation will have counter effects and justice delayed will end up in justice denial which is not desirable to the country.

The problems stated in the study are relevant and attention of the respective authorities are required urgently to redress the issued involved in this regard.

III. Conclusion:

The study is initiated to identify and locate the unwarranted restrictions in economic legislations which are highly affecting the corporate freedom and thereby the growth of the country. The method of analysis and the tools selected for this purpose has unequivocally proved that there are issues in the Indian Companies Act 1956.The liberalisation started in 1991 has to be continued with increased vigour and this effort has to be on a micro level in each and every statute and with the objective of keeping adequate freedom for development.

IV. Suggestions

The Evaluation of Indian Companies Act 1956 has unfolded a lot of intrinsic information which are very vital to the growth of Industry and the Economy in General. The statistical Evaluations facilitated to go into the depth of the problem and also to develop substantial conclusions as regards the relevance of the study in this subject. Basedon the findings we consolidate the following suggestion to tide over the issues portrayed as per the analysis:

Sec 297 of the Indian Companies act is required to be scraped considering the issues involved in this regard for obtaining the prior approval. A Board approval and disclosure of interest at the Board will be sufficient in this case.The specification for prior approval is not satisfying any regulatory objective.

New efforts are to be initiated to enhance productivity and competitiveness of Indian corporate to face the increasing challenges of Globalisation.

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Quotation:

1. [108] : Directors Interested in the Contract – Dr.KR.Chandratre, pages 19 & 37