socialising the company

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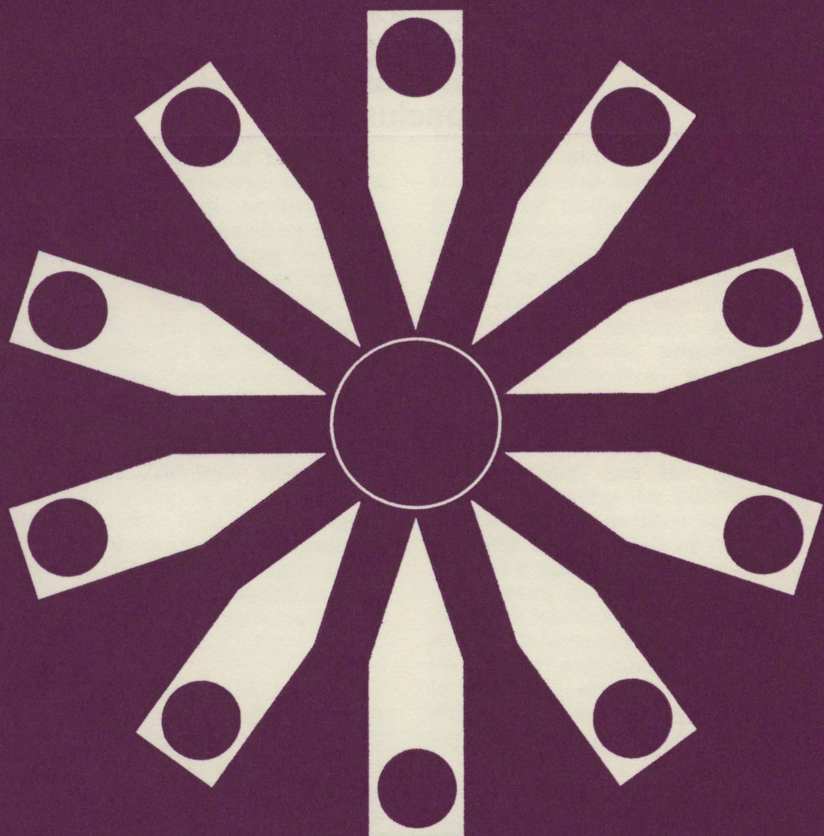
young fabian pamphlet 37 50p



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Fabian Society, 11 Dartmouth Street, London SW1H 9BN.
January 1974 ISBN 7163 2037 1

1. introduction

Should company law exercise a purely neutral role of regulation as at present? Or should a future reform of the law be used deliberately to direct industry and commerce in a certain direction? This fundamental question as to the nature and role of company law should be present in any discussion on the subject within the Labour movement. It is the purpose of this pamphlet to review the changes required in British company law to make companies, and in particular the large companies, more responsive to public needs and more accountable to public scrutiny.

During the past century the limited liability company has become the most important form of trading organisation in the United Kingdom. According to the Annual Report on Companies for 1972 there are now about 600,000 companies on the register. New companies are registering at the rate of between 4,000 and 5,000 a month. Of the total number of companies on the register the overwhelming majority are private. There are only some 16,000 public companies ; less than half of which are quoted on the London Stock Exchange. Although numerically small, this latter group is of considerable economic importance. The nominal value of British commercial and industrial shares quoted on the London Stock Exchange was over £10,000 million on 30 March, 1972. The market value was in excess of £34,000 million.

Over a century of legislation has established the legal framework within which these companies operate, although it should be remembered that the statute law only supplements the existing principles of common law and equity. The modern company legislation can be said to have had its origins in the Joint Stock Companies Act of 1844. By 1855 the principle of limited liability had been recognised, and in 1862 the first Companies Act as such was enacted. At present the principal act is that of 1948, as amended by the Companies Act, 1967. Both Acts were enacted during the period in office of a Labour government. Two main principles have always been inherent in companies legislation. First, that there should be no unnecessary obstacle to the formation of companies. Second, that the public should be given sufficient information about their affairs. Today broader public interests need to be considered: not merely those of shareholders and creditors.

Since the War two Committees have reported on company law: the Cohen Committee in 1945 and the Jenkins Committee in 1962. The Cohen Committee saw its task as ensuring "that as much information as is reasonably required shall be available both to the shareholders and creditors of the companies concerned and to the general public." The Jenkins Committee was largely inspired by contemporary disquiet over takeover bids. The common theme of these reports and of the subsequent Acts was that directors should be allowed to run *their* companies more or less as they thought fit and with as little outside interference as possible. This was summed up by the Jenkins Committee which felt that directors should have "a reasonably free hand to do what they think best in the interests of the company." Such a view of company law has led to the present position whereby the public is protected only in so far as they are shareholders (existing or potential) or creditors of the company concerned. Even here the law still leaves much to be desired ; it is doubtful whether even shareholders have enough information on future plans and investment programmes. As regards the interests of employees or the general public the law has yet to emerge from the depths of 19th century *laissez faire.*

recent developments

In August 1972 the Department of Trade and Industry (DTI) announced that a new Companies Consultative Group had been set up to advise the government on company law reform. In addition, another group (the Advisory Working Party on Europe) is considering the harmonization of British and European company law which will have to be effected now the United Kingdom is a member of the European Economic Community (EEC).

The members of these groups are drawn exclusively from the City and the management side of industry. In July 1973 the government published their much heralded proposals on reform (*Company Law Reform: Cmnd 5391*). According to the white paper: " One of the main objects of the next Companies Bill should be to enact the great majority of the remaining Jenkins recommendations " (para 9). Instead, therefore, of devising a new framework for companies to operate within the Government is merely tampering with technicalities. The Bill (expected in November) will be no more than a holding operation. Despite the promise of a Green Paper, it seems clear that no major re-thinking of the role of the modern public company by the government is to take place in the near future.

In the case of monopolies and mergers, the Fair Trading Act is now law, though it remains to be seen how effective it will be in countering monopoly power. In view of this it is certainly important that there should be a full discussion of company law reform within the Labour movement. The publication of the Trades Union Congress (TUC) interim report on Industrial Democracy marks an important step forward. In addition the EEC Commission has announced its proposals for the harmonisation of company law throughout the EEC. The proposals based largely on German and Dutch law, involve concepts new to British law.

Labour's attitude

At the time the 1967 Act was seen by the Labour government as a short term measure, a preliminary to a major measure of consolidation and extension of the existing law. Douglas Jay, then President of the Board of Trade, said that further legislation would follow for " wider reforms in the structure and philosophy of our company law." The need was seen for a new Bill to " re-examine the whole theory and purpose of the limited joint stock company, the comparative rights and obligations of shareholders, directors, creditors, employees and the community as a whole." Unfortunately there was insufficient time available for this before the Labour Party was defeated in 1970.

Increasingly it is obvious that a close examination and subsequent thorough reform of the existing legal framework is necessary. It is no longer a case of mere technicalities but of principles and the philosophy which lies behind them. This was recognised in the Labour Party manifesto in 1970 which called for an extension of the accountability of a company to its employees and the community.

As was pointed out in *Towards a radical agenda: comments on Labour's programme* (Fabian tract 414) there will have to be a closer relationship than in the past between a future Labour government and industry. Areas where nationalisation is likely include finance (banks, insurance companies, building societies) and North Sea oil. Apart from nationalisation there will be other, and probably equally effective ways in which the government will be able to intervene in industry as a whole. It seems quite likely that the next Labour government will introduce a workers' capital fund and a National Enterprise Board as well. Of considerable importance in this respect is the proposal in *Labour's Programme for Britain 1973* for a planning agreements system to involve 100 of the largest companies in economic planning. Undoubtedly a new Companies Act could also play an important role in helping a future Labour government achieve its major economic objective: " a fundamental and irreversible shift in the balance of power and wealth in favour of working people and their families." (*Labour's Programme for Britain 1973*). The present statute law is badly in need of consolidation. But as was mentioned earlier many of the principles of company law are to be found in common law and equity: some element of codification would probably also be desirable. However, some of these principles would appear to be opposed to the interests of employees and the public at large. Several instances can be found in recent case law where the shareholders, objecting to directors considering outside interests, have won their

case (see Parke v Daily News Ltd, 1961). It would certainly help to clarify this and other questions if, as a long-term aim, the introduction of a Companies Code was considered as in Ghana in 1963. (*The Ghana Companies Code*, 1963 (Act 179) codified the existing statute law and case law, both of which were largely based on British law). Despite the difficulties involved in such a complex area of the law such a codification should eventually follow the type of far-reaching reforms of company law that are now necessary.

The powers of large companies have increased to the stage where some of them are " states within states." To the largest of the multinationals international boundaries are a hindrance : local governments are played off against each other, as indeed are national minded trade unions. Within the United Kingdom there seems to be an almost frantic urge to conglomerate : while in many companies power has become the prerogative of a small minority. In several recent cases it would seem that financial institutions have decided the fate of particular companies, regardless of the interests of other shareholders. The interests of employees and the general public hardly seem to merit consideration at all in their eyes. The existing company law is powerless to act in such a situation. The whole basis of the granting by the state of the privileges of incorporation and limited liability needs to be re-examined. There is a need for a redefining of the nature of a company : of its ownership and of its control. In broader terms the responsibilities and obligations which a company owes to its shareholders, workers, creditors, consumers and the public at large need to be examined at length.

2. toward a new definition of a company

The 1,000 largest companies in the UK have a combined turnover of nearly £70,000 million and annual profits totaling over £5,800 million (*The Times 1000*, 1972). At the other end of the scale there are tens of thousands of small companies, often under the control and ownership of only one or two people. It is clear, then, that from an economic point of view companies can be divided into two groups. First, there are the economically powerful but numerically weak, companies mainly quoted on the Stock Exchange with a turnover usually over £1 million. Second, there are the economically weak, but numerically strong, small companies often under the immediate control and ownership of their directors.

The small private company is often akin to a partnership—or even in some cases to a sole trader. The shareholder will often take a keen and active interest in the business. This is obviously not the case with large public companies. The shareholder has little or no interest in the company beyond the rate of dividend and plays little part in its affairs. On the whole the activities of various ginger groups of shareholders, both in the UK and the USA, have had little effect on companies in the normal course of business. However the thalidomide affair showed that some shareholders now look beyond the profit and loss account and expect their company to show some standards of social responsibility. In economic reality, although not in law, the shareholder in a modern company is little more than a " lender of capital " on which he hopes to reap a good return, albeit with some risk involved if the company ceases to prosper.

As far as public companies are concerned it is only the inside shareholders (directors and the institutions) who are able to exercise any form of control over the company. Where then does power lie in the large company? It is no longer even true to say that it rests with the board of directors as such, for increasingly over the years as companies have expanded so the boards have become more and more unwieldy. Effective power has tended to shift to the managing director and his " inner cabinet " of directors from the smaller executive committee of the board. As the effective control of these companies has become concentrated in fewer and fewer hands, so the largest of the companies, especially the multinationals, have inceased in size and power to affect the every day lives of more and more people. The top 50 companies in the UK employ capital to the value of nearly £19,250 million and have a combined turnover of over £32,000 million; their employees number nearly 3 million (*The Times 1000, op cit*). This concentration of capital is being accentuated by the rising tide of mergers. For many such companies marketing does not consist of satisfying the public's demand for a particular good. Rather, the company creates a demand for its own particular product. Just as it is true to say that such companies are no longer really subject to the laws of supply and demand, it is equally fair to say that the shareholders of these firms are no longer in any real sense their proprietors —let alone " quasi-partners." There is no longer a real relationship between the managers and shareholders—only a legal one. If any one group can justly claim to have a special relationship with the management of these firms then it is the companies' employees—yet this remains virtually unrecognised in law. In fact very often a company's employees are far more " members " of that company than are the shareholders. As Professor Gower has pointed out: " If the relationship between management and shareholders gives rise to problems which company law has still not satisfactorily solved, the relationship between management and labour presents problems which company law has not even recognised as being its concern " (*The Principles of Modern Company Law*, 3rd ed 1969).

Since 1967 the law has recognised two types of company, limited and unlimited. The latter is unimportant now. In 1908 the private company was recognised for the first time: it was defined as a company with not more than 50 members, with a restricted right to transfer shares, none of which could be offered to the public. This is still the definition today. This was the first attempt to define the " family " company which would be exempt from certain statutory requirements (for example, the need to file

accounts with registrar). Unfortunately, this provision was used as a loophole by public companies who established private company subsidiaries which were then exempt from the disclosure requirements. In order to prevent this the 1948 Act extended the disclosure provisions to cover the private company, but at the same time introduced the concept of the exempt private company which was exempt from many of the disclosure requirements. At the same time the Act ensured that this could not be used as a loophole by public companies anxious to avoid disclosure. The Jenkins Committee recommended the abolition in law of any distinction between private and public companies. It was felt that creditors and others should be able to see the accounts of these companies especially as they have limited liability: it is not suprising therefore that the exempt private company was abolished in 1967. Then 74 per cent of all private companies claimed exemption. The question of what difference if any, should remain between private and public companies has still to be settled.

There are several possibilities. The Jenkins Committee recommendation to abolish all legal differences should be rejected as it would render it impracticable to extend the law on disclosure. Any future legislation should surely distinguish between the truly " public " company and the genuinely " private " one. Far more stringent rules regarding their accountability need to be imposed on the public companies. This is recognised by the government's white paper (para 12). Professor Fogarty (*A Companies Act 1970?* PEP 1967) has suggested a unified corporation law which would embrace the nationalised industries as well as companies, while at the same time it would classify firms into three groups: " giant," ordinary public companies, and " small." This is certainly an interesting possibility although there would surely be difficulties and obstacles involved in applying the law to the nationalised industries. Such a measure could perhaps be included in any discussions on the long term possibility of the codification of company law. Meanwhile there is a much stronger case for a " Public Corporation Clauses Act " as has been suggested in several quarters. This would be a kind of " Table A," a model constitution with minor modifications for special cases, applicable to present and future nationalised industries.

However, the most satisfactory solution would be a careful redefinition of " private " and " public " companies. Such a measure has already been suggested by the accountancy profession. There are now very few large private trading companies. Pilkingtons went public in 1970, Sainsbury in 1973. Among the number of small companies which registered as unlimited after the 1967 Act was one very large concern, C & A Modes owned by the Dutch Brenninkmeyer family. As a consequence of its having renounced limited liability it is no longer subject to the disclosure requirements of the Companies Act. There are probably few if any other major companies which could " opt out " in this way.

The private company (which could be renamed the " proprietary " company as in Australia) could be defined as: first, a company managed, controlled, and owned by substantially the same persons ; second, a company not under the control of another company that is not itself a proprietary company ; third, a company the shareholders of which are limited in number, with a restricted right to transfer shares, none of which may be offered to the public ; fourth, a company with an average weekly labour force not exceeding 200 ; fifth, a company with a turnover not exceeding £750,000 per annum. Such a company would have to include "private" or " proprietary " in its title.

It is also true to say that public and private companies are formed for different reasons. The public company is essentially floated in order to raise capital. The costs of public flotations are very high and help to reinforce the safeguards which exist to protect investors. As regards the private companies they are formed mainly to secure the advantages of limited liability. It is arguable that this process is both too easy and without sufficient safeguards for the people who will have to deal with the company. The DTI has been worried for some time by the " irresponsible multiplication " of companies, particularly the

one-man type. In the first four months of 1973 21,500 new applications for registration were made, an increase of 6,500 over the same period in 1972. There is clearly a danger of abuse of limited liability by small, under-capitalised businesses. The famous case of *Salomon v. Salomon & Co* established firmly the doctrine of limited liability, even in the case of a one-man company. This decision has been described as " calamitous " by Otto Kahn-Freund; and there is no doubt that the UK courts have been too rigid in their application of this rule. It is interesting to note the readiness of the American courts to disregard corporate entity when fraud is involved. Similarly the American courts have held the shareholders personally liable when the business has been clearly inadequately financed from the start. Particularly in such cases provision should exist in the Companies Act for the courts to ignore limited liability in cases of fraud or other illegality.

Both the Cohen and the Jenkins Committees considered that it would be too difficult to enforce a minimum paid-up capital. However, such a clause does appear in several European company laws and this point should be reconsidered, as is recognised in the white paper (para 33). A minimum figure of £5,000 would not be too high. If a business is to enjoy the benefits of limited liability then there must be some protection for the people who will deal with it. Such a reform could also have several useful side effects—not least among them helping to end both the private company loophole used to help perpetuate the lump in the building industry, and the abuse of the Companies Acts by the purveyors of " ready made " companies with all the attendant difficulties these " shelf " companies cause to the Registrar and the DTI.

The Institute of Chartered Accountants has recommended that the minimum membership of companies should be reduced to one. This would surely be a retrograde step. A minimum of two members and two directors before a private company could be formed must help to ensure certain safeguards. A stiffening of the responsibilities of shareholders and directors would reinforce this by making it unlikely that anyone would lightly assume office as a director of a company of which they knew little or nothing. On the whole, bearing in mind the exceptions noted above the law as it stands in relation to small, private, companies is adequate. It is in relation to the large companies that the law falls short of what is required.

It is of course impossible to be completely accurate in any division of companies into two groups—there are bound to be a few anomalies. However, it does seem to be the best way of extending the legal requirements to the larger companies while exempting the small (very often family controlled) business from a too onerous burden. The non-proprietary or public companies would be with certain exceptions those floated primarily to raise capital; having a turnover in excess of £750,000 per annum, and whose labour force averages over 200. For such firms a new type of administration should be evolved to take account both of the changed relationship with shareholders and of the special position of employees. Above all, whether one is discussing the position of investors, employees, creditors or the general public, the guiding principle behind future legislation must be greater public disclosure of information by such companies. For, without such disclosure worker participation, the protection of investors and creditors and indeed the safeguarding of the public interest, becomes difficult if not impossible.

Any discussion of a firm's profitability should involve not only assessment in absolute terms but also an assessment in regard to the extent that the company has fulfilled its other responsibilities. For the granting of the privilege of incorporation and limited liability by the state means that the company holds a franchise from society; and the company should therefore be legally as well as morally responsible to society as a whole for its actions.

It should be a principal objective of the next Labour Companies Act to ensure that the concept of the social franchise is recognised as being the backbone of company law.

3. capital and profits

It would appear that the amount of new finance raised from shareholders is falling in relation to other sources of capital. Further, there is evidence to show that the amount of shares held by private individuals is falling in relation to other holdings. This must clearly affect any discussion on the future of company law, for these two trends show a diminishing role for private shareholders among medium and large companies.

At present company law interests itself in capital and profits from two points of view: it is concerned to protect the firm's creditors and it is designed to prevent directors from actions likely to reduce the long term value of shares. Consequently the law attempts to ensure that no return can be made to shareholders unless net assets at least equal the share capital. A company can meet its needs for capital in a number of ways. Not only is this a question of gearing between debt and equity sources, but also of varying the sources within the debt (fixed obligation) financing section itself. It is argued that a high debt/equity ratio (over 1 : 1) would involve considerable advantages for the firms concerned. Traditionally, companies have drawn their finance from a variety of sources. Permanent capital as a source of financing of capital expenditure by industrial companies seems to have fallen gradually over the past decade or so. On the other hand loan capital (such as debentures) has increased in importance as a source of further capital. As regards medium and short term capital there has been a remarkable increase in bank borrowing. Between 1956 and 1960 bank borrowing accounted for 7 per cent of the total financing of capital expenditure by British industrial and commercial companies. Between 1966 and 1970 this figure had risen to 13 per cent.

changing pattern of capital structure

There has been a marked decline of private share ownership over the past few years, as the following table clearly shows. The fall has probably been brought about by a combination of events—not least among them being heavy sales to meet death duties and the breaking up of family holdings following takeovers. These shares would appear to have passed into the hands of the financial institutions, industrial and commercial companies and overseas holders. This is clear evidence of the growth of intermediation in share ownership in recent years. This can be borne out by an examination of the amount of company shares held amongst the personal sector's financial assets. The percentage of financial assets held in the form of company shares in the personal sector fell from 32.2 per cent in 1960 to 22.8 per cent in 1966. There has been a continued pattern of net sales of shares in the personal sector for some time: in 1971 the figure was £1,165 million.

It seems reasonable to expect the trend away from personal holdings of shares to continue. Sales on death and following takeovers are both likely to continue. It also seems reasonable to expect this trend to be reinforced by a move into unit trusts and other forms of intermediate investment. This growing intermediation in investment could well lead to certain benefits, including a more pro-

OWNERSHIP OF UK QUOTED ORDINARY SHARES BY MARKET VALUE (1957-69)

	June 1957 %	December 1963 %	December 1969 %
persons	65.8	54.0	47.4
financial institutions	17.9	25.1	31.7
industrial and commercial companies and others	16.3	21.0	20.9
	100.0	100.0	100.0

Source: *Financial Structure and Government Regulation in the* UK, *1952-1980* Professor J. R. S. Revell, IBRO paper no 1.

fessional attitude to real investment. However, an understanding of the benefits of such a trend should in no way blind us to the necessity of evolving new forms of controls and safeguards.

Debenture holders are of course in a different legal position from shareholders. They are not " owners " of the firm, but are entitled to a regular payment of interest, and eventual repayment of their loan. Concern has been expressed in some quarters regarding the privileged position enjoyed by some debenture holders, particularly those whose debentures are secured by a floating charge. Fixed charge debentures are really mortgages, but with floating charges, which is usually only found in relation to companies, the charge only " crystallises " on some default taking place. Until then the company is free to do as it pleases with the assets. So long as a floating charge remains legal certain financial institutions will continue to remain in a position of knowing as much about a company's affairs as the board of directors, while at the same time being legally entitled to repayment before the ordinary trade creditors should the business fail. A possible reform, short of actually making floating charges illegal, would be to extend section 322 of the 1948 Act. This section provides that a floating charge created within twelve months of a winding up shall be invalid unless it can be proved that the company was solvent immediately after the creation of the charge. This could be extended to the effect that the charge would be invalid if the beneficiary had " inside " knowledge as to the company's affairs, regardless of how long the charge had been in existence. As far as England is concerned the case law in this field is in urgent need of codification: in Scotland the *Companies (Floating Charges) (Scotland)* Act, 1961 is also unsatisfactory.

power of financial institutions

The steady " institutionalisation " of investment in ordinary shares has become most marked in the past decade. During 1952-55 personal sales of company shares accounted for less than one-third of the shares coming on the market. By 1956-60 they still accounted for less than 50 per cent. During 1961-65 they rose to well over half and by 1966-70 amounted to nearly 70 per cent. There is a different pattern of share ownership in different companies, but an overall pattern can be seen. Persons still hold 57 per cent of the issued share capital of the Burmah Group; but only 32 per cent in the case of Unilever, 29 per cent of Metal Box Co shares and 17 per cent of the shares of the finance group United Dominions Trust (UDT) (source: companies' latest Annual Reports).

Partly as a result of the failure of capital issues to expand to any great extent the industrial companies have come to look more and more upon the banking system as a source of finance. Above all it has been in the secondary banking system that this has been most marked. Their advances to industrial and commercial companies increased from £417 million in 1963 to just over £2,000 million in 1970. (*Revell, op cit*). This has led some people to consider it likely that the UK capital market could become " bank-orientated " in the same way as has occurred in Germany or Japan. Taking the total investment in the UK manufacturing industry the ratio of shareholders' equity capital to debt finance is 6:4. In West Germany it is the reverse, 4:6, while in Japan it is 2:8. Although it is fair to say that banks do act as " residual lenders " to companies—supplying the finance they cannot raise any other way—there are other elements. It is not just a question of costs or of convenience: banks are encouraging companies to borrow by introducing types of bank finance adapted to their needs such as the term loan. However, while it is more than likely that the banking system will play an increasingly important role, it is unlikely that it will become as dominant as in Germany. There are several factors which make this unlikely—not least among them being the influence of financial institutions such as the life assurance and pension funds. Some interesting evidence on the range and depth of the insurance companies investments has become known with the

publication in the *Times 1000* for 1972-73 of a table showing the largest shareholdings in some of the leading UK companies. Thirty-eight companies are listed and as the *Times 1000* states: "The whole impression is the power of the insurance industry as an investor in British industry." Indeed in all but six of the companies listed the Prudential Assurance Company is a major shareholder with holdings ranging from 1.06 per cent of British American Tobacco to 6.24 per cent of Coats Patons. It is to be hoped that this trend will lead to the financial institutions taking a more long term view than in the past, so that in the future they will not be so anxious to get out of a company that runs into temporary difficulties.

role of government

As well as the increasing finance from banks, government grants and loans have been increasing in significance as a source of funds. There are a number of factors which have contributed to this. Government policy has had a two-fold effect: tax allowances for investment purposes have given an additional impetus to profit retention, while investment grants have been a source of direct finance for the firms concerned. Where the rate of tax is increased any form of raising capital which will benefit from tax relief becomes more attractive. During the period in office of the last Labour administration, government policy, both in the form of direct grants and loans and as regards fundamental changes in the taxation of companies exercised a direct influence on the capital structure of companies. Government grants and loans consequent upon Industrial Reconstruction Corporation inspired rationalisation measures; the introduction of Corporation tax in 1965; and the substitution of investment grants for tax allowances: the net affect of these measures was to increase the importance of the government as a source for company finance.

It seems likely that the government's role in the capital market will increase: even under a conservative government it is unlikely that government grants and loans will be reduced very much. Indeed with the coming into effect of the Industry Act the policy of "lame ducks" seems finally to have been discarded.

As for a future Labour government the schemes under discussion in *Labour's Programme for Britain* are likely to lead to a further increase in the importance of the government's role in the capital market. Furthermore, both Conservative and Labour governments are likely to act in the future, as they have in the past, as "lenders of last resort" to certain sections of industry.

profit retention

The growing dimunition, then, in the role of the private shareholder is likely to continue. One effect of this will be to concentrate still further the ownership and control of industry and with it the power of the institutional shareholders: in many ways it seems almost as though the days of the small shareholders are numbered. This lends weight to the argument that workers should have some sort of direct share in the capital of industry: an argument that is reinforced by an examination of the growth of self finance in industry.

For the 1,000 largest companies in the UK, 1971 saw profits rise by over 18 per cent. Indeed company profits have been showing a steady rise since the beginning of 1971. Annual profits were 21 per cent up on the previous year in 1972. According to the *Economist* 25 August 1973, the profits of large companies were 40 per cent up in the first half of 1973 compared with 1972. Dividends too have risen steadily—the rate of increase for 1972 was well above that for 1971 until the freeze commenced. Indeed UK companies are well at the top of the European profits league—a recent survey lists 36 UK companies among the top 50 (*Financial Times*, 20 December 1972).

It is likely that the freeze will cause a further increase in profit retention

re-inforcing the present trend to self financing.

It has long been the case of course for an efficient company not to distribute all of its profits but to retain some in the form of reserves or sinking funds for such eventualities as the replacement of fixed assets. There is increasing evidence that many companies faced with the need for more and more capital, are retaining profits to a greater extent than before. Certainly, retained profits are now an important source of finance for companies. In the case of public companies probably half of their recent growth has been self financed. In fact quite a number of public quoted companies have self financed all their growth over the past few years. In the case of those companies which are able to exercise a fair degree of control over the prices of their products this can mean that it is the consumer who provides some of this extra finance: for the company will often be unwilling to reduce the rate of dividend. It should be noted that under UK company law there are at present no restrictions on how much of the profits should be distributed or retained.This is contrary to the situation in a number of other countries, notably in Germany where company law lays down that up to half of the year's profit may be transferred to general reserves—until these reserves amount to half of the company's capital. There is an important difference between self financing and the various forms of debt financing mentioned above. All forms of debt financing are liabilities owed by the firm: reserves of retained profits accrue to the shareholders. Even if they have to suffer a relative reduction in the rate of dividend the shareholders will find that the capital value of their stake in the company has risen. Now such a development can be justified in those small private companies where the shareholders are often in reality "quasi-partners." It cannot be justified in the case of large companies whose shareholders usually have no real connection or relationship with the company—only the legal one. For shareholders then, retention is likely to have little or no effect on their dividends. Any difference there is is likely to be more than offset by the capital accrual of their equity. It is the consumer and the employee who can suffer a real loss through retention. There are a number of ways the problem of profit retention can be dealt with. First, however, it is necessary to consider the effect retention has on investment. If profit retention is detrimental to investment as a whole—and some people would argue that it is—then the problem can be tackled largely through fiscal measures. On the other hand if it is true that profit retention performs an important, if not essential role in investment then it is a question of encouraging it on the one hand while finding some means of exercising control over it on the other hand to prevent the harming of consumer and employee interests. The "anti-retentionists" whose views are largely shared by the present government hold that a high level of distribution will encourage a high and profitable level of investment. The idea seems to be that shareholders will diligently seek out the best investment for the re-investment of their increased dividends. Such a development is to say the least highly unlikely. Further it is argued that high retention rates can obviate government attempts to influence investment in certain directions. It is this view that has led to the reform of corporation tax which took effect in April 1973.

That there is a continuing need for a higher level of investment in British industry can hardly be denied. It should also be clear that if the UK is to modernise her industrial structure—and thus improve her competitiveness on world markets—an increase in long term research and development will be necessary. At present the level of investment is anything but promising. According to the DTI total fixed capital expenditure for the manufacturing industry was £2,219 million in 1970; £1,968 million in 1971 and £1,775 million in 1972. The figures for the first half of 1973, £923 million, show only a small rise over the same period in 1972 (£913 million) (constant 1970 prices). Coming at a time when there has been something of a

major boom in consumer spending it must cast serious doubts on the value of any programme of economic expansion that is not investment based. As Jim Skinner makes clear in *Collective Bargaining and Inequality* (Fabian Research Series 298) there does seem to be a positive correlation between the level of total investment and the level of profit retention. Expanding companies often experience difficulties in raising outside finance: the cost and uncertainty of a public share issue together with the dilution of ownership and control inherent in it tend to deter many companies from further share issues once they have a stock exchange quotation. As for debentures and loan stocks the rise in interest rates has made these a very expensive source of finance for the company and a risky venture for the investor. Similarly, medium term bank finance is both expensive and often involves a representative of the bank concerned sitting on the borrower's board.

It is not suprising therefore that companies look upon self financing as a very important source of funds. An examination of companies' annual reports over the past few years bears this out. In the case of Unilever for example retained profits and depreciation together accounted for about 87 per cent of the total source of funds for 1972. The trend has become most notable in the US where the system of corporation tax and importance of equity finance are similar to the UK. Taking 1963 figures as 100 the Westinghouse Electric Corporation shows a steady increase in profits reaching 410 in 1972. Dividends however have shown a far more modest rise—to only 156 in 1972. Apart from the use of retained profits as an important source of funds, they can help a company maintain a good dividend rate when profits fall. Gulf Oil for example has shown a steady fall in profits over the past five years, although sales have been increasing. However the company has been able to maintain a stable dividend rate thanks to the existence of reserves. If it is accepted that profit retention should be encouraged it will be necessary to evolve methods of encouragement which at the same time offer a measure of protection to both consumer and employee. As far as encouragement is concerned, there should be included in the Companies Act a clause making compulsory provision for the depreciation and replacement of fixed assets. In addition to this a further measure would be to lay down that a certain percentage of profits must be retained each year. Coupled with this there should be a further reform of corporation tax: not merely a return to the previous position but to a somewhat different method altogether. Under the classical system (1965-73) companies paid corporation tax (at first at 40 per cent) on all their profits and then had to deduct income tax at the standard rate from distributions to shareholders. With the introduction of the imputation system in April 1973 companies will now have to pay a single rate of 50 per cent on all profits, part of which (ACT) is treated as a payment on account of the shareholder's income tax liability, thus ending the so called double taxation of distributed profits. This latest measure is highly unsatisfactory, as its avowed aim is to discourage retention. The system should be reformed so as to allow the first 25 per cent to be tax free if retained. The remainder of the profits would be subject to, say, a rate of 52½ per cent. In addition there should be a return to the former position regarding the deduction of income tax from dividends. Any further retention over and above the 25 per cent would be taxed at the full rate. The retention allowance could be increased to encourage investment in certain industries or in certain regions.

employees' equity?

Under company law as it stands at present retained profits accrue to the shareholders. This is clearly inequitable from the point of view of the employees. One of the reasons behind the Labour Party's proposed workers' capital fund therefore is that it would give workers generally a degree of participation in capital and profits. At present the only

way open to workers wishing to achieve a fairer share of the proceeds of industry is to press for higher wages. As things stand at present one can hardly expect explоyees to be particularly concerned with investment criteria and decisions when taking part in collective bargaining. Nationalisation is clearly not an answer in itself. It brings the workers no nearer to a direct stake in capital and it has little or no direct effect on the distribution of wealth in the community. Neither does nationalisation in itself, any more than City financial markets, ensure that investment will always be canalized into the areas of long term potential—economic and social.

So far, both management and the Conservatives have thought in terms of profit sharing schemes or the furtherance of wider share ownership. Such schemes often have the effect of increasing a worker's sense of identity with the owners of the firm at the expense of trade union influence; they are on a par with company sponsored "unions" or staff associations and are no answer to the problem. A possible solution would be a workers' capital fund, along the lines of the "national workers' fund" proposed by the Labour Party study group in its report *Capital and Equality* (*The Times*, 27 July 1973).

Quite a number of difficulties would have to be overcome before such a scheme could come into operation. The Labour Party proposals envisage the fund being run on the lines of a unit trust. Companies would be required to transfer to the fund 1 per cent of their issued equity shares, creating new shares for the purpose, This is preferable to any scheme based on the total wages bill or on the number of workers, which could have the effect of encouraging management to keep down wages or reduce the number of workers. However, companies have sources of funds other than equity shares: in some companies shares form a comparitively small amount of capital employed. To base the fund purely on equity shares would involve anomalies between those companies with a high debt: equity ratio and those with a low one. A far better base would be the net capital employed: that is to say a percentage of the equity shares, reserves and loan finance which together form the total medium, long term and permanent capital employed in a company.

This percentage of the net capital employed would then be transferred annually to the fund, perhaps in the form of a special class of share. The fund would need some time to build up before it becomes fully operational. The report (*Capital and Equality*) envisages 5 to 7 years, after which the participants would be able to cash in their annual entitlements or leave them in as a growing investment. As a weapon against inequality the fund could clearly have an important role. Some 20 million workers it is estimated would be involved, participating on an equal basis according to their record of National Insurance contributions. Obviously before such a scheme becomes operational much remains to be discussed in the Labour movement. Of considerable importance will be its increasing effect on investment and thus on the general well being of the greater part of British industry. Once it is fully established the fund should become a meaningful force for investment. It should have the power to choose whether the income it receives from companies should be in the form of shares—thus retaining funds in the business concerned—or cash for re-investing in other firms. It could re-invest in those areas where the criteria should be social rather than commercial for example.

The exact form of management of such a fund (at present a governing council with a majority of worker representatives nominated through TUC channels is proposed) should await further consideration on industrial democracy—and particularly the question of worker participation in management.

4. monopolies and mergers

The concentration of capital that has taken place over the past two decades has been encouraged and accentuated by the concentration of firms themselves. In the past 20 years concentration in the top 100 companies has doubled. Research by Professor Prais at the National Institute of Economic and Social Research (NIESR) suggests that in the manufacturing industry the share in net output of the top 100 companies increased from 15 per cent to 85 per cent between 1910 and 1970. The merger can be seen as an important, if not the major, instrument of concentration in industry.

Particularly within the past decade there has been a rapid expansion in the number of mergers taking place in British industry. This has become an international problem with the emergence of the giant multi-national companies. There is increasing awareness that the law as it stands is now no longer adequate to deal effectively either with the rash of mergers now affecting industry or with the consequent growth of monopoly power. As for the international company, it is unlikely that national laws by themselves can achieve a solution, some measure of international co-operation will prove to be necessary. The UK has seen such a spate of mergers very largely because industry has had to deal with the problem of small scale firms faced with the intensification of international competition.

Like it or not, industrial concentration is likely to continue. Indeed G. Newbould and A. Jackson in their recent book, *The Receding Ideal* (Guthstead 1972) suggest that by 1985 three-quarters of the private sector could be in the hands of 21 companies. Contrary to older economic theories there is little evidence of a general tendency for this growth in size to lead to inefficiency. Indeed, regardless of what the economic textbooks tell us of diminishing returns there seems to be no end to a firm's possible growth. Though there is evidence to show that there has been a slowing down of growth amongst the largest companies. It is among the second rank companies that growth is increasing at a high rate. This is a reversal of the position in the mid-sixties when the largest companies were those experiencing the fastest rate of growth. Company law, within which this growth is taking place, has yet to realise the full implications. This apparent conflict came to a head with the establishment of the IRC to encourage rationalisation in certain sectors of industry, often through mergers, at the same time as the government strengthened the monopoly law with the Monopolies and Mergers Act of 1965.

takeovers

With the total value of bids exceeding £2,000 million, 1972 was a record year for takeovers. As the Trafalgar bid for Bowater showed there is practically no company, regardless of size or specialised managerial ability, that is completely safe. Only the private or " close " public company would seem to be completely free from the possibility of a takeover bid. The total value of merger bids averaged around £500 million per annum during the early and mid-sixties. In 1968, largely as a result of several very large mergers (Leyland and British Motor Holdings; GEC and English Electric; Thorn and Radio Rentals; Allied Breweries and Showerings) they rose to nearly £2,000 million. Since then they have been averaging around £1,000 million per annum—until 1972 when the record 1968 figure was exceeded.

The majority of mergers are still horizontal, that is where a company extends its share of the market by buying up a competitor. According to the DTI, of the 700 mergers they have examined since 1965 80 per cent were horizontal, 10 per cent vertical and 10 per cent conglomerate. Although they account for only 10 per cent of the mergers examined since 1965, it is the conglomerates that are causing concern, and casting doubts on the ability of the present law to deal adequately with them. Some of the undercurrents below the recent spate of takeovers came to the surface during the P & O affair. In August 1972 after several months of speculation regarding the possibility of a bid for P & O, the group itself announced a bid for Bovis. On the face of it there seemed little in common

between a shipping giant and an important firm in the construction industry; indeed there was little or no industrial logic in the proposed merger. However the commercial motives behind the bid were not hard to discern. P & O, a member of a declining industry, had too many assets to be fully exploited including £50 million in cash and investments and over £100 million worth of property. Yet in many ways the company lacked the managerial ability to exploit them to the full. Bovis, it was felt, would be able to help P & O take full advantage of these assets. The immediate effect of this was to intensify the rumours regarding a possible bid for P & O, with Trafalgar House Investments seen as a possibility. Before the month was out it became apparent that the P & O board was split on the deal with Bovis. The most important member of the board to oppose the bid was Lord Inchcape, chairman of Inchcape and Co., general merchants and shipping agents.

As opposition to the bid mounted in P & O's boardroom, in the City a campaign got under way among the institutional shareholders to prevent the merger from going through. The fight among the institutions was led by Morgan Grenfells, the merchant bank, although they had no direct interest and no client to act for in the affair. In October Inchcape and Co. made a not unexpected bid for P & O. It was also announced that a banking consortium would help provide Inchcape with the necessary funds as P & O's capitalisation is considerably the larger of the two. The bid was rejected by the P & O board, to be followed a few weeks later by the shareholders' rejection of the Bovis bid. Following a reconstruction of the P & O Board, the Inchcape bid was resumed, only to be rejected by the board in December. Finally Lord Inchcape became chairman of P & O early in 1973. The motive behind P & O's actions was undoubtedly the desire to diversify: to find new activities outside of shipping and to find a way of realising the company's properties. In some ways, like the Bowater bid for Ralli it was "assets bidding for management." If successful this would have been a conglomerate merger: there is no industrial logic behind the alliance of a construction company and a shipping line. In addition, there was the background of City speculation and rumour which culminated in the institutional shareholders veto of the deal. The intervention of Inchcape and Co. with the backing of a City banking consortium raises the problem of interlocking directorships and the consequent conflicts of interest that arise. Above all there seems to have been a marked lack of any real thought on the subject of greatest importance—how to achieve a sensible rationalisation in the shipping industry which is now undoubtedly over capitalised.

There would seem to be three important features regarding the present spate of mergers: the lack of planning, the prevelance of external acquisition over internal expansion as a means of growth, and finally the growing number of conglomerate mergers. It is perhaps inevitable under the present system that there should be a lack of effective planning regarding the long term results of mergers. As far as short term forecasts are concerned they do appear to be fairly accurate. In the latest report of the Takeover Panel 56 offer or forecasts were realised to within plus or minus 10 per cent. Only 9 were more than 10 per cent out. Very little research on long term success rates exists in the UK so it is very difficult to be sure about the long term benefits. There is however little doubt that the reluctance on the part of many managements to consult with any outside source of advice before making bids is a major reason for the lack of planning in mergers. There is no doubt either that industry in the UK needs further rationalisation. This cannot be left to the vagaries of the Stock Exchange, involving as it does a callous disregard for the employees in the firms concerned and an equal indifference to the long term public interest.

There is a growing tendency for firms to prefer growth by acquisition to internal expansion. Assets, men and technologies are taken over whole. This is an area which would merit careful attention by the Monopolies Commission. In the absence of a genuine rationalisation it would clearly seem preferable for firms to expand by increasing investment (and

incidently competition) rather than by gobbling up smaller firms in the chosen field. Indeed, there is surely a connection between the present very poor level of capital investment in industry as a whole and the spate of mergers. Perhaps in this sense takeovers are far too easy, after all a major weakness of the present system is that shareholders are hardly likely to consider anything else apart from the price their shares will fetch. In the US the government has made some attempt to protect well run medium size firms by preventing their absorption by the giants. Certainly, the whole question of the relative merits of self-investment v. external acquisition is an area which needs careful investigation.

spread of conglomerates

The third feature of the present rash of mergers which is disquieting is the number of conglomerate mergers. Conglomerate mergers, leading as they do to a diverse, multi-market operation involve the holding company " par excellence." These diverse and unnatural alliances highlight most of the dangers inherent in growth by acquisition. But there is no doubt of their popularity with many managements. American research suggests that these mergers encounter only about a third of the problems that afflict other, more conventional, forms of mergers. No doubt this is largely due to the autonomous nature of the firms. Like an empire and its satrapies, the conglomerate holding company and its subsidiaries involve no element of rationalisation. Commercial logic there may be, but often at the expense of the public interest, for there are three main objections to the conglomerates. First, one company in the group will often supply a sister company at more favourable rates than outside customers. Second, there is the danger of "cross subsidisation" whereby the holding company may subsidise a subsidiary to drive competitors in a certain market out of business by price warfare. Finally, and of much greater importance, there is little doubt that the growth of conglomerate empires is not compatible with a sensible rationalisation of industry. These dangers are intensified in the case of the multinational conglomerates. The original *raison d'etre* of the conglomerates was to spread risks through multi-market or multi-industrial operations. All too often this insulation from competitive pressures will allow the management to sink into lethargy: free both from the pressures of the market and the threat of takeovers. Of increasing importance as examples of conglomerates are the large tobacco companies. For seventy years there had been a territorial trading pact between Imperial Tobacco and British American Tobacco. However, in the light of British entry in the EEC the two companies had to reconsider their position. Undoubtedly the emergence of a strong case law attack on restrictive practices in Europe was an important factor in their decision to end the pact. Similarly, the possibility of a full merger (Imperial Tobacco has a $28\frac{1}{2}$ per cent stake in British American Tobacco) would have opened the companies to attack both under the US anti-trust laws and Articles 85 and 86 of the Treaty of Rome. In July 1973 it was announced that the trading pact had ended with Imperial Tobacco entering into direct competition with British American Tobacco round the world. British firms are now coming to realise that it is not just the Monopolies Commission or the Restrictive Practices Court that they have to worry about but also the EEC Commission. And it is clear that the EEC policy on competition is far from being the least of their worries. As well as this there is the fact that tobacco is no longer a long term growth market. Both groups are therefore looking at other fields into which they can expand. There is no question here of rationalisation. It is simply that the management perceiving a diminishing market, and not wishing to see the company contract, have decided instead to try to convert them into multi-industrial holding companies. On the same day in August 1972 that the companies announced the ending of their pact, Imperial Tobacco announced an agreed £280 million bid for the Courage Brewery group. In 1971 tobacco still accounted for 80 per cent of Imperial's profits: with the acquisition of Courage the tobacco share is likely to fall to 60 per cent. So the company is well on the way to achieving quite a considerable degree of diversification,

mainly into foods and drink. Indeed the list of takeovers carried out by Imperial Tobacco over the past few years includes many well known firms: Ross Foods, Smedleys, HP Sauce and many others.

Imperial Tobacco's activity was followed in November 1972 by the announcement of a £67 million bid for the International Stores group by British American Tobacco. They apparently see the high bid for International Stores as their "entrance fee" into the UK retail trade. They already have interests in paper, perfumery and cosmetics. International Stores with its 900 retail outlets will thus be of considerable value to them. It is not so certain that the consumer will be better off as a result. It is significant that in best conglomerate style the International board will remain as it is with exception of the addition of two British American representatives. In May 1973 International Stores was used to take over another supermarket group—Pricerite.

Another conglomerate is the Trafalgar House Investment group, widely tipped as a possible bidder for P & O at one stage (it already owns Cunard). The Bowater paper group made a bid for Ralli International, the commodity trading and finance group, for very similar seasons as P & O had bid for Bovis. In November 1972 Trafalgar made a bid for Bowater. The chairman of Trafalgar admitted that he knew little about the newsprint business but went on to say "we are just restless people." There was more to it than that of course, there was the tax position to consider. Bowater would be able to use Cunard's UK tax losses (thus freeing Bowater from tax on its UK profits for several years). Trafalgar on the other hand would be able to benefit from Bowater's overseas tax losses. The bid was rejected by Bowater largely on the grounds that Trafalgar and Bowater were operating in different areas of activity. But as Trafalgar said afterwards, given more time they would probably have won. Trafalgar is now seeking a 40 per cent stake in a US offshore drilling company—Dearborn-Storm. As for Bowater their bid for the Hanson Trust was referred to the Monopolies Commission in July 1973. Hansons operate largely in different fields than Bowater: once again the main motive for the bid was undoubtedly Bowater's desire to reduce its heavy dependence on overseas earnings (60 per cent) which are penalised under the imputation tax system.

the need for new measures

The question of takeovers has not been dealt with in the Companies Acts—with the exception of section 209, a notoriously badly drafted section dealing with the bidder's power to acquire share of shareholders dissenting from a takeover approved by a majority of not less than 90 per cent. At present the only form of legal control is that laid down in the old Board of Trade rules. In fact detailed regulation has been left to the City itself. The City Code on Takeovers and Mergers is enforced by the Takeover Panel, comprising representatives from the leading City institutions. Naturally their decisions do not have the force of law. The Jenkins Committee recommended a rationalisation of the takeover rules, bringing the major points within the scope of the Companies Act. In the Australian Companies Act, for example, there is a section (184) dealing with the form of, and the information to be provided with, takeover bids. There are therefore good grounds for including some provision on takeover bids in a reformed Companies Act. The Act should lay down the form a bid should take. It should stipulate what information is made available when the bid is made, above all ensuring that more information is included than at present on the bidder company's past record and on its future plans. In addition the Act should ensure that if the necessary new shares to be issued by the bidder exceed 20 per cent of the present capital there must be either a new prospectus or else a full cash alternative offer. Further details should be left to a statutory body set up to replace the city panel.

At present under the 1965 Monopolies and Mergers Act the government can refer a merger to the Monopolies Commission if it involves the takeover of a firm with assets exceeding £5 million or if the resulting company will have a third

or more of the market for a particular product. In cases such as Boots, Glaxo and Beechams the Monopolies Commission has to consider whether the reduction of competition resulting from the merger will be outweighted by the resultant economies of scale. The difficulty here is that under the present law the share of market criterion is certainly too rigid and the government has often refused to refer a merger on the grounds of asset size alone.

Following the decision on the Glaxo takeover bids the door seems to have been effectively closed on any further rationalisation of the UK pharmaceutical industry —at least as long as it remains in private ownership. On the other hand with the law as it is there is nothing to prevent the takeover of one or other of the three companies by a group outside of pharmaceuticals altogether. Indeed one unfortunate side affect of this decision could be that it will lead to conglomerate mergers in other industries as well on the grounds that that type of merger will be less likely to be referred to the Monopolies Commission.

Events have outstripped both conventional economic theory and the law, neither of which can satisfactorily deal with the conglomerate in the same way as they can tackle straight-forward monopoly situations. This was further demonstrated by the Timpsons case. William Timpsons, one of the few remaining small independent footwear groups, was the subject of bids from both Sears Holdings and United Drapery Stores (UDS). Sears already owned a large number of retail shoe outlets, while UDS had very few. The Sears bid was referred to the Monopolies Commission on the grounds that Sears would be likely to be in a monopoly situation with around a third of the high street retail shoe outlets. Following the reference Sears withdrew its bid and UDS gained control. Ideally both bids should have been referred, for there seems no justifiable reason why either group should have taken over Timpsons. Indeed it is difficult to understand why the UDS bid was not referred under Section 6 of the 1965 Act relating to the takeover of firms with more than £5 million gross assets. Too many of this type of merger are harmful to the public interest involving as they do the threat of unemployment and hindrance to government regional policy. Industrial relations can be harmed by the lack of trust and confidence that a merger situation can so easily engender. Too many of these mergers are inspired by a desire to make quick profits out of financial manipulations rather than to achieve an increase in productivity. Asset stripping rather than asset building is becoming the occupation of the modern " entrepreneur."

In the opinion of the Stock Exchange: " Mergers . . . are a normal and healthy economic development almost invariably leading to greater efficiency." It is doubtful whether the employees who see their jobs threatened feel so enthusiastic. The power of the large institutional investors to decide the fate of industrial companies will have to be curbed. The employees of any company subject to a bid should be fully informed and consulted. The impact a merger can have on employment should be another criterion for reference to the Monopolies Commission.

To safeguard the public interest, the power, size and scope of the Monopolies Commission should be considerably extended. As well as the present discretionary power to refer bids for firms with assets over £5 million reference should be compulsory in the case of those companies with assets over £25 million, the only exception being in the case of government inspired mergers. The Fair Trading Act 1973 reduces the monopoly market definition from one third to a quarter and also attempts a definition for the first time of a local monopoly. But reliance on the definition of a monopoly market situation is inadequate and should be made more flexible. A new Monopolies and Mergers Act should break away from the old concept that a large monopoly company is prima facia against the public interest to concentrate on the behavioural pattern of a wider range of firms. Since the one-third rule was introduced in 1948 research has indicated that anti-competition behaviour in a market can exist when the four largest companies have between them 50 per cent of the market,

even if no single company has more than 20 per cent of the market. The suspected existence of " price leadership " in either goods or services should be grounds for reference to the Commission. In addition government policy should aim at some measure of control over the planning decisions of monopolistic firms: in investment, pricing and employment policies.

It should become the rule rather than the exception for a merger to be referred to the Commission if it involves firms with widely disparate interests and activities. Expansion by acquisition—especially in the case of conglomerates—should be subject to searching control. Slater, Walker for example acquired 29 companies in 1972 alone. Between March and August 1973 Unilever made bids totalling £20 million for three UK companies.

Apart from this, there is the question as to whether companies in declining or stagnant industries should be allowed to use their cash and property resources to move into further activities simply through the acquisition of existing firms. Here an important consideration is the effect such expansion might have on employees' job security. Further conglomerate and financially motivated mergers should be permitted only in very rare circumstances. In this respect Labour's proposals on land speculation control could help to eliminate one of the incentives to this type of merger. An alteration of the tax position so that it becomes impossible for the tax losses of one member of a group to be offset against the profits of another if they have been incurred prior to acquisition is also necessary. Unless conglomerates are dealt with in this manner, the only restraint on them is likely to be that of financial capability. It should be considered how some form of " trust busting " could be applied to some of the larger conglomerates already in existence.

There is clearly a need for long term planning and rationalisation in large areas of British industry. As part of any policy on mergers Labour should consider the reintroduction of a body on the lines of the former IRC. Furthermore, there is a clear case for the government to intervene still further to establish state holding companies specialising in certain sectors to take a permanent shareholding in some of the companies resulting from government inspired mergers. In the case of those industries such as pharmaceuticals where for reasons of monopoly further rationalisation is unlikely under private ownership, there is an overwhelming case for public ownership. Inherent in the present situation is the danger that if there are too many unnecessary, illogical and ill considered takeovers there will be a reaction that could harm the possibility of success of future genuine reorganisation schemes. Above all, there is now the realisation that the question of whether a merger should go through or not is far too important to be left to shareholders alone to decide. Shareholders, with their tenuous links with the companies concerned are unlikely to consider anything other than the price offered for their shares. It is a fantasy to expect them to give any thought to matters affecting the employees, the future of the industry, or indeed the public interest as a whole.

international companies

Of the 100 largest economic units in the world half are nation states, half are international companies. Although the terms "international" and "multinational" are used indescriminately by many people there is a distinct difference. The true multinational (like Nestles—97 per cent of whose activities take place outside the home country Switzerland) is rare. International companies—organising their operating divisions across frontiers while maintaining a strong presence in the home country—are much more common. Most of the large US companies fall into this category. Their growth rate is on the average twice that of the leading nation states. International companies are not a new development: they have existed for decades in such activities as primary products and general trading. What is new is the upsurge in their growth and concentration in new sectors and regions since the War. International companies have invested heavily in the manufacturing industries of developed areas, notably Western Europe. Coupled with the

increasing international diversification of production and distribution is a growing centralisation of management. Modern means of communication enable the head office to maintain an ever tighter hold on their overseas subsidiaries whose staff owe their allegiance not to the country in which they are operating but to head office. The chairman of Ronson's UK subsidiary, W. J. Kenyon-Jones has said that the executive " must set aside any nationalistic attitudes and appreciate that in the last resort his loyalty must be to the shareholders of the parent company, and he must protect their interests even if it might appear that it is not perhaps in the national interest of the country in which he is operating."("The Shape of America's Challenge," Rex Winsbury, *Management Today,* February 1967). The initial motive behind international expansion was the desire to capture foreign markets, instead of expansion by trade these companies (Fords, Singer, General Motor etc) established their own production and marketing subsidiaries in the chosen area. In recent years there has been another motive—the desire to establish cheap manufacturing facilities abroad to supply the home market. Their growth has been most spectacular in those industries where the costs of research and development are high and can only be offset by a correspondingly large market. As a recent International Labour Organisation (ILO) report stated: " The multinational firm has been a principal though not the sole vehicle for the transfer of technology." The same could be said regarding the spread of modern managerial ideas.

Of the 300 to 400 leading international companies the majority are American. Indeed they play an essential role in the situation whereby the US with 6 per cent of the world's population is able to exploit 40 per cent of the world's raw materials. The total book value of US direct investment in the EEC increased from $1,900 million in 1958 to $11,700 million in 1970. In 1958 this investment, which accounted for about 7 per cent of US overseas investment, was largely in petroleum. By 1970 three fifths of it was in manufacturing, and 15 per cent of American investment overseas was in the EEC. The total production by subsidiaries of internationals is probably already greater than the total value of world trade. By 1975 it is estimated, of the total sales by American companies abroad only 10 per cent will be direct: 90 per cent will be by subsidiaries. The threat posed to national governments by these companies has become more widely understood over the last few years. The UK is an example of a country that is both a host to foreign owned companies and a base for British owned international companies. There are two basic problems involved here: the economic effect of these companies on the country—and the question of control, the shifting of the balance of power away from the government to the company head office. In the case of the UK the greatest threat is probably posed to the balance of payments. With a third of US direct investment in Europe in the UK, the proportion of UK exports which are international companies' internal transactions is probably already 30 per cent (*The Multinationals,* C. Tugendhat, Penguin 1973, p 13). By 1980 it could be over 50 per cent, 40 per cent being accounted for by US owned companies (Tugendhat, *op cit,* p 143). The American insistence on 100 per cent control means that the policies of subsidiaries can be firmly controlled by the centre with little or no regard for the economies of the countries concerned. The subsidiaries very often claim that they are exporting a large amount: very often this apparent benefit to the economy is negated by the outflow of dividend payments to the parent company. Chrysler (UK), formerly the Rootes group, has now stopped exporting to North America: in fact the total foreign trade figures for the American owned section of the UK car industry for 1971 show that their exports from the UK increased by only 7 per cent while their imports into the UK rocketed by 200 per cent.

Chrysler (UK) are also an example of another problem involving US companies in the UK—industrial relations. Kodak for example has consistently refused to recognise trade unions. Other companies where similar difficulties have been encountered include IBM, Gillette, Heinz and Fairchild. Since 15 per cent of the UK workforce are now employed by international companies, and the figure is likely

to grow, this is an important issue. Neither should the role of British companies overseas be overlooked. British Leyland operates in Spain and employs black labour in South Africa: in both cases unions are illegal and the workers subject to severe repression. Typical of the growing realisation of the need for international action have been the recent conferences on the subject. In 1972 an ILO meeting discussed the effect international companies have on countries' employment situations. Both the automative and electrical sections of the International Metalworkers Federation have held conferences to discuss joint action to help prevent the international companies from playing off unions in one country against those in another.

It would be futile to pretend that a UK Companies Act could by itself control the operations of the multinationals in Britain, or their overall effect on the UK economy, but there are a number of actions that should be taken:

1. Government monitoring of international companies, pricing policies and international monetary movements together with a tightening of measures to prevent tax avoidance.

2. Government control over the investment and employment policies of the larger companies involved.

3. An extension of the disclosure requirements to cover the global operations of foreign owned companies operating within the UK.

4. Pressure on foreign owned subsidiaries to recognise trade unions.

5. Limitation of the extent of foreign ownership in certain industries.

6. In addition consideration should be given to limiting the size of foreign shareholdings in companies to 50 per cent. Wherever possible joint-ventures should be encouraged rather than outright ownership.

In the long run such measures will be circumvented or negated unless there is international co-operation. At present the attitude among EEC members ranges from strict control on foreign companies in France to outright encouragement through tax holidays and fiscal incentives in Belgium and Luxembourg. Until there is international co-operation, including the harmonisation of tax and company legislation, it will be difficult if not impossible to subject the multinationals to control.

the eurocompany

It has been too easy for American subsidiaries to expand in Europe backed by the huge resources of parent companies, while European companies have been hindered by the great variation in national laws. The proposed "Eurocompany" which would establish a multinational company under the aegis of the EEC Commission could help to remedy this. Indeed the position in Europe is not now so gloomy as it looked. European companies are stronger now and better able to face the "American Challenge."

As part of the Community's industrial policy it has long been recognised that separate, and often conflicting, company laws hinder the achievement of a genuine, rationalised, European industry. It has been far easier for American companies to cross frontiers in Europe than for companies based in one or another of the Community members states. European firms find it impossible to create the trans-EEC groups capable of exploiting either the Community's productive resources or meeting the rapid growth of trade. Apart from the general policy of company law harmonisation, proposals have been under discussion for some time for a special type of company—the Societe Europeenne (SE). The idea of the SE originated with Professor Saunders in 1959 and a draft statute was submitted to the Council of Ministers by the Commission in 1970. The proposed statute would provide for a company to be created under a law common to all member states.

The proposed SE would take the same form in each country, and would exist

side by side with national companies. The SE would be formed by companies of not less than 2 countries merging, forming a holding company, or forming a joint subsidiary. Once in existence, the SE would be able itself to establish another SE by merging, forming a holding company or setting up a subsidiary with another SE or a national company. The SE would also be able to form a subsidiary in the form of an SE. Certain minimum capital requirements have been laid down: $500,000 for a merger or holding company; $250,000 for a joint subsidiary; $100,000 for an SE subsidiary. For the administration of the company four bodies are envisaged: the board of management, the supervisory board, the shareholders general meeting and the works council. The board of management would be appointed by the supervisory board and would be responsible for the daily management. It would have full powers to act in the interests of the company, save in those matters specifically reserved to other bodies by statute. The supervisory board would be elected by the shareholders (two thirds of the seats) and by the workers (one third of the seats). Its function would be to control and advise the board of management and to ensure that this body acted in accordance with the EEC statute and the statutes of the company. The general meeting would be concerned with matters relating to the continuation in existence or development of the company. There would be a works council in each establishment to ensure that the workers' interests are considered when conditions of work are being settled.

The SE is far from being in its final draft, so there should be ample opportunity for it to be discussed in the UK. Over certain points there is a need for amplification and clarification. It seems to permit US owned subsidiaries to establish SE's, thus encouraging further the American domination of European industry. If the SE is to be a genuinely European company, it should be ensured that only companies owned and controlled by Europeans should be able to form SE's. American investment brings with it certain advantages in the form of advanced technology and managerial ideas. Europe should welcome American firms as partners but cannot allow them to retain or extend their present influence over so much of European industry. The Commission should discuss ways of encouraging US companies to reduce their shareholdings in those subsidiaries where they have 100 per cent control at present. Further, the Commission should consider the outright banning of further foreign takeovers of European companies, unless their shareholdings are limited to a maximum of 50 per cent.

Both in its division of management between two boards, and in its recognition of worker participation the SE is an advance on present UK company law. The German unions are seeking an extension of worker participation to cover half the seats on the supervisory board. This is in line with their national policy which recognises that a one third participation can place the worker directors in the position of a powerless minority. The German unions have long campaigned to have the half and half provisions which exist in the coal, steel and iron industries extended throughout German industry. In the UK the TUC has also come out in favour of half and half participation. In certain respects of course the UK law is more satisfactory: notably in the disclosure requirements and the extensive rules for the investigation of company affairs by the DTI. Nonetheless the proposed statute does at least form the basis for discussion on a type of trans-market European business organisation which could play a very important role in helping to achieve economic integration. At the same time the SE recognises the right of workers to participate in management, and subject to further safeguards would seem to offer workers far greater protection than exists today in regard to the multinationals.

competition in the EEC

UK companies had a 6 month period of grace after January 1973 before they became subject to the full rigours of Articles 85 and 86 of the Treaty of Rome. Even so, as was mentioned earlier British companies were already taking note of the requirements and altering their

policies accordingly before 1973. Article 85 of the Treaty of Rome is intended to control restrictive practices. In this area the Commission appears to be flexible in its approach, and between 1962 and 1971 only 5 agreements were banned; 36 were voluntarily ended and 589 amended. Under Article 86 the abuse of a dominant market position in the EEC or a substantial part thereof is prohibited if trade between the members states is affected by such an abuse. Fines of up to 10 per cent of the offending company's turnover can be imposed. The head of the Commission's competition department has described the principles behind these two articles: "The application of the competition rules is vital to the future of the Community. We have already established that there is in our and the Court's eyes a basic right for the consumer to buy everywhere in the EEC and to choose his supplier. It is a right we will contiue to uphold."

The Commission can grant exemptions to either groups or individual companies if this will facilitate desirable industrial co-operation and influence changes in the pattern of European industry. There is now a general exemption for specialisation agreements between small firms. The Commission's recent investigations have been wide ranging: shipbuilding, textiles, fibres, dyestuffs, pharmaceuticals, films and electronics have all come under examination. Indeed there has been a considerable increase in activity on the part of the Commission and several important judgements have been given by the Court of Justice. In July 1972 the Court upheld the fines of $50,000 each imposed on ICI and 8 other companies who had contravened Article 85 by "concerted practices" regarding the selling of dyestuffs in the EEC. The Court held that the Commission had jurisdiction in respect of concerted action which produced its effects within the EEC. In other words the Commission is presumably free to proceed against companies based outside the EEC who violate the EEC competition policy. (ICI *& others v. Commission of European Communities*, July 1972).

In another case the Court ruled that suggested "target prices" set by trade associations were just as illegal as fixed prices. Even if limited to one EEC country the court held that they hindered EEC economic integration and were therefore contrary to EEC commercial policy (VCH v *Commission of European Communities*, October 1972). Shortly after this case the Commission fined Pittsburgh Corning (a Brussels based subsidiary of two US glass-makers) $100,000 for rigging the market in order to sell cellular glass in Germany at 40 per cent above the prices in the Low Countries. That the Commission intends to deal very strictly with such infringements of the Treaty of Rome was further shown by the fines imposed in December 1972 on the members of a sugar ring operating throughout the EEC. Fines totalling $9 million were imposed on 16 sugar refining companies.

In certain respects the Commission's competition policy is more realistic than that in the UK. The EEC approach is based on specific economic objectives aimed at dealing with the abuse of a dominant market position, and not on legal dogma of a statutory monopoly situation. It is no longer true to say that the Commission is complacent about the growth of monopoly power in the EEC. During the past year or so the Commission has shown itself determined to enforce Articles 85 and 86; and the decision of the Court of Justice in the dyestuffs case now opens the door to firm measures to control some of the activities of the international companies operating in the EEC.

The Commission is now seeking an extension of their powers to enable them to examine mergers. Further controls over international mergers were proposed by the Commission which if accepted will come into force on January 1975. The Commission would have to be notified of mergers 3 months in advance. Companies with combined sales of less than £100 million or 25 per cent of the market would be exempted. The effect would be to ban further concentration among firms when it involves "the power to hinder effective competition."

5. the public company -a new form of administration

The provisions in the Companies Acts relating to the internal control and administration of companies have altered little in principle since the early Acts appeared. They have failed to keep pace with changing circumstances. Briefly, a company's constitution is laid down in its Memorandum of Association ; details of its internal administration are contained within the Articles of Association. There are limitations on the company's power to alter the memorandum, but the articles are freely alterable by the company in general meeting. Owing largely to the influence of the model articles appended to the Companies Act (Schedule 1, 1948 Act) the articles have become more or less standard in form. A company has two basic organs—the shareholders in general meeting and the board of directors. This applies to all companies, large and small. But in practice the system has undergone a considerable change, particularly as regards the larger companies. In theory supreme power rests with the general meetings which have to be held annually, but over the years boards of directors with only minority shareholdings have become entrenched in power taking full advantage of shareholder apathy, proxy voting, the circular system, service contracts with expensive cancellation clauses, and other devices to maintain their oligarchic position.

Indeed the only way shareholders could remove a managing director for example, would be to vote out the whole board of directors as the appointment of the managing director rests solely with the board. In fact, providing directors are acting within their powers the shareholders can only interfere by voting to remove the whole board. With the growth and increasing complexity of company affairs power has tended to shift one stage further: from the board to a managing director who has really no direct link with the shareholders at all. Usually the managing director is full time and is assisted by other full time officers of the company. It is increasingly common to find the company secretary and the chief accountant on the board. In fact the annual general meeting has in most cases developed into something of a legalistic charade. Unless there is some major dispute in progress only a handful of shareholders ever bother to attend. Despite the reforms introduced in the 1948 Act the general meeting as a means whereby the shareholders exercise control is clearly ineffectual. That the system has developed into a sham is largely because the law has failed to take into account the changing pattern of corporate activity. Power within the company has shifted away from the shareholders who often have only tenuous links with the company and who are rarely sufficiently interested enough to stir themselves into action.

As for the company's employees, their position is far from satisfactory. Their interest in the company is not recognised by law, and they have little or no legal right to be informed or consulted on company affairs and decisions no matter how much their lives may be affected by them. Yet if anybody has a direct relationship with the company it is that company's workforce. There are three main ways in which the position of the workers could be improved: through a strengthening of collective bargaining, through the introduction of profit sharing schemes, or through some form of worker participation in the management of the company. They should in no way be regarded as mutually exclusive alternatives. It is through collective bargaining that workers and their unions have traditionally exercised their power in the UK. There has been a natural reluctance on the part of trade unions to encourage a move towards worker participation, on the grounds that it could lead to management paternalism, although the Union of Post Office Workers, for example, has been in favour of co-determination for a number of years. The publication of the TUC interim report on Industrial Democracy in July 1973 marks a turning point.

Inherent in any scheme of worker participation will have to be the safeguarding of union's bargaining rights. Of considerable importance therefore will be the question of information on company

affairs. Any reform of industrial relations should include statutory provision for increased information to be given to trade unions for bargaining purposes. After all, for worker participation to work the workforce must be adequately informed and the union officials should be in a position to advise them. Participation is attracting increasing attention in Europe, and the EEC proposals on company law harmonisation include provision for an element of worker participation. In Germany it plays an important role, having being introduced into the coal, iron and steel industries in the Mitbestimmungsgesetz of 1951 and extended to other industries by the Betriebsverfassungsgesetzt of 1952. Most proposals follow a similar pattern to the German one. Both workers and shareholders elect members of a "committee of supervision" which then appoints the directors. Whatever the final system of participation adopted it is obviously going to alter the position of shareholders.

shareholders

Visions of a share owning democracy have faded into insignificance with the gradual institutionalisation of share ownership. As was mentioned earlier, the private shareholder now holds less than half the ordinary shares in UK quoted companies. Indeed as Pennington has so aptly put it "Shareholding is no longer ownership, but a form of passive profit sharing contract; the management, the directors and officers, are in control of the corporate policy and affairs." With the high charges on small share deals many small private shareholders are likely to pull out of direct investment and transfer to the unit trust and other managed funds. In November 1972 the value of funds under management rose to a record total of over £2,600 million. This is a far from harmful trend, likely to lead to a more professional attitude to investment. Indeed if it was felt that small shareholders should be further encouraged to move into unit trusts this could be achieved by exempting unit and investment trusts from capital gains tax. The growing power of the financial institutions as shareholders cannot be doubted, although it has not reached the same proportions as in West Germany where the major institutions own or control vast blocks of shares. In Germany even the trade unions own a large and prosperous bank. In several of the recent takeover situations the institutions have been prominent. If it is becoming more and more expensive for the small investor to buy and sell shares, the institutions will find it cheaper in the future. The setting up of "Ariel," a computer based "stock exchange" particularly aimed at institutional shareholders, by the Acceptance Houses Committee will considerably reduce the expense of large share dealings. Even if they do not intervene directly (as in the takeover of Watneys by Grand Metropolitan Hotels) the institutions can influence events. At the time of the Bowater bid for Ralli the Slater, Walker group held 12 per cent of the Bowater shares and had a 15 per cent stake in Ralli. It is not even necessary for the institutions to have a direct interest, as Morgan Grenfell's intervention in the P & O affair showed.

Discussions have been going on for some time between the Bank of England and the institutional shareholders over the type of watchdog body they would like to set up to intervene on their behalf in industry, when for example firms are so badly managed that the long term prospects of their investments are threatened. It is not hard to understand why the institutions want closer liaison with the firms in which they invest. As their shareholdings in particular firms become larger it becomes increasingly difficult for them to pull out and realise their shares without causing the share price to fall to an unacceptably low level. Consequently, like it or not, the institutions are having to think more and more in the long term, quite a change from old attitudes. It is not just in merger situations that the institutions can intervene. They have played their part in some major management revolutions, notably Vickers and BSA. The Prudential, largest of the institutional investors,

has been especially active. Most of the institutions' activities are behind the scenes, they rarely raise issues at annual general meetings. The Government's white paper envisages a further extension of the role played by the institutions (para 60-64). The institutions can, it seems, take decisions affecting the livelihoods of thousands of workers with a remarkable air of detachment and indifference. Indeed any scheme for worker participation is likely to meet with strong opposition from the City. The head of the quotation department of the Stock Exchange was reported in the *Financial Times* (11 October 1972) as having said that " he saw a danger in the suggestion that a two tier board structure should be applied universally in the Common Market. This, he suggested, could ultimately damage shareholders' interest in investment by subordinating their interests to a wider concept of social responsibility."

There are a number of matters affecting shareholders that will need attention in a reform of company law. The Cohen committee recommended that nominee shareholdings should be marked on the register and that individual holdings greater than 1 per cent should be shown. This proposal was not included in the 1948 Act. In 1962 the Jenkins Committee advised that the beneficial owners of 10 per cent or more of a company's shares should be listed on a special register, together with details of any transactions in them. This was included in the 1967 Act together with the requirement that there must be a statement in a company's report and accounts of the identities of companies, not subsidiaries, whose share it holds if the holding is 10 per cent or more. Recent events suggest that this requirement could be usefully extended to include details of all shareholdings and dealings therein by banks, insurance companies and other financial institutions, if their individual holdings in a company are greater than 1 per cent. The government's proposals to reduce the level of disclosure from 10 per cent to 5 per cent (*Company Law Reform*, para 27) will do little to end the practice of " warehousing " whereby one company can through the use of nominees acquire by stealth the control of another company. Ideally of course one would like to see nominee holdings abolished entirely, as they can be a cover for a number of unscrupulous activities ; there would however be many difficulties involved. It is interesting to note that several public companies do already provide voluntarily, in their report and accounts, an analysis of shareholders which while not identifying the institutions or companies involved, do give a total figure for their holdings.

A matter that is causing considerable concern—even in the City—is the problem of " insider dealing." Although often arising during takeovers (there seem to have been examples in several recent takeovers—the shares of Timpsons, International Stores and Bowater were apparently involved) it can nonetheless go on at other times too. Transactions in shares by people with inside knowledge cannot be dealt with effectively under the present law. Insider dealings have been defined by the City Takeover Panel as those " which involve the use for personal profit of privileged or secret information which the recipient has received or had access to in confidence." The people who usually have access to this sort of information include directors, top executives and their professional advisors together of course with their relatives and nominees. There are two main groups of situations in which insider dealing can arise : during the preliminaries to takeovers and mergers or just before the announcement of important information such as the interim or annual accounts or details of a large order for example. Only dealings during takeovers are at present dealt with by the City Panel and then the coverage of the City Code (section 30) is only partial.

The official attitude of the City is quite clear. The chairman of the Stock Exchange Council has called these deals " no better than stealing." But opinions differ as how best to tackle the problem : the Stock Exchange is in favour of voluntary control but the body which would presumably exercise this control—the City Panel on Takeovers and Mergers

—considers that some form of statutory control will be necessary. Indeed it is difficult to see how the City can enforce its own controls effectively enough, especially in the light of the Lowson affair. If the official attitude of the City is clear, there is no such clarity when it comes to leading figures within the City. Sir Denys Lowson, a former Lord Mayor of London, controls a £200 million empire by an intricate system of nominee cross shareholdings. In 1972 he acquired a controlling interest in National Group shares for 62-63p per share, from Nelson Financial Trust and First Re-investment Trust, of which he was the chairman. In January 1973 he sold the shares at £8.67 each, making a profit of £5 million. Following the announcement of a DTI investigation, the profit was repaid to the companies concerned. This reinforces the view that the City cannot be left to police itself.

The most satisfactory solution would be to have statutory powers to curb these deals—making them a criminal offence as they are in the US. The government's white paper recognises this (para 13-20) but offers no clear idea as to how such control is to be exercised. The statutory provisions should insist on the publication in the directors report of all share dealings by directors and senior executives, their families and nominees. Further, the time given to directors to notify the company of dealing should not be so long as 14 days (s. 27-29 1967 Act). Such dealings should be announced within 24 hours. All dealings by such persons should be banned within say the two months previous to the publication of interim and annual accounts and the directors' report. Similarly, dealings should be banned during the preliminaries to a takeover or merger. Ideally, nominee shareholdings should be abolished entirely, failing this the use of nominee holdings in UK companies by foreign banks should be made illegal; share bearer warrants should be abolished. Finally, as under the American Securities Exchange Act, insiders should be made liable in civil law to the company for any short term profits made in its shares that they have made, and they should also be liable to those they have had dealings with. Policing should not be left to the City Panel: neither is it likely that the Companies Section of the DTI could handle the extra work involved. The answer would seem to be a statutory body similar to the American Securities Exchange Commission which would investigate dealings "naming names" where necessary. The role of the City Panel, strengthened and extended by the force of law should be taken over by a statutory "Share Dealing Council."

The question of share option and incentive schemes came to the fore again during the passage of the Finance Act 1972. Something like a thousand schemes were already in operation before that date, and a dramatic increase in the number is now likely. Most schemes follow a similar pattern: after shareholders and the Inland Revenue have approved the arrangement, options are given to the participants (usually directors and top executives) which carry the right to take up shares at a stated price, not less than the current market price, during the following few years. Despite capital gains tax, given a rising stock market this can be a highly profitable venture for the participants. Some schemes even involve the company lending the money to participants to buy the shares. The idea behind the schemes seems to be that top management will have an incentive to work harder to further the interests of their company and increase the value of their shares. It is to be questioned whether such schemes have any value to other people. It is extremely doubtful that they could ever be extended so that the general body of a company's employees could benefit—schemes such as the ICI one do not seem to have been an unqualified success.

There are still a number of areas where the existing law falls short of what is required for investor protection. Investor protection in company law is based not on supervision but on the disclosure of information. Not only is it doubtful whether sufficient information is made

available to investors—existing or potential—there is really no effective machinery for checking the reliability of the information given them. The law should be strengthened with further provisions on the prospectus issued when floatations take place. Similarly, a prospectus should be required when a rights issue or an offer of sale to existing shareholders is made. The share dealing council envisaged earlier would have the task of watching over floatations and investor protection in general, as well as takeover situtations and insider dealings.

Protection of minority shareholders exists both under common law and statute. The Jenkins Committee recognised that statutory protection should be extended. The provision in the 1948 Act (section 210) should be extended to cover " isolated acts " as well as " course of conduct " that is unfairly prejudicial to the interests of some part of the members. Of course, in many public companies it is a minority that holds control. One reason they are able to maintain their privileged position is by issuing non-voting shares, non-voting stock has also been used to finance takeovers by a number of companies including Rank Organisation. Owing very largely to the influence of the institutions, this type of share has become less prevalent in recent years. There is a very good case to be made for making this type of share illegal.

On the subject of voting it would seem to be desirable to end the practice of voting during the shareholders' meeting. The purpose of the meeting should be to inform the shareholders: after time for reflection they should vote by means of a postal vote.

The question as to whether no par value shares should be authorised was considered by the Gedge Committee in 1954. The Committee came out in favour of such shares but their recommendations have never been adopted. At present shares have a nominal value which remains fixed; any retained or capital profits although legally belonging to the shareholders are shown separately. If shares had no par (nominal) value this distinction would be ended. Bearing in mind what has been said earlier of the unfairness to employees of retained profits automatically accruing to shareholders in the form of capital gains, such a system should only be introduced if at the same time a satisfactory share of the retained or capital profits were to be set aside for the employees.

In regard to shareholders, then, a new Companies Act should introduce certain further safeguards over such matters as floatations, protection of minorities, takeover situations and voting rights. A statutory body should be established to oversee financial transactions, to take over and extend the role of the City Panel. At the same time, the law recognising the diminishing role of the shareholder, should introduce a new administrative framework into the company which would recognise the rights of workers as well as shareholders to be informed, consulted, and to participate in management.

worker participation

It would be totally wrong to regard worker participation as some form of panacea. It will not in itself create good industrial relations, although it will over a period of time lead to greater understanding in industry. Indeed the existence of good industrial relations will be a necessary prerequisite for its introduction. Old attitudes die hard and some trade unionists remain to be convinced that worker participation in management is not simply just a trick to turn the unions into management stooges. In a sense this reluctance on the part of trade unions has had certain advantages. There has been no precipitate rush to introduce ill considered schemes in which workers would have gained the form of participation only to lose its substance. Further, we are now in a better position to consider the whole question in the light of several European schemes. In this way it should be possible for the Labour movement as a whole to evolve

an acceptable system of participation which will lead workers to have a genuine share in both the capital and management of industry. The TUC interim proposals on industrial democracy discussed at Congress in September 1973 have been carefully thought out and have avoided the worst of the pitfalls that are apparent in the German system.

As a prelude to whatever system is eventually adopted it is essential that trade unions and their members have the necessary information on which to base their decisions. That a strong trade union system is necessary for worker participation to succeed should be self evident. After all, one of the reasons why small shareholders, although often in a majority in a company, have not been able to exercise their power is that they lack both the information on the affairs of the company and the necessary unity without which they cannot hope to influence the course of events. The Industrial Relations Act does take the first tentative steps to giving unions the right to information they need, although the relevant section of the Act (56) is not yet in force. The Commission on Industrial Relations has recommended that firms should make voluntary agreements with trade unions on the disclosure of company information for collective bargaining. The Commission's report (*Disclosure of Information*, CIR report no 31, HMSO), covers six categories of information : organisation and activities of the employing unit ; manpower ; pay ; conditions of service ; financial information ; and short and long term prospects and plans. This is still far short of the TUC's requests in the past that unions should have complete access to all companies' books. Indeed without a statutory right of access, the amount of information given will be left to management who would then be in a position to feed the unions highly selective information.

Typical of the malaise that afflicts industrial relations at the present time is the spate of " work-ins " and " sit-ins " that have taken place since the Upper Clyde occupation in August 1971. They are not intended to help further pay demands, but to try to prevent redundancies. No doubt a major cause of bad labour relations is the lack of information and consultation that exists in quite a number of companies. It is not unkown for workers and their union officials to learn of plant closures, redundances and take-overs through the newspapers and television before being officially informed. The present legal position reinforces some managements' natural propensity to ignore the workforce whenever possible in their planning and decision making.

It would be wrong to try to introduce into UK company law concepts that appear alien to us simply because they seem to be succeeding in other countries. The fact remains, however, that participation schemes differing both in objectives and form have been introduced or are being introduced into such disparate company law structures as those of West Germany, France, Netherlands, Norway and Denmark. It would be short-sighted to ignore this trend which may well help to point the way to a more satisfactory industrial climate in the UK.

Several companies in the UK have for some time encouraged their workers to become shareholders in the company, in some cases this has been done by issuing special workers' shares. However, as the Rolls Royce affair has shown this can have disastrous repercussions on the workers if the company fails. Ordinary shareholders are free to sell their shares but all too often there are restrictions on the workers' right to transfer their shares. On the continent while the Germans have preferred participation in management, the French have tried to encourage participation in profits. The new Danish proposals involve both schemes. The French experience over the past few years shows that a lot more than a share in profits will be necessary if worker participation is to become a reality. In France since the beginning of 1968 all companies with a workforce of 100 or more have had to provide a share of the profits for the workers, some 8,000 firms and 4 million workers are now involved in the scheme which has

recently been expanded to include the nationalised industries. True, it does ensure a share of the profits for the workers, but there is no provision for workers and trade unions to have any real influence. There is always the danger inherent in such schemes that they are aimed at lessening the influence of the trade unions rather than improving the position of the workers. As was argued earlier there is a case for an employees' equity in companies, capital. However, the employees' right to a share in the management would stem simply from their very presence in an enterprise—not merely from their participation in capital. As for the employees' equity itself, it is obviously desirable that it should be run as a huge "unit trust" investing throughout industry, on behalf of the workers as a whole.

In Denmark, the social democratic government is introducing legislation to establish a workers' "dividend and investment fund." The employer will contribute 1 per cent of the total company wage bill in the first year, increasing by annual ½ per cent increments to a level of 5 per cent. Two thirds of this will be retained in the firm until the amount of workers' capital is equal to half the total equity, this on average would be after about 20 years. Each employee would receive a fund certificate of equal value, and a dividend from the central fund.

So far there have been few experiments with worker participation in British industry. The John Lewis Partnership is well known, but this scheme is unlikely to have a wide application. In the nationalised industries the British Steel Corporation has led the way with its employee director scheme which gives 16 seats on divisional boards to workers. However, there are signs that the National Coal Board could follow suit. A Joint Advisory Committee for the Coal Industry on which union and National Coal Board representatives sit has been established. It will discuss all matters of major policy affecting the industry with the exception of pay and conditions, but including such topics as investment policy, pricing, production productivity and energy policy. Apart from the central committee there will be local consultative committees at colliery level. In the Post Office, the Union of Post Office Workers is officially in favour of the workers having half the seats on the management board. With the exception of these isolated examples little can be drawn from the experience of the nationalised industries. Whatever the original intentions were, it has become the practice to appoint to the boards of naitonalised industries, as part time members only, trade unionists from outside the industry concerned. Probably the one thing which can be drawn from this is that purely symbolic participation does little or nothing to further the cause of industrial democracy.

There are two main grounds on which industrial democracy can be justified. To socialists it is surely just and equitable for the worker to be recognised as having a special relationship with the firm for which he works. The old legal position of "master and servant" is clearly a nonsense now—especially as many of the "masters" are employees themselves today—and should give way to the concept of worker participation in both capital and management. Socialists cannot be satisfied with a social system in which democracy extends only as far as the factory gate. No system of industrial relations in a democracy can rest for long on foundations of compulsion on the one hand and threats on the other without an explosive situation developing. As a recent PEP publication makes clear, modern management should be based on three fundamentals. First, that employees have more to contribute to the running of the company than they are asked to contribute at present. Second, the right to manage in a democratic society can only rest on the goodwill and agreement of the managed. Third, management should recognise trade unions as the sole channel of workers' bargaining.

The old idea still lingers on among some trade unionists and many managements

that it is the job of management and management alone to manage. Under this ethos the union's contribution is effectively reduced to opposing measures it disapproves of—a somewhat negative approach. There has been within the trade union movement a conflict here. They have been prepared to collaborate with government and with industry, and work with them on such bodies as the National Economic Development Council (NEDC). But when it came to the planning process in the individual firm the unions drew back. In some ways of course trade unionists and their officials are already a *de facto* part of the management of many companies. Without them the companies concerned very often could not be run so efficiently. The increasing specialisation of management, the almost total divorce of the ownership and control of capital, have nevertheless created an enormous gulf between the company and its employees. The old notion of avoiding direct involvement must give way to a direct contribution to the decision making process. There is, happily, a growing awareness among many trade unionists that it is only through direct access to decision making—at all levels—that they can effectively contribute to, and share in, the running of the firm. Many problems remain to be solved before this can become a reality—not least among them being the effective servicing (research, statistical analysis etc) of trade union officials to make this really effective.

works councils

If participation is to become an effective reality, then adequate provision must exist for consultation and participation at all levels within the firm. Statutory provision exists for works councils in all the EEC members except for Italy (where they are recognised through voluntary agreement only), Ireland and the UK. Undoubtedly the most advanced works councils exists in West Germany. They have a long history there, but their scope and depth were considerably increased by the Brandt government's Works Constitution Act which came into force in January 1972. Under this Act the number of members on the works council varies with the size of the company concerned. A firm with only 50 employees has a works council of five members. A large company like BASF with a payroll of 50,000 has 59 councillors. Of these, 31 are full-time released on full pay by the company. In the case of large companies with full-time councillors, office accommodation and facilities are provided. Councillors are elected for a three year term of office during which they receive three weeks full paid leave for training and educational courses.

The TUC is known to be against works councils on the continental pattern at the present time, preferring to build on the shop stewards system. However, provided the right type of works council was evolved—one which fitted into the British system of collective bargaining—it is unlikely to be opposed by the unions. Just as the shareholders have their general meetings, so the workers should have the statutory right to an assembly. Whereas the shareholders' meetings are usually only an annual affair, unless special business necessitates an extraordinary meeting, the workers' meeting should be in the form of a special council with regular and frequent meetings. The Council should be seen as the logical outcome of joint consultative committees which meet regularly, rather than of the joint negotiating committees which meet essentially on an *ad hoc* basis. They would be an essential element of any scheme of industrial democracy, for they would involve the broad body of workers in the day-to-day practice of industry.

At first the introduction of works councils should be limited to firms with a full-time workforce of 200 or over. In the light of experience it could later be extended to smaller firms. The councillors should be chosen through trade union machinery. This is essential if the works councils are not to become a rival body to existing union negotiating machinery at plant level. The existence of these legal rights of consultation and partici-

pation would act as an incentive to workers to join the unions, thus strengthening the whole collective bargaining machinery. As a corollary to this it should be mandatory for firms to recognise trade unions. The size of the works council and the amount of time and facilities members should have made available to them would depend on the size of the company concerned.

The council should have the right to be informed and consulted about many of the day to day events in the running of the firm. It will be necessary to draw a distinction between those subjects on which the council should have to be consulted before decisions were reached, and those on which it would merely have to be informed, to be given in other words a general background on the matters under consultation. There is a need to ensure that policies really do originate from joint consultations to prevent either side from taking up a dogmatic and entrenched view on difficult and often contentious issues. In general, the council would need to know quite a lot of background information as to the firm's trading position and its range of commercial activities. The council should have the statutory right to be informed about the general economic situation of the company ; its production policy ; its marketing and pricing decisions ; rationalisation schemes ; and general investment plans.

In addition the council should have the right to be consulted regularly regarding a number of important issues. The hiring and firing of labour ; the transfer of labour from one plant to another and of course the question of redundancies—these are all matters in which the council should be involved. In addition, the council could be expected to take a particular interest in general questions of industrial welfare, working conditions, safety and training, hours of employment and holidays.

The works council should be seen as one of the essential foundation stones of worker participation in management. Together with a strong trade union system and the statutory provision of information on company affairs works councils will have an important role to play, not only in extending the influence of the workers, but in helping to ensure no gulf appears between the workers and their representatives on the company's board.

two-tier boards and worker directors

For participation to succeed it must exist at all levels within a company: including the board room. At present companies have one board of directors, although there are part time, non-executive, directors and full-time, executive, ones. In theory the boards are elected by, and are accountable to, the company's shareholders. In practice the boards of many public companies are self-perpetuating oligarchies controlling large aggregations of economic power. That some measure of reform is necessary is accepted by all : though the measures suggested vary widely. The City favours the strengthening of the present system by an extension of the role of non-executive directors, probably from financial institutions. Yet such measures are mere palliatives which do not get at the root of the problem : privileged positions of economic power. No one would suggest that such abuse of power as was demonstrated in the Lonrho affair is widespread in British boardrooms : but the environment in which such authoritarian use of power could be exercised does most certainly exist.

The appointment of worker directors to boards, the achievement of participation in management at the top, would help to redress the balance. The introduction of a two-tier system with a supervisory board and a management board would minimise the possibility of conflicts of interest or loyalty that could arise if worker directors were appointed to the present unitary boards. The risks of such conflicts would be further reduced by the establishment of works councils, and by an extension of the information made available to workers.

Opposition to worker directors and the two-tier boards system seems to be based on two main grounds. First it is argued that the presence of worker directors " would undermine the confidence of investors in industry, with a consequent reduction in available capital." (Report on Engineering Employers rejection of two-tier system, *The Times*, 22 June 1973). Workers would act " irresponsibly " in management it is said, because they have no capital stake. This is far more of a subjective fear than an objective reality for most workers want to see their company efficient and successful for their jobs, their livelihoods, are at stake. As for " irresponsibility," it is hard to imagine a worse example than that demonstrated by the shareholders of Lonrho in May 1973, whose " share in capital " led them to endorse immoral, if not actually illegal actions. Second, it is said that the supervisory board " would weaken the sense of collective responsibility felt by directors meeting as a single board." (Report on Confederation of British Industry (CBI) rejection of two-tier boards, *The Times*, 29 August 1973). As recent events have shown (P & O, Lonrho, First Re-investment Trust *et alia*) boards' sense of collective responsibility seems somewhat weak as it is, and this cannot be regarded as a genuine argument against supervisory boards.

The exact form a two-tier structure would take could obviously not be decided on until there has been full discussion between the parties concerned. But in general terms the two-tier system should apply to all companies with a workforce of 200 and over as the TUC has recommended.

There should be a " supervisory board " of non-executive directors and a "management " board of executive ones. The size of the supervisory board would be determined by the size of the company but would probably be between three and twenty one in number. Half the supervisory board should be elected by the shareholders, half by the employees through trade union machinery. The TUC has suggested that the worker representatives should be elected for a two year term of office. It is also clearly desirable that the worker directors should come from the firm concerned, not from outside. Only then will they have both the necessary knowledge of the firm and be able to represent the employees' point of view. The chairman should be appointed by agreement between the directors, but not from among their own number. In addition, the employees should have the right either to appoint the personnel manager, or have a veto over managements' choice.

The role of the supervisory board can be seen as determining the general policy of the company. It would deal with major questions of policy. It would keep itself fully informed as to the general well being of the company, through having access to full reports of the company's activities and performance. The supervisory board would advise the management board, would lay down the general policy, would have to give its consent on a number of key issues, but it would not involve itself in the actual day to day management of the firm. In particular, the consent of the board would be required for the closure of the company or an important branch, for a major change in the company's activities or organisational structure and for the start and cessation of joint ventures with other companies. Further, the board would have the responsibility for ensuring that the shareholders' meetings and the works councils were informed and consulted as the law would require. The directors' report and annual accounts would also be the responsibility of the supervisory board. The normal duties and obligations that exist at present would of course devolve onto both the supervisory and management boards.

The management board of executive directors would be appointed by the supervisory board, but not from among their own number. The management board would be smaller in size than the supervisory one, depending on the size of the company, and would be responsible for the day to day management of the company, subject to the general supervision of the supervisory board.

In their evidence to the Donovan Com-

mission the TUC stated that it would prefer to see permissive and not compulsory legislation on workers' participation in management. But if the legislation were simply to permit voluntary schemes then there would be little likelihood of any effective progress. Legislation on this subject should be compulsory: it should lay down a general framework giving a period of time for its implementation. It would probably be most satisfactory for works councils to be introduced first, they could then play their part in bringing about full participation. From the date of the passing of the legislation it would probably be necessary to allow a period of two to three years for the introduction of the two tier board—and with it full participation.

It is not to be expected that such a scheme can be introduced without opposition. There is already strong opposition to the idea from the City which portrays the scheme as a threat to investment, and from the CBI to whom any form of worker participation is anathema. Some trade unions have opposed participation on the grounds that it could weaken their position *vis a vis* the management. Nevertheless, with the growing realisation on both sides of industry that something fundamental is required, worker participation will in time gain overall acceptance. It is clearly impossible to foresee definitely what effect it will have on industry, its efficiency and its climate of labour relations, but continental examples augur well.

Traditional divisions between employees and employers have tended to overshadow and indeed hide the potential contribution of employees on almost all matters affecting the company they work for. Workers and trade unions cannot be expected to play a responsible part in the running of industry when they are given no responsibility. It is one of the major strengths of British trade unionism that it has always looked beyond the immediate policy of struggle for higher wages and better working conditions to the long-term objectives of achieving a more just and equitable society. For this reason it is likely that the trade unions would welcome a policy of worker participation if it genuinely points the way to industrial democracy, as the recent TUC proposals show. Indeed, such a policy will to a large extent depend upon the existence of a strong trade union movement if it is to be effective. As for the broad mass of workers themselves, it is all too easy for opponents of participation amongst management and elsewhere to say that employees have neither the ability nor the interest to make a valuable contribution to the enterprise. When workers find that they do have a real interest in the company—its capital and its management—then they will acquire the knowledge necessary to participate effectively.

6. directors

Most of the powers of the company are vested, by law or by the articles of association, in the board of directors. In some cases these powers are exercised directly; in other cases the directors appoint managers to carry them out on their behalf. The directors' position towards the company is partly that of an agent and partly that of a trustee, but neither of these descriptions is a fully adequate explanation of the legal position of the "controlling minds" of the company. The Companies Act already contains a number of provisions regarding directors of course, these having been gradually extended notably in the 1948 and 1967 Acts. Provision already exists to try to prevent certain undesirable persons from holding office as directors. There are also a number of requirements regarding the disclosure of information on directors, including their interests in the company's shares. There is however a need for further reform covering both the role of directors and the information they should have to disclose.

At present directors are elected one at a time. This can effectively prevent even quite a sizeable minority of shareholders from ever being able to elect a director. Of course, the argument is that directors should not represent sectional interests among members. This has not prevented the appointment of institutional nominees to the boards of many public companies and there are good grounds for altering the present system of voting. The election of directors by means of cumulative voting was first introduced in the US, but since then its use has spread to a number of countries whose company law is based on English law, notably India, Canada (Ontario) and Ghana. There is therefore no reason to assume that its introduction would be incompatible with English company law. It would certainly be a further safeguard for minority shareholders.

An age limit of 70 years for directors was first mooted in the Cohen Committee report and a measure to this effect was included in the 1948 Act. However, the section contained so many exceptions that the age limit is to all intents and purposes non-existent. The Jenkins Committee tried to simplify the provision, but their recommendation was not included in the 1967 Act. There are good grounds for strengthening the age limit, reducing it to 65 and making it mandatory in the case of public companies and their subsidiaries. With the introduction of the two tier system it will be desirable to reduce it still further to 60 in the case of members of the management board.

Until the 1948 Act the company's members had very little power indeed to remove a director from office. Unless the activities of the director were actually illegal, the shareholders could only wait until he came up for re-election and then try to defeat him. In the case of those directors appointed for life the shareholders were powerless. The 1948 Act gave the members the power to remove directors by special resolution. But this section of the Act which seemingly gives considerable power to shareholders is in fact in many cases obviated by the existence of contracts of service between the directors and the company. It is in many ways a serious restraint on members' power of dismissal that they cannot deprive a director of a claim for compensation or damages if his contract is terminated (*Companies Act 1948*, section 184 (6)). Not even by altering the articles can the company avoid this liability. Although these contracts have to be "made available" to members their existence should be better publicised. In addition the Act should ensure that when the director or directors concerned have been dismissed for acting in breach of their responsibilities then not withstanding the existence of a contract of service, no compensation will be payable.

Because of the special position of directors and the amount of freedom of action that they possess in the running of the company's affairs, it is necessary to clarify the responsibility that a director has in regard to the company, and the duties he owes to it. Whereas only the board of directors as a whole can bind the company, directors stand individually responsible to the company and to the law for certain of their actions. Directors can find themselves in a position where their duties as directors can conflict with their own private interests. To help contain this

possibility, the law on disclosure should be extended so that any material interest a director has in a contract entered into by the company should be made known, whether or not the contract comes before the board.

Apart from directors' present liability for actions contrary to statutory provisions and ultra vires the company, there is a need, as the Jenkins Committee noted, for a general statement in the Companies Act as to the relationship which exists between a director and the company (see para 99 (a)). Above all, directors should, in carrying out their duties always observe the " utmost good faith " towards the company. But this should be further extended (as it has been in a number of Commonwealth countries) to cover the observance by the directors of all the " reasonable diligence and skill " in the performance of his duties, compatible with the undertaking of risk that is inherent in business activities. If a director acted in breach of this requirement then he should be liable to the company. This " fiduciary responsibility " of the director should depend, not as hitherto on the individuals own experience and knowledge (see *Re City Equitable Fire Insurance Co. 1925*), but on the degree of responsibility the particular office entails. This would take into account differences between the executive and non-executive directors. With the introduction of the two tier board there would be important differences in the duties and responsibilities of supervisory and management directors. This is already recognised in embryo form by the law in its distinction in some cases between service and other directors.

The conflict between directors' duties and interests can arise in situations other than over contracts mentioned above, or inside knowledge referred to earlier. One of the areas that is causing concern is the number of interlocking or cross-directorships there are. How often do they lead to common policies, say limiting competition for example, between companies that appear to have no connection? There is a strong case for limiting the number of directorships one person can hold, indeed conscientious service as a director must limit the number of directorships of any one person. Companies' directors' reports should include details of any other directorships held by any of their directors.

A second area of conflict could arise with the introduction of the two-tier boards and the election of worker directors. The directors elected by the workers, while representing the interests of the workers and ensuring them a role in the formulation of general company policy, should share the same general responsibility as the other supervisory directors. By ensuring trade unions' and works councils' statutory right to information the conflict that could arise from workers' directors being unable to reveal certain information should be minimised.

The information that is at present required about directors should be extended. Information on their background should be known so that shareholders, employees and creditors can judge their suitability for the post. Certain questions should be asked: are directors from the founding family? from outside banking and finance circles? from inside management? Particularly in the case of larger companies directors' qualifications should be known. Have they been appointed to the board because of their specialised knowledge of the particular business or industry? because of their general business or commercial experience? Or have they been appointed for prestige reasons, because it is felt that a title or high rank in the armed services will impress outsiders? A connection with any political party or industrial pressure group should also be disclosed. Full details of all emoluments, in cash and kind, should be made known for all directors individually. A further requirement to help shareholders and others to judge how well directors perform their duties would be to have details published in the directors' report showing how many board meetings each director attended out of the possible total.

The insistence on disclosure of the background, qualifications, and other business interests of directors, together with further legislation on their responsibilities and duties towards the company, its employees

as well as its shareholders, will help to ensure that a high standard of conduct is maintained in company boardrooms. Such action should be aimed at laying down a code of conduct for the guidance of directors. That certain strict provisions and penalties are necessary to counter the dubious activities of some directors should not hide from us the fact that the majority of directors are both conscientious and honourable in their actions, and act within the law: if it were not so all business and commerce would have long since ceased.

7. companies and the public

It is not easy to decide to what extent the relations of a company and the general public fall within the scope of a discussion of company law. Traditionally of course such relations have not been dealt with in such a way. But that in itself is no reason why they should not be included now. In a sense of course a company's relations with the public are all embracing—its creditors, investors, employees and customers are after all all members of the public. It is increasingly clear that the examination of the role of the company in relation to its investors and to its employees should now be extended to cover the relationship and responsibility of the company to its customers and the public as a whole. In the case of consumer protection this is a major field of legislative action in its own right, but with the Fair Trading Act 1973 linking consumer protection with monopolies legislation, some aspects of consumer protection have been brought within the ambit of companies' legislation. If creditors are largely protected by the existing law, and if consumers are benefiting from an increase in protection, the public as a whole has little protection from the environmental consequences of industrial activity.

the consumer

To a certain extent the "countervailing power" exercised by the trade unions is able to protect their members from actions of the large companies. The same is not true of the consumer. The consumers are often both ill-informed as regards their rights and unable to enforce them. By themselves they are powerless to act. What little legislation there has been in this field has often been inadequate to reinforce the consumer's position. The Fair Trading Act is no exception to this. Following the precipitate abandoning of the Consumer Council the government underwent one of its major reversals of policy and announced in August 1972 the appointment of a minister with responsibility for consumer affairs at the DTI. As if to reinforce their penitence, a senior minister was later appointed as Minister for Trade and Consumer Affairs. Four other ministers in departments whose work impinges on consumer affairs have been appointed to liaise with him on consumer policy.

The Fair Trading Act brings together consumer protection and companies legislation in the shape of further measures to deal with monopoly power. The Act establishes an office of Fair Trading headed by a director-general who will it is claimed protect consumers from unfair business practices, including restraints on competition. The director general has certain legal powers as well as the power of publicity. The office is intended to be independent of the government and will keep under review the extent and smooth running of competition in the economy. In addition, it will review consumer trade practices which could adversely affect consumer interests. Consumer trade practices have been defined by the Act as those practices involved in the supply of goods or services, by sale or otherwise; the terms and conditions of sale; how the information regarding terms and conditions is notified to the purchaser; the promotion of goods and services by means of advertising, labelling and marketing; and finally, the method of demanding and securing payment for the goods. The office will be advised on these practices by a Consumer Protection Advisory Committee comprising between six and fifteen members, full or part time appointed by the government. This committee will investigate the particular trade practice referred to it by either the director general or the minister.

This Act certainly represents quite a step forward—particularly in the light of the government's past attitude to consumer protection. However, quite a lot remains to be done if consumer protection is to become a reality. The Consumers' Association and the other groups active in this field are essentially middle class in both membership and outlook. Some sort of grass roots organisation is necessary if all shoppers—working class as well as middle class—are going to be fully protected. At present many consumers are confused by the various laws and just do not know what their rights are, or how they can enforce them. There are two ways in

which this problem can be tackled: a re-inforcement of the legal provisions and of the means of enforcing them; and a system of independent "watchdog" bodies for each particular industry.

That the minister responsible for consumer affairs should be of cabinet rank few people would now query. There are, however, considerable differences of opinion as to whether he should head a separate ministry of Consumer Affairs or remain within the DTI. The consumers' lobby argues that as the DTI usually has the well-being of business as one of its major preoccupations it will be unwilling to devote much time or attention to consumer affairs. This overlooks the fact that the long term interests of business are very much tied up with consumer satisfaction—an important function of a minister responsible for consumers must surely be to encourage industry to realise this. Of course in a sense the question of an independent or DTI based minister is something of a red herring. No minister of consumer affairs whether or not he has a separate department of his own will be able to do much until some way is found of informing people of their rights and making sure they can exercise them. This has been demonstrated recently following the coming into effect of the *Supply of Goods (Implied Terms) Act* 1973. For the consumer who has purchased faulty merchandise remedy now exists under this Act. The consumer now has the legal right to demand money back on defective goods from the shop where they were bought. Firms' so-called " guarantees " which take away more rights than they give are now invalid. Yet few consumers are aware of their rights. Indeed, it appears that " traders are either denying that the Act exists or disputing customer's claims to have defects put right " (*Sunday Times*, 26 August 1973). This highlights the need for a grass roots organisation able to inform consumers of their rights. Of considerable interest here has been the introduction of local consumer advisory shops by the Consumers' Association in conjunction with local authorities. The first one was opened in Camden and has now been taken over by the local authority. Others followed in Greenwich and Havering. At present some 40 or so local authorities are said to be interested in the scheme. This sort of direct information point in shopping areas could go a long way towards informing people of their rights. Neither are the civil courts usually adequate to deal with consumers' complaints. It is widely believed, whether true or not, that many county courts, being so preoccupied with running what is virtually a debt collecting agency for big firms, are not sympathetic to consumers. Besides, legal action is often expensive and legal aid is very rarely forthcoming for such actions This of course is yet another argument in favour of the introduction of small claims courts.

The office of Fair Trading will only have an annual budget of £600,000. It is doubtful whether this is an adequate sum for the financing of the organisation that is supposed to bear most of the burden for consumer protection. Indeed it is doubtful whether the whole burden should fall on such a body. Although its powers were limited, the Consumer Council was at least independent and there is a strong case for independent action in this field. There is in fact a good case for setting up independent " consumer advisory committees " to cover individual industries. At first, they could be based on the nationalised industries consumer consultative committees, particularly on the one covering the Post Office which has been the most successful. In fact a major reform of these committees is under way. They will have paid chairmen and the power to employ expert assistance, for example independent consultants. They will have the power to examine pricing policies and the services provided for the consumer. They will have the right to publish separate reports individually and at a time of their own choosing. The nationalised industries " are expected to discuss the broad outlines of any major changes in policy with the bodies representating consumers before taking final decisions." This should be the aim of the consumer advisory committees set up to monitor the various sectors of private industry. These committees should have the power to examine products and to

make recommendations and comments accordingly. An important weapon in their struggle with recalcitrant manufacturers or suppliers would be publicity. In considering the products of the particular industry being monitored one would expect the consumer advisory committees to consider such aspects as the price, performance, quality, usefulness and safety of the articles concerned. The committees should be financed by a compulsory levy on the firms concerned. With advertising revenue running at over £700 million a year (*Advertising Quarterly*: Summer 1973) firms can afford to pay something towards the cost of consumer protection.

A strong consumer policy, based on tougher laws and law enforcement on the one hand, and individual, independent, consumer committees for each sector of industry on the other, would go a long way towards making consumer protection something more than the pious aspiration.

a social audit

Indices of performance such as the volume of sales, profits, or capital employed do not by any means provide a full assessment of a firm's activities during a given period. We are rapidly approaching the time when it will become necessary to measure the full social, and not just financial, costs of production. In the concept of the " social audit " there are four possible main performance indices: economic and financial performance; ecological activities; scientific and technological activities; and social role. The amount of research carried on, whether it is pure or applied; the ends to which it is directed: these are the type of questions that need to be directed towards firms' scientific activities. As for firms' effect on ecology, the third report published by the Royal Commission on Environmental Pollution shows just how irresponsible many companies are in their attitude to the environment. Quite a number of firms seem to regard river estuaries for example as a " convenient and cheap sink for industrial waste." Some firms even move to estuary areas to escape the controls that exist upstream on trade effluent. One remedy that has been put forward by Lord Zuckerman and Professor Beckerman in their minority report is to charge firms for the pollution they cause by means of a tax on their harmful effluent. Another member of the committee has called for an " environmental audit " to determine the pollution effects of companies' activities.

A social audit would obviously need to examine firms' attitudes to their workers and to their customers. The safety and health of the employees, progress to equal pay, job opportunity for minority groups, job enrichment and education and training are the areas one would expect to see included with regard to a firm's employees. The need for a greater awareness of social needs has been recognised by a number of progressive managements. The chairman of Exxon (Standard Oil) has outlined a hypothetical eight point consumer " Bill of Rights " for people dealing with his company. The company's customers would have the right: " first, to be accurately informed of those characteristics of the company's products necessary for making prudent buying decisions; second, to be assured products will consistently meet quality and performance standards; third, to be assured the products meet public environment standards; fourth, to receive warning of potential safety or environmental hazards connected with their uses; fifth, to receive honest measure without subterfuge in packaging or pricing; sixth, to be assured that services were effective, prompt, genuine and courteously delivered; seventh, to receive prompt courteous response to suggestions, requests for information and complaints; and eighth, to receive prompt accurate understandable accounts." The adoption of similar codes of conduct throughout industry and commerce could play a useful role in bringing home to firms their responsibilities.

The development of social accounting and the concept of the social audit as supplements to financial accounting and auditing will help to reconcile the protection of the community and the furtherance of industrial activity. Their existence would help to bring public pressure to bear on offending companies.

8. disclosure

The principal safeguard which has been provided against the misuse of incorporation has been the insistence on a certain degree of disclosure of information. Since 1862 when some degree of disclosure was first insisted upon, successive Companies Acts have gradually extended the amount of information which companies must make available to their members, to their creditors and to the general public. The 1908 Act required companies to publish balance sheets; this was extended in 1929 to include a profit and loss account. It was not until 1948 that any detailed guide as to the contents and form of the accounts was provided in the Companies Act (schedule 8). Since 1967 companies have had to reveal their turnover, and the accounts requirements have been revised (schedule 2). All companies have to submit certain information to the Registrar of Companies. Companies House contains details of the memorandum and articles of association of companies, details of directors and the address of the company's registered office. To help keep this information up to date, an annual return has to be made to the registrar. The return includes copies of the company's profit and loss account, balance sheet, directors' and auditors' reports. Companies have to keep certain records themselves, including the register of shareholders, details of directors share dealings and of course books of account. As a further safeguard the annual accounts of companies have to be professionally audited.

The annual accounts and directors' report are the most important source of information on the affairs of a company. This is particularly so in the case of quoted public companies with regard to which most of this section is primarily concerned. Some companies have improved the standard of their annual report and accounts considerably, but on the whole the annual reports have progressed little. Too often the annual accounts are regarded as an exercise in public relations, stressing the progress made by the company and glossing over the areas of weakness in the firm's performance. In many of these reports there is all too often an abundance of glossy illustrations and sanctimonious platitudes from the chairman, and a scarcity of all but statutory information.

The annual report is the most important means of communication between the company and the public and should be regarded as a source of information and not merely an exercise in public relations. It should be capable of being easily assimilated and should explain and justify the company's policy. How does the company concern itself with consumers' interests? What is the effect of the firm's activities on the environment, and how is it attempting to help prevent pollution? How does the company see itself in relation to the needs and aspirations of society as a whole? These are some of the points which need to be included in the annual report, alongside the financial data and the chairman's speech.

company accounts

The Jenkins Committee reported that it could see no need for far-reaching changes in either the content or the composition of company accounts, a view that is accepted in the government's recent white paper. This is true only in so far as we consider the responsibility of a company is limited to its members and creditors. If we accept that the company owes a responsibility to its employees and indeed that a wider public interest needs to be considered, then it is soon apparent that both the format and content of company accounts leave quite a lot to be desired. The accounts should provide the necessary information for shareholders, creditors and employees. In addition there is a strong case for ensuring that the financial data they contain will be of use in national economic planning. Company accounts are useful only in so far as they can satisfy these criteria.

It is of course not only the companies legislation which determines the nature of accounts: the Stock Exchange has its requirements too. To acquire and retain a quotation companies have to provide certain information which the law does not yet require, including six monthly accounts instead of annual accounts

required by law. In fact in this and a number of other points, the Companies Act should follow suit and make this information compulsory. Apart from the Stock Exchange, there is also the influence of the financial press. The UK framework is unique in that the amount of information required by law is still fairly small in comparison with the amount required by independent institutions such as the Stock Exchange. Nevertheless, British companies have to meet a far higher and harder standard of disclosure than is the case in Europe. Only in Holland are the requirements comparable to the UK standard. With the UK now a member of the EEC, and with moves underway to harmonise European company law, this gives rise to considerable anxiety. The directive on this subject from the EEC Commission is intended to impose certain minimum requirements on disclosure for all members states. Not only are these standards far lower than those in the UK, but they contain certain principles which are in conflict with British accounting practices. In the UK auditing procedure has reached a very high standard indeed: the same unfortunately cannot be said of many of the EEC countries. In Germany the audit is mainly aimed at compliance with the requirements of the law and the company's statute, the concept of a " true and fair " picture of the company's results is unknown. In France despite recent advances auditing remains backward, although not as backward as in Belgium. As for Italy, auditing as it is known in the UK is non-existent.

The disclosure of the profit figure originally had a two-fold purpose. It was intended to help protect creditors from directors inclined to distribute capital as dividends. It was also intended as useful information for shareholders that would enable them to form an opinion of the way in which directors were running the business. In theory profit or loss is simply the difference between the firm's net assets at the beginning and at the end of an accounting period. (*Lee v. Neuchatel Asphalte Co*). In practice it is really the firm's earnings during the period, less the expenses incurred in earning them. Neither statute nor case-law has fully determined the nature of profits and the difference between revenue profits, which are distributable to the shareholders, and capital ones, which should not be. A recent draft issued by the Institute of Chartered Accountants has recommended that the profit and loss account should include " non-operating " or non-current items which should be described as " extraordinary items " in the accounts. This is surely not compatible with the view of the profit and loss account as showing the results of current trading or operations. If extraordinary items, sometimes of a semi-capital nature, are included then it will no longer be normally possible to calculate the trading or operating results of the company from the published accounts. The answer would seem to be that profits of a purely capital nature, for example on the revaluation of property or long term investments, should not be distributed but retained in the reserves. This would appear to be the position in Scottish law (see *Westburn Sugar Refineries Ltd v.* IRC (1960)) but not in English law (see *Dimbula Valley (Ceylon) Tea Co Ltd v. Laurie* (1961)). In the case of extraordinary items that could justifiably be regarded of a revenue and not of a capital nature they should be shown on a separate account to the main profit and loss account. It is argued that the whole of a company's transactions for the period should be shown in a single clear statement and not fragmented into separate sections. However, as the appropriation of profit is usually shown separately, although the law regards it as part of the profit and loss account, there seems no valid reason why extraordinary items cannot be shown separately too. It is often all important to be able to easily determine the true trading profit.

Since 1967 companies have had to disclose their turnover, if more than £50,000. In the case of large companies this requirement should be extended to include the cost of raw materials and supplies and the gross profit. This would be an important aid to industrial efficiency, revealing as it would the cost structure of companies. In this respect the disclosure of gross profit, as well as trading profit, would be of considerable importance. If these

requirements were limited to companies with a turnover of £10 million and over they would affect about 900 companies. It should be noted that such information is already provided by some European companies (for example, Hoechst, Bayer, AEG Telefunken).

valuation of assets

The true valuation of the assets of a business as a going concern depend partly on the trend of profits. But to be of use the profits must be related to the true economic value of the company's resources. To say that the balance sheet of a company presents a " true and fair " picture is now correct only in terms of traditional and outdated accountancy practices. The use of historical cost as a basis for the valuation of assets on the balance sheet is misleading, particularly in a period of inflation. The situation is not helped by the legal position regarding the depreciation of fixed assets—plant and machinery for example. Not only does the law fail to make depreciation compulsory, when depreciation is provided for the paucity of information makes it impossible to judge its adequacy. It should be one of the aims of the reform of company law to try to ensure that the balance sheet shows the complete economic situation of the company. Any figure of profit is of little value unless the assets are realistically valued. This is gaining increasing recognition, typical of the changing attitudes of a number of managements is this extract from the 1972 Chairman's report from Pilkingtons: "We pay wages at current rates, we purchase materials at current prices, and the other main elements in costs—wear and tear or depreciation on plant and buildings—must also be allowed for at current costs." The Accounting Standards Steering Committee is at present thinking in terms of quoted public companies including in their annual reports a supplementary set of accounts adjusted by reference to the consumer price index.

It should be mandatory for companies to charge annually against profits an amount designed not only to cover normal depreciation, that is to write off the book value of fixed assets over their expected useful lives, but also to set aside to reserves a contribution to the increased cost of replacing fixed assets (including the expense of premature obsolescence). The effect of inflation is already receiving attention from the accountancy profession. One would hope therefore that these calculations could be made each year by using appropriate indices of replacement costs. The development of a standard system of approximate price level adjustments as objective as existing accountancy practices should not be impossible. A major drawback of the present system is that depreciation cannot be charged for tax purposes on replacement costs. Should it become normal accounting practice to charge depreciation on replacement costs then the tax rules should be altered accordingly. The written down value of fixed assets sold or scrapped, less proceeds, should be taken to reserves and not to the profit and loss account. The true value of a company's net assets is essential if the profit: capital employed ratio is to have any meaning. The way in which a company's assets are being used, and their efficiency, is of great significance to the nation's economy as a whole and not just to investors and their advisors.

While most of the fixed assets on a company's balance sheet are subject to depreciation, there is one which has experienced and continues to experience quite considerable appreciation—land and property. It is thought that under " inflation accounting " the adjusted profits of property companies could rise three or four times (*Financial Times*, 26 July 1973). The treatment of land and property in the accounts of many companies leaves a lot to be desired at the moment and offers far too much scope for unscrupulous boards to engage in financial manoeuvres of doubtful morality. Until such time as land and property values are brought under control provision should exist in company law to enforce a professional revaluation of land and property every three or four years. The surplus on revaluation should be considered a capital profit and not distributable.

A company's balance sheet is not an account: it is a statement of the firm's assets and liabilities at a particular point of time. At present the balance sheet is an historical document which does not purport to show the real net worth of the business. The reforms outlined above regarding depreciation and the valuation of fixed assets on a replacement cost basis should change this and help to make the balance sheet useful to employees and economists as well as to shareholders and creditors. In its traditional two column style it is very confusing for the layman. Increasingly, companies are introducing a new form for the balance sheet: single column statements. But the multiplicity of layouts and different phraseology has done little to simplify matters. Just as the Companies Act lays down a model set of articles of association (table A) which have done much to influence the form and contents of articles, so a model balance sheet should be given. This should be in the form of a single column statement, and should show clearly how the firm's net assets (working capital, long-term investments and fixed assets) have been financed (by issued share capital, loans etcetera). As is usual in most accounts today, this balance sheet should be presented in a comparatively simple form and should then be expanded by a series of notes forming part of the accounts.

In addition to the profit and loss account and the balance sheet companies should be required to include in the accounts a fund flow statement (some companies already do so). The balance sheet shows the state of affairs on one day only ; the profit and loss account the profit in a given accounting period: the fund flow shows the flow of resources, and is a further aid to forming a picture of the firm's performance. Presented in columnar form it shows the sources of funds (from opening bank balances, profits, depreciation, loan capital and investment grants received etcetera) and how these funds have been used (on capital equipment, taxation, repayment of loans, dividends, closing bank balances etcetera). A positive balance would represent an increase in working capital: a negative balance a reduction.

As well as the explanatory notes to the accounts, companies should include a general statement of their accounting policies (a number already do so). This statement should include brief details of the accounting policy affecting items material in determining the company's (or group's) profit and in stating the company's (or group's) financial position. One would expect such a statement to include explanations regarding the company's depreciation and valuation of assets policy, details of the company's tax equalisation account, the treatment of profits or losses arising on the disposal of fixed assets or investments, details on how goodwill, patents and trade marks are treated in the accounts. Details of accountancy practices in regard to the treatment of newly acquired companies and the consolidation of the accounts of holding and subsidiary companies and the treatment of associated companies should also be included. All too often when alternative accounting methods exist companies select the one which helps present their case in the most favourable light.

consolidated accounts

The present system of accounting for mergers and takeovers has been described as offering "enormous scope for manufacturing profits." There can be little doubt that as a part of a comprehensive policy towards takeovers the accountancy procedures need drastic revision. The law should insist that on the acquisition of one company by another all the assets of both companies should be revalued. Any consequent capital profit, along with any pre-acquisition profits of the company taken over, should go to reserves. The cost of acquiring control, euphemistically described in the balance sheet of the holding company as "goodwill," should be written off against the reserves over a period not exceeding five years.

There are often good economic and commercial reasons for running a busi-

ness in the form of a holding company with a number of separate subsidiaries: it can for example help to avoid too much centralisation. On the other hand it may just develop out of a firm's acquisition of other companies. It may find it better for a number of reasons to keep the structure of the company taken over, particularly if it is well known. But undoubtedly the system can be abused and since 1948 the law has attempted to limit the possibility of abuse to a minimum.

At present the law is still inclined to recognise "corporate entity" rather than enterprise or group entity. One effect of this is that the liabilities of a subsidiary cannot be extended to the group as a whole. Thus the creditors of a subsidiary usually have no remedy against the group, if the subsidiary becomes insolvent—despite the fact that the group as a whole may be completely solvent. This is another example of where the effect of the celebrated decision in the Salomon case needs to be reversed by statutory provisions. The law should ensure that the liabilities of a subsidiary can become the liabilities of the group as a whole.

The 8th Schedule to the 1948 Act (para 17-22) tried to ensure that a fair picture was presented of the group's activities by insisting on consolidated accounts by bringing together the profit and loss accounts and balance sheets of the companies in the group. It is now recognised that this does not go far enough and that apart from the results of companies under the control or ownership of a holding company there is another type of business relationship which needs to be taken into account. Group accounts should make provision for associated companies in which the group hold a substantial, but not a controlling, interest in the equity voting rights and in which the group is in a position, through representation on the board, or otherwise, to exercise a significant influence an commercial and financial decisions. The Slater, Walker Group for instance has interests of 10 per cent and over in 45 UK quoted public companies.

It is not at all sure that the break-up of turnover and profits in the group's annual accounts are adequate. In a single company there are few problems involved in determining the true profits. The trading profit less interest payable gives the true operating profit. But when this is done for a holding company it hides the true figures for the subsidiaries as only the trading profit is given in the breakdown of turnover and profit. Clearly it can hide persistent loss makers if no charge is made against each activity of an appropriate share of the central costs and interest payable for the resources without which they could not operate. Holding companies should be required to allocate a reasonable approximate proportion of central costs and net interest payable to each subsidiary, proportional to its turnover.

Greater detail needs to be given on the activities of subsidiary companies, including tables of the individual results of subsidiaries over a certain threshold, perhaps a turnover of £1 million, and figures regarding the total inter-company trading within the group. The list of subsidiary and associated companies given in the annual report is often confusing and does not present clearly enough the actual structure of the group, especially when there are intermediary holding companies themselves subsidiaries of an ultimate holding company. Apart from the list, the annual report should include a group structure or organisation chart showing clearly the principal subsidiaries and associated companies and the relationship in which they stand to one another.

policing disclosure

It is of course rather pointless in insisting on greater disclosure if the machinery to enforce it is inadequate. Attention has been drawn to the laxity of some companies in carrying out their duties on disclosure by the Labour Member of Parliament Arthur Lewis, although he failed in his attempt to have a select committee set up to examine this "growing practice." There is little doubt that

the companies section of the DTI has become almost overwhelmed by the complexity of the system involving as it does over 600,000 companies—a total increasing year by year. There should be an examination of DTI procedures by a select committee. In particular, with an investigating department of only 15 staff the department would appear to be ludicrously undermanned. Not only has the system been lax, but the penalties provided for in the Act are ridiculously inadequate too. For failing to make an annual return the Act provides for a fine of £5 a day: one London court used to fine companies £1 a day—this for failure to comply with the requirements on disclosure on which so much rests in company law. The installation of a computer by the DTI should lead to a speedier identification of defaulting companies (in the past up to 250,000 companies have been in default at any one time). Every company registered in England and Wales will be listed in the computer data bank: by the end of 1973 it should be impossible for companies to avoid filing their annual return. Although the computer should speed things up and should help to prevent errors and loopholes in the system, action is needed to increase the penalties for non-compliance. At the end of the forty two day period of grace following the annual general meeting companies should be fined £100 a day for non-compliance. After the elapse of a three month period companies still defaulting should be automatically wound up. The directors concerned should be prevented from holding office again as directors of any company without DTI permission. A list of offending companies and directors should be published.

Only in the US is more information required to be disclosed by companies than in the UK. There, disclosure is controlled by a statutory body—the SEC. Too much is left in the UK to the regulations of the Stock Exchange and to the haphazard investigation of the press. The companies section of the DTI needs to be strengthened so that it can become more effective and more extensive in its coverage of company disclosure. Reports and accounts which do not reach a certain standard in both form and content should be rejected. Full publicity should be given to those companies that infringe any of the requirements on disclosure.

9. conclusion

For over a century company law has principally been concerned with a company's responsibilities to its shareholders and to its creditors. Not only does the most valuable asset of companies not appear on their balance sheet, but company law has hitherto ignored its very existence. In the eyes of successive Companies Acts, the workforce does not appear to exist. Companies legislation has consistently ignored the rights of a company's employees to be informed—let alone consulted—about matters that can affect their very livelihoods. Workers often have a much greater claim to a special relationship with the company they work for than its shareholders who simply own a financial share which is bought and sold with regard to private profit rather than the interests of the company. Unrest in industry over the past decade has been symptomatic of the increasing tension between labour and capital. Instead of getting at the root cause which is the workers, lack of an effective voice in companies' decision making, the Tory government's answer has been legislation on industrial relations which to the Labour movement appears to be oppressive in overall intent and repressive in individual application. Such action only worsens the situation, offering as is does hostages to extremists on both sides of industry.

The government's intention to introduce a new Companies Bill in November 1973 together with the debate which will commence over the harmonisation of British and EEC company law, offers the opportunity for the Labour movement as a whole to discuss what legislative framework it would like to see companies operate within. There are five main factors which future companies legislation should take into account.

First, future legislation should distinguish between the medium and large sized companies on the one hand and the small private companies on the other. The former group needs to be subjected to far greater control and supervision in their general affairs.

Second, the question of monopoly power should be tackled by far more stringent controls on mergers and takeovers, and by the replacement of the statutory monopoly situation definition by an all out attack on the abuse of a dominant market position.

Third, large and medium sized companies should be required to make public far greater information than is disclosed at present on their affairs. This is especially so in the case of large groups where the law should insist on greater information on the various subsidiaries within the group. Vigilance and care is needed to ensure that the harmonisation of European company law does not lead to a watering down of British requirements on disclosure. International companies operating in the UK should be required to file full world-wide group activities with the Registrar, not just the disclosure of UK operations.

Fourth, there has to be a greater degree of supervision on both disclosure and on securities exchange. It is to be hoped that the companies section of the DTI could be so strengthened as to extend its role on the policing of disclosure. In the case of insider dealing in particular and securities exchange in general, a statutory commission should be set up to oversee financial transactions and to safeguard the rights of investors and protect the public.

Fifth, the most important factor future companies legislation should take into account is that the present internal structure of companies is now outdated. A new method of administration is required: future legislation should ensure that the company's employees are represented, and can take an active part, in decision-making at all levels.

The majority of the country's workforce is employed by companies: the bulk of industrial output is produced by these companies. A major reform of company law could have therefore a profound effect both on the content and the method of industrial activity in the UK. The introduction of worker participation and the setting up of a workers' capital fund call into question the future role of the share-

holder, and the present capital structure of companies. The diminishing role of the private shareholder has led to an increase of loan capital in companies. Not only that, but the growth of intermediation in share ownership means that the large shareholdings of the financial institutions are often de facto loans as the institutions are frequently reluctant to sell them on the Stock Exchange because the off-loading of such large holdings could cause the price to drop to an unacceptably low level. The idea of a fixed limit on the rate of dividends is not new, but it has an important bearing on the matters under discussion. The transformation of shareholders in public companies into fixed interest creditors may well be the logical outcome both of the changing capital structure of companies and of the recognition that a company's employees have a right to participate in their firm's affairs. That industry needs increased investment is generally accepted, what is not accepted is how best it can be achieved. The trade unions regard with suspicion the self-financing by many firms of their investment programmes, this is hardly surprising when retained profits accrue to the shareholders. Workers are justified in their suspicions that they are in such cases helping to finance an increase in shareholders' wealth. The limitation of the return paid to shareholders to a certain percentage of shareholders' equity and a participation by workers in the capital and profits of companies would go a long way towards alleviating this situation.

Among the several advantages of a workers' capital fund the principal ones would be its role in helping to reduce the tremendous inequality of wealth that still exists in the UK, and its long term effect on investment. One can foresee that after perhaps 25 or 30 years it could become a major force in investment. Such a fund investing in those industries and companies where the social as well as economic potential was the greatest could help to ensure that investment was canalised to the areas of greatest need. Hopefully such a fund could weaken considerably the strangle-hold at present exercised by the City on investment decisions. The City, and indeed an increasing section of industry as well, shows an unhealthy attitude to investment. Real investment, in terms of the creation of new assets, new technologies, new job opportunities and the revitalisation of the regions, does not interest them at all. Instead the City is becoming increasingly engaged in a frenzied orgy of mergers and takeovers of dubious economic and social value. Too many of these takeovers involve a quick financial profit at the expense of the public interest. External acquisition rather than internal expansion is the motto of City investors, and the result is the growth of conglomerate empires lacking in industrial logic.

While the workers' capital fund will give employees as a whole a stake in industry's capital which will increase in importance and influence it does nothing to bring workers into the formative stages of policy making decisions in individual firms. As has been seen, the role of the private shareholder both as a holder of shares already in existence and as a provider of new funds has diminished substantially over the past decade—a trend that is likely to continue. This has led to something of a vacuum in the administrative structure of companies where it is now little more than a legal fantasy to say that the ordinary shareholders in general meeting are the supreme authority within the company. Neither is it desirable that the institutional shareholders should be permitted to exercise a growing influence, hitherto unchecked, over so much of British industry and commerce. Furthermore, there has been the shift of the centre of power within the company one stage further; from the full board to the managing director and the executive committee. This brings into question the whole internal structure of the company. Indeed with the tremendous growth in size, complexity and concentration of industrial activity over the past few years the corporate structure has outgrown the pattern decreed for it by successive Companies Acts. The growing concentration of industry (half our exports are now in the hands of 79 companies for instance) has been accompaigned by the monopolisation of economic power in these companies by a management accountable only to itself.

This continuing change in the nature of companies makes even more desirable the introduction of industrial democracy. A well informed and organised trade union movement could ensure that the workers' voice will be heard in company boardrooms far more effectively than was ever that of the shareholders, who through their lack of unity and organisation have been unable to exercise their apparent power. The introduction of a two tier board system is unlikely to cause much upset in company administration. In the larger companies at least there already exists a de facto two tier system with the presence of executive and non-executive directors. The new system would recognise and give formal expression to what already exists in many companies.

Workers' right to participate in management can be justified on two main grounds. First, it is surely incompatible with social democracy that workers should be effectively prevented from exercising a positive role in their everyday working lives. Second, there can be little doubt that there will be economic benefits in the long run stemming from the introduction of workers' representatives into the decision making process at all levels in companies. There still exists in industry sufficient mutual desire to solve problems through consultation rather than through confrontation. British membership of the EEC has now brought worker participation to the forefront of any discussion on company law reform. Paradoxically, the City and some sections of the trade union movement have seemed in the past to be united in their suspicion of worker participation in management, though of course for very different reasons. Of course the present proposals of the EEC Commission do not go far enough, and the European free trade unions are attempting to persuade the Commission to extend them. The influence of the British trade union movement could be vital here. The TUC's interim report on industrial democracy is thus very important, particularly in its insistence on parity between workers' and shareholders' representatives. Without parity worker directors will simply be in the position of a powerless minority.

All too often City investment pundits forget the fundamental objectives of economic activity, and the present company law encourages them in this. Profit can be a test of efficiency, it can help to determine the most effective economic use of capital ; but it cannot of itself be considered a justification or reason for economic activity. Industry and commerce exist to satisfy, not create, the public's demand for goods and services ; and to provide, not reduce, employment for the country's workforce. It is against these two criteria, as well as the test of financial profitability, that a company's performance should be judged. It is all too easy for companies not only to ignore their duties to their employees but to overlook their responsibility to the community as a whole. Any future legislation on companies and their affairs should have as its underlying objective nothing less than making companies socially responsible organisations.

young fabian group

The Young Fabian Group exists to give socialists not over 30 years of age an opportunity to carry out research, discussion and propaganda. It aims to help its members publish the results of their research, and so make a more effective contribution to the work of the Labour movement. It therefore welcomes all those who have a thoughtful and radical approach to political matters.

The group is autonomous, electing its own committee. It co-operates closely with the Fabian Society which gives financial and clerical help. But the group is responsible for its own policy and activity, subject to the constitutional rule that it can have no declared political policy beyond that implied by its commitment to democratic socialism.

The group publishes pamphlets written by its members, arranges fortnightly meetings in London, and holds day and weekend schools.

Enquiries about membership should be sent to the Secretary, Young Fabian Group, 11 Dartmouth Street, London, SW1H 9BN; telephone 01-930 3077.

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Cover design by Dick Leadbetter. Printed by Civic Press Limited (TU), Civic Street, Glasgow G4 9RH.

ISBN 7163 2037 1

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