CHAPTER V

ANALYSIS OF PRICING POLICY

In the preceding chapters while analysing the financial data of public manufacturing enterprises in Nepal in terms of profitability, ratio analysis and flow of funds we came to the conclusions that (i) they have not been able to generate surpluses for expansion and growth, and the rates of dividend payments are quite low; (ii) their general financial health is not sound; and finally, (iii) the share of internal sources in the total sources of funds is low. As a result of these, government has not only not received a fair rate of dividend on its investment in manufacturing public enterprises, but the enterprises have become more and more dependent on the government for the necessary current and capital funds. One of the possible reasons for such a state of affairs is the pricing policy followed by these enterprises. So, in this chapter we critically review the governmental policy regarding public enterprises and their pricing policies since the initiation of planning in the country, and analyse the pricing policies and profitability in the context of market structure in which the enterprises operate.

5.1 Price Fixation Mechanism

The Acts under which manufacturing public undertakings are set up, and also relevant documents do not indicate any guidelines for assessing the operational efficiency of the
enterprises. Neither the instructions given by the government nor the internal documents of the enterprises contain any directives in regard to pricing policy. The Memoranda and Articles of Association which elaborately deal with the various aspects like procuring of raw materials, powers and duties of the chief executive, etc., do not spell out the specific objectives of pricing policy. These documents also do not assign any specific powers to the Government in matters of price fixation of public undertakings. However, in practice, in most of them prices are fixed either explicitly by the Government or in consultation with the Government by the enterprises concerned.

5.2 Policy Under Plans

We have already outlined in Chapter I that nothing was mentioned in the First Plan document regarding the establishment and the role assigned to public sector enterprises. The document accepted the "principles of mixed economy" and simply stated that the government would initiate those industries which promised greater public welfare and where the investment is not attractive to the private sector. The Industrial Policy announced during the First Plan period laid stress on encouraging private investment, while public sector activities were to be confined to providing infrastructure and other support services.

However, in the Second Plan, the public corporation as an institutional vehicle for economic development of the country was accepted. The public enterprises, as one of the
sources for contributing to government funds by way of dividend payments was emphasized in clear terms. In other words, the Plan accepted that public enterprises should be run on profit-making basis. Thus, the controversy regarding whether the public enterprises should follow a policy of making profits for investments and dividends was resolved in the Plan document. Further, the Third Plan as well as the Fourth Plan laid emphasis on the mobilization of resources through government-owned corporations.

The Fifth Plan explicitly stated that "it is highly necessary that the existing government-owned corporations should contribute considerably towards the public revenue. It is quite logical that the resources should be mobilized through proper pricing policy of public services and products." The current Sixth Plan also unequivocally mentions that "following modern management practices, public corporations will be run on profit-principle. Efforts will be made to solve the problems arising from general economic policies in the functioning of such corporations and their efficiency will be increased so that these will be able to contribute to the public revenue to the fullest extent."

Thus, the various Plan documents of Nepal provide us indications which have relevance to the public enterprise

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pricing policies. Further, in 1980, government issued guidelines regarding the financial affairs of public enterprises which throw some light on matters of pricing policy. The important guidelines contained in the circular have been briefly summarized in the following section with relevant comments.

5.3 **Government Directives regarding Financial Affairs of Public Enterprises**

His Majesty's Government of Nepal issued a circular regarding financial affairs to all the public enterprises containing the following provisions:

1. **Reserve Fund:** The public enterprises have been asked to assign every year 20 per cent of the profit (before declaring dividend and provisions) to the Reserve Fund till it is equal to the paid-up capital. After the Reserve Fund equals paid-up capital, the Ministry of Finance is authorized to decide whether the amount in the reserve fund should be further increased.

2. **Depreciation Fund:** The public enterprises have been instructed to maintain the amount of depreciation in a separate fund called 'Depreciation Fund'. The directive admits in clear terms that till then no public enterprise was maintaining such a fund. Keeping this in view, instructions regarding the use of depreciation fund are also given. The depreciation amount is to be invested in current as well as capital assets - a

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3: HMG, Ministry of Finance, "Directives Regarding Financial Affairs of Public Enterprises," Ashad 11, 2037 (June 1980), Kathmandu (in Nepali) (Cyclostyled). The directive was issued through the concerned Ministry.
minimum of 25 per cent in current assets and the rest in capital assets.

3. **Accounting System:** No uniform system of financial accounting is followed by public enterprises in Nepal and the method of financial reporting may change from one year to another year in a given enterprise depending upon the auditors and their training background. As a result, evaluation by the management itself of their objective and functioning will be difficult. Besides, researchers would have to make a number of adjustments in the information to make them comparable. In this respect no directives were issued earlier by the government. So, the government in the present directive has mentioned that the accounts should be maintained according to the suggestions in Financial Accounting System.

4. **Dividend Policy:** The government has realized that till now dividend payments have been too low, and the objectives of establishing public enterprises have been partially defeated. So, it has issued guidelines regarding dividend declaration according to which, 50 per cent of the amount of profit after appropriations should be declared as dividends by an enterprise, and the remaining 50 per cent to be assigned to various funds, including dividend equalization fund.

5. **Investment Programme:** Till recently, there were no instructions in regard to the investment programmes of the enterprises. Now, in this circular, it has been explicitly stated that for expansion and modernization, the enterprise should prepare feasibility studies, and get the investment
proposal approved by the Board of Directors. After the approval of the Board, it has to be submitted to the Ministry of Finance, through the concerned ministry, for sanction.

6. Rate of Return and Its Calculation: As mentioned earlier, in the Second Plan, Government accepted the idea of establishing public enterprises as a medium of mobilizing resources for the economic development of the country. However, a review of the situation reveals that no resource mobilization has taken place. Because of this, many enterprises became a financial burden on government instead of contributing to the budget revenue of the government. The government, in the present circular, has emphasized the need for public enterprises to secure a minimum rate of return; a method for calculating it has also been devised.

(a) Industry and Trade Sectors:

a minimum of 10 per cent on net capital employed; and

(b) Other Sectors like Finance, Electricity, etc.:

a minimum of 7 per cent on the net capital employed.

\[
\text{Return on capital (\%)} = \frac{\text{Long-term interest + Bonus} + \text{Profit before Tax}}{\text{Net Capital Employed}} \times 100
\]

4. Here, the ratio indicates the return on capital before tax and interest. But, we do not see any reason as to why bonus should be included for the calculation of the return on capital. Where there is statutory requirements about the payment of bonus, it is an expenditure against income. In this case, bonus has to be paid whether enterprise makes profit or not. If it is not statutory, bonus is an appropriation made out of profits for the participants in the production process who have helped to make profit.
Net Capital Employed (NCE) is to be arrived at as follows:

\[ NCE = \text{Net Fixed Assets} + (\text{Current Assets} - \text{Current Liabilities}) \]

Or,

\[ \text{Share Capital} + \text{Capital Subsidy} + \text{Free Reserves} + \text{Undivided Profit} + \text{Long-term loans} \]

While the directive underlines the government’s concern about the public enterprises obtaining adequate return on capital, it is yet to be seen whether the directive will yield the desired results.

First, while fixing the rate, the government has not taken into account various factors like gestation period, demand factors, inputs supply, etc. It may not be advisable to fix a uniform rate applicable to all the enterprises. It may become necessary that in the public interest like price stability and welfare-oriented goods, some enterprises may have to be left out of the consideration while deciding the rate of return. As it stands now, for the few enterprises which are making some profit and can improve to some extent, the target is low. On the other hand, for the enterprises having accumulated losses, to attain even this target may be difficult. So, the government should have, after a thorough investigation of the present state of each of the enterprises, fixed enterprise-wise surplus target. This would have been more useful. The question regarding the enterprises running at deficits should be decided only after an in-depth study of each enterprise. However, making losses by an enterprise should not be allowed beyond a certain period, after which they have to contribute to the government budget revenue according
to government policy.

However, achieving the target rate of return fixed by the government implies that the enterprises be allowed to pursue an independent pricing policy and to manage the enterprises independently. In other words, government should not interfere in the day-to-day operations of the enterprises but issue only policy guidelines. As we know, it is quite difficult to adopt such non-interference policy overnight. During our survey, we found that out of 14 enterprises, four enterprises felt that government is interfering in the day-to-day administration, five felt that they generally received instructions relating to the long-term policy objectives of the enterprise from the administrative ministry, and two of them both type of instructions—interfering in the day-to-day administration and long-term policy objectives. Only three enterprises stated that they are not receiving any instructions from the government.

Secondly, the question regarding the fixation of a target return crucially depends upon the capacity utilization and the pricing policy. While fixing the target return, certain percentage of capacity utilization should be assumed. It is very essential to stipulate a minimum capacity utilization of plant by the enterprises. Otherwise, it is quite possible that the enterprises restrict their output and charge a higher price wherever possible. This is especially possible for enterprises working under monopoly conditions. In this way, prices may help to cover the inefficiencies of monopoly
rather than add to the surplus through cost and output efficiency.

Further, the governmental policy regarding subsidized prices should be made clear. If any portion of the products of public enterprises has to be sold at a subsidized price, the rate of return should be adjusted accordingly.

Finally, it should be borne in mind that the surplus target cannot remain unchanged for all time to come. In fact, factors such as cost and demand may be changing. Enterprises must bring to the Government's notice, where necessary, that the rate is high or low, and the reasons why they cannot fulfil the target. But, it should be noted that firms which have existed for a long time should contribute a higher rate of return to the government treasury than those newly started.

When the rate of return targets are to be fixed for each enterprise taking into account various factors like cost, demand, etc., an important question regarding 'who should fix the rate of return target?' comes up. Of course, government is the ultimate authority for any policy decisions. Still, we feel that the task would be better served if it is handed over to an autonomous agency created for this purpose. However, in no case should the task be entrusted to the concerned enterprise. What would be an appropriate mechanism for rate of return target fixation would be discussed later.

The Plan documents and government directives clearly indicate that the pricing policies of the public sector enterprises have to be broadly guided by the paramount consideration
of providing not only an adequate depreciation and return on capital but also the necessary provision for further expansion and growth. This implies that a 'cost-plus pricing' policy be followed by the public enterprises of Nepal. However, to note here, every effort should be made to control and bring down costs, and achieve efficiency.

In India, Government policies regarding pricing and profits are quite clear. For example, the Administrative Reforms Commission in India recommended that the following principles should be kept in view in formulating the pricing policies of the public sector enterprises:

(a) Public enterprises in the industrial and manufacturing fields should aim at earning surpluses to make a substantial contribution to capital development out of their own earnings, besides making a contribution to the exchequer.

(b) Public enterprises should, in any event, pay their way and should not run into losses except in pursuance of express directives issued by the Government for promoting public interest.

(c) While determining the price structure commensurate with the surpluses expected from them, public enterprises should keep the level of output as near the rated capacity as possible, taking into consideration the volume of demand for the product.

Earlier in 1968, government laid down the following guidelines regarding pricing policy: 6

(i) For enterprises which produce goods and services in competition with other domestic producers, the normal market forces of demand and supply will operate and their products will be governed by the prevailing market prices.

(ii) For enterprises, which operate under monopolistic or semi-monopolistic conditions, the landed cost of comparable imported goods would be the normal ceiling. Within the ceiling, it would be open to the enterprises to have price negotiations and fix prices at suitable levels. If the landed cost is found or believed to be artificially low or in other exceptional circumstances where it is considered necessary to have higher prices, the matter is to be referred to Government for decision.

Some instructions guiding the policy to be adopted for declaring dividends were: 7

(i) Current profits of the company should be first appropriated to accommodate the losses of the past years.

(ii) Current profits may also be appropriated to writing off preliminary expenses, research and development expenditure, deferred revenue expenditure, etc., by instalments spread over a number of years.


7 Ibid.
(iii) Of the net surplus available for distribution, a part may be appropriated to build up reasonable reserves and augment internal resources to finance the approved schemes of capital expenditure or to meet immediate financial obligations without much strain.

(iv) The balance available should be utilized for distribution as dividend on equity capital.

The guidelines further provide that in the case of manufacturing enterprises, they should aim at a dividend of at least 6 per cent going up to 15 per cent, on capital.

5.4 Analysis of Pricing Policy

In the sections that follow, we analyse the pricing policies adopted by the manufacturing public enterprises. Our main objectives would be to indicate pricing policies pursued by the enterprises and the average rate of return earned by them, and the failures in achieving the anticipated results. The analysis in the following sections, as stated earlier, is based upon the replies received to our questionnaire from the enterprises, their financial statements, budgets and cost sheets, and various other related documents.

As there exists no published documents regarding the pricing policy adopted by the enterprises, and HMG has also not specifically and categorically laid down till recently any pricing guidelines to be followed by these enterprises, it has become imperative to secure information through the use of questionnaires. So, in the sections that follow we will first of all outline the existing pricing policy of manufacturing
public enterprises in Nepal, and proceed on to appraise it on the basis of revenue budgets (estimated revenue and costs) supplied to us by the enterprises, and finally, compare the budgeted with the actual cost. In the process of our analysis some useful light will be thrown on reasons for deviation from the planned policies and programmes. The analysis would further enable us to link pricing policy with market structure and with the financial performance in terms of average rate of return on average capital employed. Finally, we would take up the issues regarding price decisions, because these constitute an important aspect of price structure.

5.4.1 Pricing Policies Followed by the Enterprises

The replies given by the public enterprises regarding the pricing policies followed by them revealed the situation presented in Table 5.1.

From the answers tabulated in Table 5.1 it is quite clear that almost all the enterprises in Nepal claim to adopt a surplus-making pricing policy. In other words, the enterprises have not used marginal cost pricing although economists claim such policy ensures efficient allocation of resources. It may be said here that the primary concern of enterprises is the level of profit, not the output level. In fact, during our survey we noted that the chief executives of the enterprises did not show adequate understanding of the marginal cost pricing. The enterprises set a price which equals total

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8 For question, please refer to 2.1 of Questionnaire: Part Two.
Table 5.1: Types of Pricing Principles Followed

<table>
<thead>
<tr>
<th>Enterprises</th>
<th>Cost- plus</th>
<th>M.C.</th>
<th>A.C.</th>
<th>Any others</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Aghupati Jute Mills Ltd.</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Timber Corporation of Nepal</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Birgunj Sugar Factory Ltd.</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Janakpur Cigarette Factory Ltd.</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Banswari Leather and Shoe Factory Ltd.</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Nepal Tea Development Corporation</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Agricultural Tools Factory Ltd.</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Brick and Tile Factory Ltd.</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. Dairy Development Corporation</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. Balaju Textile Factory Ltd.</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11. Royal Drugs Ltd.</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13. Hetauda Textile Industry Ltd.</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14. Bhaktapur Brick Factory Ltd.</td>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Cost plus a certain profit margin. The price fixation in manufacturing public enterprises of Nepal may be put as follows:

\[ P^e = \frac{TC^e + PM^e}{x^e} \]

where, \( P^e \) = the anticipated or desired price per unit;
\( TC^e \) = total estimated cost;\(^9\)

\(^9\) Total estimated cost includes both fixed and variable costs.
$P^* = \text{desired profit margin; and}$

$x^* = \text{targeted output.}$

Thus, $P^*$ is the price the enterprises wish to charge in the market in order to cover all their costs, given the utilization of capacity, and other factors affecting production; and a certain mark-up considered to be a reasonable profit under the given situation.

Raghupati Jute Mills Ltd. which is particularly affected by international market conditions (75 per cent of its products are sold outside the country as mentioned earlier) for pricing its products, explained to us that although its objective is to maximise profit as it is a mixed enterprise, it has adopted 'cost-plus' pricing at home, and is a price-taker abroad, because of market situation.

The cases of Dairy Development Corporation and the two brick factories are quite different. Although their policy is to make surplus, prices are decided by the government, and the price so fixed bears no relation to the cost of production. So, they cannot be said to be following a 'cost-plus' pricing policy.

5.4.2 Comparison of Pricing Policies With the Budgets of the Enterprises

In order to know what pricing policies have been followed by the manufacturing public enterprises in Nepal, we have examined the budgets prepared by each enterprise. (See: Appendix Table 6.)

Four enterprises could not provide budgets for the years 1978-79 and 1979-80, and three for 1980-81. Cut of ten enter-
prises which provided revenue budgets for 1978-79 and 1979-80, eight have prepared a surplus budget, and two, deficit budgets. It is to be noted here that the revenue budget is just a listing of expected costs and revenues. For the year 1980-81, only seven enterprises out of eleven have made provision in their budgets for surplus. Their claim that their pricing policy is to make a surplus, and that they are following a cost-plus pricing is not fully substantiated by the prepared budgets. So, in practice, only seven to eight enterprises have planned to follow the principle of 'profit-making' pricing policy. However, further examination is to be made to determine whether, in actual practice, the manufacturing public enterprises in Nepal have been able to follow the surplus-making policy. It may be recalled here that the profitability analysis presented earlier in Chapter III showed that profitability record of enterprises is quite dismal, and a number of them have been running at a loss. So, in the following sections, a comparison between budgeted and actual cost is made to see whether there exist any deviations between the two, and find out the reasons for such deviations, if any, and the consequences of such deviations on profits.

5.4.3 A Comparative Analysis of Budgeted and Actual Cost Per Unit and Price

In order to determine whether the manufacturing public enterprises in Nepal have followed surplus-making pricing policy in actual practice, we analyse the data pertaining to the per unit budgeted cost, actual cost, and price. (See: Appendix Table 7 for information.)
From the data provided to us, we find that there exists a wide gap between the budgeted cost per unit and actual cost per unit. In most of the cases, actual cost per unit is higher than the per unit budgeted cost, resulting in low profit if not loss. We have also computed cost deviations. (Please refer to Appendix Table 8 for cost escalation percentage.) Out of ten enterprises providing the requisite data, cost escalation has been reported by nine units. In case of units like Janakpur Cigarette Factory Ltd., Birgunj Sugar Factory Ltd., and Royal Drugs Ltd., surpluses have resulted even though the actual cost of production per unit was higher than the budgeted one, because of suitable price escalation (as the market permitted in the first two cases, and to some extent in the case of Royal Drugs Ltd.).

Some other units like Banswari Leather and Shoe Factory Ltd., Nepal Tea Development Corporation and Balaju Textile Factory Ltd., could have made some profit if costs were severely controlled within the limit of the budgeted ones, as the per unit price charged was higher than the budgeted cost. However, the actual cost per unit in case of Banswari Leather and Shoe Factory Ltd. showed considerable fluctuation (the maximum cost escalation in case of split leather was 20 per cent in 1970-81). The cost escalation record in case of Balaju Textile Factory Ltd. is 12 per cent in 1973-79 which declined

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10 In case of Birgunj Sugar Factory cost has escalated by 20 per cent, Janakpur Cigarette Factory between 15 and 37 per cent, and Royal Drugs Ltd. between 10 and 21 per cent.
to 4 per cent in 1980-81. As 4 per cent cost escalation is not so high, it could have been controlled through proper cost-reduction techniques. But the cost escalation in case of Nepal Tea Development Corporation was quite high, recording 32 per cent in 1978-79 and 65 per cent in 1980-81. This was because of very low capacity utilization in these years.

But in the case of the Dairy Development Corporation, Brick and Tile Factory (Narasiddhi) and Bhaktapur Brick Factory, government fixed the price even below the budgeted cost. The cost escalation in these cases is not high except for 29 per cent in case of Dairy Development Corporation in the year 1979-80. No cost escalation is recorded for Bhaktapur Brick Factory; in fact, the budgeted cost is higher than the actual one. In case of Brick and Tile Factory, the cost escalation is less than 4 per cent for bricks which is its main product. Thus, when prices were fixed even below the budgeted cost and costs escalated, it is quite natural that the enterprises incurred losses.

The continued cost escalation year after year witnessed in a majority of cases suggests that the task of budget preparation has not been taken seriously by the enterprises. In fact, the budgets of the enterprises are not comprehensive. The budgeting in these enterprises is very much limited in scope and coverage, being mainly confined to the planning of expenditure based on preceding year’s experience. Preparation of budget has become an annual ritual for presenting to the Board as well as to the Government. It has no functional use
in the enterprises in the sense that there is no overall link between various activities of the enterprise, say between production and sales. It is to be noted here that the enterprises prepare budgets for a very short period, of one year.

In the case of controlled prices, where the firms are not allowed to charge a fair price, the government should clearly specify the rate of return to be secured by the enterprise assuming that no losses are to be permitted. No doubt, excessive profit may not be allowed to be made. But on economic grounds no enterprise should run at a loss. Economic theory cannot support such an unwise policy of making losses continuously. Further, as stated earlier, this is contrary to the government circular which enjoins the public enterprises on earning a certain rate of return on capital employed. So, the government should allow the firms to charge a fair price but should not permit firms to cover inefficiencies by charging unreasonable prices. In case of multi-product firms like Dairy Development Corporation (milk and milk products) and Brick and Tile Factory Ltd. (bricks and tiles) where only prices of main products—milk and bricks respectively—are controlled, the firms should adopt product-mix policy in order to bring an overall profit situation.

From the above discussion it is clear that the manufacturing public enterprises in Nepal do not have a clear-cut and well-defined pricing policy, and (in many cases) prices of the products have no precise relation with the actual costs even if they are supposed to follow 'cost-plus' pricing policy.
Later in this chapter we analyse the reasons for such a wide gap between policy and performance.

5.5 Market Structure and Price Policy

Manufacturing public enterprises in Nepal are operating in different market situations. We broadly group them, for the purpose of our analysis, under two categories based on relevant criteria: (1) Differentiated Oligopoly, and (2) Monopoly. Regarding the price policies of the manufacturing public enterprises in Nepal, majority of them claim to be following the 'cost-plus' price policy. We have presented in Appendix Table 9 the information pertaining to the nature of market of various enterprises and the price policies followed by them.

5.5.1 Differentiated Oligopoly

The enterprises under this head are Nepal Tea Development Corporation, Agricultural Tools Factory, Balaju Textile Industry, Retauda Textile Industry, Royal Drugs Ltd., and Banswari Leather and Shoe Factory. These enterprises enjoy some degree of monopoly power as there is almost no competition to them from the domestic producers. But, they have to face some amount of competition from the imported goods. The imports of these products are allowed because the home production can meet only part of the national demand. In fact, these companies face competition from the goods of the well known foreign companies, especially from India, and have, therefore, to fix their prices in line with the prices of foreign goods. So, the cost of production of these enterprises should not be more than the prevailing market prices of similar products supplied by
the foreign companies if they have to secure profits. The units like Nepal Tea Development Corporation, Agricultural Tools Factory, Banswari Leather and Shoe Factory and textile mills have not been able to improve their sales even in the condition of differentiated oligopoly market situation. In case of Royal Drugs Ltd., it is a major supplier to the government hospitals; as such it has little to worry about marketing its products.

5.5.2 Monopoly Market

Under this, the enterprises are: Agro-lime Industry Ltd., Cheuri Shee Industry, Timber Corporation of Nepal, Janakpur Cigarette Factory, Raghupati Jute Mills Ltd., Birgunj Sugar Factory, Dairy Development Corporation, Brick and Tile Factory, Harisiddhi, and Bhaktapur Brick Factory. These enterprises, except the last four, have full autonomy for fixing the selling prices of their products without government’s prior approval.

Birgunj Sugar Factory, Dairy Development Corporation and brick producing units are operating under a system of price control. Prices of sugar, milk and bricks are controlled by the government and the formulation of price policy is not left to the independent judgement of the enterprise. In these cases, enterprises submit their cost estimates to the government, and the latter is responsible for price fixation. It is “often done on political expediency rather than on economic rationale”.11 Thus, there is no direct correlation between actual costs of

the enterprise and the prices so fixed.

Even in the case of other enterprises (apart from these four whose prices are controlled) administrative ministry plays a decisive role. "Sometimes in the interest of social benefit, the concerned public enterprises are not allowed to revise upward their prices despite the recurrence of financial losses."12 In fact, under the Essential Commodities Price Control Act the Government has reserved the right to control and intervene in the pricing policies of all public enterprises which manufacture or deal in social goods and services.

The four enterprises functioning under the system of price control are sore about the fact that whereas the Government has controlled the prices of their products there has been no control over the costs of materials and services to be purchased by these enterprises. The enterprises allege that the government raises the prices of the raw materials like milk and sugarcane frequently without allowing corresponding increase in the prices of the final products. By the time a rise in the prices of products is granted to the enterprise it already is late, and the enterprises would have incurred a deficit.

The cases of units incurring losses under monopoly conditions, where the demand for their products is quite high13 and the consumers are comparatively well-off urban people, are

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12 Ibid.

13 For example, there is always a long waiting-list for getting supplies of bricks, and deposit has to be kept in advance. For milk also, demand has always exceeded supply.
not understandable. There is no reason why these enterprises should be incurring losses when the demand for their products is quite high. Though these enterprises—milk producing unit and brick factories—are selling at prices below cost, this situation should not be allowed to continue further.

In case of sugar, the price in Nepal is influenced by the price of sugar prevailing in the border towns of India. This influence cannot be checked because of open border between Nepal and India, and the supply position and large gap in the two prices which gives enough scope for smuggling. Many a time, the price of Nepalese sugar has been revised in order to bring it on par with the Indian price. For example, sugar price in India during 1979-80 enabled Birgunj Sugar Factory to earn a large amount of profit.

Among the enterprises under study, Shree Naghupati Jute Mills Ltd. is the only enterprise operating in both the domestic as well as international markets. Its products are hessian, sacking and twine. About 75 per cent of its products are sold in the international markets. The pricing policy in this case cannot be decided by itself or by the government. The prices offered to the jute growers and other costs by themselves cannot be the determining factors of the prices of jute products. But a minimum price has to be offered to the jute growers, irrespective of final product price, to ensure regular supply of raw jute; on the other hand, despite the policy of making profits, the factory has to accept the prevailing international prices. Thus, it is a price-taker in the foreign market, and has not
only to manage its affairs within the prices determined in the international markets but is also required to provide quality products for enabling it to compete successfully in the foreign market. However, on the domestic front where there are only two jute mills and where it disposes of 25 per cent of its products, the prices are fixed jointly by the two enterprises. This helps the enterprise not only to cover the costs but obtain a certain margin. Thus, a discriminatory pricing policy is adopted by Shree Raghupati Jute Mills Limited.

Among the above enterprises, Timber Corporation of Nepal and Janakpur Cigarette Factory Ltd. have been fixing a price on cost-plus profit basis. The method adopted by these two enterprises is to adjust price according to cost of production.

Agro-lime Industry and Cheuri Ghee Industry have, however, not been able to make use of their monopoly situation, and are incurring losses year after year. The demand forecast for agro-lime made in feasibility study was very much off the mark. The initial production was expected to be to the tune of 6,000 metric tons per shift per year, although in 1971 it was estimated that Kathmandu Valley alone needed 26,000 metric tons of agro-lime annually to neutralize the two main problems of soil acidity and alkalinity arising out of excessive use of chemical fertilizers. But, the factory has been forced to close down agro-lime producing unit because of lack of adequate demand from the farmers, despite price subsidy given by the government. Now, the enterprise has been concentrating on industrial and construction lime.
The case of Cheuri Ghee is quite different. It was established without any feasibility study whatsoever. It is a very small village unit (with a paid-up capital of Rs.3 lakh) established to boost, to some extent, the local economy. However, due to transportation and other bottlenecks, it has rather become a problem for the government, and the government, as reported during our discussion with the concerned minister, was planning to dispose off this unit to the private sector.

5.6 Price Policy and Financial Performance

In this section we propose to analyse the price policies, targets of surplus to be made (as instructed by the government in the circular), and the financial performance of manufacturing public enterprises in terms of average rate of return on capital employed.

Despite the large proportion of enterprises adopting a surplus-making price policy, HMG has not fixed profit targets on an individual enterprise basis. As stated earlier, HMG has only issued a general directive regarding financial activities, applicable to all the public enterprises in the country. Under this circular, the manufacturing public enterprises are required to generate/minimum return of 10 per cent of their capital employed. Now, considering this circular as the basis for comparison, we tabulate the data on capital employed and the actual rate of return of all the manufacturing public enterprises, and the pricing policy adopted by them. Here, we have taken the year 1980-81 as the basis for comparative analysis because in June 1980 only (before the Financial Year started).
the circular was issued, and after the issuance of this circular, data pertaining to only one year is available.

From Table 5.2 it is clear that only two out of thirteen enterprises have been able to make surplus of 10 per cent or more. In the aggregate, only about 2 per cent return on total capital employed has been realized against a surplus target of 10 per cent. In other words, the manufacturing public enterprises in Nepal have been able to realize only about 21 per cent of the total desired surplus. In fact, the return in the year 1979-80 (the year before circular was issued) was comparatively better when compared with the year 1980-81 (after the issue of the circular). This shows that the government circular has not made as yet any impact on the enterprises for making profit. The absence of any target rate of return, taking into account the enterprise's strengths and weaknesses, for each individual enterprise suggests that the policy of generating 10 per cent return on capital employed is decided without much prethought. However, even a targeted rate of return gives only a limited guidance in matters of pricing. The shortcomings of such a target fixation are outlined below.

First, the targeted surplus for all the manufacturing public enterprises, in general, is neither based on actual conditions and potentialities of the individual enterprises nor translated into operative terms in respect of each enterprise. An overall surplus target for the manufacturing public sector as a whole has little meaning unless it is broken down into targets realizable by individual enterprises through their
<table>
<thead>
<tr>
<th>S. No.</th>
<th>Name of the Enterprise</th>
<th>Price Policy</th>
<th>Capital Employed</th>
<th>Desired Surplus</th>
<th>Actual Surplus</th>
<th>% of (3) to (4)</th>
<th>% of (5) to (4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Kaghupati Jute Mills Ltd.</td>
<td>Profit-making</td>
<td>25.766</td>
<td>2.577</td>
<td>-2.536</td>
<td>-9.34</td>
<td>-98.41</td>
</tr>
<tr>
<td>2</td>
<td>Birgunj Sugar Factory Ltd.</td>
<td>&quot;</td>
<td>81.560</td>
<td>8.156</td>
<td>16.022</td>
<td>19.64</td>
<td>196.44</td>
</tr>
<tr>
<td>3</td>
<td>Banswari Leather &amp; Shoe Factory Ltd.</td>
<td>&quot;</td>
<td>16.257</td>
<td>1.626</td>
<td>-1.956</td>
<td>-12.03</td>
<td>-120.30</td>
</tr>
<tr>
<td>4</td>
<td>Nepal Tea Development Corporation</td>
<td>&quot;</td>
<td>39.191</td>
<td>3.919</td>
<td>-0.378</td>
<td>-0.97</td>
<td>-9.65</td>
</tr>
<tr>
<td>5</td>
<td>Janakpur Cigarette Factory Ltd.</td>
<td>&quot;</td>
<td>117.160</td>
<td>11.718</td>
<td>17.268</td>
<td>14.71</td>
<td>147.36</td>
</tr>
<tr>
<td>6</td>
<td>Agricultural Tools Factory Ltd.</td>
<td>&quot;</td>
<td>6.950</td>
<td>0.695</td>
<td>-1.023</td>
<td>-14.72</td>
<td>-147.19</td>
</tr>
<tr>
<td>7</td>
<td>Dairy Development Corporation</td>
<td>Loss-making</td>
<td>71.659</td>
<td>7.166</td>
<td>-3.955</td>
<td>-5.52</td>
<td>-55.19</td>
</tr>
<tr>
<td>8</td>
<td>Balaju Textile Industry Ltd.</td>
<td>Profit-making</td>
<td>8.826</td>
<td>0.883</td>
<td>-0.700</td>
<td>-7.93</td>
<td>-79.28</td>
</tr>
<tr>
<td>9</td>
<td>Agro-lime Industry Ltd.</td>
<td>&quot;</td>
<td>3.256</td>
<td>0.326</td>
<td>-0.704</td>
<td>-21.62</td>
<td>-215.95</td>
</tr>
<tr>
<td>10</td>
<td>Brick and Tile Factory Ltd.</td>
<td>Loss-making</td>
<td>8.694</td>
<td>0.869</td>
<td>-2.800</td>
<td>-32.21</td>
<td>-322.21</td>
</tr>
<tr>
<td>11</td>
<td>Shaktapur Brick Factory Ltd.</td>
<td>&quot;</td>
<td>4.354</td>
<td>0.435</td>
<td>-1.450</td>
<td>-33.30</td>
<td>-333.33</td>
</tr>
<tr>
<td>12</td>
<td>Royal Drugs Ltd.</td>
<td>Profit-making</td>
<td>31.560</td>
<td>3.156</td>
<td>1.019</td>
<td>3.23</td>
<td>32.29</td>
</tr>
<tr>
<td>13</td>
<td>Metauda Textile Factory Ltd.</td>
<td>&quot;</td>
<td>162.567</td>
<td>16.257</td>
<td>-6.557</td>
<td>-4.03</td>
<td>-40.33</td>
</tr>
</tbody>
</table>

Total PEs: 13

| Rs. in million | 577.830 | 57.783 | 12.250 | 2.12 | 21.2 |
pricing policies. Janakpur Cigarette Factory and Birgunj Sugar Factory, as already stated above, could realize surpluses because of monopoly conditions. It is to be noted here that Janakpur Cigarette Factory alone meets 99 per cent of the national consumption needs of cigarettes.

Secondly, it is possible for an enterprise to secure a given quantum of profit by restricting its output at a point where $MC = MR$, and $AR$ is highest.

Thirdly, a given target of profit can be earned either from the application of a single price to the entire market or from a discrimination among sub-divisions or regions of the market in terms of persons, sub-regions, or products. Fourthly, low profits do not invariably imply that the prices are low. It is possible that low profits accompany high prices (occasioned by high costs through inefficiency). Nextly, high profits are not necessarily indicative of high prices. Further, profits could be realized through a proper product-mix in case of multi-product firms (restricting the unprofitable line of production, and increasing output in other lines/units of production). Thus, the aim of the enterprises should be to raise necessary surpluses, as far as possible, by reduction in costs and without restricting the output. Of course,


the terms 'high prices', and 'low prices' used here are relative ones. These can be defined and interpreted only when there are certain norms adopted.

From Table 5.2 it can be concluded that there is no relation between the price policy followed by the enterprises and the financial returns. The rate of returns ranging from 20 per cent to -33 per cent among the enterprises imply either the absence or ineffectiveness of pricing policies designed to maintain the rate of return.

When the pricing policies are linked directly with surplus targets, the enterprises can achieve the target through a general hike in prices or a general reduction in costs or through a pattern of discriminatory price adjustments in the different markets served by an enterprise or by a combination of these policies. But the enterprises should be permitted to enhance the price for securing a surplus only after reviewing the cost structure. Thus, the managements of public enterprises should explore the alternative price policies, after a thorough investigations of cost structure. Otherwise the consumer will be exploited.

5.7 Market Structure and Average Rate of Return

The data (calculated on six years' average) in this regard is presented in Table 5.3.

As stated earlier, the pricing of Dairy Development Corporation (milk) and Brick and Tile Factory (bricks) is done by the government, and the prices so fixed are below the cost of production for which there is no reason. The case of Agro-
Table 5.3: Market Structure and Average Rate of Return (in Per Cent)

<table>
<thead>
<tr>
<th>Enterprise</th>
<th>Monopoly ARR*</th>
<th>Differentiated Oligopoly ARR*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raghupati Jute Mills</td>
<td>3.99</td>
<td></td>
</tr>
<tr>
<td>Timber Corporation of Nepal</td>
<td>38.63</td>
<td></td>
</tr>
<tr>
<td>Birgunj Sugar Factory</td>
<td>10.11</td>
<td></td>
</tr>
<tr>
<td>Janakpur Cigarette Factory</td>
<td>12.13</td>
<td></td>
</tr>
<tr>
<td>Dairy Development Corporation</td>
<td>-7.73</td>
<td></td>
</tr>
<tr>
<td>Brick &amp; Tile Factory</td>
<td>-5.04</td>
<td></td>
</tr>
<tr>
<td>Agro-lime Industry</td>
<td>-10.51</td>
<td></td>
</tr>
<tr>
<td>Nepal Tea Development Corporation</td>
<td>-0.92</td>
<td></td>
</tr>
<tr>
<td>Agricultural Tools Factory</td>
<td>-5.34</td>
<td></td>
</tr>
<tr>
<td>Balaju Textile Industry</td>
<td>-1.81</td>
<td></td>
</tr>
<tr>
<td>Royal Drugs Ltd.</td>
<td>5.24</td>
<td></td>
</tr>
<tr>
<td>Banswari Leather and Shoe Factory</td>
<td>-7.14</td>
<td></td>
</tr>
</tbody>
</table>

* ARR stands for Average Rate of Return.
@ Calculated on 5 years' data.

Agro-lime is quite typical. When Agro-lime Industry was established, it was reported that there would be a good market for agro-lime because of acidity in soil. But, it has stopped producing agro-lime now due to marketing problems and started the production of industrial and construction lime. So, out of eight enterprises operating under monopoly, four are running at a profit.

Among the enterprises operating under differentiated oligopolistic structure, only one enterprise, Royal Drugs Ltd., is running at a profit. Thus, the market structure pattern
and the average rate of return clearly indicates that mainly
the enterprises operating under the monopoly sphere are making
profit. But, to note here, the cases of Dairy Development
Corporation and Brick and Tile Factory are quite different.
The prices of these enterprises are controlled by the govern-
ment and the prices are lower than the cost. As a result, they
are incurring losses. Thus, in case of the first four enter-
prises under 'monopoly', the higher the monopoly element, and
the domination in the market, the greater the possibility of
making profits. This may be interpreted as that the monopoly
enterprises in Nepal are making profits not because they are
efficient but by exploiting their monopoly power. This is
supported by the fact that two enterprises are able to recover
even a higher actual cost than the budgeted one because these
enterprises are able to make an upward revision in prices,
whenever the cost escalated as discussed earlier. During our
discussions with the chief executives of the profit-making
units like Janakpur Cigarette Factory, it was revealed that if
the cost of production is higher than the planned one, prices
are also raised simultaneously (see: Appendix Table 7). For
example, take the case of this unit and Birgunj Sugar Factory.
In these two units, there is a wide gap between the planned
cost per unit and actual cost per unit, but at the same time
price per unit has been able to cover the increased costs. Thus,
there is no accurate cost forecast, and this implies that: (1)
first, there is no cost control mechanism, (2) secondly,
customers have to pay whatever price is charged, and (3) thirdly,
if cost consciousness prevails in the enterprise and the enterprises are able to restrict the cost at planned level, there is scope for further surplus.

In case of enterprises operating under differentiated oligopolistic market structure, the average rate of returns of concerns incurring loss ranged between minus one and minus five per cent. With proper planning and control, and effective marketing strategy, losses could be avoided.

To further probe into the matter, let us see the market structure and size of average rate of return.

Table 5.4: Market Structure and Size of Average Rate of Return (ARR)

<table>
<thead>
<tr>
<th>Size of ARR (per cent)</th>
<th>Monopoly</th>
<th>Differentiated oligopoly</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 0</td>
<td>3</td>
<td>4</td>
<td>7</td>
</tr>
<tr>
<td>0.1 - 5</td>
<td>1</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>5.1 - 10</td>
<td>-</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>10.1 - 15</td>
<td>2</td>
<td>-</td>
<td>2</td>
</tr>
<tr>
<td>Above 15</td>
<td>1</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>7</strong></td>
<td><strong>5</strong></td>
<td><strong>12</strong></td>
</tr>
</tbody>
</table>

It is clear from the Table 5.4 that out of a total of 12 enterprises, seven are operating at a loss, and two have a return of less than 10 per cent. Only three (i.e. 25 per cent of the enterprises) have been making a return of above 10 per cent. Thus, a majority of manufacturing public enterprises is not contributing any rate of return on their total average capital employed. This is reflective of the fact that
although HMG's policy is to mobilize resources by running the enterprises efficiently, and rate of return have also been fixed, government has not been able to enforce their policies into practice. There exists a wide gap between HMG's policy and performance.

5.6 Price Policy Decisions

In this section we take up two basic issues regarding price decision: (a) first, the price-fixing authority, and secondly, (b) the bases of price decisions. (Refer to Questionnaire, Part Two, No. 2.2, 2.3 and 2.4.)

Our discussion with the enterprise management showed that prices of uncontrolled items are either fixed by the chief executive himself\(^\text{16}\) who is also the member of the Board of Directors, or the Board itself. In any case when the price is fixed at the enterprise level, Board is the ultimate approving authority. (For information on the bases for the authorities responsible for pricing decisions, see: Appendix Table 10.)

The prices of three items—milk, sugar and bricks—produced by four enterprises, namely, Dairy Development Corporation, Birgunj Sugar Factory, Brick and Tile Factory and Bhaktapur Brick Factory are government controlled, and for the rest, prices are decided at the enterprise level. The handling of the price decision for four enterprises at the government

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\(^{16}\) Chief executive acts under various capacities in the Board. For example, he may be executive chairman or member-secretary of the Board or simply a member. However, in a majority of manufacturing public enterprises, the chief executive is the executive chairman-cum-general manager.
level rather than giving freedom to concerned enterprises bears no relationship with their legal structure. At this stage we further explored the need for price control by the government. During our discussions, the chief executives explained that as the milk and sugar constitute daily necessities, it was imperative for the government to control prices. But the chief executives were sore at government controlling the prices of their products and asking a rate of return which is quite unreasonable. However, the prices of bricks were controlled despite strong demand and monopoly market, because a substantial increase in its prices would trigger off a rise in prices of bricks in the private sector.

Except the four enterprises mentioned above, the rest are given freedom to set their own prices; at least there does not appear to be any direct interference in the price setting. But, it is to be noted here that, as stated earlier, most of the enterprises still feel that indirect control exists, and they informally ask approval of prices from the concerned ministry. As noted earlier, KMG can any time control the prices of basic necessities under the Essential Goods Prices Control Order. Anyway, a majority of the enterprises are comparatively in a better position regarding price fixation, and it is upto the chief executive to resist the indirect interference from the government.

Regarding the factors influencing price policy in majority of the cases, prices of raw materials and the total cost of production play an important part. This is consistent
with the earlier statement that manufacturing public enterprises in Nepal are following a 'cost-plus' policy. But, the majority of the enterprises have not been able to earn surplus despite 'cost-plus' policy which may be due to a number of reasons. The reasons will be discussed in the following sections.

5.9 Concluding Remarks

From the above analysis of pricing policies in relation to budget, price, market structure, financial performance and pricing decisions, we arrive at the following conclusions:
(1) there is a certain measure of uniformity in the pricing policies of manufacturing public enterprises insofar as they plan to make surpluses; (2) the enterprises have not been able to follow the planned pricing policy of 'making profits'; (3) the actual per unit cost is usually higher than the budgeted one; (4) only a couple of manufacturing public enterprises operating under monopoly situation have coped with the increased cost of production by simultaneously increasing the prices of their products; (5) firms do not know their demand curve, and also their marginal costs; so the application of \( MC = MR \) is not possible due to the lack of necessary information; (6) although firms believed that 'cost plus' is the right price to recover total cost plus a certain margin, they have departed more often than not from the set rules; (7) there exists a greater possibility of making surplus if the firms can restrict their costs within budgeted ones; (8) the higher the monopoly elements in the market, higher the probability of making surplus by an enterprise; (9) government's instruction
of securing at least 10 per cent of the capital employed has not been fulfilled by a majority of the firms, and in the aggregate, only about 21 per cent of the total surpluses to be generated (as per government's instruction) has been realized in practice.

5.10 Reasons for the Failures in Achieving the Desired Objectives

In this section we propose to discuss in brief the various reasons for the failure in achieving the desired objectives.

5.10.1 Defective Accounting and Costing System

A wide divergence between the desired outcome and realization may be attributed to the defective system of maintaining accounts and reporting system. For the pursuit of pricing policies which are in keeping with the objectives set for public enterprises it is necessary to have prompt reporting and proper costing system. So, in the following sections, we would like to make some observations on accounting and costing practices followed in the manufacturing public enterprises of Nepal. This is based on our discussions with a couple of chartered accountants who are involved in auditing of public enterprises, Auditor General's Annual Reports, research questions and discussion with the concerned officials of manufacturing public enterprises.

(a) Accounting System: The accounting system followed in the public enterprises of Nepal is far from satisfactory. During our discussions with the enterprise management and auditors, it was revealed that there is always a time gap of,
at least, three months in recording the financial transactions. As a result of this, up-to-date accounting information is not available, which has really hampered the policy- and decision-making tasks of public enterprises. Moreover, monthly, quarterly and other periodical statements of accounts for the purpose of reviewing and taking corrective actions are not prepared at all. The present practice is just to prepare the annual financial statement, consisting of profit and loss account and balance sheet. They are then incorporated in the Auditor General's Annual Report, at least one year after the expiry of preceding financial year. But in some cases they do not appear in the Report even after the expiry of two or three years. In fact, one of the most distressing problems, as stated earlier, that a researcher finds is the lack of regularity in reporting of data of public enterprises, although they are required to publish progress reports and financial statements, within six months of the expiry of financial year. But law has little relevance when it is not enforced. The Auditor General's Report throws light on the extent of negligence and inconsistency in corporate financial reporting in Nepal. (Appendix Table 11 reveals the situation in manufacturing public enterprises of Nepal.)

Out of the fourteen enterprises under study, seven enterprises have been able to get their accounts for the year 1980-81 audited and incorporate them in the Auditor General's Report of 1982. Five enterprises have incorporated their annual financial statements only for the year 1979-80. One
enterprise has not published its reports for the year 1978-79 to-date, and hence not included in the Auditor General's Report. Raghupati Jute Mills Ltd., a public limited company, publishes its accounts separately as it is required to distribute the reports to the private shareholders before the annual general meeting is convened. Because of the non-availability of published financial statements in time, one has to go from enterprise to enterprise collecting the statements from the official records. In fact, even if the financial statements are published in the Auditor General's Report, it is necessary to go through the original statements as the reports do not incorporate the schedules and other detailed items/ headings.

An organisation should have an effective and timely accounting reporting system in order to make available basic information on business activities to the management. In its absence, management cannot formulate broad business policies for efficient management and effective control. Thus, there cannot be timely decision-making in the enterprise. As a result of much delay in the preparation of accounts, budgeting cannot be effective.

The reasons for delay in preparing accounts are:

(i) Lack of professional training of the staff: In most of the enterprises the finance department is headed by a junior officer who possesses some job experience but does not have

For example, in Raghupati Jute Mills Ltd., Balaju Textile Factory Ltd., Agro-line Industry, and in a number of other units, a junior accounts officer heads the accounts department who does not have access to the top management. The accounts

(continued)
any formal or professional training in the subject. As a result, quality of the accounting system is poor, and the accounting staffs are involved in routine tasks. In the absence of competent persons, the functioning of the finance department is only limited to routine book-keeping of the enterprises, and the task of financial planning and administration, stores planning and control has been neglected.

(ii) Lack of formal organization: The formal organizational structure of the finance department is not clearly spelt out. The permitted manning strength of the department and the delineating authority, responsibilities and duties are also not fixed, and the way the accounting work has to be performed is not well-defined.

(iii) Lack of timely information: There is no fixed time limit for submission of relevant information by other departments to finance department. Because of this, flow of information from other departments/sections like stores, sales, production, purchase, etc., is at irregular intervals.

(iv) Depots maintain their accounts on imprest system, and recording of the transactions of all depots, income and expenses are done at head office. Most of the depots do not

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(Footnote 17 from last page continued:)

department is rarely consulted in financial planning and policy formulation. In all the units, the financial reporting system is below standard and all financial statements and reports are not prepared regularly. They are prepared only after the end of the fiscal year. Thus, the impact of such a system on the functioning of the enterprise is well known.
submit timely returns, and even delayed returns are further
delayed at Head Office by not checking and compiling in time.

(v) Lack of accounting manuals: A carefully designed
chart of accounts and accounting manuals are necessary parts
of effective accounting system which must be supported by
sound practices of timely compilation of accounting statements
and the reliability of data produced. But this is lacking in
the public manufacturing concerns of Nepal.

(vi) Absence of information system: In the Nepalese
manufacturing public enterprises, cash/fund flow statements,
capital budgeting, long-range plans and so on have never been
considered as essential tools of financial management, and the
accounting data do not form part of managerial decision-making.
As a result of this, there is no pressure on the department
to keep the records up-to-date.

Thus, it is clear that accounting system in the Nepalese
manufacturing public enterprises has not been given the atten-
tion. This has adversely affected the managerial planning
and control mechanism, and finally, the pricing decisions, as
the data are not promptly made available. These will be dealt
with later.

(b) Costing System: A majority of the manufacturing
public enterprises in Nepal have claimed to be following, as
mentioned earlier, the 'cost-plus' basis for the fixation of
prices of their products and services. In such a situation
they are expected to show a sound financial position and
provide an attractive rate of return on investment. But this
is not the case. Most of them have shown, as analysed earlier, a dismal financial performance which gives rise to serious suspicion regarding the actual pricing policy followed by the enterprises. Further, the costing system itself may be defective.

Costing system in an enterprise forms an important part of the whole decision-making process. Among other things, the basic use of cost data is (a) to find out the manufacturing cost per unit produced, and for inventory valuation; (b) for cost estimates which are used for making decisions on pricing and output; and finally, (c) to measure efficiency and evaluate performance.

However, the cost accounting function is not carried out in a systematic manner integrated with the financial accounting of the enterprise. The financial accounts do not reflect the various elements of cost in necessary detail for cost analysis and control. Therefore, the costing system has little or practically no utility to management except for the purpose of inventory valuation. Moreover, the delay in compiling books of accounts has made the costing system superficial. The reasons for such a state of affairs are enumerated below:

(1) There is no costing department in a number of enterprises, and a member of the junior staff generally heads the costing unit attached with Research Department or Finance Department or some other department. The junior staff has, of course, gained experience but lacks formal training and skill on the subject.
(ii) Costing is based on financial accounting; the corollary of which is that delay in recording financial transaction automatically delays costing. As a result of this, management is unable to secure quickly cost statements that report the prevailing business conditions.

(iii) In the Nepalese manufacturing public enterprises, an actual or historical cost system is followed. This delays the presentation of results until all manufacturing operations have been performed or services rendered. It does not allow timely comparison between actual costs and budgeted costs and, therefore, does not enable the management to move quickly to check unfavourable trends and departures from predetermined standard.

(iv) Forms, records, methods and procedures in use in the process of costing system are not defined, and are carried through by tradition and, therefore, the cost measured, recorded and reported by the costing system is not reliable.

(v) The costing information is compiled with a view to know the total product cost and, therefore, it is inadequate for cost analysis and control as it does not take into account the (a) standard or budgeted cost, (b) labour-time utilization, (c) idle time or spoiled time, (d) machine time utilization, (e) normal or controllable and abnormal wastages are not established, (f) direct and indirect labour is not classified, and (g) fixed and variable expenses are not classified.

(vi) Responsibilities are not fixed for controlling wastages, overtime, machine hour utilization, etc., and,
therefore, costing data is not reported to departments responsible for production. The departmental/sectional heads, therefore, are neither given responsibility nor do they feel responsible for variation in the cost of production and actual reasons for variation are not investigated or ascertained.

(vii) Costing is not taken as a guide for price fixation and subsequent cost revisions as percentage mark-up are not clearly spelt out.

(viii) The basis for charging overhead rates for production and service departments are not clearly established. Similarly, cost of service department is not reviewed and assigned to various departments, but allocated to production department. Standard bases for allocating these overheads to producing department are not available and, therefore, it is not possible to compare actual with applied overhead and determine the over- and under-applied factory overhead.

(ix) The per unit cost of a product is affected by the extent to which capacity of a plant is utilized. Unit costs tend to increase at a decreasing rate with an increase in production as the fixed costs are spread over a larger output. Conversely, they tend to increase with a decrease in production. Since the operating capacity of a plant is not being fully used, the fixed costs of unused facilities and indirect costs connected with them operate to cause increased unit cost and the cost of such excess capacity is not ascertained.

When the enterprises prepare their revenue budget before the beginning of every financial year, they tend to
prepare a surplus budget to give an impression to the government and the public that the enterprise concerned is heading towards making some profit. There is always a tendency to under-state costs especially the wasteful ones. Such revenue budgets easily go through the Board of Directors. But by the time the financial year starts there is escalation of costs because of inflationary pressures and incurring of other unplanned costs. Such costs are incurred with the approval of the chief executive. Once these are incurred the Board has no other option but to approve them. No one is held responsible for such state of affairs.

Thus, we feel that for managerial and monitoring purposes, public enterprises should adopt Standard Costing system, and norms should be fixed. The standard cost and norms provide a measure of what should be the result if performance is efficient. The standard cost is the acceptable cost based on scientifically pre-determined standards of performance. Standard cost is arrived at by adopting the most efficient performance levels in respect of (1) materials consumption, (2) labour productivity, and (3) overheads.

5.10.2 Lack of Proper and Timely Reporting System

In a goal-oriented organization, in order to achieve the desired result there must exist an effective system of communication from the lower levels in the management hierarchy to the top management and vice versa. This sort of system is necessary in order to keep the top management well-informed as to what is happening in the organization and to enable them
to take necessary corrective action for achieving the desired results. On the other hand, information flowing from top management to the subordinates will provide necessary direction and control and the feedback. But in the Nepalese manufacturing public enterprises, the reporting system is not effective for timely decision-making, and for taking of corrective actions in time, and there exists no two-way flow of information. The chief executives fail to understand the importance of a sound management information system (MIS), and rely heavily on their hunch. Thus, in the name of the interest of the organization, unsound decisions are taken on ad hoc, arbitrary basis. Now, let us see the position of management information system in the enterprises.

In the enterprises, except for reporting of production data to the management, there is no other regular flow of information. As stated above, the reporting and recording of financial accounts and costs are not done timely and effectively, and there is always a time lag between the actual happening and reporting. Further, the communication is generally delayed in the absence of proper planning and budgeting which we shall discuss below. Thus, delays in communication have an adverse effect on both the formulation and implementation of policies.

The production data is forwarded to the top management by the production unit of the enterprises. In some of the units this is done on daily/weekly basis, while in others, on a monthly basis. The annual production target is broken down
into quarterly, and after the end of quarterly period, a review is made whether quarterly targets are made. But, as most of the enterprises are producing less than the planned target year after year, it seems no actions are taken for controlling this situation, and moreover, different units of an enterprise are not interrelated. In order to find out why production targets are not fulfilled, data on other aspects like sales, procurement of raw materials, etc., must also be considered. For example, in Mahapati Jute Mills Ltd., there is a daily/weekly reporting system from the production division to the chief executive but with no flow of other information relating to finance, sales, etc. The chief executive submits annual reports and other reports to the Board as deemed necessary. In other units like Balaju Textile Industry, Banswari Leather and Shoe Factory, etc., monthly production data are provided to the management. But the case of enterprises located outside Kathmandu is different in the sense that the chief executives are normally outside their place of work. During our visit to enterprises it was revealed by the middle level management that the chief executives are mostly in the capital dealing with the minister and secretaries. It was reported that the general manager of a sugar factory was always out of station during the crushing season. Thus, even the production data submitted by the production unit of the enter-

18 The utilization of capacity has been discussed in the latter section.
prises is of little relevance, and is of no use for the progress of the enterprises.

5.10.3 **Lack of Planning, control and Budgeting**

Corporate planning is a tool through which an enterprise sets how and when to translate the ultimate objectives in action. In the process of implementing the plans, it automatically works as a control mechanism. An effective mechanism of financial management and control can be built-up on a sound comprehensive budgetary system. Budgeting *inter alia* includes planning and preparation of both physical and financial targets, appraisal and reporting. Thus, planning, control and budgeting are closely inter-linked.

Basically two types of plans based upon varying time dimensions are prepared, namely, short-range and long-range. But, lack of clearly defined general objectives for the public sector undertakings as a whole, and the significance attached to this sector in the national plan has reduced the importance of corporate plan to a list of intentions that are being expected to be achieved without matching of resources required for such activities. Consequently, it is usual to find the absence of any measurable standards and operational plan in the state-owned enterprises in Nepal. This point can be well illustrated with the use of our questionnaire.

In order to see the type of planning adopted by the enterprises, long-range or short-range, its objectives and processes involved in preparing them, we incorporated some queries in our questionnaire. (See: Questionnaire: Part Two.)
The replies to our queries indicate three things. First, although a majority of the enterprises prepared long-range and short-range plans, they are prepared on an ad hoc basis just to fulfill the ritual of providing them to the National Planning Commission. For example, a perusal of the minute books of board meetings of eight public enterprises showed that for a whole year there had virtually been no serious discussion on the long-term plans and policies in the board meetings.19 "Similarly, seriousness about attaining the targets also is found to be utterly lacking."20

Secondly, corporate plans do not indicate anything about various considerations like how these objectives shall be fulfilled, how they shall be carried out, what inputs are necessary, etc. And at the same time a powerful tool of control inside the organisation is a must in order to take timely actions to correct any deviations.

Thirdly, the objectives of short-range plans have no relation with the long-range planning. Even if an enterprise has a long-term plan, it has to be broken into annual plan in operational terms. But no steps are outlined to achieve them. For example, in the absence of a well-devised marketing plan or sales promotion technique, how is it possible to promote


sales? Moreover, during our discussion it was revealed that the plans are prepared on the basis of previous year’s budget and experience of operation.

Regarding annual plan, during our interview, however, all the enterprises, except a few, claimed to have prepared (a) sales budget, (b) production budget, and (c) finance budget. But they could not show us any except the revenue budget which is the listing of expected expenditure and total revenue. However, one enterprise which claimed to have prepared a comprehensive annual plan provided us their programmes entitled 'Working Plan and Budget' for the years 1978-79 and 1979-80. This document outlines previous year’s progress department-wise. But unnecessary details which have no relevance with the actual workings of the enterprise are also included. The document provides data on previous year’s sales and production, and planned sales and production in quantity and amount, and budget of each unit of the enterprise. But such information has very little operational value for the enterprise’s development and growth. Thus, it is clear that the budgets in public enterprises, even though they have been prepared, had no operational value in the company management, and they were an essential document prepared to comply with the government rules and regulations.

Nepalese manufacturing public enterprises do not have any standards for evaluating performance, and consequently, there is no question of adopting corrective measures when targets are not met. Answers to a portion of our questionnaire
illustrate this point. (See: Questionnaire, Part Two.)

The answers to our questions reveal the fact that none of the enterprises under study has adopted the practice of setting targets on rate of return on assets, profit margin and capital turnover, and labour productivity. Lack of performance evaluation shows how control aspect of management is being neglected. This clearly shows that the enterprises have not thought of reducing costs so vital for the successful management. Under such a management indiscipline, there was to be no question of any functional management information system including a feedback mechanism so essential for an organization if it is really result-oriented. When corporate goals and plans do not play any role, personal whims, and prejudices and political interference may remain supreme in the enterprises.

We also posed a question regarding the use of managerial tools and planning and control. (See: Questionnaire, Part Two.) No enterprise responding to our questions has prepared an annual sales forecast, cash flows forecast and marketing budget. They have also not prepared cost-volume profit analysis. Our discussions revealed that not a single enterprise has, indeed, used any of these managerial and financial tools. Thus, sales forecasting, financial planning and cost analysis are all neglected in Nepali public enterprises. This, we feel, is the reason why most of the enterprises in Nepal are making losses despite the fact that they, in principle, are mostly following 'cost-plus' system of pricing.

During our interview we had a very tough time to convince
the management regarding the relevance and practicability of conducting cost-volume profit analysis, and the use of other techniques. They think that such type of questionnaire design, influenced by Western management philosophy, has little relevance in Nepal. However, such negative responses were quite natural when they have not used any managerial techniques, and most of the enterprises are suffering losses year after year.

Thus, from the above analysis, it is evident that lack of planning, control and budgeting is one of the contributing factors towards the dismal performance of manufacturing public enterprises in Nepal.

5.10.4 Existence of Unutilized Capacity

The failures of the manufacturing public enterprises in Nepal may partly be due to the low capacity utilization. More intensive use of available capacity offers a way to increase sales revenues without commensurate increase in the costs; thus, leading thereby to larger profits results. But the enterprises have not given proper consideration to the right kind of output policy. In Table 5.5, we present the data on percentage capacity utilization as well as percentage of progress in relation to targets of public industrial units in Nepal.

21 The unutilized capacity is the excess capacity over output as a percentage of the capacity. In symbolic terms:

\[ U = (1 - \frac{P}{C}) \times 100 \]

where, \( U \) stands for unutilized capacity; \( P \) stands for output (actual); and \( C \) stands for installed capacity.
### Table 5.5: Relation between Installed Capacity, Target and Production (in Percentage)

<table>
<thead>
<tr>
<th>Name of Public Enterprise</th>
<th>Percentage capacity utilisation</th>
<th>Percentage progress on targets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Royal Drugs Ltd.</td>
<td>31</td>
<td>33</td>
</tr>
<tr>
<td>2. Shree Raghupati Jute Mills Ltd.</td>
<td>78</td>
<td>74</td>
</tr>
<tr>
<td>3. Brick and Tile Factory Ltd. (Bricks)</td>
<td>83</td>
<td>91</td>
</tr>
<tr>
<td>4. Bhaktapur Bricks Factory Ltd.</td>
<td>-</td>
<td>88</td>
</tr>
<tr>
<td>5. Agro-lime Industry Ltd.</td>
<td>56</td>
<td>23</td>
</tr>
<tr>
<td>6. Birgunj Sugar Factory Ltd.</td>
<td>106</td>
<td>63</td>
</tr>
<tr>
<td>7. Banswari Leather &amp; Shoe Factory Ltd. (Shoes)</td>
<td>17</td>
<td>21</td>
</tr>
<tr>
<td>8. Janakpur Cigarette Factory Ltd.</td>
<td>55</td>
<td>40</td>
</tr>
<tr>
<td>9. Dairy Development Corporation (Milk)</td>
<td>40</td>
<td>41</td>
</tr>
<tr>
<td>10. Balaju Textiles Ltd.</td>
<td>59</td>
<td>59</td>
</tr>
<tr>
<td>11. Hetauda Textile Factory Ltd.</td>
<td>-</td>
<td>18</td>
</tr>
<tr>
<td>12. Timber Corporation of Nepal</td>
<td>89</td>
<td>67</td>
</tr>
<tr>
<td>14. Nepal Tea Development Corporation</td>
<td>82</td>
<td>70</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>721</td>
<td>713</td>
</tr>
<tr>
<td><strong>Average (%)</strong></td>
<td>60</td>
<td>51</td>
</tr>
</tbody>
</table>

**Note:** Agricultural Tools Factory's capacity utilization data is available only upto 1974-75, and the average utilization percentage from 1970-71 to 1974-75 (five years) was 17.6. Its capacity when established was to process 1085.8 tons of steel casting per year. But throughout its operation above 75 per cent of the capacity is unutilized.

**Source:** Plan documents, Auditor General's Reports, Other Published Documents and Questionnaires. The data on Agricultural Tools Factory is obtained from informal source.
From the Table 5.5 it is evident that the capacity in the public sector industrial units in Nepal is under-utilized. The capacity utilization which was 60 per cent in 1978-79 has fallen to 48 per cent in 1980-81. The capacity utilization of Royal Drugs Ltd., Agro-lime Industry, Banswari Leather and Shoe Factory Ltd., Dairy Development Corporation, Hetauda Textile Factory and Agricultural Tools Factory in terms of installed capacity has always been below 45 per cent. However, percentage of progress based on targets fixed by the enterprises themselves is comparatively better because the targets are fixed by the enterprise concerned, although it has not improved over the years. One of the reasons for such a low capacity utilization and non-fulfilment of targets is the lack of proper planning, control and budgeting.

5.10.5 Some Further Observations

In course of our study we observed that there exist absence of price instructions and manuals, and criteria for reward and punishment.

(a) Absence of Price Instructions and Manuals: In order to find out whether there is any pricing instruction, and manuals prepared, we asked the relevant question. (See : Questionnaire, Part Two.)

The answer to our query shows that out of fourteen enterprises, six have guidelines in one form or the other. But they could not show us any guidelines or manuals or anything for that matter relating to pricing. It is to be noted here that government has not issued any price guidelines to the
enterprises. Thus, in the absence of price guidelines or manuals, the basis of pricing may not remain the same in the enterprise. Such a situation would greatly affect the objective of generating surplus, as the enterprises will not be able to adhere to the 'cost-plus' pricing basis.

(b) Absence of Criteria for Reward and Punishment: The chief executives in the public enterprises in Nepal come from bureaucracy with very little or no experience and training relating to the job. The chief executive is both appointed and removed by the government. The government has set no criteria for evaluating the performance of the enterprise. The appointment, promotion or removal of the executive has no relation with the performance of the enterprise that he is heading.

As the performance of the chief executive has obviously no effect on his future, in most cases they have been lethargic and indifferent to criticisms. The general behaviour of the top executive is to let things move as they have been in the past. This principle of "taking things as they have been in the past" seems a paying strategy since the performance of the enterprise has no relation with his promotion, demotion or transfer to other department of the government or public enterprises. Thus, in the absence of any 'reward and punishment criteria' the performance of the chief executives cannot be improved in the present situation.

Naturally, under the above constraining situation, very little can be expected from a chief executive to contribute towards the development of his organization.
5.11 Final Analysis

From the analysis of the reasons for failure of the manufacturing public enterprises to realize 'desired' results, it is clear that a number of reforms have to be introduced in these enterprises to realize the expected financial returns and for the implementation of the pricing policy in an effective manner. The suggested strategy/reforms would be discussed in the next chapter.