CHAPTER VIII

FINDINGS
After going through the long and circuitous path of the detailed study and analysis of the financial results of 75 companies of different sizes and industrial groups, we take a comprehensive view of the whole survey and present the observations made during the course of our investigation. The main objective of this enquiry has been to examine the trends obtaining from the appropriation of corporate profits in India. For this purpose we have attempted to ascertain the level of current earnings, the pattern of dividend and cost and the uses of ploughed back profits of the corporate units covered by this study. Our investigation reveals the following facts about the management of corporate earnings in India.

CONCEPT OF EARNINGS

The concept of earnings has been very controversial. It is called a mixed and vexed income. It represents the 'flow of benefits' derived from a variety of sources acquired by capital stock. Earnings thus reflect the net accretion to economic power through a period of time. The ascertainment of earnings involves computation and comparison of values of capital at the beginning and the end of an accounting period. It is an accounting concept matching revenue with cost. This meaning of the term is rarely observed in actual practice because of the impossibility of accurate calculation and the time gap between the incurring of
cost and the realisation of revenue. Though three types of costs namely actual cost, current cost and replacement cost have come into vogue, yet the accounts are maintained at actual costs, popularly known as historical costs. Frequent changes in the purchasing power of currencies, after world war II, have made the historical costs unrealistic. Leading corporations in countries like the USA, adopt current price accounting and thereby inflate or deflate their financial facts for the actual assessment of periodical earnings.

The profit position of a corporation is different from that of a sole trader and a partnership. The determination as well as the distribution of corporate earnings is governed by provisions of corporate laws, which are often influenced by many political and social considerations. The Companies Act 1956 does not provide any definition of earnings. Ascertained profits differ for different purposes. Corporate tax is levied on earnings attributable to shareholders. Interest on debentures and borrowings is allowed as business expenditure. The Act puts restraints on the distribution of dividend out of capital. Earnings from shareholders' point of view are computed on the basis of cash flow concept and mean dividend received plus the appreciation in the market or in the intrinsic value of the shares.

After world war II, the downfall of capitalism giving way to socialisation of the means of production has brought about a great change in the attitude towards profits, particularly in the developing and under-developed countries. The advent of joint
stock companies and mechanization have led to the diffusion of capital owners from management of companies and concentration of huge financial assets in the hands of salaried personnel. The objective of maximisation of money profits is being replaced by the fulfillment of social obligations by lowering costs. Modern management, being conscious of social responsibilities, diverts funds to prestige projects of social needs and Government too takes a major portion of corporate earnings though taxation. Increase in costs and price stabilising measures lower down the margin of earnings. Thus the concept of earnings has changed both in developing and developed countries.

The ever-expanding corporate sector has brought radical changes in the structure of capital market. Individual savings have been replaced by institutional financing. Despite the continuous growth of public enterprises and direct State Regulation of economic life of the masses, the private sector continues to assume sea-power ranking only second to the State. Private sector has to shoulder the main responsibilities of industrial advancement. Modern corporations collect huge funds through the issue of shares and debentures and plough back their own earnings. Thus the task of mobilisation of financial resources has been greatly facilitated by well organised and diversified corporate sector. The procurement of adequate capital has given rise to the problem of management of earnings. On the one hand, corporate units are expected to pay steady dividends to satisfy their shareholders and on the other they have to appropriate their profits for smooth and successful working in future. Thus
the efficient management of earnings has become the sine qua non for the success of the modern business and is the crux of the problem of corporation finance. Management can influence the rate and quantum of earnings through their decisions and implementation regarding cost and volume relationship, trading on equity and many accounting and managerial practices affecting the day-to-day operations. Appropriation of earnings into payouts and plough back is carried out at the discretion of the Board of Directors.

DETERMINATES OF CORPORATE EARNINGS

1. **Cost Volume Relationship**

   The optimum relationship between cost volume and profit is the precondition for maximisation of the profits. A given amount of earnings has to be generated for a given rate of return on capital. Profit becomes maximum at a point where the per unit impact of indirect expenses is the minimum. However, the continuous increase in the cost of production during the period under observation kept the profit low. Even the indirect expenses of semi-variable nature recorded steep rise, claiming a disproportionate share in the gross profit. Operating expenses gross profit ratio rose from 28% to 43.7% in small companies, 32.8% to 56% in medium companies, 27% to 56.5% in large companies, and 30% to 54% in all the companies.

   Disproportionately increasing cost resulted into low profitability of small companies and those belonging to
traditional industries. It is suggested that the fixed overheads attributable to under-utilisation of capacities caused by Government regulation, strikes and lock-outs should be accounted for separately as abnormal losses. The wages and managerial remuneration should be linked with productivity. Government trade union and industrialists should resolve their differences in this regard amicably.

2. Trading on Equity

Second to the cost volume profit relationship trading on equity plays a very important role in the determination and distribution of earnings. Management of companies enjoying progressively upward trends in the earnings finds the trading on equity an effective measure of doing away with the adverse effects of corporation tax and keep the cost of capital low. For this purpose debt financing has to be kept within reasonable limits, suited to liquidity, interest coverage and redemption liability. Ordinarily, the debt equity ratio of 1:2 is considered as an ideal one. In all types of companies under study, the degree of dependence on debt financing has been increasing continuously. From 1988 onward, small companies appear to have crossed the working limit, large companies and medium companies kept their borrowings much below this limit. Of the three industries none of the industries borrowed in excess of their equity which followed the principles of sound financing. Our study reveals the debt financing resulted in saving in the corporation tax to the extent of
the divisable profits/net worth ratio ranging from 10% to 20%. Downward trends in the increase in the rate of earnings on net worth shows that the Government has also benefited because of debt financing resorted to by the private sector, as the corporation tax revenue would be raised at a higher level. The Government of India is now alive to the problem of disproportionate indebtedness and have framed out the guidelines for the conversion of institutional loans into equity, in the recent past, specially after the Industrial Licensing Enquiry Committee Report, Liberal borrowings extended by commercial banks have also been brought under check after the nationalisation of commercial banks in 1969.

3. **Accounting and Managerial Techniques**

The accounting techniques and managerial practices which aim at earnings smoothings, like inter period shifting of income and expenses, deferring the revenue charges as capital expenditure, affecting the method of valuation of stock, creation of reserves and the like, can change corporate earnings on all levels at the discretion of management. The tax and corporate laws provide an effective check on managerial decisions coming in the way of true and fair disclosure of financial conditions of the corporations. It is difficult to locate the impact of such practices on the financial figures of profits shown in the published accounts of the Indian Companies.
4. Corporation Tax

Corporation tax accounted for 20.24% of the net earnings of small companies, 19.08% in medium companies and 20.64% in large companies. These companies availed of depreciation allowance, development rebate and other concessions at an increasing scale than that in the case of small and medium companies. Likewise, the large companies, because of economies of scale and sound debt financing, could reduce their tax liability and shift the incidence to the customers to a considerable extent. Small companies were hard hit by tax liability. There is a strong case for providing effective tax reliefs to such companies cannot be ruled out. The differential rates introduced from 1966 have not proved of any help to these companies. It has been observed that the corporation tax has drained away much of the insufficient earnings of small companies. The government should introduce slab system, with a minimum non-taxable income for corporate units. All incentives under tax laws should be related to the size of companies, nature of industries, location, operation capacity and labour of capital intensity.

Consolidated and common size Earnings Statement:
The type and contents of Profit and Loss Accounts and Balance Sheet published by the Indian Companies lay emphasis on the compliance of the provisions of Companies Act and are not of much use for intelligent analysis. Absolute figures possess less value, unless the same are studied vertically and horizontally.
with the help of consolidated and common size earnings statements and ration analysis. The process of generation starts with the realisation of sale proceeds. In all the companies classified on the basis of the size and kind of industries, sale proceeds worked out more than 95% at the total revenue. Non-operating earnings which provided only 2% to 3% rupee value of net earnings continuously went up and doubled by the end of 1988. Comparing the sale indices with those of wholesale price and industrial output, we found that the growth in sales was not much encouraging.

Due to ever-increasing costs on all levels, gross profit did not rise in proportion to the rise in net sales. Steep rise in interest, tax and losses slashed down the distributable earnings to a considerable extent, particularly in small companies and those belonging to the traditional and recession bound industries. Medium and large companies could reap the advantage of economies of scale and proved to be economically viable. In the Indian context, the medium companies appeared to be optimal units. The performance of small companies was far from satisfactory. They possessed little resistance power to withstand economic adversities and became victims thereof very soon. About 30% of small companies belonged to low profitability and also the traditional industries like Food. The small companies in Tea and Pharmaceuticals showed satisfactory results. It is, therefore, suggested that the Government of India should give more weight to the development of medium size corporate units with a capital base of Rs. 30 lakhs to one crore
in the industrial development plans. It would be appropriate to keep medium size companies in the private sector and if necessary only these with a capital base of more than one crore may be brought under the joint sector.

Measures of Earnings : Profitability Ratio:
With a view to measuring the earnings of different companies, we have related their profits at various levels with turnover, fixed assets, total capital employed, net worth and share capital through ratio analysis.

1. **Earning Turnover Ratio**

   Earning turnover ratio is an important measure of profit potential of business concerns and reflects the fact that changes in cost, competition, price and demand influence the margin of profit to a considerable extent. The study revealed that the small companies could earn on an average 11.4% gross profit over net sale. This rate was the highest at 12.4% in 1986 and the lowest at 1.7% in (1988). This ratio varied between 10.1% (1986) and 12.2% (1990) in case of medium companies and 9.4% (1989) and 13.9% (1985) in the case of large companies. The rate was lowest in medium companies and industries like Tea and Food. Taking all the companies together, we observed that the producers could recover the direct cost of production in full and enjoyed gross profit to the extent of 1/6th of the total revenue for meeting the overheads and paying return on capital.
2. **Net Profit : Total Income Ratio**

Net earnings i.e., profit before tax total income ratio indicates the surplus producing capacity of corporations. It varied between 1.19% (1986) and 2.75% (1990) in small companies, 2.11% (1985) and 8.11% (1990) in medium companies and 7.92% (1986) and 18.28% (1990) in large companies. Industry-wise ratio was the highest in Pharmaceutical 4.9% and 11% and was followed by Tea 2.9% and 9.1% Food 3.1% and 9%. In all the industries excepting Pharmaceuticals trends were mixed despite steady growth in total income, because of disproportionate rise in costs and interest on borrowings.

3. **Earning Block Capital Ratio**

Profit before tax and interest to fixed asset ratio reflects the rate and extent of block utilisation. Block capital refers to the permanent investment and is mostly financed by the share capital. In the case of companies included in this study, the block capital accounted for 40% of total capital employed, whereas the net worth to capital employed ratio was 96%. It reveals that block capital was also financed through borrowings, particularly in capital intensive industries like Food and Pharmaceutical. This was probably due to the cheap funds made available by the public institutions for expansion as well as for meeting the financial exigencies. Earning capital block ratio varied between 1.21 (1986) and 2.01 (1990) in small companies, 1.41 (1986) and 2.19 (1985) in medium companies.
and 1.01 (1988) and 1.94 (1985) in large companies. In comparison to small and large companies, medium companies could utilise block capital more intensively. Large companies probably faced the problem of under-utilisation of block caused by recession and shortage of raw materials. Industry-wise ratio recorded downward trends in Tea. The ratio was stabilised in Food. The same travelled upward in Pharmaceuticals.

4. **Earning Before Interest and Tax : Capital Employed Ratio**

This is a more precise and effective measure of comparative profit-producing capacity of the corporations and suits to the short as well as long term analysis. It fluctuated between 32.6% and 38.6% in small companies, 31.18% and 46.4% in medium companies and 27.7% and 47% in large companies. Like earning block capital ratio, it is obvious that the overall profitability of small companies was lower than that of medium companies. Industry-wise comparison indicates that in the Tea industry the period from 1985 was marked by lower rate of earnings. The six year average rate was the highest at 36.9 in medium companies. Thus the rates fluctuated very widely and stability was missing.

5. **Interest on Borrowings**

Corporate borrowings are of many types like debentures, long term loans from financial institutions, public deposits, advances from banks and suppliers. From the published accounts of the corporations it is not possible to analyse the trends in the interest rates in each of the
aforsaid types of borrowings excepting the debentures. The rate and quantum of interest and period of loans are not separately mentioned for each type of borrowings. Our study reveals that the debentures have not been a popular sources of finance, in Indian companies. Out of 26 small companies included in this study only 4 issued debentures worth Rs. 0.9% crores amounting less than 25.9% of the average capital employed. Number of such companies was 9 out of 24 in medium companies and the amount of debentures worth Rs. 15.6 crores i.e. about 40.4% of the average total capital employed. Out of 25 large companies as many as 10 issued debentures worth Rs. 15.00 crores, which amounted 23.1% of their average capital employed.

Unlike debentures borrowings showed steady growth. To compare, in 1985 there was four-fold rise in the quantum of borrowings and two fold rise in the rate of interest in 1990. This indicates that the cost of capital has doubled itself because of the tight money policy of Reserve Bank of India and low level of savings in the country. Interest rates varied between 17% to 18% in small companies, 19% to 20% in medium companies which enjoyed cheaper borrowings because of better credit worthiness.

6. **Distributable Earnings : Net Worth Ratio**

(Table No. 4.09 & 4.10)

This ratio measures the rate of return available on owned funds. The same varied from 17.4% to 23% in small
companies and was quite unstable. It fluctuated between 18.6 and 23.6% in medium companies and 14% and 25.2% in respect of large companies. The average worked out to 19.9% for small companies, 20.6% for medium companies and 17.4% for large companies. The rate was the highest in Tea and the lowest in Pharmaceuticals. These trends were progressively stabilised in large companies and in Tea industries whereas Pharmaceutical industries suffered from declining rate of return on net worth.

APPLICATION OF EARNINGS
Application of divisible profits into dividends and retained earnings is the peculiar feature and crucial problem of corporation finance. It influences the day-to-day working and capital formation of the corporate sector. Before world war II, the Indian companies cared little for ploughing back of their earnings. Huge profits earned during world war I, were squandered in paying exorbitant dividends, consequently, dividend could not be paid during the lean years. Faulty management of earnings made the impact of depression of more severe and other traditional industries, leading to the high rate of corporate failures. Till 1960 dividend could be distributed even without providing for the depreciation on fixed assets. The amendment to Companies Act in 1960 made it compulsory to provide for depreciation at the rates prescribed by the Income Tax Act before any dividend could be declared. The grant of development rebate, subject to ploughing back of at least 75% of the total allowance, has made the process of appropriation saving oriented and
conducive to the financial needs of the developing economies like ours. Corporate law frowns upon the payments of dividend exceeding the divisible profits. The Companies (Amendment) Act 1974 now provides that in the event of inadequacy or absence of profits dividend from accumulated surplus can be declared, only after complying with the Companies Rules, 1975 (Declaration of Dividends out of Reserves). Thus the legal provision, quantum of divisible profits, financial expediencies, vis-a-vis the desire to pay steady dividends, have become the predominant factors determining the pattern of equity dividends and plough back. We have studied the trends obtaining in the appropriation of earnings after tax plus depreciation provisions. Deliberate inclusion of depreciation to the divisible profits has been attempted because of the fact that the depreciation provision has taken a major portion of earnings which is used for internal financing along with earnings retained by way of development rebate etc.

It has been found that corporation earmarked about 50% of such profits i.e. divisible profit plus depreciation. For amortisation in the small companies this ratio travelled as high as 30.6% and fluctuated between 22.6% (1990) and 35.28% (1985) in medium companies and 24.7% (1986) and 40.39% (1987) in large companies. Both depreciation and development rebate reserves resulted into ploughing back of current earnings. In small units of pharmaceuticals both these provisions exhausted fully the otherwise insufficient amount of earnings. There is thus the need for a more realistic and scientific approach to depreciation and the development rebate so as to ensure the intensive use of
block capital and the payment of steady dividends. Substantial increase in the provisions for amortisation and development cuts the size of divisible profits and narrows down the scope of discretion exercised by the Board of Directors while recommending distribution of earning into payouts and plough backs.

i] **Preference Dividend : Total Appropriable Earnings Ratio**

This ratio varied between 0.07% and 0.65% in small companies, 0.03% and 0.30% in medium companies, 0.04% and 0.20% in large companies. Industry-wise average ratio was the lowest at 0.05% in Tea followed Pharmaceutical at 0.1% and the highest at 0.16% in Food. The actual amount of Preference Dividend kept gradually rising, but mixed trends in the ratio were due to the fluctuated profits. (Table No. 5.05 & 5.06).

ii] **Earnings Accruing to Equity**

Residual earnings accruing to equity dividend varied between 22.5% (1985) and 32.6% (1988) in small companies, 31.4% (1987) and 42.4% (1988) in medium companies and 31.9% (1985) and 55.01% (1990) in large companies. Industry-wise the average ratio was the lowest 35.7% in Pharmaceuticals followed by Food at 38.9% and the highest at 45% in Tea. The actual amount of residual earnings was consistent in medium and large companies. In all other cases, trends were mixed and uncertain. (Table No. 5.07 & 5.08).

iii] **Equity Dividend : Distributable Earnings Ratio**

Equity dividend to divisible earnings ratio fluctuated between 22.5% (1985) and 32.4% (1988) in small companies,
31.3% (1987) and 42.4% (1988) in medium companies and 31.9% (1985) and 55% (1990) in large companies. The industrial average ratio was the lowest at 35.7% in pharmaceuticals and was followed by food at 38.8% and the highest at 45% in Tea. Loss of accumulated surplus in aggregate terms was heavier in small companies.

Dividend-declaring Companies

On an average only 19% companies out of 75 included in this study could declare equity dividend each year which amounted to 94.7% of the total number. In small and medium companies, the number of dividend declaring units was the lowest. There were 24 companies out of 26 i.e. about 92.3%. The same was 22 out of 24 in medium companies and amounted to 91.6% and 25 out of 25 large companies i.e about 100%. In all these categories the number was the lowest in small and medium companies because of low profitability.

Dividend Out Of Current Earnings Only

All the dividend declaring companies paid dividend out of current earnings. This indicates that there was a strong tendency to pay dividends from the current year’s divisible profits. It is observed that once a sum is ploughed back, it becomes difficult to withdraw the same and once a company sustains loss, it is difficult to recoup arrears of depreciation and development reserves. This marred the dividend potentiality of the companies for few years together.
The process of appropriation appears to have been governed more by the desire for steady dividends than the need for plough back. Statutory retention by way of depreciation and development reserves and cheaper and loss painful term lending, available from public financial institutions, have made the retention only a conventional and secondary thing. Except the small companies, medium and large companies could pay the steady dividends and plough back sufficient profits in addition to statutory retentions. Small companies had to forego dividends for want of earnings and accumulated surplus. Thus the companies which needed plough back most for maintaining dividends could not do so because of insufficient earnings.

**Payout Frequency**

Payout frequency reflects the degree of steadiness or regularity in dividend distribution. Out of 75 companies covered by this survey, only 58 paid dividend for all the six years, 5 companies for 4 years, 3 companies for 3 years, 1 company for 2 years, 4 companies for 1 year. Number of companies with zero payment frequency was 4 i.e. about 5.3% of the total number. Analysis on the basis of size reveals that 17 small companies, 16 of medium companies, 25 of large companies paid dividend for all six years regularly. This ratio in various industries was the highest at 83% in Tea and the lowest at 70% in food. Thus the trends were not unexpected, when we keep in view the unsatisfactory profit position of small companies and that of traditional industries.
Overall Plough Back

Overall plough back refers to the total amount of current earnings retained with the business i.e. profit after tax but before depreciation loss dividends plus development rebate reserve. Trends obtained in this confirm our hypothesis. Overall plough back fluctuated 1.78 crores (1986) to 3.29 crores (1990) in small companies, 3.61 crores (1985) to 9.06 crores (1990) in medium companies, 11.70 crores (1986) to 22.01 crores (1990) in large companies and 17.44 crores (1986) to 34.36 crores (1990) in all the companies. This plough back was lowest in Food, 7.4 crores (average) and the highest in Pharmaceutical 10.2 crores (average). It appears that large companies ploughed back substantial profits even at the risk of over-capitalisation leading to loss profitable use of funds, whereas the small companies could not pay even regular dividends, because of inadequacy or absence of profits.

Pattern of Corporate Dividends

By the pattern of dividend is meant the size frequency and shape of payout and the factors affecting the same. Our analysis clearly shows that the earnings accruing to equity i.e. profits after corporation tax, development reserves and preference dividend, have been the predominant factors influencing the behaviour of equity dividend in India.

1. Equity Dividend

The rate and quantum of equity dividend reflect the financial performance of corporations and motivate the entire process of their business. The pattern of dividend
can be studied in relation to paid-up capital, net worth, average market price or normal rate of interest on borrowings. Market price, being influenced by a variety of factors falling outside the scope of financial analysis, does not provide a suitable measure of dividend behaviour.

### Dividend Paid-up Capital Ratio (Table No. 6.03)
Dividend paid-up capital ratio fluctuated between 13.4% (1985) and 20.9% (1990) in small companies, 19.2% (1986) and 31.4% (1990) in medium companies and 22.8% (1986) and 35.2% (1990) in large companies. The dividend rate of small companies was the highest because of the lower payment frequency. The average rate was the highest at 44.8% in Tea and was closely followed by Food at 25.2% and the Pharmaceuticals, the lowest rate of 16.7%.

### Dividend Equity Net Worth Ratio (Table No. 6.05)
This ratio fluctuated between 3.9% (1985) and 6.8% (1990) in small companies, 6.9% (1986) and 9.3% (1989) in medium companies, 5.6% (1987) and 11.1% (1990) in large companies. The average was the highest in medium companies at 7.70% and was followed by large companies at 7.30% and small companies at 5.80%. The average for all the companies works out to 7.21%. The same was the highest in Tea at 9.43% and lowest at 5.24% in Pharmaceutical companies. Trends were progressive in all industries. Thus the trends were in tune with the prevailing dividend paid-up capital ratio.
Dividend Divisible Profit Ratio (Table No. 6.07 & 6.08)

This ratio indicates the portion of profits distributed as dividend. Companies with lower and insufficient amount of earnings paid higher proportion as equity dividend than those with regular and substantial profits. Large companies paid about 42.45% of their profits as dividend and were followed by medium companies with 37.53% and small companies 29.09%. The overall average rate was 39.79%. The average ratio was the highest at 57.69% in Tea and Pharmaceutical had the lowest at 30.46%.

COMPARATIVE STUDY OF DIFFERENT PAYOUTS: (Table No. 4.07)

A comparative study of different rates of return reveals that equity dividend paid-up capital ratio was the lowest of all payouts. On an average it was one half of the rate of interest on debentures and borrowings. Dividend net worth ratio was about one half of the dividend paid-up capital ratio. In all the companies net worth was double the paid-up capital. Development rebate reserves led to compulsory retention, resulting into a continuous rise in net worth. Preference dividend rate was lower than the interest rates. Debenture interest was the lowest in large companies and the highest in medium companies. Interest on borrowings varied between 34% and 84%. This was more than 25% in large companies and was the highest. Small companies availed of the borrowings at the lowest rate of interest i.e. 41%. It is thus obvious that the trends obtaining in different payout ratios of the private corporate sector in Indian during the period 1985-90 were in compliance with the basic principles of
financial discipline. However, all dividend declaring companies
could not maintain their payouts at a level above the normal rate
of interest, thus providing a sufficient margin for additional
risk assumed by equity and preference shareholders.

DETERMINATION OF PATTERN OF DIVIDENDS

The behaviour of dividend culminates out of the relative effect
of factors like divisible profits, liquidity, accumulated
surplus, tax liability, trading on equity, lagged year dividend,
age and size of the companies and the like. It is difficult to
measure the relative effect of each of these factors. Management
has to reconcile the conflicting forces exerted by these factors,
while recommending the quantum of equity dividend. Efficient and
more profitable use of financial resources is considered to be
the guiding principle of the appropriation of earnings.

Accordingly, corporations should not part with funds by way of
payouts exceeding the normal rate so long as they have the
opportunity for a more profitable use of the same. Thus the high
rate of return on retained earnings justifies the low rate of
dividends. The corporate units in fast growing industries like
Food and those needing modernisation like Tea would not be
expected to pay higher dividends. The phenomenon is doubly
confirmed on account of lower profitability of such industries.
Thus the portion of divisible profits after preference dividend
and development rebate reserves has been a predominant factor,
determining the pattern of equity dividend in India. The desire
to pay steady dividend, though an important factor, is also
influenced greatly by the size of divisible profits, the number
of companies paying dividend out of the accumulated surplus was negligible in the corporate units included in this study.

**NET EARNINGS**: **NET WORTH** v/s **EQUITY DIVIDEND** : **NET WORTH**

The correlation coefficient of these two ratios indicates the influence exerted by the changes in the rate of earnings on the equity dividend. The same was positive in the case of all the companies. Categorised size-wise and industry-wise in this study, correlation coefficient was significant in Food and Pharmaceuticals. This shows that these companies changed their payouts in tune with the net earning net worth. Correlation was insignificant in large companies and also those belonging to Tea. This shows that these companies followed consistent payout policies and ploughed back substantial profits by keeping their dividends more or less stabilised. Companies belonging to traditional industries too gave priority to steady dividends to plough back for modernisation, because of the availability of easy and cheaper terms lending from public institutions. In other words, they were prompted to pay the regular dividends as and when the divisible profits permitted them to do so.

Close analysis of the statistical tests, explaining the dividend behaviour framed by experts like Dobrovolsky, John Linter and Darling, reveals that the Linter Model based on current profits and lagged year dividend appeared fully working in the Indian corporate sector. However, instead of the entire divisible profits (i.e. profit after tax) the residual profits, which remain after providing for development rebate reserve and
preference dividend out of the divisible profits, have been found to be the prime factor determining the pattern of equity dividend. The relative influence of the residual profits was far greater than the lagged year dividend, in Tea, which explains the fact that units belonging to these industries revised their dividend rates in keeping with the trends obtaining in their residual profits. In the companies belonging to Food and Pharmaceuticals the relative influence of lagged year dividend was greater than that of residual profits. This confirms the results obtained through correlation coefficient of net profit/net worth and equity dividend/net worth ratios, i.e. the payouts were more or less stabilised in these companies. Macro analysis of factors influencing the payouts of companies of different sizes shows that the lagged year dividends exerted greater influence on dividend behaviour.

COST AND USES OF RETAINED SURPLUS

The impossibility of measuring the money incidence of business dealings in exact terms on the periodical profits and the need for providing cushion to weather economic adversities have made the retained earnings as necessary and the most important aspect of the appropriation of earnings. Profits earned by a company in one particular year cannot be ascribed only to the operations of that year. These results stem from so many past actions and future expectations. Adequate retention out of the current earnings is a must for stable and steady payouts. In the present situation of shortage of capital and shyness in investment in countries like India, corporate savings are far more necessary.
for speeding up economic development. The same are anti-inflationary and act as an insurance against corporate failure. However, the danger of misappropriation of retained earnings is inherent in the very process of retention. Unwarranted retention of funds results into over-capitalisation and waste of resources. Excessive retention induces management to incur unproductive expenses and uneconomic use of capital. It may lead to heavy inter-corporate investment whereby a few entrepreneurs can control huge capital resources and create industrial barriers serving their petty interests. In advanced countries it is argued that by retained earnings shareholders are denied their right to choose the type of investment. It is an infringement on their discretion. In India, many units have resorted to diversification of business which is fundamentally opposed to the object with which the companies were incorporated.

The Companies Act and tax laws have a positive bias towards substantial plough back through liberal depreciation allowance and development rebates. Recently, the Government of India has taken a number of steps to do away with the evil effects of retained earnings. Forward trading in shares has been banned, development rebate and tax exemption to priority industries have been withdrawn. Concentration of economic power and monopolistic trade practices of big business houses are being controlled. We are of the opinion that the retention of profits is essential for corporate growth, but at the same time the evil effects or the misuse of the same should be checked effectively. The Companies (Amendment) Act 1974, has laid down that in the case of
inadequacy of profits, dividends out of accumulated reserves can be paid subject to the compliance of Companies (Declaration of dividends out of Reserves) Rules, 1975. But looking into the dividend policies practiced by our corporate sector, it is found that there was a high degree of reluctance and inertia towards the payment of dividends out of the past surplus. The approach towards the management of earnings, specially during the planned period, has not been an unsatisfactory one. In the recent past the climate for investment has remained obscure and depressed due to heavy taxation and lower profitability. The more effective measure to remedy such a situation lies in the payment of steady dividends and not in the negative measures like check on dividends out of the accumulated profits.

The desirability or otherwise of retained profits should be measured by the marginal profitability of the additional funds. In other words, the infusion of funds should not lower the return on equity below the normal rate. This phenomenon can be tested with the help of profit after tax to net worth ratio. In the companies included in this study it was found to be in keeping with the normal rate and provides a sufficient margin for additional risk attached to equity investment. But the trends obtaining therein were lop-sided and deviated downwards in almost all the cases. The rate of return on net worth is the net outcome of all the factors and considerations affecting the day-to-day working of companies including the size of equity. Any fall or rise in the rate of return of net worth alone cannot provide a fool-proof measure of the desirability or otherwise of
plough back. Efficient utilisation of capital primarily requires qualitative as well as quantitative judgment.

**CORPORATE SURPLUS**

In addition to plough back and payout, capital receipts and gains like premium on shares, forfeiture of shares, discount on redemption and the capital payment or losses like bonus issue, premium on redemption etc. are the main items which increases or decrease the corporate surplus. We have analysed the composition of corporate surplus under the headings, Plough back of profits.

**PLough BACK PROFITS**

As regards the retention of earnings, the small companies could retain out of current profits the development rebate reserves only. The propensity to save was greater in medium and large companies. Their savings recorded continuous upward trends and were in excess of the development rebate reserves. Industry-wise trend in ploughed back profits reveal that in Food it is increasing every year whilst, in the case of Tea the amount to be ploughed back every year is more or less stable. On the contrary, the same was mixed in Pharmaceuticals. Nevertheless, all companies in different industries could plough back a substantial portion of divisible profits every year. Low profitability and increase in corporation tax caused a lower plough back. It is pointed out that at the present juncture it is difficult to eliminate the capitalistic character of the Indian economy and no one can deny the existence of low profitability units in different industries even in future. There is thus the need for progressive taxation and other
incentives to improve the profitability, payouts and plough back of such companies together with an effective check on the misappropriation of funds by the large and other high profitability companies.

**INDEX OF CORPORATE SURPLUS**

The index number of corporate surplus recorded a continuously upward trend in medium and large companies. It went as high as 470 crores (1990) in medium companies and 196 crores (1990) in large companies. Its growth was far from satisfactory in small companies.

**USES OF CORPORATE SURPLUS**

Accumulated surplus constitutes to be a prominent source of finance for the diversified industrial growth of the country. Recent changes in the lending policies of the financial institutions, particularly after the Industrial Licensing Policy Enquiry Committee Report recommending the conversion of term loans into equity, are expected to eliminate the imbalance in the debt equity relationship of the corporate sector. Corporate undertakings will have to rely much on the ploughed back profits for financing the expansion as well as the working capital requirements.

Uses of accumulated surplus can be studied with the help of 4 important ratios, namely i) accumulated surplus as percentage of paid-up capital, ii) Net worth, iii) Fixed assets and iv) capital employed. Corporate surplus paid-up capital ratio was the lowest between 2.34 and 3.88 in small companies and the
highest between 13.14 and 22.93 in large companies. The same in medium companies fluctuated from 3.79 to 10.56.

Accumulated surplus to net worth ratio indicates the proportion in the intrinsic value of the shares contributed by the surplus. It fluctuated from 6.14 to 11.97 in small companies, 10.15 to 43.67 in medium companies and 46.74 to 69.7 in large companies.

Self-financing to capital employed ratio travelled between 11.5% (1987) and 32.6% (1989) in small companies, 31.6% (1986) and 46.8% (1989) in medium companies and 27.8% (1986) and 59% (1989) in large companies.

Though the actual amount of saving recorded a continuous rise, these ratios possessed mixed trends with short circuit fluctuations in all types of companies. In most of these ratios the trends were upward during the period under study.

It can be concluded that the policies practised by the management for treating corporate earnings in India in the context of the economic background of different industries can be called satisfactory. The appropriation of earnings into payout and plough back was carried out with great foresight and a strong tendency to pay steady dividends. Development rebate and depreciation allowance encouraged the corporate savings to a considerable extent and improved the financial strength of the private corporate sector.

In the planned economy of India, State regulation and control over the issue of securities and appropriation of earnings have
proved to be of utmost help in providing sound financial structure to our corporate sector. The size of the corporate units and the nature of industries have been the predominant factors influencing the quantum and the rate of earnings, as well as the pattern of dividends. Small companies and traditional industries were hit hard by the adverse economic conditions.

PRESENT POSITION

TEA*

Tea occupies a predominant place in the Indian plantation industry and India tops in the world production of tea. The industry has made rapid strides in recent years, registering a phenomenal growth in production from 5612 million kgs in 1982 to 700 million kgs by in 1988.

The industry was on uncertain ground until the seventies due to both internal market pressures and international market fluctuations. The Eighties, however, have proved to be a decade of consolidation. This has proved to be a decade of consolidation. This has been largely due to the introduction of modern production technique in planting and processing along with modern management practices in the plantations and marketing.

Tea brings good cheers with health and stimulation without intoxication. It is refreshing and energising and constitutes an important non-alcoholic beverage considered to be a pure, safe and helpful stimulant.

* Kotharis Industrial Directory of India.
Tea is mainly grown in Assam, West Bengal, Tamilnadu and Kerala. The four states account for 98.5 per cent of production. Karnataka, Tripura, Himachal Pradesh, Uttar Pradesh, Sikkim and Bihar are other tea producing states. Tea cultivation has recently been introduced in Manipur, Nagaland and Arunachal Pradesh. Experimental plantation has been started in Orissa.

Tea grown in an area of over 4 lakh hectares is one of the most labour incentive industries employing more than a million workers. Following good agro-climatic conditions the production of tea in 1990-91 has increased to 719 million kgs. The government has been making continuous effort to increase production of tea. Twenty five top tea estates have been identified for increasing production of tea. Besides, efforts are being made to increase the area under cultivation in the states of Uttar Pradesh and Orissa.

Market Profile

Tea is the cheapest beverage available to the country’s teeming millions and is consumed by the rich as well as the poor. The market for tea in India comprises three segments - Orthodox tea which is a small segment; CTC (crush-tear-curl) leaf tea which is the largest segment and CTC dust tea. Nearly 70 per cent of tea sold in India is in loose form while the rest is the packaged form, constituting the value added products.

Based on flavour and strength, blends are classified as premium, popular and economy. While the premium blends naturally are high priced with strong flavour and medium strength, the economy
blends are low priced with high strength and light flavour. The economy blend is preferred by the lower income groups whereas the premium blend is the choice of the higher income groups.

The production target for tea in 1990-91 and 1994-95 are 756 m.kgs and 876 m.kgs. By maintaining this trend in production the country should reach 958 m.kgs by the turn of the century.

Table 1

<table>
<thead>
<tr>
<th>Category</th>
<th>North India 1991</th>
<th>South India 1991</th>
<th>All India 1991</th>
</tr>
</thead>
<tbody>
<tr>
<td>CTC</td>
<td>186564</td>
<td>72922</td>
<td>259486</td>
</tr>
<tr>
<td>Orthodox</td>
<td>57544</td>
<td>341823</td>
<td>92726</td>
</tr>
<tr>
<td>Others</td>
<td>1524</td>
<td>1137</td>
<td>2661</td>
</tr>
</tbody>
</table>

Source: Tea statistics Sept. 91 (M/s J. Thomas & Co. Pvt. Ltd.)

The economics of tea marketing is peculiar. On the one hand, the auction price determines the material cost, while on the other, blends accounts for the value addition. The marketing costs are higher for premium tea than for the economy blends. Tea is sold through auctions centres of Calcutta, Gauhati, Siliguri, Amritsar, Coonoor, cochin and Coimbatore.

The tea markets continued to be favourable for the plantation companies during 1989-90. The price of tea had gone up at the wholesale level by about 45 per cent in the last 1989 period. The price rise was attributed to reduction in the manufacture of CTC type of tea without any decline in exports.
In recent times there has been an unprecedented rise in the price of tea and the cup of tea has become anything but cheering.

Exports - All India

A total of 199.7 m kg. of Indian tea was exported during the year 1990. This was valued at Rs. 1028.2 crore compared to 204.7 m kg. exported at a value of Rs. 824.1 crore in 1989. Total exports during 1990 accounted for 30% of the Indian crop. The 1990 unit realisation for tea exports was Rs. 51.50 per kg as compared to Rs. 40.26 per kg. in 1989.

Retention - All India

Domestic retention during 1990 totalled 515 mkg registering an increase of 7.5% compared to the retention figure of 479 in kg in 1989.

Given below are the retention figures of Indian tea in the last seventy years.

Table 2

<table>
<thead>
<tr>
<th>Year</th>
<th>Crop</th>
<th>Export</th>
<th>Retention</th>
<th>3 years average figures</th>
<th>% increase based on 3 yrs. avg.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1984</td>
<td>640</td>
<td>217</td>
<td>423</td>
<td>389</td>
<td>+ 9.9%</td>
</tr>
<tr>
<td>1985</td>
<td>656</td>
<td>214</td>
<td>442</td>
<td>413</td>
<td>+ 6.2%</td>
</tr>
<tr>
<td>1986</td>
<td>625</td>
<td>203</td>
<td>422</td>
<td>429</td>
<td>+ 3.9%</td>
</tr>
<tr>
<td>1987</td>
<td>674</td>
<td>209</td>
<td>465</td>
<td>443</td>
<td>+ 3.3%</td>
</tr>
<tr>
<td>1988</td>
<td>701</td>
<td>201</td>
<td>500</td>
<td>462</td>
<td>+ 4.3%</td>
</tr>
<tr>
<td>1989</td>
<td>684</td>
<td>205</td>
<td>479</td>
<td>481</td>
<td>+ 4.1%</td>
</tr>
<tr>
<td>1990</td>
<td>715</td>
<td>200</td>
<td>515</td>
<td>498</td>
<td>+ 3.5%</td>
</tr>
</tbody>
</table>

Average Increase + 5.0%

Loose and Packet Tea

Consumption of tea, the common man’s beverage has been increasing steadily in the country. However, it is surprising that the entire growth in domestic consumption relates to the loose tea segment of the market.

An important reason that led to the decline of packet tea is 'value addition'. With the cost of packing soaring during the seventies the price differential between packet and loose tea increased to level which adversely affected consumer franchise.

There has been a welcome change in the Centre’s pronouncements on the desired status of packet..... in the domestic market. The Commerce Ministry came out with the policy decision to encourage packet tea so that this segment obtains 70 per cent share of consumption by the end of the Seventh Plan.

The Eighth Plan Period Targets

Various measures like infilling vacancies of tea busbes, replanting expansion of land, better irrigation and drainage, soil conservation, better method of processing, improving labour productivity, mechanical harvestings and fruitful R & D are suggested to reach the production target of 1,093 m kgs by 2000 A.D. This would indicate an annual compound growth rate of 3.76 per cent over the 1986-87 average production. On this basis, the target for the Eighth Plan are aset as under:
Table 3

<table>
<thead>
<tr>
<th>Year</th>
<th>All India [in m kgs]</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-91</td>
<td>756</td>
</tr>
<tr>
<td>1991-92</td>
<td>784</td>
</tr>
<tr>
<td>1992-93</td>
<td>814</td>
</tr>
<tr>
<td>1993-94</td>
<td>844</td>
</tr>
<tr>
<td>1994-95</td>
<td>876</td>
</tr>
</tbody>
</table>

Source: UPASI’s Eighth Five Year Plan for plantations

Role of Tea Board

The Tea Board is presently operating the following important schemes to assist tea industries:

1. Tea plantation finance scheme
2. Replanting subsidy scheme
3. Rejuvenation and consolidation subsidy scheme
4. New Tea unit finance scheme
5. Tea machinery and irrigation equipment Hire Purchase Scheme
6. Tea packeting / Tea packaging machinery finance scheme
7. Tea extension planting interest subsidy scheme
8. Interest subsidy scheme for irrigation and drainage
9. Crop diversification scheme

FOOD PROCESSING INDUSTRY*

Food Processing is seen as an industry with quick returns, whose gestation period is much less than that of other industries. This is also the reason, why a large number of NRI investors have shown keen interest in food processing. In the past three years, since food processing became the ‘new wave industry’, many foreign giants have decided to enter this segment of the Indian market.

* Kotharis Industrial Directory of India.
The changing lifestyle of the people, the increase in urban population, the rise in the literacy level and the enlarged TV coverage have triggered greater scope for the food processing industry.

There is a strong economic justification for setting up food industries, from the viewpoints of farmers and consumers, and for employment generation and industrialization. It should however be admitted, that food processing industry in India is still in its nascency. Institutional demand, the requirements of hotels, restaurants and household consumption comprise, the domestic demand for the processed food industry. The two characteristics governing consumption of processed food in the household sector are, the change in food habits and standard of living of the people. As regards the structure of the industry, it is noticed that small and big co-exist in the industry in India. The food processing industry covers the entire range from wheat flour, rice milling, oil extraction, sugar etc., to the latest of the 'ready to eat' kind of tinned and preserved foods. The products, which constitute roughly 90 per cent of the processed foods exports and which therefore, deserve specific attention are meat and meat products, fresh fruits, vegetables, beverages, fruit and vegetable products. A recent study conducted by the Indian Institute of Foreign Trade showed that nearly 40 per cent of the processed horticultural items are exported, 29 per cent is consumed by the institutional sector and 31 per cent by common consumers. The CFTRI and the Defence Research Laboratories and the food technology departments of the
agriculture universities have done good research work in several aspects of food technology. There is a need for more effective transfer of the technology from the research institute to the industrial units.

The products needed to be manufactured and marketed appropriately in order to tap the domestic and export potentials are cereal products, sugars, preservatives, confectionery, dairy products, fruits, vegetables, fish products, meat poultry, ice creams tea and coffee.

The importance of food processing, as a means of value addition to farm produce has been recognised for quite some time, as reflected in the setting up of the processed food export promotion council and enlargement of its scope by renaming it as Agricultural and Processed Food Products Export Development Authority (APEDA). In the last decade, the growth rate was around 4.8% per annum. Against the backdrop, the setting up of a full-fledged Ministry for food processing industries is a significant step to achieve "Brown Revolution".

According to the confederation of Indian Food Trade and Industry, the food processing industry is the largest determinant of GNP, accounting for 19 percent of the total industrial production and employing around 18 per cent of the national labour force.

There are over 50 units manufacturing ready-to-eat snack foods. Masala mix units have increased to about 230, protein food units have increased from 13 to 67. There are around 40 units
manufacturing convenience snack mixes. The number of units making processed meat has gone up from 19 to 17% over the last 15 years. Manufacture of a variety of health foods has gone up to 67 units. The increase in the manufacture of ready-to-eat snack foods has in turn, led to an increase in the production of modified starches. Introduction of aseptic packaging system has revolutionised, the fruit beverage sector and according to estimated available with the confederation of Indian Food Trade and Industry, 70 million fruit juice tetrapacks, are being produced now and this figure is expected to increase to 175 million packs over the next three years.

The untapped potential is brought out by the fact that about 54 million tonnes of fruits and vegetables are grown on five million hectares of which hardly 1.4 lakh tonnes get processed into various products like juices, pulps, chutneys, pickles and jams. There are an estimated 3,000 units, with a capacity utilisation of around 38 per cent in India.

Another important sector of the food processing industry comprises the bakery units. There are an estimated 75,000 units, including those in the small scale and cottage sectors, with an annual turnover of Rs. 2,000 crore. The annual rate of growth of this segment is estimated at five per cent.

Problems

The industry has been facing a number of constraints; unreliable data base for availability of raw materials; shortage of raw materials; infrastructural limitations; limited research and
development support; difficulties in technology transfer and absorption; unorganised state of industry; inadequate incentive; problems relating to quality control; implementation of the prevention of Food Adulteration Act; high cost of product development and promotion; taxation policies that continue to treat this industry as catering to the elitist sections and problems relating to packaging.

The policy measures, which the Government has sought to initiate, are meant to remove these constraints. It has provided a single window for the industry, which hitherto had to deal with five departments.

**INCENTIVES FOR SETTING UP OF FOOD PROCESSING INDUSTRY**

All the food processing industries other than milk food, malted food and flour and all items of packaging for food processing industries, but excluding the items reserved for small scale sector, have been placed in Appendix-I of the Industrial Policy. All scheduled Industries under 27(5) and 27 (1) of the Industries (Development and Regulation) Act, have been broad banded except those items reserved for small scale industries. In the Budget for 1989-90, various concessions have been extended to the food processing industries in the form of reduction in the custom duty/import duty/excise duty in respect of certain items of machinery and equipment, certain food preparations etc. The Ministry of Food Processing Industries have a Plan scheme under which financial assistance is extended to State Governments/cooperative agencies for setting up and development of fruit and vegetable processing industries in the country.
The Government of India encourages the food processing industry motivated by the following objectives: (a) to put to use the enormous amount of vegetables, fruits and grains, which were otherwise going waste for lack of local sales and storage facilities (b) to generate rural employment and (c) to bring about a change in the eating habits of the people, by making them more accustomed to fast and processed foods. The prospects for the food processing industry have become bright with growth of international tourism, changes in the consumption pattern in metropolitan centres and enormous export potential.

EXPORTS

Export of processed foods has been identified as one of the thrust areas for augmentation of country’s exports. India’s export of processed foods also needs extensive diversification. At present about 54 per cent of the exports reach the USSR and another 20 per cent, the Gulf countries. The Agricultural and Processed Food Products Export Development Authority (APEDA), proposes to set up export complexes for fresh fruits and vegetables in Bombay, Calcutta, New Delhi and Trivandrum. Processed food items currently exported, cover a wide gamut of items, such as fruit and vegetables, meat products and other miscellaneous items of which, fruit and vegetables is one of the important areas offering scope for export development. The main constraints that inhibit export growth are, the high freight and lack of adequate air cargo space. The export strategy should take suitable measures to neutralise them. It is estimated that by 1989-90, the export would tough a target of around Rs. 600 crore.
PHARMACEUTICALS*

Among the third world countries, India has been recognised by UNIDO, as one of the top ranking countries in terms of production and distribution of pharmaceuticals. At the time of Indian Independence, the value of pharmaceuticals output was only Rs. 10 crore. The industry consisted mainly of units concerting imported bulk drugs into formulations with no production base. Today, the industry has grown in a gigantic way both in terms of output and product diversification.

At present there are over 15,000 drug manufacturing units in the country with a preponderance of small scale units. The relatively large scale units in the organised sector number about 250 including six FERA companies and the five units in the public sector. There were 31 FERA companies with direct foreign equity exceeding 40 per cent in March 1978 on the eve of the announcement of drug policy (1978). Since then, 25 of them have diluted their foreign equity to 40 per cent or below. Hence, now there are only six FERA companies, viz. Alkali & chemicals Ltd., (amalgamated with ICI), Bayer India Ltd., Johnson & Johnson Ltd., Roche Products Ltd., Sandoz India Ltd., Wyeth Laboratories.

The public sector units are: Indian Drugs and Pharmaceuticals Ltd., (IDPL), Hindustan Antibiotics Ltd., (HAL), Bengal Chemicals and Pharmaceuticals Ltd., (BCPL), Bengal Immunity Ltd., (BIL), and Smith Stainstreet Pharmaceuticals Ltd. (SSPL).

* Kotharis Industrial Directory of India.
The organised sector units numbering about 250 (including six FERA and five public sector units) account for nearly 70 per cent of the industry's total value of production. The national sector has witnessed a spectacular growth over the last two decades. It now accounts for 90 per cent of the production of the industry including that of the small scale sector. The six FERA companies account for 10 per cent of the production.

<table>
<thead>
<tr>
<th>Year</th>
<th>Rs. Crores</th>
</tr>
</thead>
<tbody>
<tr>
<td>1984-85 (Estimated Production)</td>
<td>2204</td>
</tr>
<tr>
<td>1989-90</td>
<td>4112</td>
</tr>
<tr>
<td>1994-95</td>
<td>8300</td>
</tr>
<tr>
<td>1999-2000</td>
<td>15996</td>
</tr>
</tbody>
</table>

Source: OPPL, Annual Report

The production of drugs and pharmaceuticals continued to show an upward trend as against a production of Rs. 377 crore of bulk drugs and Rs. 1,827 crore of formulations in 1984-85, their production in 1988-89 is estimated to be of the order of Rs. 630 crore and Rs. 2,690 crore respectively. As against the estimated production of Rs. 2,204 crore in 1984-85 the demand for drugs by 1989-90 is estimated at Rs. 4112 crore and by 1999-2000 it may be Rs.15,996 crore as shown in the Table.

* Estimated by the National Council of Applied Economic Research.
<table>
<thead>
<tr>
<th></th>
<th>Sixth Plan Targets</th>
<th>Seventh Plan Target</th>
<th>Estimated Production</th>
<th>Estimated Production as % of Targets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulk Drugs</td>
<td>665</td>
<td></td>
<td></td>
<td>377</td>
</tr>
<tr>
<td>Formulation</td>
<td>2450</td>
<td></td>
<td></td>
<td>1827</td>
</tr>
<tr>
<td>Total</td>
<td>3115</td>
<td></td>
<td></td>
<td>2204</td>
</tr>
</tbody>
</table>

Source: OPPI, Annual Report.

**DRUG PRICE POLICY**

As medicines constitute an item concerned with the life of the people, their prices have to be kept at levels affordable to the masses. Realising this fact, the Govt. has imposed statutory controls on drug prices. Under the Drugs (Price Control) Order of 1979, along with order requirements, such as printing of retail price on some packed formulations, it provided for mark-ups on costs. Category I provided for 40 per cent mark-up, for category II, 55 per cent and for category III (upto) 100 percent. The DPCO 1979, had brought under its net about 400 bulk drugs and 4,000 formulations marketed in 25,000 odd packs.

As per the drug policy announced in December 1986, the existing three categories of drugs were reclassified into two categories. Drugs necessary for the national health programme are listed in the first category and other essential drugs in the second category. Formulations of the first category would be entitled to 75 per cent maximum allowable post-manufacturing expenses (MAPE) and those of the second category to 100 per cent MAPE.
Under the revised Drugs (Price Control) Order, 1977, 166 drugs were brought under Government price control scheme, 27 drugs in category I (essential drugs) and 139 in Category II.

Under the order, the Government may, with the view to regulating the equitable distribution and increasing supply of an indigenously manufactured bulk drug, fix a maximum sale price at which such a bulk drug would be sold.

While fixing the price of a bulk drug, the Government may take into consideration of post-tax return of 14 per cent on net worth or a return of 22 per cent on capital employed or in respect of a new plant an internal rate of return of 12 per cent based on long term marginal costing depending upon the option for any of the specified rates of return that may be exercised by the manufacturer of a bulk drug. All vitamins as bulk drugs are exempted from price control. No person would sell a bulk drug at a price exceeding the sales price fixed, plus local taxes if any, payable.

Every manufacturer, producing a non-scheduled bulk drug would submit a list of all such bulk drugs currently produced by him within 30 days of the commencement of the Order and indicate the details of cost of such bulk drugs.

The Government has also worked out a formula for calculation of retail price of formulations. The formula allows maximum post manufacturing expenses of 75 per cent in the case of category I formulations and 100 per cent in category II formulations.
In November 1988, vitamin A and C were brought within price control under Drugs Prices control of 1987, as per the provision of Drug Price Control Order, the prices of bulk drugs formulations prevailing on 18th November 1988 stood frozen.

Following a study made by the Bureau of Industrial costs and Prices of the cost of production of Paraxylene - an input for DMT and up date study of DMT costs, based on the revised cost of paraxylene the government advised DMT producers to sell, effective March 1990, their product at an interim price not exceeding Rs. 23,500 per tonne as against the pre-revised price of Rs. 23,000 per tonne.

In July 1989, the Centre removed 26 bulk drugs from price control as their turn over was marginal. In August 1989, drug price increased on the basis of new conversion and packaging norms were approved for companies which had submitted price revision applications for their entire range of products and price adjustments based on maximum allowable post-manufacturing expenses in case of formulations were announced. Price of 164 pharmaceutical formulation packs were reduced by the Centre on March 9, 1990 based on prices of 21 bulk drugs which were brought under drug price control in February 1990. With the extension of drug control to 21 more drugs, the market share of controlled formulations increased to about 70 per cent. The government set up in February 1990 a permanent 12-members standing committee under the chairmanship of the Secretary, Department of chemicals and Petrochemical to review the Drug (Price Control) Order, 1987.
In July 1990, five more bulk drugs were brought under Drug (Price Control) Order 1987 thereby raising the number of controlled drugs from 145 to 150. Again August 1990, all bulk drugs used to make formulations for national health programmer like calcium and iron formulations, opthalmic preparation etc. were declared to be category I bulk drugs under the Drug (Price Control) order 1987. All formulations containing category I or II bulk drugs will be considered category I or II formulations respectively. The centre also allowed price increases for 400 drug formulations based on 1979 packaging norms. In October 1990, the government ordered a five per cent increase in pharmaceutical prices regardless of actual cost increases against the industry's demand for a 15 per cent across the board hike to absorb the cascading impact of the hike in petroleum prices.

IMPORTS & EXPORTS

The indigenous production of bulk drugs is not sufficient to meet the growing demand. There are as many as 37 items of bulk drugs, whose import exceeds Rs. 40 lakh per annum. As against this, in certain drugs, because of indigenous production, the imports have decreased substantially.

There is a growing market for exports to developing countries, which do not have indigenous bulk drugs manufacturing activity and trying to be self sufficient in the area of finished formulations. The coming year, therefore indicates an excellent opportunity for growth. Exports are estimated at Rs. 380 crore by the end of the Seventh Five Year Plan. As per one of the
estimates, 12.5 per cent of total pharmaceutical production in the country is exported.

The Basic Chemicals, Pharmaceuticals and Cosmetics Export Promotion Council (Chemexcil) surpassed its export target in 1988-89. US and USSR emerge as major markets for the Indian drug industry. Bulk drugs are exported to West Germany, the U.K., France, Japan, Switzerland and some other developed countries.

In 1988-89, the total export of drugs and pharmaceuticals from India was only Rs.400 crore. USSR has finalised deals for the import of about Rs.175 crore worth of drugs and pharmaceuticals from India. A quantum jump in the export of drugs and pharmaceuticals to the US is also likely during 1989 with the recent registrations of some drugs from India by the US food and drug administration.

Chemical Pharmaceuticals and Cosmetics Export Promotion Council, otherwise known in chemexcil was established in 1963-64 for promoting exports of non-traditional items such as drugs and pharmaceuticals, dyes and the intermediates, basic inorganic and organic chemicals, cosmetics and toiletries and agarbattis.

Against the scope of substantial growth in Exports during 1989-90 estimated to exceed Rs. 2100 crore and against the target of Rs. 3,100 crore for 1990-91 and pitted against a target of Rs. 10,000 crore by 1994-95, Chemiexcil has laid emphasis on exports to Europe, the US and South East Asian markets in the coming years.
INCENTIVES

Among the various new concessions and incentives, which have been agreed upon by the Government in response to pleas by Chemexcil and by the Federation of Indian Export Organisations (FIEO) are:

A) Banks to administer the cash compensatory support (CCS) scheme, instead of the licensing authorities, at the option of the exporter.

B) Amendments to the existing regulations should be made so that once the entries are made in the DEEC book by the customs authorities indicating the quantity and FOB value of exports and other documents needed by the licensing office, the bond and legal undertaking should be released within the maximum period of 30 days for submission of such documents. This step is being taken to cut down the delays—first with the customs and then with the licensing authorities—in redemption of bonds and legal undertakings against advance licences and passbook provisions.

C) The CCI & E in consultation with the department of revenue, is to evolve a scheme under which instead of taking legal undertaking or bank guarantee with every licence separately as at present, only a single legal undertaking or bank guarantee, from a unit for the whole financial year should be obtained. This is being done in response to the Chemexcil’s plea to streamline the procedure on the lines of the SPS scheme for granting advance hence, where input-output norms have already been announced under appendix 13-
C of the import policy. The government had agreed to create a separate channel for expenditious disposal of such cases.

If a drug unit exports 25 per cent of its output in any product, that product would be out of the purview of price control (provided it is not a monopoly item). If the units export 50 per cent of the output of the product, then it would be totally out of price control. Unconditionally, the existing scale of tight parameters for maintaining the ratio between the bulk drug and formulations outputs would not be applicable to those units, which export 20 per cent of their formulation product and those units whose export earnings contribute to more than 10 per cent of their total sales turnover would be allowed to make one per cent additional profit by adjusting the pricing formula.

Among the other important measures which are being considered by the government, according to the Chemexcil's chairman, are: availability of export benefit on deemed exports on par with physical exports, including computation of deemed export supplies towards performance for recognition as an export/trading house and grant of exemption from income tax on profits derived from such income tax on profits derived from such supplies, sharing of income tax benefits between merchant exporters and supporting manufacturers (presently the benefit is restricted to only export/trading houses and their supporting manufacturers) and tax exemption on receipts of CCS and duty drawback.
FUTURE PROSPECTS

The Indian Pharmaceutical industry which made notable progress in the post Independence period and emerged as the largest producer of pharmaceuticals among the third world countries, is at the cross roads today. The study on cost structure of drug companies, reveals that the Indian Pharmaceutical industry is in deep trouble, owing to the ever escalating costs of inputs, packaging materials and other expenses including power and fuel.

Though India has emerged as the largest pharmaceutical producer among the developing countries, its share in world production is still insignificant at 1.6 per cent even though it accounts for 15 per cent of the world population. At about Rs. 42 the per capita consumption of drugs in India is among the lowest in the world. Thus the growth potential of the industry in the coming years is obvious.

As a result of this study, one comes to the conclusion that the management of earnings of the private corporate sector in India during the period under study has been by and large satisfactory. The companies specially of large and medium size have been contributing commandably to the capital formation by means of their plough back policies. However, in the case of small companies things are not satisfactory.

It is therefore recommended that no hectic measures should be taken to disturb the working of the private corporative sector. Sometimes one suffers from the apprehension may introduce such
legal measures as may tamper with the financial soundness of the corporation. No doubt, as and when any malady crops up in the private sector, remedial measures must be taken, but the conclusion is that the present policies appertaining the appropriation of earnings are found to be satisfactory. It is worth mentioning that the joint sector, which is often talked of and debated these days, may create new situations which may necessitate the review of the whole issue. It appears timely to opine that the management of earnings of medium and large companies does not require state interference. The present regulatory measures as incorporated in the Companies Act and tax laws could be continued without any radical changes but for the uneconomic working of the small companies.