FINANCIAL PLANNING

When the feasibility of a project is established, there arises an immediate need to think of sound financial planning because of an acute scarcity of capital resources in developing economies. Financial planning is "concerned not so much with operating details as with the relationship between the capital markets, on the one hand, and the use of funds within an enterprise on the other".¹ It is "to serve as the point of contact between the uses of funds within an enterprise and its sources of funds".²

In other words, financial planning is concerned with the evaluation of a basis that will guide not only the process of fund raising but also the way in which funds would be used for specific activities at a particular point of time.

In case of public sector projects, there were no clear directions issued by the Government regarding the establishment of financial goals. The usual explanation provided by such units was that they were expected to pursue the objectives as given in 'Memorandum of Association'.

² Ibid.
Such points of view are not only evasive but also amount to the absence of a perspective with which these undertakings can formulate and operate their financial plans.³

The objectives contained in the memorandum are vague and varied and are more to fulfill a legal formality. The subject received the attention of Administrative Reforms Commission, which recommended that the Government should, in consultation with public enterprises, lay down the principles for determining the precise financial and economic obligations of public enterprises.⁴ This recommendation has been accepted by the Government of India. If lack of initiative continued on the part of the unit in this direction, the financial planning and accordingly, financial decisions will have a tendency towards adhocism and possibly arbitration. Hanson had also advocated that both determination of prices and calculation of capital requirements are part of the process of planning.⁵

Following are the important ingredients of a financial plan:

(A) Capital requirements;
(B) Sources of capital;
(C) Capital structure.

Capital requirements:

Estimation of Capital requirements may be called a sine-qua-non of a financial plan. Financial forecasts must be made on a sound basis because both shortage and excess of funds lead to financial crisis. Capital needs must be carefully taken into consideration while estimating the capital requirements of an organisation. Capital requirements are estimated on the basis of forecasts made with the aid of scientifically prepared budgets of anticipated sales or production capacity, promotion expenses, expenses on organisation, cost of fixed assets, operating costs, administrative, selling and distribution expenses and other necessary costs. In case of new enterprises funds are required for getting the various reports prepared, consultation, incorporation expenses, cost of fixed assets, working capital in addition to preliminary engineering, legal, accounting and marketing advice.

"In modern money-using economy, finance may be defined as the provision of money at the time it is wanted". 6

Finance is the life-blood of all monetised socio-economic formations ranging from simple nuclear families to complex national and international organisations. 7 As the brain

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which controls the entire organisation of a human body has
to be supplied with sufficient blood, similarly sufficient
funds are required for the smooth and uninterrupted running
of an enterprise. Finance plays an extremely crucial role
in the continuity and growth of a business enterprise. It
has been called as a circulatory system of an enterprise
making possible the needed co-operation between diverse units
of activity. As the blood stream augmentation helps the
young to grow and the old to renew and sustain, similarly
finance plays a crucial and important role in the establish­
ment, operation and expansion of a business enterprise.

In a narrower sense, the finance function deals with
only procurement of funds but from a broader angle, it not
only concerns itself with procurement but also with their
effective use. There is need to define the scope of finance
function which covers decisions not only for the acquisition
of funds but also for their effective use. 8

While making an estimate of capital requirements the
most important point to be borne in mind is that money is
not without cost. Whenever funds are to be invested the
benefits accruing from such an investment are to be balanced
with the costs and problems involved in the procurement of
funds. "The successful financial man in business must be
not only a money man; he must be a businessman" 9

8 Kuchhal S.C.: Corporation Finance- Principles and
9 Hunt Pearson: Basic Business Finance - Texts and
neither mean cash nor money but anything used as means of payment. "You have got to have money to make money". No organisation can run without funds which have to be gainfully employed for its uninterrupted and smooth functioning.

For the successful running of an enterprise, the need for a sound financial plan may not be over-emphasised. In this connection it is of utmost importance that a long term view of the proposed business is considered. The unfortunate part of the picture is that generally those who are concerned with such a plan consider only the immediate financial requirements and the long term possibilities of expansion, diversification and combination are overlooked. Regarding the importance of a financial plan Prof. Hoagland said, perhaps the most prolific source of failure of business undertaking is the lack of a definite financial plan. Bad production management and bad sales management have slain their thousands but faulty finance had slain its tens of thousands. Thus planning and forecasting is a must from the very beginning of a project.

Prof. Ramananadham had suggested that the financial organisation should be such as to work automatically towards the pricing and profit policies declared as appropriate to

10  Ibid., p.12.
it. It should be conducive to the right allocation of the nation's resources and be compatible with national financial policies. Every Government will try to ensure that all economic activities are directed towards the attainment of national objective. Public enterprises being the instruments of economic development cannot come in clash with it, particularly in developing countries. Financial consistency in public enterprises should not be misunderstood as the adoption of rigid standards regarding pricing and profit policies but as the propriety of uniformity in such matters as provision of depreciation, provision of interest on capital and welfare expenditure etc.

At the time of the preparation of detailed project report, an estimate is made regarding the capital requirements. The persons responsible are generally not guided by any theory of capitalisation because the objective is not only to earn profits but the public enterprises are expected to perform several social obligations also. In the context of public enterprises in India, sometimes the costs are deliberately underestimated and outputs are overestimated in an enthusiasm to get the project through. This fact emerged at a seminar organised by the Institute of Public Enterprises, Hyderabad for Financial Advisors and Financial Controllers of public enterprises. Substantial increase in outlay is then placed for approval after
the project has been launched. The authorities are left with no alternative but to sanction the increase. Thus, it is necessary at the planning level for the management to submit realistic proposals after a careful and technical evaluation because lack of planning in capital expenditure in public sector undertakings creates serious problems for the Government. In case of Central public sector undertakings the total cost is substantially more than that originally estimated with resultant change in the scope and capacity of project.\(^{13}\)

In the Central projects 60 to 70 per cent revisions of estimated cost is the normal feature in most of the public enterprises.\(^{14}\)

In the following few pages an attempt has been made to see the extent to which the project costs were realistically estimated in the units (under study) at the time of the formulation of project.

A former Managing Director of Punjab Footwears Limited told it clearly that actually no estimation was done regarding the project cost.

Chart 3-A shows the amount of cost over-runs in Punjab Nylo-Transmissions Limited, Punjab Scooters Limited and Punjab Tanneries Limited.

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13 C.P.U. (Fourth Lok Sabha), 15th Report, April, 1968.
As is evident from Table 3.1 there had been an increase of 41 per cent in the actual expenditure of Punjab Nylo-
Transmission Limited as compared to original estimates. It was revealed during discussions that because of the time
gap in implementing the scheme, the price of machinery had
gone up due to the rampant inflation in the Western countries in general and Austria and West Germany in particular from where the machines were to be imported. In the project report no provision was made for the administrative block which costed the company Rs 2,42 lacs.

Table 3.1

Table showing the cost over-runs in the Units

<table>
<thead>
<tr>
<th>Name of the unit</th>
<th>Original estimates</th>
<th>Actual expenditure</th>
<th>Over-runs</th>
<th>%age increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Punjab Nylo Trans-mission Ltd.</td>
<td>13.65</td>
<td>19.35</td>
<td>5.70</td>
<td>42</td>
</tr>
<tr>
<td>2 Punjab Scooters Ltd.*</td>
<td>401.00</td>
<td>420.00</td>
<td>19.00</td>
<td>5</td>
</tr>
<tr>
<td>3 Punjab Tanneries Ltd. **</td>
<td>79.04</td>
<td>88.52</td>
<td>9.48</td>
<td>12</td>
</tr>
</tbody>
</table>

* The amount approved by the all India Financial Institution was Rs 340 lacs. If the actual expenditure was compared with this figure the over-runs would have been to the extent of Rs 80 lacs i.e. 24 per cent.

** Still under implementation.

In the case of Punjab Saltpetre Refinery Limited the project cost was originally estimated at a meagre amount of Rs 50,000. As the unit could never start the refining
of crude saltpetre it had to be diversified and then the project cost was estimated at ₹ 6 lacs. (This has not been considered as the cost over-runs because the unit has been diversified from the initial stage). In a 'write-up' on the unit sent by the General Manager of the project on 22 July 1977 he said, 'this all will need a capital investment of about ₹ 5 lacs to ₹ 8 lacs alongwith the appointment of technical experts in the manufacturing division'.

In Punjab Semi-Conductor Devices Limited, the original estimates of capital cost was ₹ 89.25 lacs and the unit could be completed within these financial limits, i.e. without any cost over-runs.

The project cost in case of Punjab Scooters Limited was approved at ₹ 340 lacs by The All India Financial Institutions, whereas in project report this cost was estimated at ₹ 401 lacs. Actual expenditure at the time of completion was worked out to be ₹ 420 lacs. It was revealed during discussion that the expenditure on civil works was underestimated in the project report. On the issuance of capital, more expenses had to be incurred than estimated. Because of delayed production the pre-operative expenses had also gone-up. The likely increase in the prices of fixed assets was overlooked at the time of preparation of the report for the reasons best known to the consultants. It was also discovered from the discussions that the cost over-runs
were touching Rs 94.54 lacs but could be reduced to Rs 80.00 lacs (if compared with the approved amount of Rs 340 lacs) by economising in plant and machinery.

So far Punjab Tanneries Limited, is concerned, it was revealed that no estimates of costs were made at the time of starting the unit. The fact that the project of this size was started with a paid up capital of Rs 5 lacs only goes to prove the inadequate financial planning which went into it. The company wanted to apply for a loan from the Punjab Financial Corporation and keeping in view the condition imposed upon it, got a project report prepared from National Productivity Council (NPC). In the report prepared by the NPC the project cost was estimated at Rs 38 lacs. Even in this report no provision was made for the construction of a cold storage for storage/preservation of raw-material or for a proper and bigger finished leather store. The total expenditure on these additional works worked out to be Rs 3.80 lacs.

The machines listed in the report by the NPC were inadequate for achieving the targetted capacity. For instance, the machines to be imported at a cost of Rs 14 lacs were not provided for at all. The cost of equipment and works provided in the report was short by Rs 8.28 lacs.
Another project report was prepared by the Company itself in 1976 in which the project cost was estimated at Rs 80.10 lacs. The major items of equipment and works omitted from the NPC report and provided for by the company were:

(Rs in lacs)

(i) Construction of toggling chamber: 2.10
(ii) Provision for sewerage : 1.50
(iii) Conveyor cum drying tunnel : 0.75
(iv) Electric fitting and change of wiring: 1.00

The machinery which had already been purchased by the company at a cost of Rs 13.31 lacs did not find any place in the report prepared by NPC.

Punjab Tractors Limited and Punjab Wireless Systems Limited were completed without any cost over-runs.

From the above discussion it is evident that in some units the importance of determining/estimating the project cost was not realised. In some, these estimates were made but proved to be wrong because of numerous reasons. In both the cases the viability of the project was adversely affected from the initial stage.

Several sophisticated techniques, as discussed in the preceding chapter, are available for making capital
investment decisions. Private sector undertakings do make use of these techniques. In the case of public enterprises such techniques are not made use of because of several conflicting and unquantifiable objectives such as development of backward areas, potential and necessity of building socio-economic overheads etc.

Public investment decisions are relatively more cumbersome and intricate as compared to the private sector. In private sector, the basic objective is the maximisation of profits without much consideration of environment pollution and wasteful depletion of natural resources, while public sector is conditioned with several other considerations such as social obligations and anti-pollution.

Now-a-days public enterprises are also expected to generate surpluses, but, within the broad constraints of social objectives. And, therefore, the fact remains that the public sector could make very little use of the analytical tools and techniques that are available for rational investment decisions. In case of industrial projects, in public sector also, the use of sophisticated tools and techniques will go a long way in the betterment of public sector in general and the units in particular, as has been emphasised in the last chapter also.

The estimation of working capital forms an integral
part of the overall estimation of capital requirements. Some authorities hold the opinion that current assets and working capital are synonymous terms whereas others have defined the working capital as the excess of current assets over current liabilities.

Before the estimation of working capital requirements it may be noted that a part of working capital is fixed in nature. The size of working capital is also affected by the attitude of management towards risk in addition to such factors, such as size of cash, inventories and receivables etc. Insufficient cash is harmful to the operative health of the enterprise and excessive cash is still worse, cash in hand being a non-earning asset. Excessive inventories in relation to normal requirements retards not only the cash cycle but also disturbs the real liquidity of the organisation. Similarly the shortage of inventory may affect the size and continuity of production and employment adversely. The problem of inventory will be discussed in detail in the succeeding chapter.

The actual quantum of investment in receivables depends upon the credit sales and collection policy of the enterprise. The greater the volume of credit sales and longer the term of credit allowed, the greater will be the investment in receivables and hence there will be a greater need of working capital.
Since the public sector enterprises operate in a typical decision environment, such an approach would be most realistic in their context. If all the determinants are considered before determining the size of working capital, the problems may be identified at an early stage and corrective action may be initiated before it is too late. All the public sector undertakings under study (except Punjab Tractors Limited) were facing the problem of shortage of working capital as was discovered during discussion. This fact has been corroborated in many balance sheets of the units.

(3) Sources of Capital

Money is required for the establishment, operation, expansion and diversification of a business enterprise. The money that is sunk in it is called capital. Hence, it is very important to see the various sources from which such funds could be procured. The sources are different in private and public sector because in the former, the ultimate objective is to maximise the profits and accordingly a capital structure is arrived at in such undertakings.

Before examining the various sources of capital of public enterprises, considerable emphasis is to be laid upon the form of organisation chosen for an enterprise, because the form of organisation has an important bearing on the success of an enterprise.
Broadly speaking the public enterprises may be organised:

(i) as departmental undertakings;
(ii) as statutory corporations;
(iii) as Government companies.

In case of departmental undertakings, the capital requirements are estimated by the department concerned for each financial year and the requisite funds are appropriated in the normal way at the time of annual budget. The exchequer is responsible for absorbing any loss or gains of the undertaking. Under this form the field of discretion with the management of the enterprise is highly limited and consequently the enterprise experiences inflexibility in financial planning and other similar matters. This form may not be fit for a business organisation because the system militates against the initiative and flexibility which are fundamental and basic for the successful operation of a business enterprise. The overemphasis of a bureaucrat on caution, conservative temper and through the proper channel mentality do not leave even elbow room for refreshing, bold approaches, adventure and risk. "Under this form of organisation public enterprises have sometimes become synonymous with red tape, delays, inadequate service and insensitivity to consumer needs".  

It was thought and rightly so that this form of organisation was neither desirable nor feasible for the purpose of an industrial undertaking. In industrial undertaking the finance function is to be performed in a business-like manner and quick decisions are to be taken. Moreover, the funds are to be provided from time to time as per the requirements of the organisation.

A statutory corporation may be defined as a legal entity created by the Government but is exterior to the Government organisation, hence financially independent for carrying on specific activities prescribed in the law creating it. Earnest Davies said that a statutory corporation is, "a corporate body, created by public authority, with defined powers and functions and financially independent. It is administered by a board appointed by public authority, to which it is answerable. Its capital structure and financial operation are similar to those of the public company, but its stockholders retain no equity interests and are deprived of voting rights and power of appointment of the board". In the words of Morrison, in it "we are seeking a combination of public ownership, public accountability and business management for public ends".

The initial capital to a corporation is provided by the Government. It can borrow both from the Government and the public. The funds also flow from the revenues derived

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from the sale of goods and services. A corporation does not suffer from red-tapism and inflexibility. The decisions can be taken more promptly. President Roosevelt had said that a public corporation is one which is clothed with the power of Government but possessed of the flexibility and initiative of private enterprise. It can follow standard commercial practices in conducting its business. It can finance expansion of facilities to cope with an anticipated growth in business without an undue delay by use of revenues and borrowings.

The company form of organisation which has been widely used both in case of Central and State undertakings possesses the necessary freedom in finance and autonomy in administration and at the same time permits adequate control by the Government. It is very difficult to say that what considerations led the Government to choose this form against the statutory corporation. The Union Cabinet on the basis of paper submitted to it by the Ministry of Industry and Supply, took a decision on 12 November 1950 to form private limited companies for the management of state industrial enterprises.\(^{18}\)

Company form of organisation can associate private enterprise, national or foreign. In other two forms already discussed the association of private enterprise can be only in the form of loans. In developing countries like India it may not be possible for the State to subscribe the entire

\(^{18}\) Public Accounts Committee: 15th Report, Volume 2, Appendix £ III.
amount of share capital. In this form the Government could also obviate going to the Parliament/ Legislature for any change in the set up of the organisation.

Many a times the Government enters the field of business just to initiate the process of development and has no intention in staying in it permanently. When the Government feels that the capital could be withdrawn, it proceeds with it, giving a sound industrial base to the economy. Such an arrangement can be possible in the company form of organisation.

For public sector undertakings, whole or a major part of share capital is subscribed by the Government. Following are the major sources of finance for a public enterprise:

(a) Public issue of shares and 'State Guaranteed' loans;
(b) Funds from Government:
   (i) As an outright grant;
   (ii) As share capital;
   (iii) Loans.
(c) Loans from banks and other financial institutions;
(d) Ploughed back profits.

(a) Public Issue of Shares

There are two schools of thought over this issue. According to one school of thought there should be no public
issue of shares. According to Hanson, "the issue of equities is ruled out as a means of raising capital". The same view has been expressed by 'Red Cliffe Committee' of England which was appointed to see the working of monetary system. Prof. E.V. Morgan had suggested the issue of equity to the public in a modified form. He tried to link the dividends not with profits but with sales, guaranteeing a minimum dividend.

Herbert Committee had expressed the opinion that the nationalised industries should go to the market and attempt should be made to raise their requirements in competition with other business enterprises. According to this view the public sector requires massive investments which may not be fully fed by the State. Krishna Menon Committee in India had also favoured public participation but only to the extent of 25 per cent. Recommending at least 25 per cent public participation the Estimates Committee emphasised that there should be a ceiling on individual

23 Estimates Committee (First Lok Sabha) 16th Report, June 1955, p.3.
holdings of shares as well as dividends. The Estimates Committee\textsuperscript{24} of the Second Lok Sabha had also been in favour of public participation.

The Government of India had set up a Committee to scrutinise the matter and make recommendations on the various aspects of public participation. The committee was in favour of public participation when it said that it was the general public and not the investing public which it had in mind as the permissible candidate for participation in the capital of a public enterprise. In case of developing countries like India, where resource mobilisation is a gigantic problem, with the help of public participation the Government would be relieved to some extent and the funds could be diverted to some other fruitful channels which otherwise could have been a non-starter or starved because of the non-availability or lack of funds. Moreover, the people will have a sense of belonging with the organisation. A minimum return will have to be guaranteed so that the private capital may be forthcoming. In this context the attitude of the Government of India seems to be inconsistent when on one hand it found no objection to a minority participation,\textsuperscript{25} whereas on the other the Government thought that sufficient private capital may not be forthcoming because the private investor was always motivated by the return on investment.

\textsuperscript{24} Estimates Committee (Second Lok Sabha), 19th Report, April 1958, pp.1 and 2.

\textsuperscript{25} Ibid., p.16.
Moreover, profits in certain cases may be deliberately limited for reasons of public policy and in other cases the larger monopoly profits of public enterprises could not justifiably be shared with groups of private sector.

No serious efforts in this regard seem to have been made by the Government of India. But at the same time it cannot be denied that whenever an attempt had been made (for example in Ashoka Hotels Limited) very little success could be achieved.

It is not out of place to make a mention that essential elements necessary for the growth of projects have been found to be deficient in India. Capital goods in the nature of plant and machinery, technical know-how to set up plants and necessary foreign exchange for the purpose of importing equipment and hiring technicians were found lacking. This led us to seek foreign collaboration. Collaboration may be technical, financial or both. In case of technical collaboration there was no financial involvement of the collaborator. It had been found desirable that collaboration must involve some sort of share participation or credit assistance or both.

Issue of State guaranteed Bonds

For public enterprises the issuance of fixed
interest bearing bonds could be another way of raising funds. It has not been found feasible and practicable in developing countries because of the lack of public response. At the state's level, these bonds have been issued by State Electricity Boards.

(b) Funds from Government

(i) As an outright grant: An outright grant is not a very sound method of financing public enterprises particularly in case of industrial projects. Since these projects are to be run on sound commercial lines such a source of finance is not at all desirable. It is likely to make the organisation extravagant in its actions, because easy money goes the easy way.

"The fact that a rate of interest and/or amortisation payments are included among the charges that a public enterprise is required to meet stimulates efficiency more powerfully than the mere announcement that, eventually, it will be expected to yield a surplus of indefinite amount". Loans carrying a rate of interest make the public enterprise recognise that the capital as a scarce commodity, has a price and, therefore, is not to be wasted. Grants generally breed irresponsibility and inefficiency.

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(ii) **As share capital**: Most of the industrial undertakings in the public sector have been organised in the form of a company and as such have been financed by the Government by subscribing to its shares. The equity represents the availability of interest-free capital. The right to own and control the enterprise goes with the ownership of equity which in the case of public enterprises is held by the Government or by a holding or apex body or bodies for its subsidiaries. A few public enterprises which were either started in the private sector or in joint sector continue to have a small portion of domestic private equity also.

(iii) **Loans**: A part of capital may be provided in the form of long-term loans. This adds to the financial burden of the enterprise both in regard to payment of interest and repayment of principal. It should, therefore, necessarily be related to the cash flow of the enterprise, its capacity to earn surplus, its gestation and commissioning periods and the nature of its activities. Detailed discussion on the subject is given under the head 'Capital structure' in the latter part of the chapter.

In certain cases the Government also grants short-term loans to the enterprise to tide over the temporary financial difficulties. But such loans are generally arranged by the units from the banks. In Indian context it
may be said that the Government has generally advanced interest bearing repayable loans.

(C) Loans from banks and other financial institutions

Short term loans are generally obtained by the public enterprises from the banks mainly in the form of cash-credit arrangements, for the purpose of working capital. Sometimes the banks advance term loans also, against which the bridging loan may be availed by the organisation for the time being, pending the completion of all formalities.

In 1974, the Reserve Bank of India had constituted a study group under the Chairmanship of Shri Prakash Tandon, to frame guidelines for the follow-up of bank credit from the point of view of ensuring proper end use of funds. The working capital gap, as identified by the group, namely, the borrower's requirements of finance to carry current assets (based on norms) other than those financed out of his own current liabilities, could be bridged partly from his own funds and long term borrowings, and partly through bank borrowings. The panel recommended that the maximum permissible level of bank borrowings could be worked out in three ways, namely:

(i) the borrower will have to contribute a minimum

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of 25 per cent of working capital from long-term funds, i.e. owned funds and term borrowings;

(ii) the borrowers will have to provide a minimum of 25 per cent of total current assets from long-term funds; and

(iii) the borrowers contribution from long term funds will be to the extent of the entire 'core' current assets, and a minimum of 25 per cent of the balance current assets.

The group recommended that the beginning may be made with the first method.

Another committee appointed by the Reserve Bank of India, popularly known as 'Chore Committee' was to review the system of cash-credit and credit management policy. The committee observed that there was a gap between the sanctioned limits of cash credits and the utilised limits. It further said that the unused gap in the public sector was much more than the private sector. The Committee favoured the increased use of long-term sources of finance to provide a part of the working capital and to curb over-dependence of large units on bank borrowings. In order to forecast their needs of funds accurately it was recommended by the group that over and under use of borrowing facilities should be penalised, having a tolerance limit of 10 per cent. The group was in favour of the present system i.e. the assistance may be continued in the form of cash-credits, loans and discontinuing of the bills. It was felt that directional

changes need be given to ensure that wherever possible the use of cash-credit would be supplanted by loans and bills. The group was also of the opinion that the second method of lending as recommended by the "Tandon Panel" should be considered by the bank. Chore Committee felt that a part of working capital should be financed from (company's) own funds.

The banks sometimes sanction the limits only when the Government furnished the guarantee to that effect.

The financial institutions, both at the Central and States' level had been engaged in advancing loans to public enterprises. At the national level there are many institutions such as IDBI and IFCI etc. At the State level there are State Financial Corporations and State Industrial Development Corporations. Regarding the functioning of financial institutions, it is important to note that in 1961 the Government of India had decided that public enterprises should not ordinarily be assisted by the IFCI. In July 1967, after the IDBI had come into existence the Government reiterated their policy of not entertaining the applications from the public sector. This policy was revised in 1969 when it was decided to accept applications from public enterprises also, subject to some conditions.
However, in 1971 the public financial institutions were authorised to entertain applications from Government companies and provide them assistance at par with private parties. Loans have also been advanced by other public financial institutions such as ICICI, UTI, LIC and GIC etc. There are examples where the public financial institutions have contributed towards the share capital of an organisation and the glaring example to be cited here is that of Punjab Tractors Limited, Mohali.

(d) Ploughed back profits

Corporate enterprises rely upon retained profits as an internal source of funds. After the payment of all prior claims and corporate taxes, the profits of any year could be wholly or partly distributed as dividends. Corporate savings play a very significant role in the growth and development of an industry. Most of the big concerns (particularly in USA and UK) owe their present size to this policy.29

As a source of capital this policy does not play an important role in the public sector because the profits are to be earned within the social obligation which results into losses (atleast) in the initial years. In a developing economy like India the public enterprises are expected

Table 3.2

Table showing the Contribution of PSIDC/ Government and the public in the total Capital of the Units as on 30.6.1979 *

<table>
<thead>
<tr>
<th>Name of the Undertaking</th>
<th>Percentage share of PSIDC/Government and its agencies</th>
<th>Percentage share of public</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Punjab Footwears Limited</td>
<td>100</td>
<td>-</td>
</tr>
<tr>
<td>2 Punjab Nylo-Transmissions Limited</td>
<td>95.5</td>
<td>4.5</td>
</tr>
<tr>
<td>3 Punjab Saltpetre Refinery Limited</td>
<td>62</td>
<td>38</td>
</tr>
<tr>
<td>4 Punjab Semi-Conductor Devices Limited</td>
<td>100</td>
<td>-</td>
</tr>
<tr>
<td>5 Punjab Scooters Limited</td>
<td>93.82**</td>
<td>6.18</td>
</tr>
<tr>
<td>6 Punjab Tanneries Limited***</td>
<td>100</td>
<td>-</td>
</tr>
<tr>
<td>7 Punjab Tractors Limited</td>
<td>Equity: 97.12**** Preference: 98.00 2.00</td>
<td>2.88</td>
</tr>
<tr>
<td>8 Punjab Wireless Systems Limited</td>
<td>100</td>
<td>-</td>
</tr>
</tbody>
</table>

* In Punjab Scooters Limited the financial year ends on 31 December

** PSIDC 57.80 Financial Institutions (IDBI,ICICI, IFCI,& LIC) 36.02 93.82

**** PSIDC 41.91 HMT 7.75

Financial institutions (IDBI,ICICI, IFCI,LIC & UTI) 47.46 98 97.12 98

*** The company has Rs 5 lacs as preference share capital subscribed by Punjab State Schedule Castes Land Development and Finance Corporation.
as a source of capital does not make any significant account. In Punjab Saltpetre Refinery Limited the public contribution has been to the extent of 38 per cent because of the fact that the unit had been incorporated as 'Punjab Saltpetre Refineries (Pvt.) Limited', Ferozepur City. Because of cordial relations between the PSIDC and the private partners the share of the latter remained undisturbed.

Chart 3B shows the subscription of equity share capital.

No unit had financial collaboration with any foreign collaborators/parties. Punjab Nylo-Transmitters Limited, Jullundur and Punjab Wireless Systems Limited, Mohali have gone for technical collaboration with LERIPA of Austria and REPCO, INCORPORATED OF USA respectively. Punjab Wireless Systems Limited had sought foreign collaboration only when Bharat Electronics Limited, a Government of India Undertaking had refused to oblige.

So far as the funds from Government are concerned there is no instance of an outright grant to any of the units. Regarding the subscription of share capital, the major contribution had been made by the Government, which is evident from Table 3.2 (Also see Chart 3B).

The loans have been advanced by the Government (through PSIDC) to all the units. In case of Punjab Tractors
CHART 3C

DIAGRAM SHOWING AMOUNT OF PRINCIPAL DUE TO PSIDC (FROM UNITS)

UNITS
- PUNJAB SCOOTERS LIMITED
- PUNJAB NYLO-TRANSMISSIONS LIMITED
- PUNJAB TANNERS LIMITED
- PUNJAB WIRELESS SYSTEMS LIMITED
- PUNJAB SEMI-COUPON TRACTOR DEVICES LIMITED
- PUNJAB FOOTWEAR LIMITED
- PUNJAB SALTPETRE REFINERY LIMITED

(in Rupees Lacs)

<table>
<thead>
<tr>
<th>Company</th>
<th>Amount (Lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>PUNJAB SCOOTERS LIMITED</td>
<td>54.00</td>
</tr>
<tr>
<td>PUNJAB NYLO-TRANSMISSIONS LIMITED</td>
<td>19.10</td>
</tr>
<tr>
<td>PUNJAB TANNERS LIMITED</td>
<td>16.22</td>
</tr>
<tr>
<td>PUNJAB WIRELESS SYSTEMS LIMITED</td>
<td>5.50</td>
</tr>
<tr>
<td>PUNJAB SEMI-COUPON TRACTOR DEVICES LIMITED</td>
<td>5.25</td>
</tr>
<tr>
<td>PUNJAB FOOTWEAR LIMITED</td>
<td>4.00</td>
</tr>
<tr>
<td>PUNJAB SALTPETRE REFINERY LIMITED</td>
<td>3.00</td>
</tr>
</tbody>
</table>
Limited, the loans had also been given directly by the State Government. During the interviews with the officials of PSIDC it was observed that the institution was in favour of advancing term loans but it had to advance short term and bridging loans also depending on the circumstances. It was revealed during discussions that the amount of loan advanced by PSIDC also formed one of the major sources of funds for the units. Amount of the principal due to the Corporation from the units as at the end of the financial year 1979 has been given in Table 3.3.

All the loans advanced by Government and the PSIDC are interest bearing repayable loans. Chart 3C shows the principal amount due to PSIDC from the units.

Another practice discussed during the interviews was that in case of certain units the loans had been advanced by the PSIDC and subsequently the unit insisted on the conversion of such loans into equity. A conversion of short term loan of ₹ 15 lacs in case of Punjab Tanneries Limited is the most glaring example.

The banks have advanced both term loans and working capital loans (called cash-credit) to the units. The cash-credit is allowed generally by the banks against pledge and hypothecation. Such limits have been sanctioned by the banks to all the units which have been shown in table 3.4.
### Table 3.3

Table showing the Principal amount due to PSIDC by the units as at the end of the financial year 1979

<table>
<thead>
<tr>
<th>Name of the Undertaking</th>
<th>Amount (in lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Punjab Footwears Limited</td>
<td>4.00</td>
</tr>
<tr>
<td>2 Punjab Nylo-Transmissions Limited</td>
<td>19.10</td>
</tr>
<tr>
<td>3 Punjab Saltpetre Refinery Limited*</td>
<td>3.00</td>
</tr>
<tr>
<td>4 Punjab Semi-Conductor Devices Limited</td>
<td>5.25</td>
</tr>
<tr>
<td>5 Punjab Scooters Limited</td>
<td>54.00</td>
</tr>
<tr>
<td>6 Punjab Tanneries Limited</td>
<td>16.22</td>
</tr>
<tr>
<td>7 Punjab Tractors Limited**</td>
<td>-</td>
</tr>
<tr>
<td>8 Punjab Wireless Systems Limited***</td>
<td>5.50</td>
</tr>
</tbody>
</table>

* Amount is also due to the Director of Industries, Punjab under deferred payment scheme (₹ 1.06 lacs)

** Owes ₹ 30.00 lacs (to Government ₹ 15 lacs and to Punjab Agricultural Marketing Board and MARKFED ₹ 15 lacs)

*** Amount is also due to Punjab State Small Industries Corporation ₹ 0.61 lacs. Deferred payment due to National Research Development Corporation amounted to ₹ 1.62 lacs.
CHART 3D

DIAGRAM SHOWING CASH CREDIT LIMITS SANCTIONED BY THE BANKS TO THE UNITS

UNITS

PUNJAB TRACTORS LIMITED
PUNJAB SCOOTERS LIMITED
PUNJAB SEMI-CONDUCTOR DEVICES LIMITED
PUNJAB WIRELESS SYSTEMS LIMITED
PUNJAB TANNERS LIMITED
PUNJAB NYLO-TRANSMISSIONS LIMITED
PUNJAB FOOTWEAR LIMITED
PUNJAB SALTPETRE REFINERY LIMITED

(IN RUPEES LACS)

180.00
53.00
48.42
37.00
28.00
8.00
5.50
5.00
<table>
<thead>
<tr>
<th>Name of the undertaking</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Punjab Footwears Limited</td>
<td>5.50</td>
</tr>
<tr>
<td>Punjab Nylo-Transmissions Limited</td>
<td>8.00</td>
</tr>
<tr>
<td>Punjab Saltpetre Refinery Limited</td>
<td>5.00</td>
</tr>
<tr>
<td>Punjab Semi-Conductor Devices Limited</td>
<td>48.42</td>
</tr>
<tr>
<td>Punjab Scooters Limited</td>
<td>53.00</td>
</tr>
<tr>
<td>Punjab Tanneries Limited</td>
<td>28.00</td>
</tr>
<tr>
<td>Punjab Tractors Limited</td>
<td>180.00</td>
</tr>
<tr>
<td>Punjab Wireless Systems Limited</td>
<td>37.00</td>
</tr>
</tbody>
</table>
Table 3.5

Table showing the term loans sanctioned (and availed) by the All India Financial Institutions

(Rs in lacs)

<table>
<thead>
<tr>
<th>Name of the Underking</th>
<th>Name of the Financial Institution</th>
<th>Amount sanctioned</th>
<th>Amount availed with percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Punjab Scooters Limited</td>
<td>IDBI</td>
<td>100</td>
<td>100 (100)</td>
</tr>
<tr>
<td></td>
<td>IFCI</td>
<td>35</td>
<td>31 (88)</td>
</tr>
<tr>
<td></td>
<td>ICICI</td>
<td>30</td>
<td>30 (100)</td>
</tr>
<tr>
<td></td>
<td>LIC</td>
<td>30</td>
<td>- (0)</td>
</tr>
<tr>
<td></td>
<td>Insurance companies</td>
<td>25</td>
<td>25 (100)</td>
</tr>
</tbody>
</table>

| 2 Punjab Tractors Limited | IDBI* | 80.03 | 80.03 (100) |
| | IFCI | 75.00 | 75.00 (100) |
| | ICICI | 30.00 | 30.00 (100) |
| | LIC | 25.00 | 25.00 (100) |
| | UTI | 20.00 | 20.00 (100) |

* Inclusive of a foreign currency loan of Rs 9.21 lacs
CHART 3E  TERM LOANS SANCTIONED BY ALL INDIA FINANCIAL INSTITUTIONS TO THE UNITS

(IN RUPEES LACS)

<table>
<thead>
<tr>
<th>Year</th>
<th>Punjab Scooters</th>
<th>ICICI</th>
<th>LIC</th>
<th>Insurance Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981</td>
<td>100</td>
<td>30</td>
<td>40</td>
<td>80</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Punjab Tractors</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981</td>
<td>100</td>
</tr>
</tbody>
</table>
in May 1979 by the Appraisal Committee, to be sanctioned to Punjab Wireless Systems Limited, Mohali. The other institutions which provided financial assistance were National Small Industries Corporation and State Trading Corporation. They had advanced Rs 4 lacs and Rs 5 lacs to Punjab Nylo-Transmissions Limited and Punjab Tanneries Limited, respectively.

Chart 3-E shows the term loans sanctioned by All India Financial Institutions

Ploughing back of profits could be found only in case of Punjab Tractors Limited, where the expansion programme was financed through the internal resources. As already mentioned the grant of excise duty relief proved to be a turning point in the history of the company. The amounts transferred to general reserves by the company were:

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount (Rs in lacs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976-77</td>
<td>54.41</td>
</tr>
<tr>
<td>1977-78</td>
<td>67.00</td>
</tr>
<tr>
<td>1978-79</td>
<td>94.96</td>
</tr>
</tbody>
</table>

Regarding working capital, the Director Commercial Audit and the Government of India have followed the 'net concept'. For the permanent sources of working capital

* Current assets - current liabilities.
both the internal and external sources are to be examined. Most explicit among the internal sources are retained earnings and depreciation. Retained earnings depend upon mainly dividend policy and are generally used for financing expansion schemes. Depreciation may also be used as a long term source of working capital because in most of the cases the life of the assets is pretty well. Any of these two generally may not accrue in the initial years in case of public enterprises and, therefore, these units are left with no other alternative than to use the external sources for financing the permanent working capital requirements. In public sector undertakings the Government may be the only source of funds from this point of view. It depends upon the policy of the Government whether the sum is advanced as a loan or in the form of (holding) equity. In most of the cases, the concerns are in favour of equity because it bears no commitment. In the initial years such requirements should be met by the Government in form of equity so that the concern is not laden with the burden of interest charges from the very beginning.

Cash-credits from banks form the most dependable source of current working capital. Trade credit may also be looked upon as a source of working capital but with the usage of 'net concept' it has to be treated as a normal trade transaction and hence does not form a source of finance
because in this sense it is automatically accounted for.

Depreciation and cash-credits from banks have been the main sources of working capital in context of the units taken up for the purpose of present study. Only in Punjab Tractors Limited, retained earnings have also been shown as a source of working capital. In this unit it was gathered that the net concept of working capital was used and at the same time the trade credit was taken into account as a source of working capital. No satisfactory reply was forthcoming for this lapse. All the units had been using the net concept of working capital. Main source of working capital was through the arrangement of cash-credit limits with the banks. It was observed during discussions that in most of the cases the interviewees themselves did not know whether depreciation was being used as a source of permanent working capital or as a current source. In Punjab Tractors Limited, it was revealed that more or less the depreciation had been used to meet the permanent needs of working capital.

(c) Capital Structure

Capital structure refers to the combination of various types of securities through which funds had been raised. The broad headings under which capital could be classified are equity and debt. The ratio between debt
and equity is often referred to as gearing ratio or leverage ratio.

After taking a decision regarding the sources of funds, the vital issue to be decided is about the composition of various securities in the total capitalisation of an organisation. Because funds raised by way of equity are required to pay dividends which is an appropriation of profits and in case of loans raised, the interest has to be paid because it is a charge against profits.

Regarding the determination of capital structure many approaches have been advanced by the authorities on the subject, e.g., Solomon, Modigliani and Miller, Donaldson, John F. Childs. Solomon had emphasised a capital structure at the minimum cost of capital, while Modigliani and Miller did not consider seriously the problem of determining capital structure for the reason that the value of a firm was independent of leverage. Donaldson emphasised cash adequacy as the main determinant of capital structure. Childs considered the judgement factor to be more important but at the same time emphasised the cost of capital and financial risks of the firm as the major determinants of capital structure. If these approaches are deeply looked into, it will be evident that except the approach of Modigliani and Miller all other have laid too much emphasis on the
cost of capital and financial risk. These approaches hold good in the case of private sector when the securities are traded in the capital market and there are many options available to the firm. In case of public sector both of these are almost non-existing factors, Government being the main supplier of funds. Profitability, though a desirable objective may not be the only cause of their establishment. The cost of capital and financial risk are important considerations but determination of capital structure in the public sector would be decided to a greater degree by other considerations.

In case of private sector the cost of equity capital may be defined as the minimum rate of return that must be earned on equity financed investments, so that the value of the existing ordinary equity remains unaltered. This may not be applicable in public sector enterprises where the shares are not (generally) floated in the market. The Government may make use of opportunity cost concept where the cost and return in alternative investment is to be worked out by the Government and that should be the minimum cost level at which the capital can be made available to a particular enterprise, subject to, of course, risk factor.

Unlike the private sector units where the capital structure is appraised in terms of control, cost, tax burden and market rate of return in each share, the capital
structure in public sector units is the result of an 'adjustment' between the enterprise and the Government. In most of the cases it is a compromise without applying any scientific technique of appraising different methods of financing. The demand for fresh funds from public enterprises continued to be in favour of equity because debt involved an explicit cost to them. In public sector units, one point to be taken care of is that by providing additional equity share capital the return on the previous investment should not stand diluted.

Whatever is the financial mix, a capital structure should positively be a flexible one to suit present and future needs. The critical factor in the whole system is that the relationship between the operating enterprise and the Government should be that of a borrower and the lender.

While deciding the terms on which the capital is to be provided the Government has to bear in mind two considerations. Firstly, the strategic investment should not be tested with the strict test of rate of return criteria. The second being that in the long run public enterprises must become capital creating as well as capital

absorbing, if the proportion of the national income-saved and invested is to be stepped up. It is with regard to these investments that the Government has decided that the public enterprises should be made economically viable units and an all out effort should be made to increase their efficiency and establish their profitability at the earliest.36

It may be concluded by saying that in the initial years enough funds may be provided by way of equity but during the manufacturing and operating stage a judicious mix is to be arrived at so that it takes the minimum possible time for the unit to stand on its own.

Debt: Equity

The public enterprises are immune to the changes in market conditions affecting the cost of capital. Prior to 1960, the Government of India did not have any clear cut policy in regard to the debt and equity. It was in 1961 when the Government decided on a debt-equity ratio of 1:1. Since then the pattern of capital structure on this basis is generally prescribed by the Government as the 'true economic costs', the argument being that without an appropriate burden of interest charges the costs will remain understated.

in Government companies and its managers will be having an easy time in making profits.

The norm of 1:1 became a subject of controversy and while examining this issue the Committee on Public Undertakings observed that there cannot be one common ratio applicable to all undertakings. Moreover, even in the same undertaking such rigidity cannot be adopted for all the times. The Committee recommended that the rigidity should be avoided and if any undertaking makes out a strong case for a change in this ratio, due consideration should be given to that. The Administrative Reforms Commission also made a similar observation. The Union Government has accepted these recommendations.

The issue was also examined by the National Commission on Labour which recommended that the investment on township should not be a charge on the undertaking but should come from a separate fund. After taking this recommendation into account, the Government decided that the expenditure on township may be treated as part of its equity investment in

37 CPU: (Fourth Lok Sabha) 15th Report, p.29.
that four units namely, Punjab Nylo-Transmissions, Punjab Scooters, Punjab Tanneries and Punjab Tractors suffered from an inappropriate capital structure. But the ratio of net block to net worth (see Table 3.7) reveals that all the units (except Punjab Wireless which was in its initial stage of production) had too much dependence on the outside funds. In some of the units there has been a decreasing trend of such dependence during the later years, e.g. Punjab Semi-Conductors Devices and Punjab Tractors. All the units except Punjab Tractors Limited were in favour of equity for their fresh need of funds. The reason advanced for this by these units was that there was no explicit cost of equity share capital. Moreover, with more equity available their position improved regarding negotiations with banks. But the Government should make it clear that the amount of equity is not without cost and should be used with care and caution. In case of fresh need of funds of the existing units and in case of the clearance of new projects strict tests of financial viability should be exercised, so that wrong investment decisions are either not initiated or abandoned with minimum wasted expenditure.

Most of the units have been burdened with an unbearable amount of interest which had adversely affected the working of the units. All the units were paying huge amounts of interest charges but in case of Punjab Scooters, Nabha the
situation was worst on this front. Interest charges contributed 20.60 per cent to the total cost of the vehicle which came next to the raw-material component. For the year ending 1977 the indirect costs accounted for 26 per cent of the total costs, and 70.6 per cent of the indirect cost was made up of interest charges alone. The interest liability during the year 1977-78 and 1978-79 stood at Rs 33.07 lacs and Rs 36.06 lacs respectively. There is no real equity left in this unit. Most of the business was being conducted with the help of borrowed funds. Payment of interest to All India Financial Institutions stands suspended from January 1, 1978.

Financial position of Punjab Footwears looked to be grim because of the interest burden. Almost the whole of the capital was eroded during the initial years. And the unit had to depend on borrowings from PSIDC and the banks. This dependence is evident from the fact that the ratio of net block to net worth stood at 304.84 per cent during the year 1975-76. Moreover, for other years this ratio could not be calculated because of negative net worth as is evident from table 3.7.

When the company got the export orders through Punjab Export Corporation, two loans were availed from the United Commercial Bank on 23.6.1973 and 5.10.1973 amounting to Rs 2.70 lacs and 0.95 lacs. The rate of interest charged by the bank was 11 per cent p.a. (compound).
Table 3.7

Table showing the burden of interest and percentage of net block to net worth in the units (Rs. in lacs)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Punjab Footwears Limited</td>
<td>1.57*</td>
<td>1.32*</td>
<td>1.24*</td>
<td>1.50*</td>
<td>1.47*</td>
</tr>
<tr>
<td>2 Punjab Nylo-Transmissions Limited</td>
<td>1.15</td>
<td>2.85</td>
<td>2.63</td>
<td>3.56</td>
<td>3.43</td>
</tr>
<tr>
<td>3 Punjab Saltpetre Refinery Limited**</td>
<td>0.23</td>
<td>0.22</td>
<td>0.68</td>
<td>0.67</td>
<td>0.95</td>
</tr>
<tr>
<td>4 Punjab Semi-Conductor Devices Limited</td>
<td>(919.14)</td>
<td>2.85</td>
<td>3.84</td>
<td>12.71</td>
<td>12.31</td>
</tr>
<tr>
<td>5 Punjab Scooters Limited</td>
<td>(85.86)</td>
<td>0.22</td>
<td>184.35</td>
<td>181.23</td>
<td>(173.10)</td>
</tr>
<tr>
<td>6 Punjab Tanneries Limited</td>
<td>5.28</td>
<td>8.43*</td>
<td>10.71*</td>
<td>11.97*</td>
<td>(321.18)</td>
</tr>
<tr>
<td>7 Punjab Tractors Limited</td>
<td>36.63</td>
<td>48.72</td>
<td>45.89</td>
<td>23.65</td>
<td>27.37</td>
</tr>
</tbody>
</table>

* From proforma accounts.
** Figures represent total financial charges.

Notes: (1) Figures in parenthesis are the ratios of net block to net worth (in percentage) showing the dependence on outside funds.

(2) The figures for Punjab Wireless Systems Limited, Mohali have been excluded from the table because it had worked only for six months i.e. from January 1, 1979 to June 30, 1979.
On a production of 100 pairs the financial overheads worked out to be 17 per cent, whereas the company was charging these overheads at the rate of 9 per cent to the production cost. The unit was charging financial overheads on the basis of loans availed for working capital only and not on the total loans availed by the concern. The burden of total interest as per proforma accounts of the company came to be Rs 1.24 lacs, Rs 1.50 lacs and Rs 1.47 lacs during the years 1976-77, 1977-78 and 1978-79 respectively.

It may be mentioned that during the initial years the unit had to depend on borrowings because the private promoters failed to contribute their agreed proportion of the share capital, which was worked out to be Rs 3.60 lacs.

Punjab Nylo-Transmission could not make the payment of interest due to National Small Industries Corporation, Punjab State Small Industries Corporation and Bank of Baroda at the time it was due. Upto 30.6.1977 the cash losses were financed by way of arranging temporary loans from PSIDC at the rate of 15 per cent p.a. During the discussion it was revealed that the unit had been facing the problem of servicing the debt. While calculating the figures of expenditure for the year 1978-79 the interest due to PSIDC was not taken into account.

The dependence of the company on the outside funds is evident from the ratio of net block to net worth which
CHART 3F

GRAPH SHOWING THE BURDEN OF INTEREST FOR DIFFERENT UNITS

- PUNJAB TRACTORS LIMITED
- PUNJAB SCOOTERS LIMITED
- PUNJAB SEMI-CONDUCTOR DEVICES LIMITED
- PUNJAB TANNERS LIMITED
- PUNJAB NYLO-TRANSMISSIONS LIMITED
- PUNJAB FOOT-WEARS LIMITED
- PUNJAB SALT PETRE REFINERY LIMITED

YEARS
stood at 919.44 per cent during the year 1974-75 and this ratio could not be calculated for the subsequent years because of negative net worth. The figures of interest for different years have been given in Table 3.7. The percentage of interest to total cost of sales which stood at 24.89 in 1974-75 was 43.47 at the end of the year 1978-79. Thus, it is evident that the unit was too much dependent upon borrowed funds and hence had to incur a big liability on account of interest.

Punjab Saltpetre Refinery Limited was started with a meagre amount of Rs 50,000. The unit had to diversify the production because of the supply of faulty machines and equipment. The unit was mainly working on borrowed funds (which is evident from the table 3.7) as the ratio of net block to net worth was 879.25 per cent during 1978-79. The rate of interest had gone upto 20 per cent at certain times as was revealed during the discussions. The element of interest contributed 6.15 per cent to the total cost of sales during 1974-75 whereas it accounted for 13.58 per cent at the end of the year 1978-79. Interest and bank charges were 52 per cent of administrative and other expenses and almost double than the salaries and allowances bill during the year 1978-79. Chart 3F shows the burden of interest for different units.

Punjab Semi-Conductor Devices Limited also had to incur a huge liability on account of the interest charges.
Interest in this unit was 18.14 per cent of the total cost of sales during 1974-75 which came down to 10.83 per cent during the year 1978-79. The ratio of net block to net worth came down to 173.10 per cent during the year 1978-79 showed that the company was depending on the outside funds, though this dependence had been showing a decreasing trend. The element of interest had affected the unit adversely.

Punjab Tanneries Limited was saddled with unproductive interest burden. The heavy interest burden on the unit was mainly on account of the fact that the company had been raising borrowings at interest rates ranging from 12 to 14 per cent from the PSIDC to meet the working capital needs and also the need for addition to fixed assets. One of the former Managing Directors revealed that at no stage realistic estimates were made and the funds were obtained from time to time from PSIDC at varying rates of interest. The unit was depending heavily on the external funds which is evident from the ratio of net block to net worth which stood at 321.18 per cent at the end of the year 1978-79. The amount of interest paid during the year 1974-75 was Rs 5.28 lacs and in the proforma accounts this figure has been estimated at Rs 11.97 lacs during the year 1978-79.

The burden of interest on the company could be seen from the fact that PSIDC had to convert a loan of Rs 15 lacs into equity on 8.2.1977 and a temporary loan of Rs 13.62 lacs
was also converted into a term loan. All this happened on account of the continuing insistence of the company. When this point was discussed with the officials of PSIDC, it was gathered that the unit was always making defaults in the payment of interest, what to talk of the payment of principal.

Before the grant of excise duty relief in 1975, Punjab Tractors Limited was too much dependent on the outside funds which is evident from the ratio of net block to net worth, which stood at 5958.7 per cent during the year 1974-75. The company had to request the All India Financial Institutions for the deferment of interest, PSIDC was requested for the conversion of loan into equity and the National Research Development Corporation was approached for the postponement of royalties. On 3 November 1976 the rate of interest was reduced to 8½ per cent per annum by Punjab Government on its loan. PSIDC also reduced the rate to a similar figure for the entire period for which the loan was availed, i.e., from the back date. These rates had been reduced because this condition was put by the All India Financial Institutions for the deferment of interest (for a period of one year) due to them amounting to ₹ 20.75 lacs. The Institutions had also insisted on the other condition for the conversion of loans into equity amounting to ₹ 15 lacs and ₹ 10 lacs of Punjab Government and PSIDC.
respectively. But as the grant of excise relief proved to be a landmark in the history of the company, it was requested that the second condition may not be insisted upon because the unit would be able to service the debt in the near future with enough cash accruals. The company cleared all the arrears of principal and interest (due to various agencies) during the years 1977 and 1978. Now the dependence on the outside funds has also come down by a considerable extent as is evident from Table 3.7. Interest which accounted for 9.78 per cent of the total cost of sales during 1974-75 came down to 1.21 per cent during 1978-79.

Punjab Wireless Systems Limited was not burdened with the amount of interest. On the loan of NRDC the company was not to pay any interest and upto the year ending 1979 the unit had availed of a bridging loan of Rs 5.50 lacs against a term loan sanctioned by the PSIDC.

**Summary**

From the above analysis, it is evident that in most of the cases proper and enough attention had not been given to the vital issue of financial planning. Actually no unit prepared a financial plan for a long-term except in the case of Punjab Tractors Limited where the attempts had been made in the later years in this direction.
Estimates had been made without any basis and hence realistic estimates could not be formulated. Estimation of capital requirements in most of the cases had been done on the adhoc basis.

Most of the funds had come from PSIDC either in the form of equity or loan. Term loans have also been advanced by banks and other financial institutions such as PFC, IDBI, IFCI, ICICI, UTI etc. A major portion of working capital had been met through cash-credit arrangements with the banks.

The capital structure of most of the units has been inadequate and ill-planned. Inadequacy has been further heightened by grossly insufficient provision for working capital needs. In case of Punjab Semi-Conduct Devices Limited once it was communicated by Indian Overseas Bank to PSIDC that the requirements of working capital indicated by the company were beyond the limits stipulated by Tandon Panel.

except Punjab Wireless Systems,

All the units had too much dependence on the external funds, though a decreasing trend has also been witnessed in Punjab Tractors and Punjab Semi-Conductor Devices. Interest had accounted for a major portion of the total cost of sales. The burden of interest charges
Realism in planning requires that each firm in the public sector must find out its own answer to the question of an appropriate capital structure. Some establishments will embody simplicity by presenting a thick equity base, while others will be attracted by the leverage and borrowed funds at such rates so that these may be employed in the business at a rate higher than the cost. There will be several layers of debt in the capital structure of such organisations. Some undertakings may be convinced that financing from retained earnings was the best. Any single formula for the capital structure may be impracticable.

(i) A financial plan should encompass both long term and short-term requirements of the organisation. The calculations should not be merely guesstimates and should be based on certain facts and figures. More care and caution is to be exercised at this stage so that the chances of revisions (of estimates) should be minimised, if not eliminated.

(ii) There is no harm if the public is also invited for the purchase of shares as it will relieve the State Government to a great extent. The experience of the
State had not been a happy one in case of Punjab Footwears Limited and Punjab Nylo-Transmissions Limited, where the PSIDC had to intervene and purchase the shares of private promoters in both the companies. To avoid this the shares may be offered to general public and not to a group of private promoters who generally join hands and pose a problem for the smooth running of the organisation. It will be better if the workers/employees are involved in the share capital because it will evolve in them a sense of belonging with the organisation. To make this scheme a success a minimum rate of return should be guaranteed by the State, at least in the initial years of its operations.

(iii) At the time of providing funds in the form of share capital it should be made clear by the PSIDC that these funds were not free of charge. Loans may also be advanced by the institution on the condition that the interest and instalments of principal will be paid regularly. In case of any default PSIDC should initiate action and should not provide additional funds till the past arrears are cleared and assurance is given that in future the unit will not indulge in this type of activity. It is felt that the approach in this context is very lenient on the part of PSIDC. Since all the units are in competitive market, they should be able to service the debt in addition to paying at least a reasonable rate of dividend on the
shares. In a competitive market, only those units should be nursed by the Punjab State Industrial Development Corporation which required hospitalisation, those which require 'Crematorium' should not be allowed to become permanent parasites on the state exchequer.

(iv) Technical collaboration without any sort of financial involvement should be discouraged. Because with financial involvement, the foreign collaborator takes an active interest to bring the unit on sound footing, as early as possible. The financial involvement may be kept at the bare minimum, if not more.

(v) The capital structure should be so designed that the payment of interest does not pose a problem for the unit. Undue dependence on the outside funds is not at all desirable in such State undertakings where there are no earnings, what to talk of stability of earnings. More debt could be infused where the earnings are stable. The ratio of net block to net worth (in percentage) should not generally be allowed to exceed 100 or so. Capital structure of a public sector unit should have a sufficient equity cushion to absorb the shocks of business oscillations.