CHAPTER VI

SUMMARY AND CONCLUSIONS

The appropriate pricing policy to be adopted by the public enterprises is a controversial issue. In this regard, a number of theories and principles have been put forward by economists. Among them, economists argue, marginal cost pricing (MC = MR) ensures efficient allocation of resources in the economy. Theoretically, this seems to be an appropriate pricing policy. But marginal cost principle makes the rate structure unstable. The fixed costs are known in advance but marginal cost rests in the sphere of uncertainty. In many cases marginal cost may be indeterminate or negligible or nil. Further, when marginal cost is below average cost, loss is incurred by equating price with marginal cost. In the Nepalese context too, marginal cost pricing does not seem to be feasible for many reasons of which the following are important: (i) information regarding the exact position and shape of demand curve is lacking; (ii) it is also difficult to determine the detailed costs of each and every item when the existing accounting and costing systems are not complete and properly maintained; and above all, (iii) the chief executives are quite unaware of the meaning and uses of the concept of marginal cost pricing.

Since the formulation of the Second Plan in 1962, His
Majesty's Government of Nepal has visualized public enterprises as one of the instruments for mobilizing resources needed for economic development of the country, and in all the plan documents dividend receipts from them has been emphasized as one of the major sources of finance for the government. This goal was reiterated by the government circular issued in June 1980 which stipulated that the manufacturing public enterprises should earn at least 10 per cent return on capital employed. In fact, surplus is necessary for the existence, expansion and growth of the concerned enterprise as well as for payments of dividend to the government. In this context, the theory of average cost pricing or the break-even principle does not seem to be an appropriate pricing policy. For the purpose of generating reasonable amount of surpluses on the capital employed with a view to providing sufficient funds for investment, 'cost-plus' pricing principle seems to be an appropriate one.

An analysis of the pricing policies followed by the manufacturing public enterprises leads to the following conclusions: (1) there is a certain measure of uniformity in the pricing policies of the 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 enterprises operating under monopoly situation have been able to cope with the increased cost of production by
simultaneously increasing the prices of their products, (v) 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 their set rules because of a high cost escalation which squeezes the margins, and under-utilisation of capacity, (vi) there exist possibilities for making a surplus if the enterprises can restrict their costs within the budgeted ones, (vii) whatever be the pricing policies followed, they did not result in adequate profits to the enterprises, and lastly, (ix) government's instruction of securing at least 10 per cent return on capital employed has not yet been fulfilled by a majority of the firms. But, it is too early to pass judgement on the basis of one year data.

As a result of defective pricing policy, and ad hoc pricing decisions taken by the enterprises, the profitability record of Nepalese manufacturing public enterprises is far from satisfactory. Despite government's policy of using public enterprises as an instrument for mobilizing resources, the financial performances (of manufacturing public enterprises) in terms of sales margin, rate of return on capital employed, return on net worth and dividend pay out ratio, and the share of retained earnings in gross saving have been far from satisfactory. For example, during the last eight years under study, HMG has not received even one per cent annual return on its net worth. The average dividend paid by even the dividend-paying companies during the eight years is less
than 2 per cent. The share of retained earnings in gross savings has also not been satisfactory. Except for the years 1973-74, 1974-75 and 1979-80, it is less than 13 per cent, and even negative during the years 1978-79 and 1980-81. As a result, the dependence of the enterprises on external finance, especially from government, has been quite high. Thus, the basic objective of creating public enterprises, viz., augmenting internal resources for speeding up the rate of economic growth, as envisaged in the Second and subsequent plans has not been achieved so far. The Government also did not give the enterprises any specific directive to earn profits when they started their operations.

The effect of unsatisfactory profit record is reflected in the overall financial health of the enterprises. An excessive inventory position is the weakest point in the working of the manufacturing public enterprises. As a result of an excessive stock-piling of inventories, various ratios relating to inventories turn out to be non-optimal. The ratios relating to inventories such as sales to inventory, and working capital such as inventory to working capital, sales to working capital and other ratios are quite below optimal. Sales to inventory relationship suggests that, because public enterprises tended to hold excessive inventory, sales are always less than three times of inventory as against a norm of four to five times. To maintain an appropriate level of inventories, each public

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1 We have already noted earlier that inventory constitutes 52 to 62 per cent of the total cost of production.
enterprise should set up an "Integrated Inventory Management Department".

The current as well as liquidity ratios are quite high, indicating lack of proper management of current assets. This necessitates optimisation of inventories, receivables, and cash and bank balances of the enterprises.

The enterprises are heavily dependent upon the equity capital including capital subsidy from the HMG. The debt-equity ratio is, thus, quite low. Fund flow analysis attempted by us indicates that the internal resources could not finance the expansion and growth of the enterprises.

A number of reasons may be given for the defective implementation of pricing policies, and consequently, the low profitability and unsatisfactory financial health. First of all, financial management is one of the weak points in the enterprises. The enterprises do not have an effective and prompt financial reporting and proper costing system for the pursuit of pricing policies which are in keeping with the set objectives. The modern managerial tools and techniques for timely decision-making such as cash budget, cash flow forecast, marketing budget, sales forecast, target rate of return on assets and target profit margin and turnover, are non-existent in the enterprises. One can judge the functioning of management information system by the fact that only

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Here, we do not propose to deal with the various aspects of managerial problems. We mainly concentrate on problems relating to pricing.
production data is forwarded to the top management by the production department of the enterprises; there is no regular and timely flow of financial and other information. Thus, the whole accounting and costing techniques, and management information system cannot be utilized in the manufacturing public enterprises of Nepal for locating errors and inefficiencies at the source by setting up standards as a basis for judging actual operating performance. Enterprises without a cost control system may have to close down in the long run as they cannot diagnose the real causes of loss sustained with the result that the right type of remedy cannot be prescribed; and the economy as a whole labours under a long-term disadvantage.

Further, the existing installed capacity in the enterprises has not been utilized fully; only 50 to 60 per cent of the capacity has been utilized.

Above all, the management of the enterprises have not been held responsible by the government for such a depressing state of affairs. This is because a number of chief executives belong to bureaucracy, and their hiring, firing, transfer and promotion are independent of their performance as chief executives of public enterprises. A crucial question in this regard arises: whether the public enterprises should be manned at all by people who have no experience in business management? The enterprise management has now become so professionalized that a person possessing general management aptitude and training, attitude and hailing from the bureaucracy may
not meet the requirements adequately for public enterprises. Thus, there is a need for setting up a separate cadre recruited, and whose chances of occupying higher echelons of power lie in public enterprise. The present top management drawn from bureaucracy may be given an opportunity to choose whether in the public enterprises or revert to bureaucracy.

Therefore, it is necessary to effect a number of reforms in the manufacturing public enterprises of Nepal in order to make them viable and objective-oriented.

Regarding the pricing policies to be followed by the enterprises it is not possible to lay down a uniform price policy applicable to all the enterprises, and it cannot remain unchanged for all the time to come. In fact, there should be an enterprise-wise study taking into consideration the objectives of the enterprise, market structure, cost structure, demand factors, and social obligations, if any, imposed by the State. The best thing that can be done under the present circumstances is to work out some guidelines (by the government) to be followed by the enterprises while formulating their pricing policies. It is to be noted here that commercial efficiency is necessary for ensuring survival, growth and stability of the enterprises. In the ensuing paragraphs we suggest some reforms.

First, the objectives, especially the operational objectives, should be clear and be quantifiable, and the management should have clear understanding of what is expected of them, within a certain span of time. The relation between
the government and the enterprises relating to pricing and other matters should be better and clearly defined, and strictly observed. There should not be any government interference in the day-to-day administrative affairs of the enterprises; only the policy directives should come from the government.

Secondly, an integrated approach should be taken in formulating capital budgets, long-range plans, and periodical evaluation of progress and performance of enterprises. The finance department should be associated with the preparation of plans and programmes, and should submit financial information (incorporating information of other departments like sales, production, stores, etc.) in proper form for taking decisions in time. The information duly processed and communicated in right form and in right time comprise the basic component of management information system for pricing and other matters. The communication should be channelled in both horizontal and vertical directions with proper feedback mechanism. The information of actual performance as against targeted and/or standard indicators along with other variables (such as constraints outside or within the control of management) should form an integral part of evaluation and control system. This should be planned and developed as an in-built system. For this purpose, the management has to streamline the procedures and systems of accounting so that all desired information can be collected and reported through various financial reports.
After proper planning, control, budgeting and information and reporting systems are set in order in the enterprises, the Government should explicitly specify the general financial and economic obligations applicable in general to all the enterprises. The broad guidelines should indicate, inter alia, the following: (i) the minimum percentage of utilization of installed capacity; (ii) the minimum return on investment to be secured; (iii) the bearing of social interest, if any, on the formulation of pricing policies; and (iv) determination of standard costs for fixation of prices. These guidelines (along with the suggested reforms above) should be implemented by all the enterprises irrespective of the type of pricing policy followed.

However, we suggest that the following pricing model, in broad terms, may be followed in manufacturing public enterprises of Nepal.\(^3\)

\[ P^* = V.C. + \frac{F.C.}{X^{pm}} + ROI \times OQ \]

where, \( P^* \) stands for the price to be charged for a unit of product;

\( V.C. \) stands for variable cost per unit of each product;

\( F.C. \) stands for the total annual fixed cost of each product;

\( X^{pm} \) stands for aggregate output of each product;\(^4\)

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3. As stated earlier at various places, the enterprises should be run at a profit, however small.

4. The minimum output to be produced (if possible for each product) is to be specified by the government.
ROI stands for the target rate of return on investment; and
QG stands for the other quantified objectives.®

For the use of the above formula, if the minimum level of output is fixed by the government, there is less likelihood of the consumers being exploited. The goods will be available at a reasonable price. The capacity utilization figure should be as high as is reasonably attainable. The rate of return target will make the enterprises viable, and help them expand and grow. The government, on the other hand, can plan the resources to be mobilized through the public enterprises.

Such a system of capacity-cum-objectives-oriented system of pricing policy would have a number of merits. First, the enterprises would have to be result-oriented, and resist all unnecessary interference from the government. They will enjoy considerable freedom in the fixation of prices of individual items.

Secondly, the enterprises cannot restrict the output with a view to raise the prices of their products to increase their profit.

Thirdly, such a system would give government sufficient scope for performance appraisal of the enterprises. However, the functioning of the enterprises would have to be reviewed. If the enterprises have not been able to perform according to

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5 Other objectives may relate to redistribution of income (selling at a lower price in backward region), cross-subsidization, social objectives, etc. If losses result due to bearing of social objectives they should be compensated by the government.
the set norms/standards (in various spheres like costs, etc.),
and achieve the return targets, the reasons should be
thoroughly investigated, and the deviations remedied.

Finally, the chief executives would have to be more
alert, and result-oriented. They have to take prompt deci-
sions for achieving the results.

However, for the attainment of target rate of return-
cum-capacity-linked production, the present management/
organisation structure of the enterprises should be thoroughly
overhauled to bring about proper coordination in their
activities. A committee of departmental chiefs under the
chairmanship of the general/deputy general manager may be
helpful for assessing and reviewing the results from time
to time, and for taking timely corrective actions, if devi-
ations occur.

We feel, an autonomous organization and advisory body
is highly necessary to achieve the stupendous task of making
enterprises viable and contribute towards the economic deve-
lopment of the country. Hanson suggests an agency for pricing
to advise the minister. He is of the view that 'an industry
which provides a basic service cannot be left entirely free to
determine its prices, particularly if it occupies a monopolistic
or quasi-monopolistic position.' To quote Hanson, "What the
Minister surely needs is the advice of an agency which has
both the facilities and the time to engage in continuous study
of pricing policies, with particular reference to the
nationalized industries—an agency which, having the necessary
material at its disposal, could present the necessary facts and figures without delay and indicate the probable results of different kinds of decision. If such an agency were in existence, it would become possible to place the ultimate control of price policies squarely in the hands of the Minister, with the proviso that before issuing a direction or giving an approval, be received the agency's opinion. It might even be desirable to impose a time-limit within which that opinion had to be received.  

The existing Corporation Coordination Division under the Ministry of Finance which has been running on bureaucratic lines should be abolished, and a new autonomous advisory body with professional staff for issuing guidelines and for evaluative purposes should be formed. It may be named Public Enterprise Commission which shall have an Executive Chairman at the top (preferably an assistant minister rank) with six other members. Among the members, the Cabinet Secretary, Finance Secretary and Secretary to the National Planning Commission would be ex-officio members, and the other three professionals such as management expert, economist, and a technical person. These three members would work as full-time members. The Commission should have experts on its staff. The Commission would perform, inter alia, the following functions:

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1. To assist the administrative Ministries, the Ministry of Finance, National Planning Commission and other official bodies in scrutinising and evaluating investment proposals, feasibility studies and detailed project reports relating to public enterprises.

2. To help formulate and ensure implementation of the desired pricing policy for the enterprises.

3. To assist the concerned Ministries in controlling wasteful expenditure on project construction, minimising delays in completing projects, etc.

4. To undertake training programmes for public enterprise staff, advise on management development, and undertake research activities on various aspects of public enterprises.

5. To ensure coordination among various public enterprises on the one hand, and between the government and the enterprises on the other.

6. To help setting norms/standards for various aspects relating to public enterprises like cost and accounting system, formats for preparing short and long-range plans, personnel policies, etc.

7. To evaluate performances of public enterprises and report to the Government every year on the working of public enterprises, and steps necessary for further improvement in their working.

The above-outlined functions are not exhaustive. They are only indicative in nature. However, it should be seen that (1) all necessary instructions from the government to
the enterprises are channelled through the Public Enterprise Commission; and (ii) the Commission would only issue the policy directives to the enterprises, and supervise their activities, and convey government-decisions to them. A Committee on Public Undertakings may also be formed in the Rastriya Panchayat (national legislature) to go through the various reports submitted by the Public Enterprise Commission to the Government in order to make government more responsive.

At present there is no separate committee for public enterprises in the national legislature. A general discussion is held in the Finance Committee of the House, and Estimates and Accounts Committees examine and discuss the Auditor General's Reports. So far no detailed discussions have been held on the various aspects and functioning of the enterprises, and no guidelines issued.

If the above suggestions (based on the conclusions of the study) are properly implemented, the profitability and other financial records of the enterprises would be improved, and the enterprises can contribute to the economic development of the country. The enterprises themselves, consumers as well as the government will also be benefited. But the Government should not hesitate to assign such an important role to an independent institution. Any pressures from any group against the required reforms for toning up the management of the enterprises should not influence the decision of the government. In fact, it is said that "the Nepalese community (bureaucrats, politicians, businessmen and
intellectuals) seem to be against the successful operation and development of public enterprises." If the government is not serious enough in the development and growth of public enterprises in the country, we propose that where appropriate and feasible, the manufacturing public enterprises (especially the consumer goods producing units) be divested to the private sector (as envisaged in the industrial policy of the country). The Government should take necessary initiative in this respect, as the corporations should work efficiently whether in the public or private sector. Otherwise, "continuous and large scale financial losses in the public enterprises would not only create conditions of weakness and demoralization within enterprises, but also weaken their capability of meeting social obligations. In any event, the burden of losses would have to be borne by national economies and ultimately by the taxpayers." 

In the present circumstances, even if all the suggestions outlined above are not carried out, the enterprises can reduce the extent of deficit by at least limiting their expenditures to budgeted ones (through control on cost of production), better sales planning and marketing arrangements and exploitation of new markets. These steps would help improve the

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surplus generation. But, it is to be noted here that the enterprises should not be allowed to resort to monopolistic exploitation of consumers.

Finally, we suggest that the Government should publish a White Paper on Public Enterprises incorporating its policies relating to various aspects of public enterprises.

Our study does not incorporate an in-depth enterprise-wise research relating to pricing. Further, the study has explored only one objective, that is, the generation of surplus. Studies regarding other objectives of Nepalese public enterprises may be done by future researchers. Other objectives, explicit or implicit, like redistribution of income through pricing policies, replacement/promotion of private sector through pricing, etc., should be explored. A comprehensive series of studies on pricing policy problems and life experiences should be undertaken.