PREMJUS ROY

EMPLOYEE SHAREHOLDINGS

IN recent times it is coming to be better realized that if employees who worked for a business concern—be it organised as a cooperative society, partnership firm or as a company—had a stake in the profits of that concern, it would make for greater personal interest of the employees in the future prosperity of that concern and will, in the case of an industry, promote the improvement of industrial relations. If employees have a larger stake in a company as shareholders, they will feel more identified with the concern, will have better incentive to work for its progress, and will be less inclined to do things which will be harmful to the company. Other advantages claimed for industrial co-partnership (giving employees shareholdings) included that stock-holding in industry would be more broad-based, that it would give a sense of dignity and status to the employees, and that the scheme might help as an anti-inflationary measure in a country like India.

In several industrially advanced countries, many companies have employee stock purchase plans in operation. India, on the other hand, lagged behind in this sphere. Under the Indian Companies Act, 1913, a company was prohibited from advancing any loan or giving any financial assistance to any employee or other person for purchase of shares of the company. The basis of the restriction was to prevent improper use of the company's assets by speculators in management of the company who may seek to obtain control of the company by such acquisition for their own advantage. In the Companies Act of 1956, this prohibition was removed on the recommendation of the Bhaba Company Law Committee, which stated that although under Section 54 of the English Companies Act 1948 no limit is imposed on the purchase of a company's shares it was desirable to limit the purchase to three months' salary of an employee. The limit of 3 months' salary was raised to 6 months by the Joint Committee of Parliament.

Section 77 of the Companies Act, 1956, provides that no public company, and no private company which is a subsidiary of a public company, shall give, directly or indirectly, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the Company or its holding company. Such financial assistance would include making of a loan, giving a guarantee, providing security or any other kind of financial assistance. The following exceptions are provided namely (*a*) lending of money by a banking company in the ordinary course of its business (*b*) provision by a company, in accordance with any scheme for the time being in force, of money for the purchase of, or subscription for, fully paid shares in the Company or its holding company, being a purchase or subscription by trustees of or for shares to be held by or for the benefit of employees of the Company, and (*c*) making by a company of loans, upto a limit of six months' salary or wages of an employee, to employees of the Company, for the purchase of the Company's shares for their own benefit. Loan under exception (*c*) above cannot be given to a director or manager, even though he may be employee of the Company, or to managing agents, or secretaries and treasurers. But there is no objection to a company providing funds to trustees for purchase of the Company's shares for the benefit of employees, which may also include a director who is an employee of the company. An infringement of Section 77 renders the Company and every defaulting officer to fine of upto Rs. 1,000/-. The provisions of Section 77 are based upon Section 54 of the English Companies Act, 1948, with the difference that under the English Act, there is no restriction of six months' salary of an employee as under the Indian law. *It will be seen that the restriction under Section 77 does not apply either to a private company or to financial assistance by a public company for the purchase of shares of a subsidiary company.*

TYPES OF EMPLOYEE STOCK PURCHASE PLANS

There are different types of employee shareholding schemes in operation in various industrially advanced countries, particularly the United Kingdom and U.S.A. Apart from the general objective of giving the employees a stake in the fortunes of the company they work in, some of the schemes are also intended to finance employees' savings funds and retirement funds. Some of these schemes in operation in companies include the following

1. *Ordinary shares purchased for employees from amounts available under profit-sharing schems.* Whenever the Company's annual dividend on the ordinary share capital exceeds a certain specified percentage, a bonus is paid to a trust fund on behalf of the employees, the amount of the bonus depending upon the employees' total remuneration and the dividend paid on ordinary capital in excess of a specified minimum. For instance, in the case of the Imperial Chemical Industries Ltd. of U.K. when the Company's annual dividend on ordinary stock exceeds 5%, a bonus of 1% of the employees' total annual remuneration for every 1% of the Company's ordinary stock dividend in excess of 5% became payable to the employees. This money is put into a trust fund and invested by the trustees in the ordinary stocks of the company at market price. The shares are made over to the employees either immediately, or after a specified number of years of service with the company. In some schemes only preference shares are issued to the employees, so that no voting rights may accrue to them.

2. *Instalment purchase of ordinary shares by employees at market price or proportion thereof*

Usually an interest-free loan is given by the Company for purchase of the shares and is returnable in instalments. The shares are issued either at market price or at a concession of 10% or 20%. The employees become shareholders immediately on registration, and enjoy full voting and dividend rights. Cash dividends are, however, appropriated by the Company towards repayment of the loan.

3. *Stock options granting employees right to buy stocks at a prescribed price*

Under this scheme, instalments to be paid are deducted from the monthly pay of the employees in convenient instalments. The employee becomes a full-fledged shareholder with voting rights, only after the full amount due on the shares is accumulated in the employee's account created for the purpose of purchasing the shares. The employee is entitled to dividend on shares from the beginning.

4. *Employee's savings matched by the Company's contribution and invested in ordinary shares*

Such savings schemes are somewhat akin to Provident Fund schemes, with the basic difference that while under Provident Fund schemes, funds have to be invested either wholly or mainly in government securities or gilt edged securities, in these schemes it is intended to invest the funds wholly or mainly in the Company's own shares. As in the case of Provident Funds, these funds are mainly operated through trust funds, and while the employee may withdraw his contribution after a specified number of years, the Company's contribution can be withdrawn only on retirement from the company's service.

5. *Employees savings invested in the company's shares at par*

These are also savings schemes under which special type of employees' ordinary or preference shares are issued at par for cash on instalment purchase terms. The employee shareholder exercises full membership rights, and enjoys the benefit of dividends like other shareholders. There is, however, restriction on transfer of shares. In case an employee desires to sell the shares at any time, he is required to give a pre-emptive right of purchase to such other employee as may be appointed by the directors to purchase them at par.

6. *Employee savings invested in Preference or Loan capital convertible into ordinary stock*

These are also savings schemes. The employee can make payment for the Preference or loan stock by monthly deduction from pay. The right of conversion into ordinary stock is exercisable after a specified number of years. If the option is not exercised by a certain fixed date by the employee, the Company may repay the stock at its original price. On conversion, the employee shareholder enjoys the same voting, dividend and other rights as other ordinary shareholders.

7. *Employee investment in nominally priced shares having prospects of appreciation*

Under this scheme, a special class of shares with a nominal face value is issued, which entitles the employees to a share of the net profits of the Company, subject to a dividend ceiling. The allocation of shares to each employee is made according to the monthly remuneration or status of the employee. The employee's shares are held by the trustees on behalf of the employee. The transferability of the shares is restricted. On leaving the company before retirement, the employee has to sell the shares at par to the Company, but on normal retirement he may sell the shares at the market price.

8. *Shareholding trust for employees' benefit for acquiring control of business*

Certain benevolent businessmen have formed trusts for the benefit of employees with a view to making them eventual owners of the Company. The trust is formed by putting in a block of shares in a trust fund, and additional purchases of shares are made from the open market from dividend accumulations. Voting rights are exercised by the Trustees. An employee who leaves service ceases to participate in the scheme but one retiring continues to participate in the distribution of the trust income at full rates for the first five years after retirement and thereafter at half the rate until his death.

EMPLOYEE SHAREHOLDING IN INDIA

Although there are no general plans of employee stock-purchase in operation, individual companies have from time to time reserved shares for their employees at the time of fresh issue of capital, such shares being offered at the same price as to others. The Companies agreed to advance loans to the employees for purchase of the shares, the amounts of the loans not exceeding 6 months' salary and being repayable in instalments through payroll deductions. For instance, Richardson Hindustan Ltd., Warner Hindustan Ltd., reserved shares for their employees at the time of public issues of capital made by them in 1966-67. So did Metal Box, Indian Oxygen, Guest Keen Williams Ltd, Glaxo Laboratories (India) Ltd. and other companies. There seems to be a general lack of interest on the part of managements to encourage employees to acquire the company's shares on a worthwhile scale. However, managements do often encourage employees to hold small number of shares in order to secure the employees' presence at general meetings of the ompanies.

Opinions have been expressed against giving employees shares in the company they work in. Lester has stated in his book on Industrial Relations. "The attempt to make workers part owners of the business, and thus cause them to be management-minded violates the principles of spreading one's risk. It concentrates the workers' job and his invested earnings in the same firm which may be a fluctuating business. With all his eggs in one company, his attitude towards the company is likely to turn to one of resentment if and when the basket breaks....Stock-purchasing plans have with few exceptions proved harmful to employer-employee relations because they are based on unsound investment principles. In the monograph on "Profit sharing and Stock Ownership for Wage Earners and Executives" by Bryce M. Stewart and W. J. Cowper the view is expressed that there is no considerable body of evidence that such schemes have any more effect in inciting workmen in greater effort than a lottery ticket ; and even by G.D.H. Cole who looks forward to a time when all the essential means of production will be owned by the people says in the Chapter on "The case against profit sharing" in his well known book on Co-partnership: "As a socialist I am against capitalism and all its works ; and the last thing I would wish to do would be to turn the labourers into an inferior sort of capitalists or to entangle the workers into acceptance of a superficially amended system of capitalist exploitation". In India, under the Payment of Bonus Act, employees get bonus of up to 20 per cent of the profit and a minimum bonus of 4 per cent even if there is a loss. It is argued that if this profit-sharing, without loss sharing, has failed to evoke any sense of belonging to the concern or to emphasise the common purpose between management and labour—the very existence of prolonged industrial disputes and strikes on the issue of bonus shows that the profit sharing by bonus has not reduced industrial strife but increased it—it is idle to suppose that giving shares to the workers will reduce industrial strife. Obviously, employee shareholding schemes would not be acceptable to the Workers' Unions in concerns which either make loss or whose shares are not marketable. For the same reasons, shares in public sector undertakings would have little investment attraction for the workers. Workers would be interested in higher and higher wages and fringe benefits etc., and there is no reason to suppose that they would advance the interest of industry in preference to their own interests. Nor it can be supposed that the workers would be eager to study or are qualified to study papers relating to production and expansion programmes and policies, financial statements, sales and commercial policy etc., so as to exercise more control over industry by virtue of preferential rights as shareholders. It is therefore argued that a system of employee shareholding can never have an incentive effect any more than the present system of bonus has any such effect. To introduce a second system of incentive unrelated to effort wholly ignores the productivity aspects of the country's industrial problem. Workers' unions in this country, as indeed in other countries, are not enthusiastic about employee shareholding schemes as they may tend to lessen the interest and militancy of workers in the unions.

It has sometimes been suggested that, instead of having employee stock purchase plans separately from bonus, bonus under the existing system might be paid to the workers in the form of shares in the undertaking. However, workers and their unions will have nothing to do with any such proposal. One of the terms of reference to the Bonus Commission was that bonus should be paid in the form of National Savings Certificates. The Commission did not recommend this and expressed the view that the cash bonus system suits the workers' pattern of consumption for spending once a year on articles which cannot be conveniently done from the monthly wage packet. When the Government announced its acceptance of the Commission's recommendations with modification, one of the modifications proposed was that a portion of the bonus should be paid in the form of National Savings Certificates, but the proposal had to be given up owing to opposition from the workers' unions. Such a proposal would perhaps be acceptable to workers and the unions if shares equivalent in value to the amount of bonus are given to the workers at a rate below the market price and there are no restrictions on sale of the shares. Formerly when in the Maharashtra State a portion of the bonus was paid to workers in the form of National Savings Certificates, a large percentage of the workers sold them at a discount. If shares are given to workers, there will have to be some restrictions, such as that the shares should not be sold for a particular period and that they should be sold only to other workers ; otherwise the scheme of making workers shareholders to create a sense of partnership will have no meaning. But if there are such restrictions, the scheme will not be acceptable to the workers.

Speaking at the All India Shareholders Conference in Bombay on 19-4-1969, Shri Arvind Mafatlal, the well-known industrialist, pleaded for more liberal allotment to workers of shares in companies they work in. The Management of Geep Flashlight Industries Ltd of Allahabad, recently gave four of its workers who had rendered the longest period of service with the company shares in the company worth a substantial amount, free of cost, by way of reward for long and devoted service. Although workers, participation in Industrial ownership is thus taking place, the process is only slow, and could perhaps be accelerated.

I would like to offer a few suggestions in connection with the Employee Shareholdings. Considering that participation of empoyees in the capital of company will make them more identified with the company and its welfare, the limit of loan from the company to an employee for the purchase of the company's shares prescribed by Section 77 of the Companies Act, 1956, might be increased from 6 months to 12 months, pay. The Government should encourage companies by positive measures to increase employee participation in capital. Section 81 of the Companies Act might be amended to provide that at the time of fresh issue of capital, if a company should reserve upto say 20% of the capital for employees, this will not require the shareholders' approval. If necessary, companies may be required to get their employees' shareholding schemes approved by the Company Law Board. If shares are offered to employees at some concession as compared with the market price of the shares at the time of the offer, the amount of the concession should not attract any tax liability either in the hands of the Company or in the hands of the employees. If necessary, provision might be made in the Income Tax Act for approval of an employees' shareholding scheme by the Income Tax authorities, just as there is provision under the Income Tax Act for recognition of Employees Provident Funds, Superannuation Funds and Gratuity Funds.

In order that employee shareholders may not be under undue influence of the Company management at the general meetings of shareholders, it might be provided that the votes of employees would be recorded on a poll by a secret ballot, and not by open ballot, or that the employees will have no votes at all. It might also be desirable to require companies to have either a separate enclosure for employee-shareholders at general meetings, or such employee shareholders might be required to bear a badge or other token clearly indicating that they are employees of the company.