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CORPORATE LAW IN COLONIAL INDIA:
RISE AND DEMISE OF THE MANAGING AGENCY SYSTEM

Umakanth Varottil[*]

Abstract

This paper focuses on the managing agency system, a peculiar type of corporate governance arrangement that emanated in India during the colonial period. Under this system, a managing agent (either an individual, partnership firm or company) would be appointed to manage one or more joint stock companies. The managing agent would also hold shares in the managed companies and control their boards of directors. While this system was introduced in the early part of the nineteenth century to facilitate trade and investment by British businesses in India, it was also adopted by Indian businesses. Over a period of time, its advantages were overshadowed by mismanagement by the agents and consequent abuse of the shareholders of the managed companies. The legal response was ineffective as the colonial government refused to recognise or rein in managing agents for nearly a century from its inception. It is only in 1936 that restrictions were imposed. Following India's independence in 1947, the restrictions were tightened further before the system itself was abolished in 1970. This paper offers an analysis of the system using a corporate law and governance framework, and finds the existence of several institutional, economic, political and social factors that led to its emergence and disappearance.

Keywords: Managing Agency System, India, Corporate Law, Corporate Governance

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I. INTRODUCTION

Conventional scholarship in corporate law ascribes the origins of governance debates to the seminal work of Berle and Means (1932). Through a study of US corporations during the period between 1880 and 1930, they concluded that there is a "separation of ownership and control" in which the individual interest of shareholders is made subservient to that of managers who are in control of a company. Due to the diffusion in shareholding, the shareholders are unable to monitor the managers, as widely dispersed shareholders lack sufficient financial incentives to intervene directly in the affairs of the company. Left unchecked, the managers may abuse their position by acting in their own interests rather than the interests of the shareholders, which they have a duty to promote (Cheffins, 2003: 26). Much of the effort in corporate law over the years has been to address the agency problem[1] between managers and shareholders as identified by Berle and Means, at least in countries where diffused shareholding is the norm. While the field of corporate governance has witnessed substantial progress, there is much to evolve.[2]

This paper focuses on the managing agency system, a peculiar type of corporate governance arrangement that emanated in India during the colonial period, which not only preceded the Berle and Means corporation but it has also largely escaped attention of corporate law scholars. Although the managing agency system displayed more acute forms of agency problems between shareholders and management on account of the separation between ownership and control, it remained overshadowed by its well-known US variant. While the quest for appropriate mechanisms to resolve agency problems in the Berle and Means corporation is yet ongoing, the problems that plagued the managing agency system in India for over a century were resolved ultimately by legislative fiat that sounded its death knell. The objective of this paper is to analyse the evolution of the managing agency system, its

[1] For a detailed discussion on the concept of the agency problems in a company, see Jensen and Meckling (1976: 310); Kraakman, et. al. (2009: 35).

[2] For example, the Economist (2015) portends the decline of the Western corporation. On the other hand, Bainbridge and Henderson (2014) propose a radical idea whereby corporate boards are substituted by board service providers who are themselves firms (either partnerships or corporations).

benefits, the agency problems it generated and finally the attempts by corporate law in India to deal with those that led to its abolition.

The managing agency system emerged in India in the early part of the nineteenth century and gradually spread to certain other British colonies in Asia. Under this, a managing agent (typically a sole proprietorship, partnership or private limited company) would enter into a contract with one or more joint stock companies so as to manage those companies (Brimmer, 1955: 554).[3] Although the managed companies would constitute their own board of directors, it was the managing agent that carried out all management functions, including establishing and running the business as well as raising finances (Rosen, 1979: 263). The managing agent often held a limited number of shares in the managed company, but exercised significant control by virtue of the management contract and additional measures that include obtaining representation on the board of the company and soliciting proxies from other shareholders. British managing agents dominated the system for most of the colonial period. The business rationale for the system is understandable as it provided the much-needed impetus for entrepreneurship and financing at the time. However, by the latter half of the nineteenth century, the system fell victim to failures in the form of large-scale abuse by some managing agents who were only interested in perpetuating their control over the managed companies for their private benefits, much to the detriment of their shareholders who remained rather passive due to their low individual shareholdings.

The composition of the managing agents and the managed companies altered over a period of time with greater Indian involvement. While the later part of the colonial period witnessed greater participation of Indian shareholders and directors on managed companies and also the emergence of Indian-owned managing agents, following India's independence there was a gradual retreat of British business interests who divested their stakes in the managing agents in favour of Indian businesses that ended up holding the skeletal remains upon the demise of the system.

[3] This was a form of external management, which is not altogether alien to contemporary corporate governance given that mutual funds and real estate investment trusts (REITs) are managed by external entities such as fund mangers or investment advisors (Fisch, 2010: 1968). It is a different matter that external management is at present largely confined to the investment industry unlike the management agency system that was broader and covered manufacturing and trading activities.

The legal responses to the managing agency system are somewhat remarkable. For a century since its inception, the concept did not receive any recognition whatsoever under Indian law. The constant protestations of shareholders from mid-eighteenth century against wholesale abuse of the system fell on deaf years. The colonial government refused to legislate on the matter until 1936, when companies' legislation in India imposed some restrictions on the operation of managing agencies and limited the scope of their control. Although there were calls for the abolition of the system by the time India gained independence in 1947, the independent Government refused to accede to these requests, although it did impose additional controls. It was only in the 1960s that the noose around the managing agency system was tightened further, culminating in its abolition with effect from 1970.

As elaborated in this paper, the legal responses to the managing agency system were affected by several considerations, including economic, social and cultural factors. The colonial government did not possess adequate momentum to rein in changes to the system, as it would have impinged upon British business interests in India. It was only towards the end of the colonial period when Indian influence in the legislative process became more pronounced that checks and balances were in fact introduced. The effect of interest groups and rent-seeking behaviour continue to manifest even in the post-colonial period.

Part II of this paper discusses the evolution of the managing agency system. It seeks to ascertain the reasons for its origin, and the institutional, economic and social factors that led to its prominence. Part III analyses the contractual structure and the relationship between the managing agent and the managed companies, and identifies the various corporate governance problems that arose from the structure as well as its operation in practice. Part IV charts the legislative response to the managing agency system. A century of inaction led to the imposition of the restrictions on the system followed by its abolition. Part V concludes with a discussion of the key lessons arising from the managing agency episode.

II. EVOLUTION OF THE MANAGING AGENCY SYSTEM

Given the uniqueness of the managing agency system to colonial India, the concept cannot be examined in isolation. The institutional, economic and social circumstances prevailing at the time of its emergence as well as its evolution thereafter take on tremendous significance. The necessity for its introduction as well as its subsequent distortion must be examined in these specific contexts, as this Part seeks to do.

A. Origins

The emergence of the modern business corporation in India can be attributed to the establishment of the English East India Company ("EIC") in 1600, which was granted a royal charter that effectively conferred upon it a monopoly to trade in India (Harris, 2005: 219). EIC officials were barred from undertaking private business, but towards the end of the eighteenth century several agency houses sprung up that were established and managed by ex-officials of the EIC (Tomlinson, 2013: 78). These agency houses performed the role of facilitating remittances between British citizens residing in India and London, but they thereafter also began undertaking trade and commerce generally (Tripathi, 1971: M-61). While little is known about the precise nature of the agency houses' activities, they shot into prominence when EIC's monopoly to trade in India came to an end in 1813 (Tomlinson, 2013: 78). There is consensus that the agency houses acted as precursors to the more organised form that took on the character of managing agents.

The precise timing of when the agency houses metamorphosed into managing agents is much less settled. Rungta (1970: 222-224) identifies features of the managing agency system among life insurance companies in the first two decades of the nineteenth century. However, Kling (1966: 38) points to the establishment of Carr, Tagore and Company in 1834 for the origin of the system. Interestingly, this was a partnership between Willam Carr, a British trader, and Dwarkanath Tagore, a wealthy merchant in Calcutta. In 1836, Carr, Tagore and Company undertook the management of the Calcutta Steam Tug Association, and subsequently added other joint stock companies to its managed portfolio. The promise of an Indo-British joint venture was short-lived, as the partnership came to an end in 1847

due to its inability to deal with a financial crisis and also internal mismanagement (Tomlinson, 2013: 78; Rungta, 1970: 226).

The uniqueness of the managing agency system to colonial India can be related to the trade and investment relationship between Britain and India, and "can be seen as an institutional innovation for directing capital flows and … to alleviate agency problems in the context of long-distance investment for the British" (Gupta, 2010: 19-20). Its close association with British enterprise in India is without doubt, as it began in India and then went on to the port cities of British colonies in Southeast Asia and East Asia, and "that there appears to be an assumption that it represented some special adaptation of British business practices to the peculiar economic environment of Asia." (Munro, 1998: 51).

Brimmer (1955: 560) suggests that the system was necessitated on account of (i) the lack of entrepreneurial capacity on the one hand, and (ii) a shortage of financing on the other. Since Indian businessmen were engaged in traditional trading and financing, the British managing agency firms who had gained knowledge not only of local markets in specific industries, but also of foreign markets and sources of supply, were able to quickly fill the gap with their superior technology and managerial skills (Tripathi, 1971: M-62). Similarly, on the financing side, the managing agents played an important role. When either the managing agent or a group of businessmen came up with a business idea, it was possible to raise financing through investments by shareholders in a joint stock company promoted by the managing agent (Reed, 2002: 251). It was the managing agent's capabilities and reputation that attracted businessmen to invest on the understanding that they would not be involved in the management of the business as they were themselves handling their own businesses with limited time to devote to the affairs of the joint stock company (Rungta, 1970: 228; Roy, 2006: 260). This helped fill the funding gap as it provided comfort to investors to infuse funds into the managed company without considerable oversight.[4] It has been noted that in the early stages, it fit well with the needs of the Indian business environment and that there was indeed no alternative to this mechanism (Lokanathan, 1935: 23).

[4] Thus the seeds of shareholder passivity were sown at the very outset.

At the same time, the evolution of the managing agency system cannot be viewed as a mere business phenomenon or a financial venture, as it is ensconced in a combination of geographical considerations and factors of ethnicity that require examination.

B. Geography; Ethnicity

The evolution of the managing agency system is closely related to the geographical diversity in business activities in colonial India. Historians have been occupied with the divide between the eastern part of India (focused on Calcutta) and the western part (focused on Bombay and Ahmedabad). Business activities evolved rather differently in these two regions. British businesses dominated eastern India with control over jute mills, collieries and tea plantations (Goswami, 1989: 290). One rationale for this phenomenon is that these businesses were export-oriented wherein British businessmen possessed the expertise and contacts for international trade (Morris, 1979). Conventional accounts indicate that the entry and expansion of British businesses in the eastern region was made possible because the local population was not entrepreneurially driven, but also that the British businesses imposed significant high barriers to entry due to their dominance in the region.[5]

By the end of the nineteenth century, British businesses maintained a strong foothold over the eastern region, particularly in the three industries of jute, collieries and tea plantations. Consistent with this account, British managing agencies too acquired dominance in the region. Goswami (1989: 292) finds that in eastern India at the eve of World War I, "[o]f 849 tea plantations, 729 (89 percent) were managed by Britons … all fifty jute mills were under the control of European managing agencies, and … the major collieries—commanding greater capital and larger mining rights—were joint-stock firms, and 89 percent of these were controlled by European, mostly British, managing agencies". By this time, British businesses began sharing their existence with the commercially influential community of the Marwaris, who had migrated to Calcutta and established themselves as traders and investors in the stock market (Roy, 2010: 124). Although the Marwari community initially

[5] However, this account has attracted some challenge on the ground that it is overdrawn (Roy, 2014:13) and that it does not explain the subsequent entry and expansion of some domestic ethnic groups into the core of Calcutta's business sphere (Goswami, 1989: 291).

operated in a different field, they were to subsequently threaten the dominance of the British managing agencies by staging takeovers on some of the managed companies and eventually on managing agency firms themselves.

In the western part of colonial India, however, indigenous business initiatives were more prominent. Business communities in Bombay such as the Parsis and the Gujaratis had been experienced traders. Moreover, the principal industry that developed in the western region was cotton textiles, which was focused on import-substitution also attracted the required amount of domestic entrepreneurship and capital (Gupta, 2010: 2). Similarly, the managing agents themselves began taking on an indigenous tone with business groups such as the Tatas arriving on the scene (Rungta, 1970: 238). Hence, the British managing agents were unable to make as much inroads in Bombay as they did in Calcutta and the eastern region.

Some historians have ventured to explore the differences in management style between the British and Indian firms. Brimmer (1955: 556-9) finds that while British managing agency firms were set up by one or two members of a family who would continue to maintain control over the firm, they were keen to attract external talent by inducting partners. On the other hand, the Indian managing agents were strongly driven by their sentiment towards their communities where strict succession rules and the need for stability prevented the induction of outsiders. It was common for Indian business families headed by a 'karta'[6] to control managing agencies who in turn managed several joint stock companies (Das, 2012: 9). In that sense, indigenous business forms had an important role to play in operating Indian-owned managing agency firms. Brimmer argues for the aforesaid reasons that the British managing agents portrayed the desirable aspects of the system. While this might be true from an entrepreneurship perspective, both types of managing agents were afflicted with similar agency problems when it comes to corporate governance, as discussed further in this paper.

Finally for most of the colonial period, barring exceptions such as Carr, Tagore and Company, there is little evidence of collaboration and business relationships between the

[6] A 'karta' is the head of a Hindu undivided family who manages the property and business of the family.

British and Indian businesses. As Misra (1999: 56-7) notes, "British law and institutions were becoming more influential from the late nineteenth century, while Indian and British business communities were becoming more isolated from one another. This suggests that institutional explanations must be placed in a broader social and cultural context".

This brings us to the question as to how these developments can be considered from an institutional perspective. Such an understanding would provide the framework upon which the corporate governance issues and legal responses can be analysed.

Before examining the institutional implications, it is worth noting that from a geographical standpoint the managing agency system transcended beyond India's shores and found a significant presence in East Asia and Southeast Asia as well, mostly in port cities with British business influence. Leading agency houses such as Jardine Matheson dominated the business scene in Hong Kong during the colonial period (Meyer, 2004: 34). British managing agencies flourished in Singapore and Malaya as they managed the rubber estates in Malaya during the rubber boom in the early part of the twentieth century (Huff, 1994: 181-8).[7] The system extended to other Asian cities such as Penang, Sarawak, Shanghai and Yokohama (Carney, 2008: 43; Chapman, 1992: 108). While the underlying reasons for emergence of the managing agency system in those locations comport with those in India, the system took on very different overtones and did not receive the type of scrutiny it did in India. Hence, much less is known about the benefits and abuses of the system in non-Indian territories.

C. Institutional Framework

Extensive literature seeks to explain the emergence of institutions and organisations, including why individuals would commit themselves to mutually beneficial arrangements (Grief, 2006). It posits that specific organisational forms emanate to fill a number of institutional voids confronting the prevailing society. For example, where legal systems are weak and informational asymmetries are rampant, the role of community and kinship based

[7] In addition, the European managing agencies undertook business in banking, shipping and tin mining (Goh, 2013: 37).

arrangements acquires importance (Gupta, 2010: 30). In their detailed overview of the literature on family groups in emerging markets, Khanna and Yafeh (2007: 341) note:

> "Limited contract enforcement, weak rule of law, corruption, and an inefficient judicial system should all lead to high transaction costs between unrelated parties. Under such circumstances, intragroup trade, within the context of long-run relationships supported by family and other social ties may be relatively cheap and efficient."

These institutional imperatives are evident in the emergence of managing agents, and more importantly in the dualism between the British and Indian managing agents (and businesses more generally). One explanation for the divergent flow of businesses relates to the "comparative advantage enjoyed by social groups in information and the role of social networks in determining entry and creating separate spheres of industrial investment" (Gupta, 2013: 1). Hence, while the British businesses were more knowledgeable in the export-oriented businesses of tea and jute, the Indian business enjoyed greater awareness of the indigenous cotton textiles industry.

The informational asymmetry problem arises in other ways as well, i.e. between the investors and managers. By definition, the managing agency system acknowledges the existence of this asymmetry as it emerged to enable investors who are less knowledgeable and uninterested in management to entrust their funds to managers who enjoy informational advantage. If the economic and legal systems are incapable of addressing this asymmetry (as was the case in the early colonial period in India),[8] the informational gap can be filled either (i) through the reputation that the managing agency firm has established for honest dealing, or (ii) by limiting financing among communal or familial groups with deep ties (Akerlof, 1970: 497-8). A closer analysis would indicate that the British and the Indian managing agents resorted to each of these distinct mechanisms.

[8] Contemporary corporate and securities laws are meant to address this asymmetry in a more sophisticated manner through governance and disclosure norms prescribed by regulation, which is supported by an appropriate enforcement mechanism through the imposition of legal sanctions.

The British-owned managing agents attracted a heterogeneous investor body (Akerlof, 1970: 498), which consisted of investors who resided in Britain and also those who resided in India. Over a period of time, indigenous investors were brought in as well. In these circumstances, it was the reputation of the managers for good management that attracted the investors (Roy, 2010: 121-2). The information asymmetry was bridged by the reputation of the managing agent (Gupta, 2013:14-5). On the other hand, different factors operated in the case of Indian managing agents. The common origins of the investors and the managers and the communal ties between the two groups ensured that any abuse of the investing relationship could result in social sanctions (Roy, 2010: 121; Wolcott, 2006: 33). In fact, there is ample evidence to indicate the classification of firms across various communities such as the Parsis, Gujaratis, Bengalis and Marwaris (Akerlof, 1970: 497; Rungta, 1970: 241).

While the initial establishment of the managing agency system fits within the institutional paradigm discussed above, the subsequent expansion of the system resulted in its abuse and gradual breakdown. Roy (2010: 122) argues that with the further evolution of company law and the introduction of the limited liability principle in India, investments transcended beyond kinship to outside investors as well. The familiarity between the managing agents and the investors diminished, thereby diluting the reputational incentives as well as social sanctions. The establishment of the Bombay Stock Exchange in 1875 added to the anonymity of the shareholder body. The absence of the two mechanisms that helped address the information asymmetry problem resulted in wholesale mismanagement and fraud, whereby the agents acted to enrich themselves rather than in the interests of the managed companies and their shareholders (Roy, 2006: 261). In such circumstances, it would have been necessary to resort to the legal system to address the asymmetry, but that was not to occur until much later.

As we have seen, the managing agency system’s peculiarity is closely tied to several economic, social, cultural and institutional factors that were at play in colonial India at the turn of the 19th century. An understanding of these factors is essential in order to analyse the corporate governance problems produced by the system and also the efficacy of the legal response to address these problems.

III. MANAGING AGENCY SYSTEM: STRUCTURE AND GOVERNANCE PROBLEMS

Different approaches may be adopted while considering the structure of the managing agents and their relationship with the managed company. Institutional economists consider the managing agent to be the "firm", which is the decision-making authority, and the managed companies merely as the operating units of the firm (Brimmer, 1955: 563; Tyabji, 2015: 6). They argue that it is necessary to avoid becoming preoccupied with the legal aspects of the managing agency system. In that sense, the system generates benefits such as integration and synergies through economies of management and administration (Misra, 1999: 67-8),[9] for which reason the system has been compared with the *zaibatsu* system in Japan that existed following the Meiji Restoration in 1868 and is the predecessor of the *keiretsu* system that is currently in vogue (Charlesworth, 1982: 47). Under the *zaibatsu* system, wealthy Japanese families exercised control over corporate groups by organising them into pyramidal structures (Morck and Nakamura, 2003: 1-2).[10]

However, in order to examine the corporate law and governance implications of the managing agency system, it is necessary to treat the managing agent and each of the managed companies as separate entities and to identify the exact legal relationships involved. Viewed as such, it would be possible to examine four specific areas: (i) the nature of the managing agency contract between the managing agent and the managed company; (ii) the nature and extent of shareholding of the managing agent in the managed company, and the exercise of voting rights in respect of those shares; (iii) role of the board of directors of the managed companies; and (iv) the interrelationship among the managing agent and various managed firms under its control, especially on financial matters (Brimmer, 1955: 567). I now elaborate on each of these areas.

[9] Rosen (1979: 263) notes that "managing agents developed a system of administrative integration, the forerunner of modern corporate conglomerates."

[10] A principal difference between the two systems is that control is exercised in the *zaibatsu* through a holding company whereas in the managing agency system control is exercised through the management contract in the absence of a holding company structure.

A. Management Contract

The most unique feature of the managing agency system is the management contract entered into between the agent and the managed firm. Compared to other companies, particularly those with diffused shareholding, it is the extensive powers granted to the agent under the management contract that not only conferred excessive control upon the agents but also gave rise to distorted incentives on their part and enabled them to subject the system to abuse.

1. Powers of the Managing Agent

The scope of the managing agents' powers was rather extensive, such that the exercise of all crucial decision-making powers pertaining to the managed companies were conferred upon the managing agent. For example, a managed company in its contract to the managing agency pertaining to the first cotton mill in Bombay stated: "The entire management of [the establishment of the cotton mill] is entrusted by us, of our own will and pleasure, to you, and you will continue to do so in the course of your lifetime." (Rungta, 1970: 228). Brimmer's (1955: 569) study of twenty-four management contracts indicate that the managing agent can carry out the "general conduct and management of the business of the company", although subject to the overall supervision of the board of directors of the managed companies. As we shall see later, the exercise of supervision by the board turned out to be extremely weak. In any event, one might imagine that the agent will be subject to duties and liabilities under contract law as a fiduciary, but the historical accounts do not allude to this legal technicality and how they were treated by the legal system.

The other powers of the managing agent included those to enter into contracts on behalf of the managed companies, undertake the purchase and sale of goods and materials, initiate legal proceedings, receive monies on behalf of the managed company, issue financial instruments and also engage and dismiss employees (Brimmer: 569). All of these suggest

that the managing agents effectively exercised complete management control over the companies.[11]

Managing agents enjoyed some flexibility in terms of engaging in competing businesses. While the agents themselves could not enter into a business that is in the same field as a managed company, nothing prevented them from managing multiple companies within the same industry (Brimmer, 1955: 568-9). Given the extensive role and powers of the managing agents, this would have clearly given rise to sensitivities in terms of using competitive information to the disadvantage of one or more managed companies and their shareholders.

The problems with excessive control were exacerbated by the structure of the managing agents themselves. They were largely constituted as sole proprietorships or partnerships, and at most as private limited companies. Only in exceptional scenarios have they been public limited companies. Arguably, such entity structuring on the part of the managing agencies was by design. Establishing closely held firms would ensure that control would remain with a small group of individuals. This would extend both to control over the managing agents and indirectly to managed firms as well. Misra (1999: 75) notes that in 1930-31, "of the thirty-six largest managing agency firms active in Calcutta only seven held limited liability status." The compulsion to maintain tight control was so strong that the managers were willing to sacrifice the benefits of limited liability when they confined themselves to non-corporate entities.

[11] In contemporary corporate law, one can imagine such powers being conferred upon the managing director of a company, albeit within strict limits and subject to conditions. The risk of conferring such significant powers on the managing agent is that they are augmented by the other relationships the agents enjoyed with the managed companies, which enhance the shareholders' exposure to the vagaries of the agent.

2. Term of the Managing Agency Contracts

The structure of the management contracts ensured that the managing agents' positions in the managed companies were well entrenched without any risk of removal. Terms of managing agency arrangements were extremely lengthy, and "usually ran for twenty or thirty years" (Misra, 1999: 69-70).[12] There have also been instances where managing agents have been appointed for life, or where their appointment has been secured by incorporation in the articles of association (Rungta, 1970: 228, 231).[13] Moreover, it was almost impossible for shareholders to remove managing agents as that required the support of two-thirds majority of shareholders, which was difficult to obtain since managing agents themselves either held shares or solicited proxies to defend their position in the company (Misra, 1999: 70; Lokanathan, 1935: 28). Hence, shareholders were left without recourse even if managing agents engaged in serious misconduct and destroyed corporate value.

3. Remuneration of the Managing Agents

The managing agents were rewarded handsomely irrespective of whether they performed to create value for shareholders. The management contracts provided for three kinds of remuneration payable by the managed companies to the agents (Misra, 1999: 69).[14] The first was a percentage of the profits. This aligned the incentives of the managing agents and the shareholders as it motivated the agents to work in the interests of the managed companies and their shareholders. There seems to have been a considerable variation in the percentage levels, but some of the better-known managing agents pegged their earnings at ten percent of the profits (Rungta, 1970: 237). However, in several cases, the managing agent's profits were determined as a turnover of the company. This distorted the incentives as it allowed the agents to focus on production and sales rather than profitability. While higher productivity would benefit the managing agents, this system did not provide

[12] Buchanan (1934: 165) finds that the term sometimes extended to fifty years.

[13] The Bose Committee (1962) highlights the severity of a clause in a managing agency agreement in which the managing agent's compensation for early termination was the amount that equated to the total remuneration the agency would have earned during the unexpired term of the contract. In such a case, the agent would obtain the entire amount upfront upon termination rather than over the term of the agreement it if continued.

[14] Oonk (2001) elaborates on the types of payments sought by managing agents and how they changed over the years, arguing that the "managing agency system was an extremely dynamic and flexible system".

adequate motivation to them to increase profitability even though that is what matters for shareholders.

The second method of payment from companies to the managing agents was a commission on purchases and sales. Rungta (1970: 230) notes that the "standard pattern … was to charge a commission of ¼ anna or 3/8 of a penny per pound of yarn and/or cloth produced in the mill." The payment of commissions is common in the case of normal agency arrangements. But, the important feature of the managing agency system was that these commissions were in addition to other forms of remuneration. Their entrenchment in the company through the managing agency contract would ensure a constant flow of earnings through the commissions whether or not they delivered results for their shareholders.

As a third form of payment, the managing agents were paid a "head office allowance", essentially as a mechanism for reimbursement of costs. While the agents earned profits and commissions, they did not have to incur significant costs of their own as those were met by the managed companies, which effectively made the agent's financial outlay rather negligible.

This combination of payment obligations that managed companies carried towards their agents created distorted incentives, which hardly motivated them to act in the interests of the companies. The agents were interested in perpetuating their own rewards even though they came at the cost of the shareholders.[15] The problem was compounded because several managing agents entered into similar arrangements with multiple companies. Even though the agents acted on a part-time basis without necessarily devoting the required care and attention to managed companies on an individualized basis, they were able to reap excessive rewards with almost no risk.

[15] Such arrangements involving "pay without performance" have come under severe attack in the contemporary corporate governance discourse (Bebchuk and Fried, 2004).

B. Shareholding and Voting Rights

The managing agents bolstered their contractual protection by acquiring shares in the managed companies that conferred them with an element of corporate control. Unlike in a typical pyramidal structure, the managing agents did not own a significant amount of equity in managed companies. They only held a minority stake, usually ranging between 15 and 20 percent (Misra, 1999: 70; Goswami: 1989: 294).[16] This was sufficient to bestow control in favour of the managing agents as the remaining shareholding of the managed companies tended to be dispersed among a large number of shareholders. There is evidence that whenever the managing agents floated the shares of a managed company on the stock exchange, they would ensure that the shares are allocated to outside shareholders such that the managing agent can exercise control despite owning a small number of shares (Goswami, 1989: 293-4). It is this aspect of the managing agency system that bears similarities with the Berle and Means corporation as it aggravates the agency problems between the shareholders and managers. The managers are in a position to exercise significant control despite having invested only a limited amount in the shares, thereby having very little "skin in the game". The collective action problems among the outside shareholders impede their effective exercise of monitoring over the managers. Buchanan's (1934: 169) observations are characteristic of this phenomenon: "The shareholders' meetings are often summoned only to say "aye" to what has already been laid down by the agency firm. As an example, one firm advertised the half-yearly meetings of five large jute mills in five successive periods of five minutes each."

If agency problems between managers and shareholders existed by virtue of the limited financial investment by the managing agents, that was exacerbated through additional features of the agents' shareholding in the managed companies. Brimmer (1955: 573) refers to the use of deferred shares, which were allotted to managing agents. While these shares carried low denominations, thereby limiting the agents' financial investments into the companies, they conferred disproportionate voting rights that rendered them on par with ordinary shares. Hence, managing agents were able to exercise greater control with far

[16] However, this was not always the case as in some cases managing agents held a larger stake in managed companies so as to exercise control through shareholding (Nomura, 2014; Lokanathan, 1935)

limited financial investment, which created a disparity between economic rights and control rights.

Another practice was rampant: managing agents solicited proxies from other shareholders so as to enhance their voting rights (Goswami, 1989: 294). This would ensure that managing agents were able to obtain shareholder affirmations on key decisions taken by them. Further, it enabled the agents to enhance their control over the company in a manner that was disproportionate to their financial investments. Finally, managing agents could always increase their shareholding in the company by acquiring further shares, an option they exercised only when their position in the company was threatened by one or more shareholders intending to take over control. Presumably, this was a fallback option since it involved financial outlay, but that may not have been a significant constraint given that managing agents were earning attractive remuneration from the company that they could utilise to buy more shares. Even if such remuneration was not forthcoming due to unfavourable business conditions, managing agents could resort to borrowing from the companies at reduced interest rates so as to preserve their hold over the companies. All of these conferred undue benefits to managing agents at the cost of shareholders.

In an account that challenges conventional wisdom, Goswami (1989: 294-6) finds that in the eastern region of India, these protective measures adopted by the British managing agents to maintain control over the managed companies were not effective in preventing the ingression of indigenous Marwari shareholders who managed to wrest control over some companies towards the later part of the colonial period.[17] The managing agents were unable to obtain proxy support when there were wild swings in market prices, as existing shareholders became keen to cash out their holdings. Taking advantage of such opportunities, the Marwaris began creeping up their shareholding in companies through the stock markets and even demanding seats on the board of managed companies. Goswami also highlighted another practice that enabled Marwaris to obtain additional shares in companies. During periods of cash shortages, the managing agents began obtaining loans at

[17] Misra (1999, 75) also notes that in case of scarcity of capital, if managed companies were unable to raise funding through the managing agents, they may have to look to Indian investors for such capital, in which case the agent's shareholding was likely to be diluted.

attractive interest rates from the Marwaris against pledge of shares they held in the managed companies. In several instances, the Marwari's invoked the pledge on account of failure by the managing agencies to repay the loans, which resulted in the Marwaris acquiring control over the companies. Thus, there is some evidence of a market for corporate control in managed companies in the 1920s (Goswami, 1989: 296).[18]

Barring the occasional takeover of British managing agents by local businesses, the shareholding structure devised through the managing agency enabled the agents to cement their positions in the managed companies without external threats. Despite holding relatively low (non-controlling) shareholding percentage in the managed companies, the agents were able to exert significant influence on the companies due to the dispersed nature of the remaining shareholdings, which they supported through mechanisms such as shares with disproportionate voting rights, proxies and even exercising, when it became necessary, the option of shoring up the agents' shareholding in managed companies to preserve their position. Arguably, such undue entrenchment by managing agents was inimical to the interests of the shareholders of the managed companies.

C. Structure and Role of the Board of Directors

In corporate law, the primary power for superintendence and management of a company rests with its board of directors (Kraakman, et. al., 2009: 12-4). However, the position was not straightforward under the managing agency system. While the boards may in theory have possessed significant powers, they rarely exercised them, instead leaving all matters of management to the agents. Although the law treats board members as fiduciaries, the managing agency system rendered them superfluous.

At the inception of the managing agency system during the early part of the nineteenth century, joint stock companies were not required to have boards of directors (Rungta, 1970: 228). In such a milieu, the need for and role of the managing agents is understandable. It is possible to visualize a scenario whereby the vacuum created by the absence of a specific

[18] The market for corporate control suggests that inefficiently run companies with dispersed shareholding could be subject to a takeover by an outside acquirer (Easterbrook and Fischel, 1981).

corporate organ to carry out management functions was filled in by the management agency system. This disposition prevailed for nearly a century since the inception of managing agents.

However, when a legislative mandate for elected corporate boards was introduced in 1913, it resulted in an overlap between the roles of the managing agents and boards of directors of the managed companies. Any friction over exercise of management functions was expediently avoided when managing agents invited family and friends to take up directorial position (Lokanathan, 1935: 20; Ray, 2009: 114, 118). Hence, the boards came entirely within the control of the managing agents. It was common for a partner of the managing agency firm to be the *ex officio* chairman of the companies it managed (Misra, 1999: 69). Due to the dispersed nature of the managed companies, the agent was in a position to control the composition of the board even though it held a stake that was far less than majority.

Brimmer (1955: 575) offers useful insights into the composition of the managed company boards. In addition to directors nominated by the managing agent, the board primarily consisted of "prestige directors" who were appointed for their position in society rather than for their contribution towards management strategy or monitoring. According to him, "managing agency directors held an average of 4.7 directorships in the controlled companies and prestige directors held an average of 2.5 each. On the other hand, nonagency and non-prestige directors held only 1.1 directorships …" Given such a board composition, it is unrealistic to expect the boards to monitor the actions of the managing agent or to raise objections if those actions go contrary to the interests of the shareholders. This went against the grain of corporate law which recognises the primacy of the board of directors on matters of superintendence and management of the company. To quote Brimmer (1955: 556):

> While the managing agent presumably functions under the supervision of the board of directors, the latter is frequently nothing more than a fiduciary body which exists to persuade the public to invest and fulfill legal requirements. A look at the large number of "prestige" directors—"Sirs," "Rajas," "Rao Bahadurs," etc.—on the boards

> of Indian companies will make this suggestion quite obvious. Thus, the managing agency firm is responsible for practically all decisions made in the company under its control.

From a corporate law perspective, the managing agency system introduced parallel centres of power. While the board of directors is possessed with *de jure* powers to control the management of companies, the powers were exercised *de facto* by the managing agents, thereby rendering the board of directors redundant. Although one might expect the board of directors to be in a better position to protect shareholder interest, the managing agency system vested all powers in the agents who were largely interested in perpetuating their holds over the companies.

D. Financial Relations Between the Managing Agent and Companies

From an industrial organisation perspective, the managing agency system has been advantageous as it allowed the companies not only to take advantage of economies of scale and superior management, but it also allowed for diversification of businesses by way of a de-risking strategy. Moreover, the competence and reputation of the managing agents enabled portfolio companies to raise the required finance. The agents even went to the extent of guaranteeing loans and deposits availed of by the managed companies (Roy, 2010: 122). However, the benefits of the group structure were overshadowed by its abuses, as discussed below.

Essentially, the managing agents treated all companies within their portfolio as part of a single unit without regard to the separate legal personality and the separate interests of the shareholders of the individually managed companies. The managing agents handled the financial matters commonly across the group as it if it were a single entity. For instance, monies raised by one company by accessing the capital markets would be routinely transferred to another company that may have developed a dire need for finances (Brimmer, 1955: 570). Similarly, managed companies would make loans and advances to one another and buy or sell products or raw materials, in each case on terms that are not necessarily consistent with the market price. These transactions may not have been carried

out on arm's length basis due to which there was a transfer of value from one company (and its shareholders) to another (and its shareholders).[19]

Such attitude of the managing agents adversely affected shareholder interest. While the agents were responsible for, and earning income from, several managed companies and were largely indifferent to inter-company transactions within the group, this left shareholders vulnerable as their interest was confined only to one company. For instance, nothing prevented the managing agent from shifting funds from one managed company to another, by which it "can nourish or strangle any company under his control to any extent [it] desires." (Brimmer, 1955: 570). At the same time, the boards were powerless to intervene. While there are examples of shareholder rebellions against such conduct of the managing agencies, they were rendered futile and did not result in significant improvements to governance. Managing agents also enjoyed informational advantages, which they were not required to share with shareholders. Legal requirements relating to disclosure of financial information and auditing standards were weak (Brimmer: 1995, 570; Misra, 1999: 81).

In concluding this Part, I find that while the managing agency system was devised to address certain needs that arose in the business relationships between Britain and its colony, its structure was open to abuse by the agents in its actual operation. While shareholders were aggrieved, they were unable to bring about changes through exercise of their voting control due to a combination of the dispersed shareholding in which individual shareholders held limited number of shares and also the additional entrenchment mechanisms deployed by the managing agents. That leads to the next question as to whether shareholders or others impacted by the adversities of the system could benefit through governmental intervention. I now turn to the legislative responses and examine their nature and effect (or lack thereof) in addressing the problems generated by the managing agency system.

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[19] Contemporary corporate governance is rather circumspect about such transactions as they are related party transactions that amount to tunneling. Bertrand, et. al. (2002).

IV. LEGISLATIVE RESPONSES TO THE MANAGING AGENCY SYSTEM

In this Part, I discuss the governmental efforts to rein in the managing agency system and the resistance by businesses, especially when agencies were still in British hands. The underlying political and economic factors had a significant role to play in the legislative outcome. This Part is divided into two sub-parts, the first of which relates to the period until 1936 when managing agents enjoyed a free hand, and the second deals with the subsequent period when they were regulated and finally abolished.

A. Origin to 1936: Freedom from Regulation

Beginning with the history of corporate law in India, companies were established and carried on business in India without the existence of a specific body of law regulating them. Specific company legislation made a debut in India only in the year 1850 when an Act for Registration of Joint Stock Companies was passed (Rungta, 1970: 36). This was based essentially on the then prevailing Companies Act, 1844 in England and marks the beginning of an era when legislative developments in the corporate field in India merely kept up with developments in England (Varottil, 2015: 12). It was only in 1857 that limited liability was conferred upon companies other than banking and insurance companies.[20] New pieces of companies' legislation were introduced periodically in India, usually to track the legislative developments in England.[21] The last piece of legislation in the colonial period was the Indian Companies Act, 1913, which was subject to significant amendments in 1936.

1. The Philosophy of Corporate Lawmaking in the Colonial Era

Here, I seek to analyse the impact that corporate legislation had on Indian businesses in the colonial period, and also the possible motivations behind the introduction of such legislation. Any attempts to regulate the managing agency system must be viewed in this

[20] Banking companies were conferred limited liability in 1860 and insurance companies in 1866 (Varottil, 2015: 13; Rungta , 1970).

[21] For details of these legislative developments and corresponding English companies' legislation, see Varottil, 2015: 15).

context. Two trends are quite evident in the colonial period. *First*, the transplant of English corporate law into India was to serve British business interests rather than to modernise Indian corporate law. *Second*, English company law as transplanted to India operated as an instrument of market regulation, a sort of "colonial *laissez faire*" (Birla, 2009: 243).

The motive behind transplanting English company law into India was to facilitate better trade between Britain and India, which could be accomplished if there was symmetry in the corporate legislation between the two countries (Rungta, 1970: 68; McQueen, 2009: 10). In other words, the familiarity of the British businesses with Indian corporate law was thought to minimise their risk in trading with that colony. Rungta (1970: 214) is unequivocal in his analysis:

> If there is any underlying theme running through the company legislation of a full half century in India, … it is a steadfast adherence to the policy that what was good for Britain must also be good for India. It was not that the legislators responsible for these Acts were not able men, some of them were well qualified and experienced in company affairs in India. … What they seemed to lack the most was the will, rather than the wisdom, to change.[22]

Narrowing this discussion to the managing agency system, despite the close cross-referencing of Indian developments (both in the business and legislative spheres) with Britain, the evolution of the system in India bears little connection with Britain and emerged on account of specific local requirements. The system was born out of the need to ensure British trade and investments in India. Intriguingly, a business innovation in the Indian context was sought to be governed by laws that originated in Britain. Here, knowledge and familiarity of British businessmen with corporate law in India can be considered an imperative to enhance business activity. The idea was to promote British business interests in India, which were dominated by managing agency firms controlled by them.

[22] Although these observations pertain to the second half of the nineteenth century, they largely hold good for the remainder of the colonial period spanning the first half of the twentieth century.

However, the transplant of English law into India so as to favor British businesses was accompanied by a consequential impact, in that it often ran counter to local business interests (McQueen, 2009: 10). Hence, even when indigenous shareholders acquired large stakes in companies managed by British managing agents, the legal system failed to provide recourse to them. Given that the managing agency system was not prevalent in Britain, the legislation did not contain any specific protections to shareholders. Impulsive transplant of English legislation to India without consideration of the local circumstances meant that the managing agency system avoided any treatment under the Indian legal system, and was able to operate for over a century without any legal constraints. As Lokanathan (1935: 331, 351) astutely observes:

> One of the unfortunate results of reproducing English legislation in the entirely different industrial conditions of India is the lack of control over the managing agency system of industrial management. The Government did not realize that the managing agency system was quite different from the English method of industrial management, and that the company law should recognize this vital distinction. …
>
> Nothing has done more to enable abuses to creep into the system than the failure of the Indian Companies Act to distinguish between the British system and the Indian system of company management.

Moving to the second factor, since the transplanted law was intended to operate for the benefit of British traders, it adopted a largely free-market ideology. This was also consistent with developments within England at the time. During the colonial period, law was used as an instrument to facilitate trade. As Birla (2009: 243) notes:

> I would like to reconsider the performance of colonial sovereignty, this time as a staging of market actors and as an implementation of a certain kind of colonial laissez-faire, manifest in legal frameworks standardizing the ‘free circulation’ of credit and commodities, most especially in the institutionalization of the law of contract as operative mode for market exchange.

This philosophy resonates with the legislative approach taken towards the managing agency system. The free-market ideology meant that managing agents and the managed companies were free to establish their relationship through contract, with no interference whatsoever from the government. This was consistent with a similar approach followed in company law as a whole. The result was that shareholders were left to fend for themselves against abuses by management. Without additional legislative support, they were unable to make much headway, and were left at the mercy of the managing agents who enjoyed tremendous freedom.

In this background, the paper proceeds to deal with some of the attempted reforms during the initial period until 1936.

2. The (Non-)Regulation of Managing Agents

Interestingly, the first attempts at reform came directly from shareholders who sought to alter corporate practice without governmental intervention. Since the 1870s, shareholders of some companies succeeded in replacing their managing agents with managers operating under the direct supervision of the board of directors, others succeeded in varying the terms of the management contract to introduce favourable terms such as limiting the tenure of office to ten years and the remuneration to ten percent of the profits of the company (Rungta, 1970: 236-7). But, these developments failed to gain more widespread support without legislative intervention and remained sporadic. It is also puzzling that despite the concerns with the managing agency system, no alternative mechanism that addressed those was forthcoming.

The ill effects of the managing agency system appeared in the legislative debates as early as 1882 when a Companies Bill was being considered for enactment. Birla (2009: 41) identifies the concerns:

> As the official responses to the Companies Bill elaborated, British directors and managing agents speculated on invested share capital, transferred shares between a variety of companies they controlled, and in the process produced a chain of

> bankruptcies that financed new concerns. As bankruptcies became common, directors absconded with the share capital of populations of largely "native" shareholders.

The underlying tension between British managers and indigenous shareholders is largely evident in this episode. However, the result of the debates was that the Companies Act of 1882 sought to address the problem by streamlining the procedures for dissolution and winding up of companies (Birla, 2009: 41). The managing agency system itself was left untouched.

When company law came up for reform next in 1913, further attempts were made to ensnare managing agents within the sphere of regulation. The Secretary of Commerce and Industry Department sought to prevail on the Government to deal with the problems of the managing agency system, explicitly recognising that "English Company Law when imported into the country requires special modifications if it is to deal with conditions which do not exist in England." (Rungta, 1970: 215). The concern was that managing agencies were being allowed to get away with conflicts of interests, which would not be allowed in the case of directors (even under English law), presumably indicating that the managing agency system provided for a regulatory arbitrage in India that was unavailable in England. The valiant attempt to constrain the freedom of managing agents was set at naught when the proposals were met with severe objections, particularly from the Bengal Chamber of Commerce (Rungta, 2009: 216). The Government caved in, and did not incorporate any suggestions to provide for specific treatment of the managing agency system.

During the initial period, we find that sufficient support was being mustered for regulating managing agents (and even to abolish the system altogether). But, the attempts failed. Several reasons could be attributed to this outcome. The primary reason is the effect of legal transplants and path dependence whereby there was a lack of impetus to deviate from legislation in England. The managing agency system suffered the most from this inertia because it did not receive any treatment whatsoever in English legislation as the system originated and existed only in the colonies and did not affect domestic companies' legislation in England. At the same time, even though it did not affect the management and

operation of British companies, the legislation had a role in ensuring that British interests in India were protected. Since British agents dominated the managing agency system, the lack of regulation worked to their advantage. Although there is no direct evidence, it is reasonable to conclude that the colonial government played up to British business interests during the period. The indigenous shareholders and businessmen were not influential within the political circles so as to have exerted pressure to push legislation through. But, this was to change in the next phases, to which I now turn.

B. 1936 - 1970: From Regulation to Abolition

During the first half of the twentieth century, there were significant economic and political changes both within India and around the world that had an impact on the managing agency system and its oversight. From an economic standpoint, businesses were subject to greater uncertainties due to the two World Wars. Moreover, the interwar period saw the Great Depression that plagued the global economy for several years since its onset in 1929. This added a greater element of risk to Indian companies, especially those involved in the export market, although some did benefit from the excessive demand for certain products arising from the World Wars.

Domestically, the managing agency system witnessed substantial alterations. Indian shareholders had by then acquired significant shareholdings in companies managed by British managing agents, and had begun to assert themselves. The voices against abuse of the managing agency system grew louder. More importantly, the Indian businessmen became more influential in the political system, and their opinions began receiving deference from the colonial Government. As Misra (1999: 124) notes: "an increased involvement in politics and a close relationship with Congress enabled some Indian businessmen to promote legislative bills designed to limit the sphere of operations of British firms on the grounds that they excluded Indian capital, management and employees." She also argues that the British managers were not only disinterested in developing ties with the Indian businesses, but they also adopted a largely apolitical attitude showing apathy towards government relations. This may have resulted in their waning influence compared

to previous years. It is in this background that legislative reforms commencing in 1936 must be viewed.

1. Company Law Amendments in 1936

Following the enactment of the English Companies Act of 1929, significant amendments were made to Indian law by way of the Companies (Amendment) Act, 1936. A unique aspect of this legislative effort is that the Indian legislature decided to embark upon a process of amending the then existing Indian Companies Act, 1913 rather than a reenactment along the lines of the 1929 English legislation, indicating for the first time of a hesitation in a wholesale transplant. The Statement of Objects and Reasons of the 1936 amendments suggests that it was decided not to adopt the wholesale English legislation due to some unfavorable criticism it attracted, and also because of the recognition that problems peculiar to India had to be dealt with, especially those relating to the managing agency system (Bhabha Committee, 1952: 17).

The 1936 amendments for the first time expressly recognised as well as defined a managing agent. Several restrictions were imposed on their activities (Indian Companies Act, 1913, sections 87A to 87I). The term of office of the managing agents was limited to a maximum of twenty years . Provisions were made for vacation of office by managing agents or even removal by shareholders in certain circumstances such as where the agents have been convicted of certain offences. This ensured that managing agents' ability to continue was dependent upon shareholder decision-making, due to which the may be motivated to act in the interests of the shareholders. Remuneration of managing agents was limited to a percentage of the net profits of the company to be computed in the prescribed manner. Any other form of remuneration was possible only with the approval of shareholders through special resolution. This limited the ability of managing agents to charge commissions or peg their remuneration to turnover rather than profits. Transactions involving intercompany loans and share transfers were restricted when they were carried out either between the managing agent and a company or between the managed companies themselves. This curbed the ability of managing agents to move funds among companies so as to adversely affect the interests of shareholders of some companies for the benefit of others through

transfer of value. Managing agents were prohibited from engaging in businesses that competed with managed companies. They were also permitted to appoint no more than one-third of the board of directors. This diminished their role on the boards, whose altered composition would confer upon it greater powers.

The set of amendments in 1936 is significant in that it sets at rest the free market under which managing agents were operating until then. Their powers were significantly curbed. At the same time, "it appears merely to have undermined their position rather than changed their behaviour", as they simply buttressed their diminished powers by acquiring controlling shareholdings in managed companies (Misra, 1999: 84).

The subsequent period witnessed India's independence in 1947, following which legislative powers were exercised by the government in free India under its Constitution that came into force in 1950. While it is reasonable to assume that decolonization would have brought with it a major shift in corporate law in India, the reality turned out to be different. Signs of change emerged only a few years later.

2. First Companies' Legislation in Post-Colonial India

By the time of decolonization, the managing agency system had become a significant economic institution in India exercising dominance over business. While British managing agents continued to be active, several Indian agents too began providing competition. The new government's policy towards the managing agency system as well as business in general lacked clarity. There were different factions within the ruling Congress party: one that advocated the model of "Fabian socialism" with state ownership and regulation of key sectors of the economy, and the other that sought to pursue liberal economic policies by providing incentives to private investment (Varottil, 2015: 22). This mixed attitude of the government towards business became evident even in the first legislation after independence, i.e. the Companies Act, 1956.

The inspiration for a new companies' legislation in post-colonial India arose from the appointment of the Company Law Amendment Committee in England (known as the Cohen

Committee), which suggested far-reaching changes to the then applicable English company law, whose recommendations resulted in the enactment of the English Companies Act of 1948. After some initial law reform efforts, the Indian Government appointed a committee under the chairmanship of C.H. Bhabha, which undertook an extensive exercise (including interviewing experts across the country) and submitted its 477-page report to the Government in March 1952. The Bhabha Committee Report is striking in many ways. Despite the momentous shift in India's destiny through decolonization, the reliance on English laws as the model for Indian corporate law was unaffected. The tenor of the Bhabha Committee Report is such that on every aspect of the law, it largely referred to the developments in English company law and considered whether that would be relevant to the Indian context or not. There was no intention whatsoever to frame an indigenous legislation that is apt to India's changed circumstances.

While the Bhabha Committee (1952: ch. X) considered the various issues plaguing the managing agency system, it did not find the need to abolish the system, but only to make incremental changes. It observed (at 84-5):

> Having regard to all the circumstances, we consider that under the present economic structure of the country it would be an advantage to continue to rely on the managing agency system … We feel that, shorn of the abuses and malpractices which have disfigured its working in the recent past, the system may yet prove to be a potent instrument for tapping the springs of private enterprise … [and] the recommendations that we make are designed only to tighten up the relevant provisions of the Indian Companies Act ...

The Committee went on to recommend changes to processes relating to the appointment of managing agents, their conditions of service, remuneration, powers and matters pertaining to intercompany relations. Since the changes to the managing agency system were expressed in measured terms, the Bhabha Committee recommendations suffered a backlash from certain political quarters, and its recommendations were referred to a parliamentary standing committee which tightened them further (Misra, 1999: 191). The Companies Act, 1956 as enacted contained further restrictions on remuneration of managing agencies,

limits on the number of managed companies under one agent and a prohibition on certain types of intercompany transactions such as loans. At no point during this process was there adequate legislative will to radically address the matter by eliminating the managing agency system altogether due to its mounting ill effects.

In all, although the Indian Parliament was presented with the opportunity following independence to radically alter the nature of company law, especially given the altering economic sentiment, it chose to adopt the path dependence approach and continued to rely on transplanted law from England. In other words, decolonization did not represent any break whatsoever from the past (Varottil, 2015: 27). Limiting the discussion to managing agencies, Goswami (1989, 302) argues that "the impact of decolonization on European business was not discontinuous and centered on 1947". The decline of the system and process of tighter regulation began in the 1930s, and the events surrounding India's independence can be said to be a continuation of that process rather than any sharp shift initiated by the independent government. This also explains why we do not see a swift retreat of British managing agency firms from India as a consequence of decolonization, although there was a sharp shift in the nature of their operations as they became more collaborative with Indian businesses and also raised more capital from and shared their stake with Indian shareholders (Misra, 1999: 194). But, change became evident, albeit gradually and incrementally, in the two decades following India's independence.

3. Abolition of the Managing Agency System

India's corporate law began witnessing a departure from its colonial past only from the early part of the 1960s. The socialist ideology of the Government appears not to have taken effect immediately upon decolonization, but only in the years that followed (Tripathi and Jumani, 2007: 26-7). The managing agency system too was caught by the rising tide of socialism. This was coupled with some high profile episodes of mismanagement by certain managing agents that demonstrated the abuse of the system, which evoked significant political and popular sentiment. For example, a controversy surrounding the Dalmia-Jain group of companies attracted investigation by a specially constituted committee that unearthed several wrongdoings in an 815-page report (Bose Committee, 1962).

Other committees that were appointed during the period too came up with scathing attacks on the managing agency system. The Shastri Committee (1957: 129) discussed the differing points of view on whether the system should be continued or abolished, and called upon the Government to take a definitive stance. Subsequently, the Patel Committee (1966: 15) considered in detail the advantages and disadvantages of the system. Based on its analysis, the Committee concluded that the advantages of the system are largely exaggerated, and hence should be discontinued, but in a phased manner. Even among academic community, there were growing calls for abolition, primarily on the ground that the system engendered concentration of ownership and control of companies, and prevented competition (Hazari, 1964; Hazari, 1965). Heeding to these calls, the managing agency system was abolished by the Companies (Amendment) Act, 1967, which finally came into effect in 1970. Even though several recommendations of Government-appointed committee called for an industry-wise phased abolition, it was finally decided to put an end to the system in one fell swoop.[23]

By the time of its abolition, most British managing agencies had changed hands and transitioned into the control of Indian business groups (Misra, 1999: 209). However, the legacy of some of the former managing agencies continues to be carried on by businessmen, although those firms are currently operating other businesses.[24]

Furthermore, the managing agency heralded the ascent of another mechanism of corporate governance in the form of "business houses" that operated large businesses in India. This form of family ownership continues to be dominant in Indian corporate governance, including in listed companies (Malla, 2010: 178-80). The owners of erstwhile managing agencies became controlling shareholders of family business groups (Reed, 2002: 252). This dawned a new phase of corporate governance in India during the 1970s and thereafter following India's economic liberalization in 1991, wherein the problems between controlling shareholders and minority shareholders took centre-stage (Varottil, 2015: 57-60).

[23] In that sense, the legislative effort is similar to other more recent scandal-driven responses in corporate governance in the form of the Sarbanes Oxley Act of 2002 in the US following the Enron scandal and stringent measures in the Companies Act, 2013 in India following the Satyam corporate governance scandal.

[24] Examples include Williamson Magor & Company, Greaves & Company, Gillanders & Arbuthnot & Company (Rungta, 1970; Misra, 1999: 209).

Elsewhere in South Asia and Southeast Asia where managing agencies were existent, there is little evidence of legislative or regulatory responses to deal with the managing agency system. It appears that the system was not put to the kind of abuses that were experienced in India. Consequently, the system quietly faded away into oblivion as it was overshadowed or succeeded by the more modern forms of business organizations such as the multinational corporations (Jones and Coplan, et al, 2010: 73-5).

V. LESSONS & CONCLUDING REMARKS

This paper is essentially a longitudinal analysis of the managing agency system using a corporate law and governance framework. It is possible to take away some key lessons from this analysis. *First*, the system is indeed peculiar in that it was born out of the trading and investment needs of British businesses in certain colonies. While it emanated in India and spread to other British colonies in Southeast Asia and East Asia, nowhere did it acquire the kind of prominence and controversy as it did in India. Arguably, it was the unique circumstances present in India's colonial industrial and social setting that may have enabled it to proliferate. Curiously enough, the system did not receive any recognition or acceptance within Britain itself for its domestic business concerns. In that sense, it can be considered to be a targeted innovation arising from colonial influence on overseas trading that has had an impact on corporate law and practice, and influenced the business relationships between the colonies and the Empire.

Second, the managing agency system was conceived to fill a gap in the entrepreneurial needs of British businesses in India. However, once the system gained popularity and became entrenched in India's corporate ecosphere, Indian businessmen too began adopting the system, although their needs were arguably somewhat different (albeit with some overlaps). In that sense, the innovation was put to use for reasons beyond those that related to its appearance in the first place.

Third, it is nobody's case that the managing agency system is inherently problematic. It did perform a useful role at the relevant time. However, over the years, the practices that surrounded its implementation became rather devious in that the system was subject to

capture by managing agents who were interested only in enriching themselves at the cost of the shareholders. This gave rise to the acute agency problem between shareholders and the managers. Unlike the Berle and Means corporation, the managing agency system furthered the interest of the managing agents through other mechanisms such as a one-sided management agency contract. This resulted in severe abuse of the system, perhaps an unintended consequence.

Fourth, the factors relating to ethnicity seem to have an important role to play, given that the literature is replete with discussions of the conflicts between British managing agents and mostly Indian shareholders. There is some indication that this may have been the reason for the lack of political will within the colonial government to address the problem through corporate law, at least until the very end of the colonial period.

Fifth, there is sufficient correlation between the aforesaid economic, social and political factors and the nature of the legislative responses to the excesses of the management agency. Given that corporate law in India until 1936 was essentially a transplant of English company law, the system was left untouched, as it was a concept alien to English law. Moreover, this was consistent with the *laissez faire* attitude adopted by English company law. It was only from 1936 that the system was reined in gradually, and that too when Indian businesses (and shareholders) obtained a political voice.

Finally, decolonization does not appear to have been the primary reason for the demise of the managing agency system. Even in independent India, the system had its sympathisers both within government and among the business and intellectual elite. Moreover both British and Indian managing agents continued to thrive, although the balance between the two had by then substantially shifted eastward. It was only the rise of socialism and the magnitude of scandals involving managing agencies that mustered the will required to abandon it.

Although the managing agency system was unique to certain colonies of the British Empire and has been defunct now for nearly half a century, the rich lessons in corporate law and governance it offers cannot be ignored.

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