CHAPTER III

THE PROFITABILITY CRITERION

In this chapter, we propose to define the term 'generation of surplus', discuss it as an objective of public enterprise, put forward the case for and against it, and finally see its need in the Nepalese context. Later, we analyse the financial data compiled out of published information with the purpose of finding out whether manufacturing public enterprises in Nepal have been successful in financial terms.

3.1 Meaning of Generation of Surplus

The emphasis on the term 'generation of surplus' is fundamentally based upon the socio-political environment of a given country where the enterprise to be studied is located. In virtually all modern communities, the paramount economic goal is the satisfaction of the pressing needs of the members of the economy. In economic terminology, it means the rapid economic growth in gross domestic product. But the means to achieving this economic goal differ widely among nations because of the prevailing economic factors and political system.

In the U.S.A., where free competitive market forces play an important role, pricing system helps allocate the resources. But the socialist countries like the U.S.S.R. and the G.D.R. have stressed the state-ownership and management of all the productive resources. However, within the "mixed economy
model", still other countries, especially the developing ones, have followed a path between the two extremes. For example, Nepal adopted the "mixed economy model" with the implicit understanding that the state and private sectors can complement each other in the development process over time.

We will be using the terms 'profit' and 'profitability' interchangeably to refer to 'generation of surplus'. By surplus, we mean the balance of resources expected to be available with an enterprise after providing for its working expenses and interest payments, and various provisions for liabilities. To put it in an alternative way, 'surplus' is the amount of resources left with an enterprise in the form of retained earnings, and the provision of depreciation, besides the dividend payments to be made to the owner, vis., government. In other words, surplus is a part of the value of production which directly re-enters the economy to finance further growth. Regarding the question of generating surpluses, there are views for and against it. We shall first summarize the different views in this regard and then analyse the situation in Nepal.

3.2 Arguments For and Against the Necessity of Surpluses in Underdeveloped Countries

3.2.1 Profitability and Public Interest

It is possible to argue, as has been argued by some, that the aim of public enterprises is not to work for profits but to serve the public interest by providing goods and services. The profit motive of public enterprise is sometimes rejected on the ground that the enterprises running at deficits will be making a contribution to the welfare of the community.
through selling of cheap gas, electricity, transport, water and postage. If high prices are charged for public utilities like electricity, transport, etc., there would be a rise in the cost of production of those commodities which use them as inputs. This will have a cascading effect and the rise in the prices of finished goods may lead to creation of inflationary tendencies in the economy. It is, therefore, sometimes suggested that in consumer goods industry, the 'surplus price policy' may be followed, and in the intermediate and capital and basic goods, the 'break-even' one.

Meanwhile, the question arises: What is 'public interest', or 'social obligation'? If the term public interest is interpreted to include all policies that aim at the rapid expansion and growth of the economy, and all means that help the fulfilment of the targets of the plan, there would be no contradiction between profit-making by public enterprises and serving the national interest, because profits help serve the national interest by further growth in the economy.

However, even if in the interest of the society, performing social service is necessary, certain clear-cut instructions need be issued.

First, the questions as to 'what is social service?' and 'what types of services rendered by public enterprises are regarded as social services?' should be defined in clear terms.

Secondly, if the government decides that prices of the goods and services (which include a reasonable rate of return on capital) provided by the public enterprises should be
comparatively lower, then it should issue instructions to the public enterprises in this regard in clear terms.

Thirdly, once a decision regarding social service is made by the government and instructions given accordingly, the cost of social service in financial terms should be quantified. After this the crucial question arises: Who shall pay for these services and by what means? This is really a very important decision which should not be overlooked.

Next, after quantification, either the rate of return from that particular unit should be adjusted according to the government policy or the government should provide a subsidy for the estimated deficit arising from the performance of social service.

Finally, the instructions issued by the government if followed strictly, would serve as automatic control mechanism in the public enterprises.

In the U.K., the policy regarding providing subsidy is quite clear. We quote here from a U.K. report: "Where extra social or wider public interest obligations are imposed on or undertaken by the industries, they should be publicly identified and appropriately financed by the Ministers concerned."  

However, the argument that the public enterprises should not make any profit on the ground that they are meant to serve the people is misplaced and irrelevant, and not appealing in

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present times when capital has a cost and when people aspire for achieving an increase in their standard of living in the shortest possible time. In fact, in an underdeveloped country where there is extreme shortage of capital, low savings, and the rate of capital formation is quite low, and much of the developmental activities have, of necessity, fallen on the state, public enterprises have to play a more positive role in the nation’s economic development. In this connection, a U.N. Seminar stated that “industrial enterprises ... should normally aim at something very much more than a break-even position as they can be expected to contribute significantly to the process of capital accumulation, the surplus being either ploughed back into enterprise itself or made available for other enterprises through the Ministry of Finance or Treasury.” At another place it emphasized that “in promoting domestic saving and ensuring proper investment public enterprises have an important role to play. They may operate so as to raise surplus which will be available for investments in the same enterprise or elsewhere in the economy.” The Rangoon Seminar on ‘Organisation and Administration of Public Enterprises’ held under the auspices of ECAFE (now ESCAP) had also come to the conclusion that public enterprises should make profits. Their main contention is that in the underdeveloped


3 Ibid., p. 12.
countries there exists scarcity of capital and a portion of surplus made should be made available for the industrial development in the country as a whole and the other portion should be ploughed back in the industry itself for its further expansion and growth.  

Thus, the U.N. Seminar reports clearly stress the desirability of the generation of surplus in public enterprises for the industrial development in the country and for further expansion, diversification and growth of the concerned enterprise.

3.2.2 Surplus and Self-Financing

In the developing countries, governments expect the public enterprises to yield resources for financing not only the latter's own expansion but also financing the national plans. In fact, the increasing obligations of the public enterprises in mobilizing additional plan resources have been widely and increasingly recognised in the Plan documents of developing countries. This has been accepted in Nepal too since the formulation of the Second Plan.

In the U.S., there are some economists like I. M. D. Little and Harrod, who are in favour of earning as large an amount of profits as possible. Profit is necessary, they argue, for expansion of the concerned enterprise, for welfare of the worker and for contributing to the national revenues. They have alleged that the prices and profits in nationalized

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industries have been deliberately kept low, leading to a wasteful use of the products of these industries and this has distorted investment allocation.

Regarding earning of profits by the public enterprises, I. M. D. Little states that the larger the public sector, the more important it becomes that this sector, taken as a whole, should earn profits. These profits would be required to finance expansion and development of the industries concerned. It is also equally necessary to contribute to general revenues. He suggests that profits be used partly for expansion and renewal, and partly for workers’ welfare and partly for augmenting the national revenues.5

Turning to the question of surplus vis-à-vis borrowing for financing expansion programmes, assuming that the government does not come forward with equity capital in full amount necessitated for the expansion, and also does not support with loan finance, the enterprise concerned has to find the necessary finance either through surplus or through institutional loans.

Each enterprise must earn certain surplus funds through pricing process if it wants to have a certain rate of expansion. Now, if the funds necessary for expansion are not provided by the pricing policy, they have to be borrowed from external sources. Then, interest payment to the lending institution becomes a cost to the enterprise. In order to keep the borrowing obligation to the minimum, the enterprise has to make

reasonable rate of profit. This is even necessary to build up the unit's creditworthiness for borrowing. But if the enterprise cannot make some profit, say, a normal rate of profit, then either the expansion programme has to be discarded or it should look upon the government as its saviour, as the latter is the last resort for providing finance. In this case, Government has to divert part of its scarce financial resources to the enterprises. Thus, on the whole, we feel, there is a strong case for making profit by a public enterprise.

Sir Roy Harrod even went to the extent of expressing the view "... that the nationalized industries be told in future they will have to find all their capital requirements by internal finance. ..." 6

3.2.3 Unprofitable Services and Profitability

The case against profitability can also be argued in terms of the unprofitable services assigned to public enterprises. Let us for the time being suppose that certain commercially unprofitable activities have been imposed on a particular public enterprise. As a result of this the objective of profitability cannot be achieved. But, the enterprise has to earn a reasonable rate of return for its existence, and the financing of social services should come from the Treasury.

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In the U.K., government's policy in this regard has been made clear by the White Paper of 1967. To quote here: "Where there are significant social or wider economic costs and benefits which ought to be taken into account in the industries' investment and pricing, these will be reflected in the government's policy for the industries, and if this means that the industry has to act against its own commercial interests the government will accept responsibility." In the same Paper it has also been explicitly mentioned that, where necessary, the government will make a special payment to the industry or make an appropriate adjustment to its financial objective.

The Herbert Committee (U.K.) has severely attacked the public enterprise board's wooly notions of serving public interest. We quote here: "We state our view without any qualification that the governing factor in the minds of those running the boards should be that it is their duty to run them as economic concerns and to make them pay."

3.2.4 Generating Surplus and the Socialist Economy

Of late, there is a striking emphasis in the Soviet Union, the home country of thousands of public enterprises, on generation of surplus. Evsey Liberman, a prominent Soviet economist, advocated that the public enterprises should have

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profit objective, and in fact, it should be used in conjunction with other factors for evaluating enterprises' performance. After a long controversy and deliberations since Lenin came to power, the Soviet political thinkers considered the proposition seriously. This is evident from the statement of Khruschev, the then Prime Minister of the Soviet Union, at the Twenty-Second Congress of the Communist Party in October 1961.9

In the socialist societies, like the USSR, Yugoslavia and so on, profits have an important place. The difference between the economic price and social price would be what may be called planned profit. In the socialist societies, the individual enterprises are permitted to retain a large share of surpluses mainly to build up the financial resources needed for following their own independent investment policies which help to increase productivity.10 In such societies, profit from public enterprises is one of the most important sources of revenues.

In the USSR, normally only about 10 per cent of the public revenues is derived from taxation and loans and the remainder from the profits of public enterprises and the turnover tax on the products of public enterprises.11


clearly underlines the importance of profits from the public enterprises in the USSR. Thus, industrialization in the socialist countries rests on the profitability of public enterprises. Profits have been quite helpful in making the process of economic development entirely self-financing.  

3.2.5 Profits for the Establishment of a Socialistic Pattern of Society

The All India Congress Committee in its Coity Seminar Report has stated, "State enterprises are not invariably social utility concerns. They have to serve as important media for raising resources for development." It also expressed the view that, in the conditions of an underdeveloped country, there should be no objection in theory to the use of state trading to finance development. The report recommended that state trading and/or differential taxation should be extended to selected commodities which yield a good margin of profit.

12 In some articles, it is claimed that even in a predominantly private enterprise economy, public enterprises have appreciably contributed to the state revenues. Some of the Latin American and Middle Eastern countries are reported to obtain revenues from public enterprises in the form of profits. In some countries of South-East Asia and the Far East, the state ownership covers not only some basic industries but also trading in certain major articles of export which offer scope for substantial profits. In Philippines and Puerto Rico, profits made by the government or government-sponsored projects and enterprises are deliberately used as a source of finance for further development. In Burma, state trading and state monopoly in rice and timber have been responsible for sizable revenues to the exchequer. In a similar way, the monopoly of export trade in rice and fiscal monopoly in opium and tobacco have made remarkable contribution in case of Thailand's economy. See: K. Shamaana, "Price and Profit Policy in Indian Public Enterprises," A.I.C.C. Economic Review (March 22, 1961), New Delhi, p. 36.

At the same seminar, while presenting his paper, V.K.R.V. Rao argued that public enterprises must be carried on on a profit-making basis. He adds that not only the public enterprise must yield an economic price but also for the community sufficient resources for financing a part of the investment and maintenance expenditure of the government.14 Rao had expressed these views keeping in mind the establishment of a socialist pattern of society in the country.

3.2.6 Should Profits of Public Enterprises Be Comparable to Those of the Private Sector?

The U.K.'s Conservative Government in their 1961 White Paper stipulated that profits and returns in nationalized industries should be comparable with those in the private sector. If profit rates are lower in nationalized industries, the government has to support its expansion and growth, and as a result, nation's savings will be diverted to nationalized industries. In 1967, the British Government published a new White Paper on Nationalized Industries: A Review of Economic and Financial Objectives. It started from the position that nationalized industries should be operated basically as commercial concerns and must have the objective of promoting an efficient allocation and use of resources.15 It was also indicated that investment should be directed to those activities where the expected returns were greatest. As a part of


more specific guidelines, public sector industries were expected to cover fully their accounting as well as operating costs, and avoid deficits.16 A public enterprise should be able to provide a rate of return on capital comparable with that earned by a private enterprise.17

3.2.7 Profits and Other Sources of Government Revenue

On a different basis, Hanson endorses the view that public enterprises should earn profits. To him profit earning is necessary for the purpose of redistribution of income. If the enterprise makes no profit, its activities have to be financed by the government, raising the necessary funds by increasing taxation or by inducing inflation or through public borrowing. If it is possible to raise capital through public borrowing, the effect will be to redistribute in favour of certain well-off members of the community.18

The profit objective of the public enterprises has also been supported on the ground that it will help to reduce public debt. If public enterprises sell their product at a loss, it will give rise to private income, and government, on the other hand, has to borrow from private sector for investment on development projects. To quote Hanson, "... in countries

where (a) taxing powers are weak and (b) the emphasis is on state investment as means of economic development (for ideological reasons or for practical reasons or for both), the making of profits by some (if not all) public enterprises will be both desirable and necessary. In fact, it is both a direct and convenient method of contributing towards national capital formation.

3.2.8 Profit and Exploitation of Consumers

The argument against profit-earning by the public enterprises is that once it is decided to follow a policy of profit, there may be a continuous temptation for the government to raise prices of the products of public enterprises to meet its increasing needs for revenues. This would lead to the exploitation of consumers through the monopoly power enjoyed by the public enterprises. In this way the poor consumers will have to be at the mercy of the State. "Public enterprises generally have some degree of monopolistic power and a directive to maximise profits would inevitably lead to 'exploitation' of consumers." It is also said that the profit motive of the enterprises should be abandoned because the public enterprises will always be tempted to hide the inefficiencies and the resultant higher costs by raising prices. However, if appropriate guidelines in regard to profit and price policy are issued, and the norms for costs are set by the government, this

19 Ibid., p. 437.
situation need not occur.

3.2.9 **Profitability and Mixed Enterprise**

The governments of developing countries have started collaborating with the foreign as well as local private sector firms. In such a case, when public enterprise has to work in collaboration with local or foreign private firms, the principle of "generating surplus" has to be followed. The private firms do not agree to invest their funds or permit the use of their patent rights without being adequately rewarded for the same.

Thus, it is quite clear that whether it is a developing economy or a developed one, capitalist, socialist or mixed economy, profit is necessary at least to keep the enterprise going and to make a minimum contribution towards the development of the country. If it does not generate any surplus for its own expansion and development, it cannot keep going and becomes a 'permanent liability' to the state. In fact, "the essential purpose of any enterprise is not to be a liability but to be an asset."\(^{21}\)

Stephen A. Marglin, after weighing the pros and cons of generation of surpluses by public enterprises, concludes that the possibility of recovering costs through revenue should not necessarily be decisive in the allocation of investment funds nor should the cost recovery determine price policy of public enterprises, once they are in existence. He supports the

operating deficit, if any, only on the ground that the projects are in existence. He rejects the disposing off of public enterprise, just on the ground that price does not recover costs.22

Now, to sum up the arguments in favour of and against profit-making by public enterprises it can be said that profit should be generated at least for the existence of the concerned enterprise and for financing the economic development of the country. There is nothing vicious or immoral about generating surplus in an industrial unit; it is a legitimate social aim. In fact it should be made one of the criteria for evaluating the performance of public enterprises. In its absence, the enterprise will be a continuous burden on the government and has to be subsidised through tax-payers' money. The government should make its policy clear regarding the rate of return on capital employed and the amount of surpluses it expects from various industries taking into account the objective of the enterprise, its constraints, etc. Non-profit making may be an exception, not a rule.

3.3 Surplus in the Nepalese Context

One of the main reasons for creating public enterprises in the underdeveloped countries, as mentioned earlier, is to raise the internal resources by way of retained earnings and dividend payments. In Nepal too, public enterprises are established with the explicit objective of augmenting internal

resources to supplement government's development budget. The role of the public enterprises in augmenting the internal resources needed for the economic development of the country was accepted in the Second Plan. Of late, government has issued instructions to the public enterprises to earn a minimum return on the capital employed.\textsuperscript{23} Earning a fair rate of return on assets is, therefore, one of the desiderata of Nepali public enterprises.

Earning a target rate of return is important as well as essential. Some of the arguments in support of the stand may be given here. First, the evaluation of public enterprise performance in financial terms would be facilitated. Secondly, the enterprises would be less dependent upon public money, and as a result, they could plan their productive programmes independently. Finally, a prescribed minimum rate of return would help them expand, diversify and grow. Of course, the amount to be generated by public enterprises depends on Government's policy. In the Third Plan, the Indian Planning Commission urged that profits should be large enough for financing the expansion programmes of the public enterprises.\textsuperscript{24}

If the public enterprises are not dependent on the government for their expansion, they can maintain their independence and initiative to a great extent. Otherwise uncertainty

\textsuperscript{23} We will outline the government's instructions later, in Chapter V.

\textsuperscript{24} Government of India, Planning Commission, \textit{Third Five Year Plan}, New Delhi, 1961, p. 97.
with change in political situation, political and lobby pressures may come into play. These factors have played some role in the U.S. where public enterprises are subjected to annual public appropriation. The dependence on State subsidies has increased the degree of government control over the public enterprises in France. However, giving subsidies and grants to a public enterprise in a mixed economy like Nepal where the private enterprises also operate side by side is morally unjust and economically unsound. It simply helps to conceal their inefficiency and financial indiscipline, entailing a direct burden on the taxpayers.

Thus, it is clear that in the context of Nepal where public enterprises have been established with the explicit objective of generating surpluses for further economic development, earning surplus is compatible with the national economic goals. The questions that may come up would rather be 'how much surplus is to be generated by each enterprise?' and 'who is to receive it?' Regarding the latter question, in the present context of Nepal, a part of the profit that a public enterprise makes goes to the treasury of His Majesty's Government by way of dividend payment which is meant for


26 Ibid.

27 By our definition of the term 'surplus', tax and other payments to the government are not considered here. Moreover, ownership pattern makes no difference to the government regarding tax receipts.
further economic growth of the country, and the balance is apportioned for various reserve funds, and retained earnings. The amount so apportioned could be used anytime for reinvestment, expansion and improvement of the enterprise.

Regarding the first question posed above, as to 'how much surplus is to be generated?', the government has to decide as it is the owner as well as the policy-maker. This has to be done taking into consideration the nature of market in which a particular public enterprise is operating, its surplus-generating potentiality, national objective, enterprise constraints, etc. In other words, surplus target for each enterprise should be fixed, and finally, it should be linked with the pricing policy of each enterprise.

Even in a private enterprise economy such as in the U.K., public corporations were created with a view to conducting their day-to-day business in a commercial way; that is, in very much the same manner as a private company. There has been a statutory requirement that the corporation shall pay its way; that is, "... the revenues of the Board shall not be less than sufficient for meeting all their outgoings properly chargeable to revenue account ... on an average of good and bad years". This general policy is to be found in Section 36(1) of the U.K.'s Electricity Act, 1947.

Finally, it would be appropriate to quote here J. K. Galbraith: "If I had to lay down a measure of performance for

the publicly owned corporation in the developing country it would be the earnings that it is able to put into its own expansion. The most successful firm would be the one which by its efficiency and drive finds the earnings that allow it the greatest growth.“29

3.4 Rate of Return Analysis

As our objective is to assess pricing policy in relation to rate of return in manufacturing public enterprises in Nepal, analysis in this section is confined to the rate of return of only these enterprises.30 The data are collected from the financial reports of the concerned enterprises and Auditor General’s Reports. In the sections that follow we make use of five measures of profitability.

a) Operating profits as percentage of sales: This will help to measure the profit margin on sales.

b) Operating profits as percentage of capital employed: It is an indicator of the gross returns on the capital employed in the business.

c) Operating profits after tax and interest (operating net profit) as percentage of net worth: This measures the return on shareholders’ equity or the owned funds.


30 The analysis in this section draws heavily from the researcher’s paper “Profitability in Nepalese Manufacturing Public Enterprises” discussed in Staff Seminar at Gokhale Institute of Politics and Economics, Pune 4, on April 2, 1982.
d) **Dividends as percentage of total paid-up capital**: It indicates the rate of return on the original investment.

e) **Dividends as percentage of net worth**: It is a measure of the profits distributed in relation to shareholders' equity.

In addition to the above-outlined five measures of profitability, we also analyse the position and constituents of gross savings.

However, before actually entering into the rate of return analysis, we shall explain the methods employed in analysing them with the help of basic financial data.

### 3.4.1 Basic Financial Data

The basic financial data relating to the composition of capital funds, sales, gross operating profit (operating profit before tax and interest), net operating profit (operating profit after tax and interest), and dividends are presented in Table 3.1. The capital funds invested in Nepali manufacturing public enterprises are in the form of paid-up capital, capital subsidy, reserves and undistributed profits and

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31 The paid-up capital of the enterprises includes investment from private and other corporations too. It is unavoidable because it is not possible to separate out the private/corporations' equity in another public enterprise. The adjustment in this respect would demand the proportionate exclusion of profits, reserves, etc. However, it is to be noted that the share of these firms in equity capital is quite negligible, hardly 2 to 3 per cent. So this does not affect our analysis and conclusions.

32 We have included capital subsidy in the net worth of the company. In some cases we have observed that subsidy, irrespective of current or capital, has been included in the capital of the company. But we have included only the subsidy given for capital purposes, ignoring the subsidy given for regular expenditure or to recoup losses.
## Table 3.1: Basic Financial Data

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Public Enterprises</th>
<th>Paid-up Capital (in million)</th>
<th>Capital Subsidy</th>
<th>Accumulated Reserves, P/L</th>
<th>Net Worth</th>
<th>Long-term Loans</th>
<th>Total Capital Funds</th>
<th>Operating Profit * (in million)</th>
<th>Operating Net Profit ** (in million)</th>
<th>Dividend ***</th>
<th>Sales (in million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973-74</td>
<td>11</td>
<td>152.5</td>
<td>3.8</td>
<td>48.3</td>
<td>204.6</td>
<td>10.8</td>
<td>215.4</td>
<td>19.3 (7)</td>
<td>16.8 (7)</td>
<td>1.3 (3)</td>
<td>171.0</td>
</tr>
<tr>
<td>1974-75</td>
<td>11</td>
<td>169.1</td>
<td>4.9</td>
<td>60.3</td>
<td>234.3</td>
<td>34.2</td>
<td>268.5</td>
<td>20.7 (7)</td>
<td>12.0 (7)</td>
<td>1.06 (3)</td>
<td>257.9</td>
</tr>
<tr>
<td>1975-76</td>
<td>12</td>
<td>182.2</td>
<td>14.2</td>
<td>65.4</td>
<td>261.8</td>
<td>31.2</td>
<td>293.0</td>
<td>20.7 (6)</td>
<td>7.9 (5)</td>
<td>1.3 (3)</td>
<td>285.6</td>
</tr>
<tr>
<td>1976-77</td>
<td>12</td>
<td>194.2</td>
<td>10.5</td>
<td>71.2</td>
<td>275.9</td>
<td>39.6</td>
<td>315.5</td>
<td>19.9 (7)</td>
<td>5.9 (7)</td>
<td>1.3 (2)</td>
<td>371.0</td>
</tr>
<tr>
<td>1977-78</td>
<td>12</td>
<td>219.1</td>
<td>13.1</td>
<td>66.0</td>
<td>298.2</td>
<td>44.7</td>
<td>342.9</td>
<td>24.6 (7)</td>
<td>8.5 (7)</td>
<td>1.0 (1)</td>
<td>410.0</td>
</tr>
<tr>
<td>1978-79</td>
<td>14</td>
<td>264.0</td>
<td>143.4</td>
<td>78.1</td>
<td>490.5</td>
<td>48.9</td>
<td>539.4</td>
<td>17.4 (5)</td>
<td>1.2 (5)</td>
<td>(1)</td>
<td>469.1</td>
</tr>
<tr>
<td>1979-80</td>
<td>14</td>
<td>272.4</td>
<td>146.3</td>
<td>108.7</td>
<td>527.4</td>
<td>89.2</td>
<td>616.6</td>
<td>67.7 (6)</td>
<td>20.8 (6)</td>
<td>2.8 (1)</td>
<td>527.9</td>
</tr>
<tr>
<td>1980-81</td>
<td>13**</td>
<td>272.2</td>
<td>163.0</td>
<td>58.9</td>
<td>459.1</td>
<td>78.8</td>
<td>577.9</td>
<td>12.3 (3)</td>
<td>5.3 (3)</td>
<td>2.7 (1)</td>
<td>468.4</td>
</tr>
</tbody>
</table>

**Notes:**

* - Figures in parentheses indicate the number of concerns making operating profit.

** - Figures in parentheses indicate the number of concerns making net profit.

*** - Figures in parentheses stand for dividend paying concerns.

** - Data for the Timber Corporation of Nepal is not available.
long-term loans. The sales figures exclude all items of non-operating incomes. In other words, income from other sources, that is, the non-operating income like interest from fixed deposits, fees and commissions, profit on sales of assets, etc., are not included in the figures of sales.

Table 3.1 shows that total capital funds investment is increasing year after year from Rs. 215.4 million in 1973-74 to Rs. 616.6 million in 1979-80, registering a compound growth rate of 19 per cent per year. Such a rapid increase was due to the creation of new enterprises, and a huge subsidy of Rs. 135.2 million given to Hetauda Textile Industry Ltd. But, the total capital investment stood at Rs. 577.9 million in 1980-81 which really is not comparable to 1979-80 because of non-availability of data of Timber Corporation of Nepal for the year 1980-81.

Regarding the composition of the total capital investment, equity capital constitutes the largest share, that is above 44 per cent in all the years. In 1973-74, it was as high as 71 per cent.

Secondly, the capital subsidy, which was nominal till 1977-78, has since then been the second important source of capital funds for the manufacturing public enterprises in Nepal. In the year 1973-74 it was about 2 per cent of the total capital funds employed and went up to 5 per cent in 1975-76. But from the year 1978-79, it has occupied an important place, always having a share of above 24 per cent.

The reserve funds including profit and loss balance
occupied the third place during most of the period of study. From Table 3.1 it is noted that the position of reserves and profit and loss balance has not shown any improvement. In the year 1973-74, its share in total capital funds employed was 22 per cent which remained unchanged till the year 1976-77. However, from the year 1977-78, the share started showing a decline, and stood at 19 per cent and 14 per cent respectively for the years 1977-78 and 1978-79. The position of reserves and profit and loss balance in the total capital funds employed improved slightly in 1979-80, reaching 18 per cent, but declined to about 10 per cent in 1980-81 due to the non-inclusion of one unit, thus reducing the item to the fourth place.

Finally comes the long-term loans. They have always constituted a very small percentage of the capital funds. Initially, their share in the total capital funds was 5 per cent. The share rose to a maximum of 14.5 per cent in 1979-80. Except for the year 1973-74, it fluctuated between 9 and 14.5 per cent of the capital funds for the other years. The share was nearly 14 per cent in 1980-81, occupying the third place.

Thus, from the analysis of the composition of capital funds, it is clear that the paid-up capital and capital subsidy together constituted more than two-thirds of the aggregate funds during the period under study.

Between the years 1973-74 and 1980-81, sales have increased from Rs.171.0 million to Rs.468.4 million. This represents an increase of almost three times, or a compound growth
rate of 15.5 per cent per annum. In fact sales had recorded a high figure of Rs. 527.9 million in 1979-80, implying an annual compound growth rate of 20.7 per cent over 1973-74. Although sales on the average of all the manufacturing enterprises have increased, a number of units have not been able to improve sales over time. Inventories also recorded an annual compound growth rate of 22.3 per cent in 1979-80 over the year 1973-74. Further, inventories constituted normally between 50 and 60 per cent of the total cost of production. For example, the share of inventories in total cost of production was 62 per cent in 1979-80. In this context it is worthwhile exploring whether inventories are efficiently managed. The capacities are also under-utilized, and has always been between 50 and 60 per cent. The highest capacity utilisation was recorded by Birgunj Sugar Factory in 1978-79 at 106 per cent, whereas Banswari Leather and Shoe Factory had the lowest capacity utilization of less than 20 per cent the same year. The capacity utilisation, on the average, has decreased over time, from 60 per cent in 1978-79 to 48 per cent in 1980-81.

The operating profit fluctuated from year to year touching a high figure of Rs. 67.7 million in 1979-80. But in the year

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33 In the chapters that follow we analyse how sales-inventory ratio has affected the profitability.

34 Discussed in a later chapter.
1980-81, it was only Rs.12.3 million. This was due to non-inclusion of Timber Corporation of Nepal, and dismal profit performances of a number of enterprises. The performance is, thus, quite discouraging. The position of operating net profit (after deducting tax and interest but before adding non-operating profit) is much worse. It is highly volatile. In 1973-74, the operating net profit was Rs.16.8 million; it reached a high level of Rs.26.8 million in 1979-80 and came down to a negative figure of around Rs.0.6 million in 1980-81. This steep decline in the net operating profit was not only due to non-availability of data of Timber Corporation of Nepal but also owing to losses incurred by a number of enterprises. Regarding dividend payments, only a couple of enterprises have been able to declare. Even the number of enterprises paying dividends has been declining over time (see Table 3.1); in 1978-79, no company paid dividends.

Table 3.1 also indicates that the last three years under study are slightly different from the preceding years, and in fact, the year 1978-79 is an exceptional one. In that year two new enterprises, a brick factory and a textile mill, were brought into operation. As a result, the total capital investment and sales increased substantially but the profit position was greatly affected.

The year 1979-80 showed an impressive record in terms of operating profit, operating net profit and sales. In this year, the Timber Corporation of Nepal made a huge operating profit of Rs.43.1 million, and Raghupati Jute Mills Ltd., and
Birgunj Sugar Factory improved their profit position. Birgunj Sugar Factory which had incurred a loss of Rs. 0.5 million in 1978-79 made an operating profit of Rs. 15.7 million in the following year. Its sales almost trebled between 1978-79 and 1979-80. However, the year 1980-81 is quite dismal as the number of units making profits declined (as mentioned earlier, data for Timber Corporation was not available). Two new concerns noted above also continued to be running at a loss.

3.4.2 Measures of Financial Profitability

As stated earlier, we shall be discussing the financial profitability under five different criteria.

(a) Operating Profits as Percentage of Sales: The ratio helps measure the profit margin on sales, and serves as an index of overall efficiency. In Table 3.2 we have presented the relevant information.

Table 3.2: Operating Profit as Percentage of Sales

<table>
<thead>
<tr>
<th>Year</th>
<th>All companies</th>
<th>Companies making profits</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973-74</td>
<td>11.30</td>
<td>13.64</td>
</tr>
<tr>
<td>1974-75</td>
<td>8.03</td>
<td>9.18</td>
</tr>
<tr>
<td>1975-76</td>
<td>7.26</td>
<td>9.87</td>
</tr>
<tr>
<td>1976-77</td>
<td>5.37</td>
<td>8.13</td>
</tr>
<tr>
<td>1977-78</td>
<td>6.00</td>
<td>9.04</td>
</tr>
<tr>
<td>1978-79</td>
<td>3.70</td>
<td>7.44</td>
</tr>
<tr>
<td>1979-80</td>
<td>12.83</td>
<td>14.29</td>
</tr>
<tr>
<td>1980-81</td>
<td>2.62</td>
<td>10.29</td>
</tr>
</tbody>
</table>

Note: Information on number of companies making profits is furnished in Table 3.1.
The Table 3.2 exposes the poor performance of manufacturing public enterprises in terms of sales margin. The ratio showed a decline for the first four years and year to year fluctuation since then. The year 1980-81 recorded the lowest percentage of about 3 per cent because of non-exclusion of one company. Even if we do not take into consideration the two enterprises which went into operation in 1978-79, the ratio comes to only 4.46 per cent. It is to be noted here that because of non-availability of data, Timber Corporation of Nepal has not been included for the year 1980-81. If we exclude Timber Corporation’s share in 1979-80 as well (which is not represented in 1980-81), operating profit as a percentage of sales would come to about 6 per cent for that year.

However, as is to be expected, the performance of companies making profit as represented by operating profit as a percentage of sales is much better than that of all companies. The profit-making concerns have been able to maintain a return between 8 and 18 per cent. The year 1979-80 is exceptionally good as compared to other years. This is because of a higher operating profit of 46 per cent of sales recorded by the Timber Corporation of Nepal.

The tendency of increased sales and falling profits (Table 3.1), indicates four things: First, as stated earlier, a number of units have not been able to improve their sales over time. For example, Nepal Tea Development Corporation’s sales decreased from Rs.2.7 million in 1979-80 to Rs.1.2 million in 1980-81. Secondly, cost of production has gone up in a
majority of units. For example, between the years 1978-79 and 1980-81, cost per unit increased by 18 per cent in case of Raghupati Jute Mills Ltd., in Birgunj Sugar Factory by 79 per cent, by 43 per cent in Janakpur Cigarette Factory, and by 83 per cent in case of Brick and Tile Factory. But, on the other hand, prices have not increased in the same proportion, except for Janakpur Cigarette Factory. For example, the prices are less than the cost of production in case of Brick and Tile Factory (bricks) and Dairy Development Corporation (milk). In these two units, even when costs increased, prices are raised only after a gap of at least one to two years. In case of Raghupati Jute Mills prices are fluctuating, underlying downward tendency. Birgunj Sugar Factory's cost of production increased from Rs. 393 in 1978-79 to Rs. 537 in 1979-80, but the average price remained the same at Rs. 411 in the second year also. Thirdly, in most of the units, actual cost per unit of output is higher than the budgeted cost per unit. For example, in the year 1980-81, cost has escalated by 65 per cent in case of Nepal Tea Development Corporation, by 26 per cent in Janakpur Cigarette Factory, by 20 per cent in case of Birgunj Sugar Factory and by 10 per cent in Royal Drugs Ltd. Finally, growth trend of sales in a number of units, higher cost per unit and cost escalation indicate that budgets have not been prepared with the required amount of care. Thus, it can be

35 Pricing Policy has been analysed in Chapter V.
36 See: Chapter V.
concluded that there is lack of proper planning, budgeting and management information system. 37

(b) Operating Profits as Percentage of Capital Employed:

This ratio helps us ascertain the enterprise's success in terms of profit earned, and measure the operating effectiveness. Table 3.3 gives us a clear picture of operating profits as percentage of capital employed.

Table 3.3 : Return on Capital Employed (Percentage)

<table>
<thead>
<tr>
<th>Year</th>
<th>All Companies</th>
<th>Profit-making</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973-74</td>
<td>8.96</td>
<td>11.93</td>
</tr>
<tr>
<td>1974-75</td>
<td>7.72</td>
<td>9.32</td>
</tr>
<tr>
<td>1975-76</td>
<td>7.08</td>
<td>11.59</td>
</tr>
<tr>
<td>1976-77</td>
<td>6.31</td>
<td>10.83</td>
</tr>
<tr>
<td>1977-78</td>
<td>7.19</td>
<td>11.95</td>
</tr>
<tr>
<td>1978-79</td>
<td>3.23</td>
<td>13.25</td>
</tr>
<tr>
<td>1979-80</td>
<td>10.93</td>
<td>26.86</td>
</tr>
<tr>
<td>1980-81</td>
<td>2.12</td>
<td>14.90</td>
</tr>
</tbody>
</table>

Table 3.3 shows that the return on capital employed has not improved over the years. This has ranged between 6 and 11 per cent, except for two years - 1973-79 and 1980-81. Even if the two enterprises which went into operation in 1978-79 are excluded, the return comes to only 4 per cent in 1980-81 (excluding Timber Corporation of Nepal). The performance of public enterprises in terms of return on capital is not satisfactory when we consider government's directives to all the

37 Discussed in Chapter V.
manufacturing public enterprises to achieve a rate of return of 10 per cent on total capital employed. Such a state of affairs may be because of (i) the inefficient utilization of assets, and (ii) the lack of operational objectives, proper planning and control.\textsuperscript{38}

However, compared to the return on capital of all companies, concerns making profit naturally show a better performance. The return has reached a peak of 27 per cent in 1979-80. These enterprises have been able to normally maintain a return between 10 and 15 per cent on the capital employed. But out of these profit-making concerns, only a couple of them have a uniformly good record of profit, which is reflected in Table 3.4.

\textit{Table 3.4: Classification of Public Enterprises according to Profit Records}

\begin{center}
\begin{tabular}{|c|c|c|c|c|c|c|c|c|}
\hline
\hline
Less than 0\% & 4 & 4 & 6 & 5 & 5 & 9 & 8 & 10 \\
0\% to 5\% & 2 & 2 & 3 & 3 & 2 & 1 & 2 & 1 \\
5.1\% to 10\% & 3 & 3 & - & 3 & 3 & 1 & - & 1 \\
10.1\% to 20\% & 1 & 1 & 2 & - & 1 & 3 & 1 & 1 \\
Above 20\% & 1 & 1 & 1 & 1 & 1 & - & 3 & - \\
\hline
Total PEs & 11 & 11 & 12 & 12 & 12 & 14 & 14 & 13 \\
\hline
\end{tabular}
\end{center}

The Table clearly exhibits that in all the years about three-fourths or more of the enterprises are making less than 10 per cent return on capital employed. Normally, only the

\textsuperscript{38} Discussed in other chapters.
Timber Corporation of Nepal had given above 20 per cent return. Its contribution especially during three years from 1975-76 to 1977-78, and 1979-80 is quite high. In 1979-80, three enterprises namely Timber Corporation of Nepal, Raghupati Jute Mills and Birgunj Sugar Factory have given a return of over 20 per cent. In case of Timber Corporation of Nepal (TCN), there is always a high demand for sawn wood, and the primary raw materials costs for the factory are low as they are supplied by the Government at a concessional rate. Even the amount of royalties the company has to pay for felling trees has not been paid to the government. Till now the enterprise has been lucky enough not to encounter any raw material problems as it is located in the heart of a rich forest region. Since its inception, the TCN Forest Reserve has been the main source of the supply of logs for the sawmills of the Corporation. But now the Corporation has started facing the serious problem of log shortage. Afforestation scheme launched by TCN is neither adequate nor satisfactory.

In 1979-80, Raghupati Jute Mills Ltd. was able to record a good performance because of the export subsidies given by the State, coupled with the permission granted by the Government of India for Nepalese jute imports in the country. In the same year, due to sugar crisis in India, Birgunj Sugar Factory was able not only to get a highly remunerative price for sugar, but also to clear accumulated stocks.

(c) Return on Net Worth: This ratio will bring out the percentage of net profit earned to shareholders' funds, measuring the return on investment in the form of profit.
The return on shareholders' funds which was about 8 per cent in 1973-74 came down to almost nil in 1978-79. Although there was a temporary improvement during 1979-80, there was a negative return in 1980-81. This is because of a number of losing and low surplus making concerns. However, the return on net worth of concerns making profit is, of course, comparatively better. It has ranged between 5 and 16 per cent. Except for 1976-77, the return on net worth was around 7 per cent for other years. Out of the profit-making enterprises, only a couple of them have a good record in terms of return on net worth as may be seen from Table 3.6.

From the Table 3.6 it is clear that a number of enterprises are making losses every year. The number of enterprises making losses which were only four in 1973-74 increased to 10 (including two new enterprises established in 1978-79) in the year 1980-81. To note here, Banswari Leather and Shoe Factory has been making losses for all the years. This has greatly

<table>
<thead>
<tr>
<th>Year</th>
<th>All Companies</th>
<th>Profit-making</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973-74</td>
<td>8.23</td>
<td>11.04</td>
</tr>
<tr>
<td>1974-75</td>
<td>5.12</td>
<td>6.90</td>
</tr>
<tr>
<td>1975-76</td>
<td>3.02</td>
<td>6.81</td>
</tr>
<tr>
<td>1976-77</td>
<td>2.13</td>
<td>5.24</td>
</tr>
<tr>
<td>1977-78</td>
<td>2.85</td>
<td>6.50</td>
</tr>
<tr>
<td>1978-79</td>
<td>0.24</td>
<td>6.65</td>
</tr>
<tr>
<td>1979-80</td>
<td>5.07</td>
<td>15.57</td>
</tr>
<tr>
<td>1980-81</td>
<td>-1.10</td>
<td>8.53</td>
</tr>
</tbody>
</table>
affected the overall profit position of manufacturing public enterprises. Out of the contributing concerns too, very few have good return on net worth. For example, from the year 1975-76 to 1978-79 only one concern has been able to contribute above 20 per cent return on net worth each year. However, only two enterprises gave a record of more than 20 per cent in 1979-80. In other words, more than 64 per cent of the enterprises are either making losses or giving a small return of less than 5 per cent on net worth for the period under study.

(d) Dividend Payout Ratio: Dividend payout ratio is a very important ratio especially in a country like Nepal where the primary objective of creating a public enterprise was to augment the resources of Government in the form of dividend receipts from public enterprises. Table 3.7 provides the relevant information.
Table 3.7: Dividend Payout Ratio (in Percentage)

<table>
<thead>
<tr>
<th>Year</th>
<th>Dividend Payout Ratio on Total Paid-up Capital</th>
<th>Dividend Payout Ratio on Capital of Paying Concerns</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973-74</td>
<td>0.83</td>
<td>2.00</td>
</tr>
<tr>
<td>1974-75</td>
<td>0.63</td>
<td>1.53</td>
</tr>
<tr>
<td>1975-76</td>
<td>0.68</td>
<td>1.72</td>
</tr>
<tr>
<td>1976-77</td>
<td>0.58</td>
<td>1.94</td>
</tr>
<tr>
<td>1977-78</td>
<td>0.46</td>
<td>1.61</td>
</tr>
<tr>
<td>1979-80</td>
<td>1.01</td>
<td>5.00</td>
</tr>
<tr>
<td>1980-81</td>
<td>1.00</td>
<td>4.92</td>
</tr>
<tr>
<td>Average</td>
<td>0.66</td>
<td>2.37</td>
</tr>
</tbody>
</table>

* No companies paid dividend in the year 1978-79.

Out of eleven enterprises in the year 1973-74, only three have paid dividends (see: Table 3.1). But the number of dividend-paying enterprises declined over time. During the year 1978-79, no enterprise paid any dividend at all (Table 3.1). During the last two years only one enterprise has been able to declare dividend. However, Table 3.7 shows that dividend payout ratio of even profit-making concerns has always been five or less than five per cent. The highest dividend payout ratio was reported in the year 1979-80. When we calculate the average dividend payout ratio for all the years under study it comes to about 2 per cent only. But, when we consider from the owners' point of view and calculate the dividend on total paid-up capital of all enterprises, the average dividend on aggregate paid-up capital works out to 0.66 per cent. Thus,
the government has received, on an average, less than one per cent on its equity capital during the above period.

(e) Dividends as Percentage of Net Worth: In Table 3.8 we have shown dividends as percentage of total net worth which measures the profits distributed in relation to shareholders' equity. This helps us to know how much owners have received on their funds. Higher the ratio, larger the availability of funds available to the government for further investment.

Table 3.8: Dividends on Net Worth

<table>
<thead>
<tr>
<th>Year</th>
<th>All Companies</th>
<th>Dividend paying Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973-74</td>
<td>0.62</td>
<td>1.77</td>
</tr>
<tr>
<td>1974-75</td>
<td>0.45</td>
<td>1.34</td>
</tr>
<tr>
<td>1975-76</td>
<td>0.48</td>
<td>1.47</td>
</tr>
<tr>
<td>1976-77</td>
<td>0.48</td>
<td>1.75</td>
</tr>
<tr>
<td>1977-78</td>
<td>0.38</td>
<td>1.58</td>
</tr>
<tr>
<td>1978-79</td>
<td>0.52</td>
<td>-</td>
</tr>
<tr>
<td>1979-80</td>
<td>0.52</td>
<td>3.97</td>
</tr>
<tr>
<td>1980-81</td>
<td>0.54</td>
<td>3.64</td>
</tr>
<tr>
<td>Average</td>
<td>0.43</td>
<td>1.94</td>
</tr>
</tbody>
</table>

The dividend percentage in terms of net worth is quite negligible. In fact, as mentioned earlier, no dividend was declared for the year 1978-79 on a sum of Rs.490.4 million. It has always been less than 0.62 per cent. If we average the dividend earned percentage for all the years, it comes to 0.43 per cent. Even the dividend-paying companies have been able to pay around two per cent only.
On the whole, the performance of manufacturing public enterprises in Nepal from the point of view of sales margin and the rate of return on capital employed, net worth and dividend payout ratio is far from satisfactory.

3.5 Magnitude of Gross Savings

Gross savings is one of the most important success indicators of any business enterprises, and consists of two components, namely, depreciation and retained earnings. It represents the source of internal financing for the expansion and growth of the enterprise. However, the magnitude of financing depends upon the profitability, and the dividend policy of the enterprise. In Table 3.9, the information pertaining to gross saving and its components in the Nepali public manufacturing enterprises has been presented.

In the composition of gross savings, we have not taken into account the non-operating incomes because, as stated earlier, our main interest is to see the savings generated in the enterprises out of their operating incomes.

Table 3.9 shows, that over the period under analysis, there have been considerable fluctuations in the retained earnings of the enterprises. In the year 1973-74, the share of retained earnings in gross savings was nearly 67 per cent which declined to 4 per cent in 1976-77. Although a slight improvement was shown in 1977-78, the share declined to a negative percentage in 1978-79. In the year 1979-80, the share of retained earnings improved significantly, reaching 48 per cent of gross savings. But the following year, there was a
Table 3.9: Components of Gross Savings

<table>
<thead>
<tr>
<th>Year</th>
<th>Retained earnings</th>
<th>Depreciation</th>
<th>Gross savings*</th>
<th>Percentage of Retained Earnings to Gross Savings</th>
</tr>
</thead>
<tbody>
<tr>
<td>1973-74</td>
<td>14.86</td>
<td>7.63</td>
<td>22.49</td>
<td>66.07 (73.08)</td>
</tr>
<tr>
<td>1974-75</td>
<td>9.10</td>
<td>9.89</td>
<td>18.99</td>
<td>47.93 (58.75)</td>
</tr>
<tr>
<td>1975-76</td>
<td>0.99</td>
<td>11.65</td>
<td>12.64</td>
<td>7.63 (48.37)</td>
</tr>
<tr>
<td>1976-77</td>
<td>0.69</td>
<td>14.80</td>
<td>15.49</td>
<td>4.45 (35.80)</td>
</tr>
<tr>
<td>1977-78</td>
<td>2.56</td>
<td>17.34</td>
<td>20.90</td>
<td>12.57 (42.34)</td>
</tr>
<tr>
<td>1978-79</td>
<td>-0.95</td>
<td>19.12</td>
<td>18.17</td>
<td>+ (49.96)</td>
</tr>
<tr>
<td>1979-80</td>
<td>21.38</td>
<td>22.76</td>
<td>44.14</td>
<td>48.44 (74.57)</td>
</tr>
<tr>
<td>1980-81</td>
<td>-18.66</td>
<td>25.30</td>
<td>6.64</td>
<td>+ (42.94)</td>
</tr>
</tbody>
</table>

Notes: * Figures in parentheses indicate gross savings of profit-making concerns.
@ Figures in parentheses indicate the percentage of retained earnings to gross savings of profit-making concerns.
+ Calculations not done as retained earnings are negative.

sharp decline, recording a negative percentage. However, this is not comparable with the earlier year because of the non-inclusion of data of the Timber Corporation of Nepal for the later year. Except for the years 1978-79 and 1980-81 (years with negative retained earnings), the retained earnings were positive only because of a very low dividend declaration by a
couple of enterprises.

However, if we take into account the case of profit-making concerns only, the picture is different and somewhat better. For example, in the year 1973-74, the share of retained earnings of these concerns in gross saving was almost 73 per cent. After 1973-74 the share started declining, and reached a low level of nearly 36 per cent in 1976-77. From the next year, it has been improving steadily, and reached almost 75 per cent in 1979-80. However, as mentioned above, none of the profit-making enterprises declared a dividend in 1974-75.

The earnings retained in a year may not really represent net capital formation in that year because of: (a) first, as noted above in the earlier section, it is not after paying a reasonable dividend to the government that the profit-making concerns could report retained earnings. (b) Secondly, the factor responsible for even such a meagre amount of retained earnings is that under the industrial policy 1974 the enterprises in Nepal are exempted from paying income-tax for the first few years of the operation. Under the policy, tax exemptions given to the enterprises vary from a period of three to twenty years and sometimes even longer depending upon the type of industry, capital investment, employment potentiality, reinvestment and regional location. It is, therefore, doubtful whether even the limited magnitude of free surpluses reported by some of the public enterprises represent surplus funds for reinvestment after an appropriate payment for the cost of
capital. It is the predominance of equity share capital on which the government has forgone current dividend earnings, that has made the small reserve accumulation possible. Had there been, say, bonded debt in place of equity capital, reserve accumulation would not have been possible after payment of interest charges. To the extent that reserves are built up at the sacrifice of even a minimum dividend, they are strictly in the nature of additions to capital, through fresh subscriptions from the government; they are analogous to dividend paid out in the first place but returned as additional financial investment by the shareholder, namely, the Government.

Over the years, the depreciation figures have shown an increase. This was partly because of the creation of a couple of new enterprises, and partly because of growth of assets over time. It is noted that there has not been any change in depreciation policy. The share of depreciation in gross savings in 1973-74, was simply 34.0 per cent which increased to a considerable extent, reaching 105 per cent in 1978-79 because of negative retained earnings. The year 1980-81 is not comparable due to non-inclusion of data of the Timber Corporation of Nepal. On an average the share of depreciation in the gross savings is 81 per cent for all the years. But when the case of profit-making concerns is separately studied, the share of depreciation of such concerns in the gross saving averages to 41 per cent.

The data furnished in Table 3.9 clearly show that the public enterprises in Nepal have not been able to step up the
share of retained earnings in the gross savings; the share has, in fact, fallen over time. As a result, the enterprises have not been able to finance the expansion and growth from the internal resources. This can be explained only when the uses of funds is studied which will be done later.\textsuperscript{39} In Nepal, because of low profit record the enterprises have not been able to build up reserves and employ them to earn higher returns. However, in the advanced capitalistic countries like the U.S.A. and U.K., internal resources account for over 70 per cent of the total resources for corporate finance.

3.6 Concluding remarks

From the foregoing analysis it is obvious that the financial performance of manufacturing public enterprises in Nepal is far from satisfactory. The enterprises are not successful when judged from the objective of increasing the value of enterprises, and the basic objective of creating public enterprises as a source of augmenting internal resources required for speeding up the rate of economic growth, as envisaged in the Second Plan, has not been achieved so far. As a result, Government issued a directive in 1980 to all the trading and manufacturing enterprises to realize a rate of return of at least 10 per cent on the capital employed. But the circular does not make it clear to the managements whether each of them has to aim at this return or this is supposed to be an indication of the average performance expected from all the manufacturing and trading enterprises taken together. However, the 10 per cent fixed in

\textsuperscript{39} See: Chapter IV for the Sources and Uses of Funds.
the circular is the bare minimum. This is also not adequate if
the firms want to expand and grow. For the expansion and growth,
they must attempt at earning more than 10 per cent return on
capital employed. How far this circular will be implemented, in
a "Soft" state that has always been ready for compromise and con­
cession, by the government and the enterprises is to be seen. If
this is really implemented, it would work as a control mechanism,
too, and the government would also be restrained from interfering
in the day-to-day affairs of the enterprises. The government
should also ensure that the enterprises fix a fair price. They
should not be allowed to resort to arbitrarily high pricing for
increasing the profit.

Finally, we feel it is worthwhile to investigate the
possible causes of poor profitability which should help in
devising suitable remedial action. Otherwise, the relationship
between public enterprise and economic development in the context
of the objective of creating public enterprises will turn out to
be of no help. One of the prime reasons affecting profitability,
other factors being given, is the pricing policy adopted by the
public enterprises. Hence in the succeeding chapters we will,
first, analyse the ratios to examine the financial health of
manufacturing public enterprises; then the uses of funds will
be studied to see to what extent the enterprises have been able
to finance the expansion and growth out of the internal resources;
and finally, these will lead us to the study of pricing linking
it with profitability which is the main objective of our study.