CHAPTER - III

FINANCIAL PERFORMANCE EVALUATION CRITERIA

IN PUBLIC SECTOR: A DICHOTOMY BETWEEN

SOCIAL AND COMMERCIAL CRITERIA

A) Introduction.

B) National Objectives and Profitability norms.


D) Profitability and Pricing in Public Enterprises.
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(A) Introduction:

It is well known that any investment decision is intended towards achievement of the enterprise objectives commercial as well as social.

In the 'Mixed Economic' system, the Government is fully committed towards creation of a 'Socialistic Pattern' of society as its ultimate objective for which it has played a dominant role in the creation of public sector enterprises especially in the field of heavy and basic industries under the popular theory of 'Commanding Heights of the economy'.

In case of private sector the government has applied various measures of controlling the commercial and industrial activities in directing their functioning for the social purposes; even though this sector mainly remains on the lines of the commercial profits. In this sense the Indian private sector may not be truely called as 'Private' or 'Capitalist', as it does exist in the 'Free Market Economies' of the western world.
This makes our private sector and public sector to function more effectively and efficiently towards contributing the achievement of national economic objectives in its macro sense. The only difference lies in both these sectors is that, the private sector has to test its efficacy in a competitive markets, while the public sector does not. There are public sector departmental enterprises like Railways, Arms and Ammunition, Air Transport, Posts and Telegraphs and so on, in which private sector is not allowed to enter and it assumes a kind of government monopoly, where the government has not to face the competition at all, but this may not be the case, that the public sector enterprises in the field of trade, commerce and industry should not face the competition. Moreover, the crux of the problem is whether industrial or commercial enterprises existing in both public as well as private sector, which act as the providers of industrial supplies and intermediate products should be allowed to function on the different norms of performance criteria i.e., social and commercial criteria, or whether they should be treated on par? Whether private enterprise should compete with the public enterprise? It is this type of controversy which has invited a lot of criticism on the public sectors enterprises in particular.

(B) National Objectives and Profitability Norms:

For fulling broad national objectives it is expected
that the public sector should execute its role in a more effective manner. It should also be noted that, the co-relation between national objectives pre-set by the planning commission - and the public sector objectives in the national economy vis-a-vis unit level objectives have always remained so closed that the line of demarcation had been lost and it has become almost customary to evaluate the performance of individual public enterprises at par with that of measuring the performance of the national economy based on the macro-performance criteria.

Under the circumstances as mentioned above there is bound to be divergence of opinions against and for, on the issue of performance measurement criteria for the public sector.

It is many a times said that the profit alone may not necessarily be the sole criterion for judging the financial performance of public enterprises. Social objectives like the contribution to public exchequer, potentiality of creating the small scale and ancillary industries, development of infrastructural facilities the establishment of basic and core industries, provision for investment on townships and other social welfare needs, employment generation, are also the other criteria for performance evaluation.

Ironically, it is besides these criteria which are of the nature of 'Macro-economic' criteria, which come
under the purview of measuring the growth of economy with these indicators, have also been used on the firm or a unit level; while at the incorporation stage of these public sector units have had incorporated 'Profit' as a commercial criteria.(2)

Eventhough, it may be true that the public enterprises have contributed towards the above social objectives, but when talking about the developing economy like India "it is of paramount importance to see that investments are made to yield positive returns ... as a matter of fact, planned profits are a "must" for establishment of socialistic pattern of society". (3)

More specifically, the objective performance in private sector individual units are fully, commanded by the 'Profit' motive, while the criteria for measuring the performance in public sector as a whole and at a unit level have remained social benefit oriented. The dichotomy lies in determining the unique criteria which would be applicable to both, private sector and public sector performance measurement. Presently, the measurement of the performance of public enterprises, as a whole and the public sector enterprises in particular has been overshadowed by the social considerations.

(C) Review of the "Profit" and "Profitability" as the Performance Appraisal Criteria in Public Sector Units:

It is an accepted fact that the public sector in
India has reached to its 'Commanding heights' and has, over last 40 years, been functioning as provider of the basic services and infrastructure in the national economic development. At the same time, it has been criticised also that the returnability of the public sector over its huge investments has always remained at a very low level. Large number of public enterprises have sustained huge losses over several years, and the public sector managements and government are criticised heavily on their gross inefficient management, operational inefficiencies and lack of proper co-ordination and control at various managerial, operational, and organisational level.

Before reviewing the various views placed by the authorities on development economics, administrators, and writers on the performance appraisal criteria it is better to take a brief account of the views expressed by Industrial Policy Resolution 1948 and 1956, as well as by the planning commission of India in its volume "Feasibility Studies for Public Sector Projects", published in May 1966.

The Industrial Policy Resolution of 1956, says, while emphasising the speedy decisions and willingness to assume responsibility for the successful running of the public enterprises further adds that "their management should be along business lines" stating further that "It is to be expected that public enterprises will augment the
revenues of the State and provide resources for further development in fresh fields...(4).

Industrial Policy Resolution of 1948 has also rightly emphasised on the above aspect by referring the resolution which was unanimously passed by Industrial Conference, held in December 1947. It stated that "The system of remuneration of capital as well as labour must be so devised that, while in the interest of consumers and primary producers excessive profits should be prevented by suitable methods of taxation and otherwise, both will share the products of their common effort after making provision for payment of their wages to labour, a fair return on capital employed in the industry and reasonable services for maintenance and expansion of the undertaking."(5).

It should be noted in this regard that the Central Government and Planning Commission have emphasised on the various occasions that, "Public Enterprises have to provide not only an adequate depreciation and return on capital but also the necessary surplus for future expansion. The Fourth Plan suggested that "the public enterprises must yield not less than 11 to 12 per cent rate of return on capital". (6)

The various governmental bodies like 'Bureau of Public Enterprises(BPE) and Committee on Public Undertakings'
(CCPU) have constantly made the suggestions in regard with the need for establishing unit level objectives for each public enterprise, to the government. The government has so far failed to do so on various grounds, one being that, the public enterprise have been set with a view to achieve the socio-economic objectives, the socialistic pattern of society as its supreme goal.

Another fact that the government does not feel it necessary to fix-up performance evaluation criteria and objectives at unit level on the reason that the detailed Project Report of each public enterprise and memorandum of Association of Government Companies contains the detailed objectives regarding each public enterprise separately.

It has been also pointed out that "setting of the clear corporate objectives for each one of these enterprise would go a long way in facilitating the managers to administer the enterprise efficiently towards the realisation of goals, it would also help the administrative ministries to correctly guage and assess the efficiencies of the managers in terms of objectives laid down; finally, it would also help the public of India to understand and evaluate their performance in relation to objectives".(7)

Dr. Bakul Dholakia takes a totally different view on the applicability of the performance criteria for the
public sector industries; "The objectives are different than that of private sector industries. Hence, only profitability cannot be the sole criteria for measuring the performance of public enterprises - Criteria should be based on the basis of wide range of objectives which are required to be fulfilled by the public enterprises alternative criteria for performance evaluations that would be used by public enterprises are -

(1) Public enterprises should make significant contribution to financing plan outlays for attainment of further economic development by generating commercial surpluses.

(2) Public enterprises should make a significant contribution to the acceleration of the growth rate of national economy and improve the economic efficiency of resources utilisation.

(3) Public enterprises should effectively contribute to the fulfilment of long term socio-economic objectives to be pursued.

The broad criteria for performance evaluations that would correspond to each of the above mentioned objectives are -

(1) The criterion of Financial Viability
(2) The criterion of Factor Productivity

(3) The criterion of Socio-economic benefits.

respectively.(8).

It is true in many public enterprises especially in service rendering organisations that they may not earn increasing rates of returns on capital employed. Because their basic objectives is that, the people should get such services, at cost, or even below cost, and no private competition should be allowed in such activities where the larger public interests are involved. As it is rightly put by Professor V.V. Ramanadham, that:

"A public enterprise may, therefore, be permitted to aim at maximum profits as in the case of private enterprises, only where the difference between its social productivity and private productivity is nominal, whereas it may be asked to earn above full cost but below the level of maximum profit where the social returns are of same significance, and where the social returns are estimated to be considerable, it may be allowed to operate below full cost."(9)

But when all sort of public enterprises described as "infrastructures" in the interpretation of socialist idealism, like power, electricity, oil and gas, banking, steel, cement, coal, fertilisers, roadways and railways,
communications and telephones, if by the definition are called as infrastructures, then it is highly impossible to turn such public enterprises as profit making. Hence, there is a need to clearly define the targets of public sector enterprises by which their performance can be judged on some concrete norms" instead of vogue exhortations to serve the community, of being a model employer". (10)

It has been observed by the Indian Planning Commission that the profits are universally accepted as an index of efficiency and any amount of talk about special objectives cannot disprove it. In the "feasibility studies for public sector projects" issued in May 1966 the Planning Commission mentions clearly that "the prime objective of the feasibility studies on public sector projects however is somewhat different, (than the private sector projects). This objective may be defined as the determination of those projects which will provide the most economical achievement of the Five Year Plan objectives." (11).

While hitting hard on the 'profitability norm for the measurement of the performances of public enterprises, it is ironically a true that, the public enterprises contribution has remained at a very low level at 20 to 21 per cent than that of the remaining 79 to 80 per cent savings of the total national savings which come from private sector." (12)
Total neglect on the part of profitability on an individual public enterprise level has created several problems in the areas like pricing, capacity utilisation, renovation and modernisation with the application of new technology, and financial strength of the public enterprises at large.

As said by Professor V.K.R.V. Rao who was one of the member of the Planning Sub-Committee during the formulation of Third Five Year Plan that, "Public enterprises, should charge an economic price, which means that price should cover the cost of production of the commodity which normally covers allowances for replacement plus normal profit for expansion, maintenance or capital formations, a certain amount for the non-investment activity of government. It has to be understood here that, if no profits are generated towards the plan development of the country as well as for the self financing of developing needs of capital resources for the public enterprises it would creat some sort of double burden on tax system and policy to create funds for plan and non-plan activities. In such a case public sector would be a drag on financial resources of the country and the process of economic development as a whole is bound to be slowed down. This would naturally bring the whole economy as high cost - low efficient economy, wherein, the pricing policy as a tool in the hands of government will loose its importance as governing
the resources allocation for the economic development of the country according to plan priorities."(13).

As regards pricing policy of public enterprises, the planning commission of India has stated in the Memorandum of the Fourth Plan that, "Capital is a scarce resource and the prices of public enterprises must be so set as to provide an adequate return on the capital employed in them. A return of 12 per cent on the invested capital would be an appropriate criterion for determining the price policy of most public enterprises."(14).

Profit is even accepted as an inevitable criterion for measuring the enterprise performance in many of the socialist countries including Soviet Union. Professor Liberman says that, "Even under socialism the only all embracing criterion that could ensure the growth, stability, quality and efficiency of production was the maximisation of the enterprise profits." Even the Central Committee of the Communist Party of the Soviet Union as barely accepted the truth behind profit motive, in the following words -

"Every achievement or break through in the organisation of production, in the use of fixed and circulating assets in the observance of financial discipline, in the quality and variety of products, in brief any move in the work of the enterprise is inevitably reflected in the profit—positively or negatively."(16). While describing
the significance of the profit criterion, J. Wilezynski in his book says that, "The significance in the fact that a direct link has been established between profits and incentive payments, so that it is in the interest of the enterprise personnel, and at the same time of society - to strive to maximise enterprise profits. But profits can achieve more than merely a better utilisation of resources at the operational level. Trends in the levels of profitability of different branches of economy provide guidance to centra-planners in their endeavour to optimise the allocations of resources on the macro-social scale. Thus profit provide that unique bond of union between micro and macro-economic interest the missing link from which socialist economies had traditionally suffered," adds further that... profits are now becoming the main source of state revenue, displacing turnover taxes." (17).

(D) Profitability and Pricing in Public Sector Enterprises:

Basically a profitability of public enterprises or rather any firm depends on the excess of the selling price of the product over the cost of production. The price policy and proper price determination for public enterprises is an area which is in the hands of Central Government for some basic reasons of maintaining the public good at large and supposedly, not only for the purposes of maximising
profits in public enterprises. But it is also a fact, if there happens to be a constantly upward price movement of some basic inputs for the other producing sectors of the economy, that naturally would lead towards a high cost, low efficient economy and the demand for such goods will be sluggish. The anti-effect of such situation has always resulted in underpricing of the various end products, or which are basic inputs for the other producing sector, which leads the hauling of the progression of economy in general. This point has been stressed elaboratively by V.Kolesov(18). The phenomenon of underpricing in public sector has acted in stimulating private entreprenarship and privatisation of public enterprises due to the non-profitable functioning of public enterprises. Another thing is that, the pricing policies of public enterprises are not rational. The pricing policies as a measure to monitor the performance of public enterprises assume greater significance. The function of price system as is stated by Oskar Lange, in economic planning is two told (19). Firstly, the price serves as a means of evaluating costs of production, value of output, and comparing the two. Secondly, the role of pricing is to act as an incentive system. At an early stage of planning a price policy may be absent as to the first function, but when the economy grows and becomes more complex and diversified, the problem of efficiency and incentives becomes more important.
As such, the price policy, in an increasingly complex economic process, should be aware of highest efficiency through the proper cost accounting and through properly established incentives.

It was "no profit no loss" principle which did hold water till the beginning of the Third Plan. Before that, the "low price doctrine" was popular for it would bring a rapid economic development. Both of these principles did not possess allocative rationality and were short sighted. The draft Third Five Year Plan mentioned a radical change and expected the profits large enough to cover the financial needs and programmes of the public enterprises. Professor V.K.R.V. Rao in his paper at Ooty Seminar, also stressed on price policy for profits.

He gave the stress on the point that public enterprises must be carried on profit making basis and the share of the profits of public enterprises in financing the investment and maintenance expenditure of government must keep on increasing. Only increasing expenditure on public enterprises will not indicate that we are on the path of socialism. More important is the increasing role that the public sector must play for finding resources needed for meeting both maintenance and investment expenditure of government. This involves a price and profit policy in regard to public enterprises which goes against accepted
opinion so far, in regard with the public enterprises. (20).

The theory of 'no profit - no loss' in public enterprises is inconsistent with socialist economy and if pursued in mixed economy it will hamper the evolution of socialist society from mixed economy.

The Ooty Seminar emphasised on "Prices of commodities and services in the public sector should not only be sufficient to meet the cost of production but also include the following items viz., depreciation, provision for expansion, contribution to tax revenues and capital formation." (21).

Even after the various authorities and economists stressed on the need of 'Profit' and 'Profitability' as a criteria; for performance evaluation in public enterprises, the experience in the public enterprises in India is that they have been the big loss makers during the four decades of the plan era of Indian Economy with some exceptional cases like state owned oil companies. Apart from the views and thoughts on the profitability as an essential performance indicator in public enterprises, the huge losses of public enterprises have put strain on the budgetary, resources for the planned economic development in India. The talk of "Privatisation" has come to the rescue of the panic situation in country's economic affairs. Whether 'privatisation' is the real need in Indian reconstruction of economy
would certainly an interesting area, of study to ponder in particularly in the 'socialistic' attributes of socio economic justice. There is already a trend towards 'Liberlising' the economic policy and other measures wooing the private sector under the 100 per cent export orientation scheme. Giving more freedom to the private sector enterprise cannot be equated with the 'Self-off' of the public enterprises which comes under the definition of privatisation, which includes sale of public enterprises to foreign investor or multinational firms. Some basic issues have emerged due to the wave of 'Privatisation', and those are -

1. Whether there would be complete withdrawal of the policy of Government intervention in business enterprises?

2. Does Privatisation create a renewed concern for 'Laissez-fairism'.

3. Whether it will be possible to protect public good, socio-economic justice or create distributive justice under privatisation?

4. Does privatisation mean delinking from 'Socialism' which in Indian Constitution has been a guiding force of socio-economic development? Or whether privatisation would not be anti-constitutional?
On such counts Privatisation has no answer to provide. One has to accept the 'profitability' as a basic condition in business whether public or private sector, in a manufacturing and trading activities.

It can be very clearly observed from the review of public sector performance norms that the 'Commercial Profitability' was considered as a financial performance indicator. The Central Government in its socialist ideals and objectives neglected the issue of profitability in public enterprises.

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REFERENCES


16. Ibid., p.50.
17. Ibid., p.53.


