CHAPTER X
CONCLUSION
Now the problem before us is to examine whether, in view of all that have been stated in the past chapters, it would be justified to conclude that the hypothesis that was formed in chapters III and IV, was correct. That is to say, whether it is justified to formulate the view that the Central government companies attained their capital structure from the year 1960-61 to 1969-70, as observed in the study, owing to intervention of an external agent i.e., the Central Government in the internal management of the different units of the Central government companies. For the same reasons the internal managers had no scope for exercising their individual management skill regarding the formation of their capital structure. Accordingly, the capital structure did not develop in accordance with the principles of minimising the average or total cost of capital by the wilful manipulation of the capital structure so that it might get an optimum form. As against this, the companies in the private sector could exercise their individual management skill of minimising the cost of capital by optimising the capital structure and the structure obtained during the period, as mentioned in the previous chapters, was the direct result of this freely employed management skill.

There is, however, no definite proof that the managers of the private sector companies concerned were actually able
to exercise the principles of scientific management in shaping the capital structure in the private sector companies. Still there is no evidence to prove that efforts to achieve the objectives of maximising the profits by trying to raise the internal rate of return and reducing the cost of capital were not made by them in a method however unscientific it might have been. One is forced to presume that the managers of the individual business units tried their best scientifically or otherwise to achieve their objectives in the management of the firm. Of course, questions like capital issue, government interference in such issues and other regulations which control the activities of the company may be raised in order to disown the assertion that the managers of private sector companies have complete freedom of activities. For instance, till November 4, 1966, all issues of capital whether for cash or for anything else, including capitalisation of profit or reserve and reorganisation of capital by all companies would require the prior approval of the Controller of capital issue in India. Non-government public limited companies even to-day cannot issue capital exceeding Rs. 50 lakhs in a year without the approval of the Controller of capital issue except on the fulfilment of certain specific criteria regarding debt-equity ratio, equity-preference ratio, issue of capital at par, issue of preference shares and debentures, carrying rates of dividend and interest respectively not exceeding
certain notified limits and others. Bonus issues of all companies and issue of capital at a premium are still under the rigid control of the Controller of capital issues. Similarly, no company can pay dividend without observing the provisions contained in section 205 of the Companies Act, 1956, amended to date. These are only illustrative but not exhaustive.

Nevertheless, the clutches of the law are not so stringent as those of the regulation imposed by the Central Government on the activities of the Central government companies. In spite of all legal constraints, the managers of the private sector companies find an open field, however limited, in which they may exercise their choice as to the source and quantity of capital. It is a fact that their freedom of action is much affected by the existing economic conditions. But their managerial skill nevertheless comprised of how much good they could do of a bad bargain.

The next question that arises is that, assuming that the managers of the Central government companies are given the freedom of action similar to the managers of the private sector companies, will it be still possible for them to manage the capital structure of Central government companies in the same way as that of private sector companies is done? The reason of raising this question is that the very nature of the securities of the Central government companies appear to differ from those of private sector companies. The shares of Central Government companies are not generally bought and
sold in the share market. As a result they have practically no market value. In the absence of a market value one may realise how difficult it is to find out the cost of equities. Even if the cost of debts may be known, for the difficulty of knowing the cost of equities and for that the cost of retained earnings, the weighted average cost of capital as a whole cannot be known. In that case finding out an optimal capital mix is bound to end in futility. Therefore, owing to this limitation of the nature of the securities of the Central government companies the capital structure is bound to take a shape of its own, whether it is managed freely or not by the managers of the companies.

**Findings**;

The problem identified at the beginning of this chapter has to be considered in this background.

It is a fact that some similarities or resemblances were observed between the trends in the changes of the capital structure of the Central government companies from 1960-61 to 1969-70 and those of some classes of private sector companies, as stated earlier, in the same or other periods. But dissimilarities were also specifically pointed out at the end of the last chapter. Therefore the hypothesis drawn in Chapters III and IV, that is to say that the two aforesaid trends of capital structure are likely to differ because, in case of the former, i.e. the Central government companies the internal managers have no freedom of action, while in case of the latter, they have. Unlike those other
categories of companies in the private sector, the Central government companies can neither influence the cost of capital by changing the capital mix nor can regulate the Internal Rate of Return at their own initiative. For both the purposes they are to depend more or less on the guidelines prepared by the government which is often influenced by the economic and political consideration of a welfare state. As a result even if, instead of partial similarities, there would have been complete similarities between the observed trends in the changes of the capital structure of Central government companies and others, the conclusion would have been all the same. The presumed complete similarities would have entirely been accidental. Naturally it may be concluded with an element of strength that the two trends are bound to differ.

Before arriving at this conclusion firmly it is necessary that the relative position of the government and any single unit of Central government companies is properly ascertained with reference to equity and debt. Here the government is the holder of both the debt and equity. The said unit as a firm is a gainer in respect to debts because it enjoys tax allowances on interest paid on the same. Consequently the government is a loser to that extent. On the contrary, so far as profit on equities is concerned, the firm is a loser whereas the government a gainer to that extent. Under the circumstances, it may appear that the government should have financed all Central Government
companies by equities alone. If the facilities of limited liabilities and other commercial advantages allowed by the Companies Act of India, could have been ignored the financing could have been made by the government, in that case, even in the capacity of the owner of an individual proprietorship business. But a company form of organisation cannot do without equities. It at least saves the firm that is not very flourishing in its operation, from the burden of a fixed cost capital, cost of equities is so flexible that it comes down with the fall in the amount of profit, till it becomes entirely costless with the advent of losses. Evidently, it is clear that the government has shifted from the position of financing all-equity companies for the good of the companies themselves at the sacrifice of its own income in the form of dividend where necessary, and together with that, the involved shortage of income tax inflow. But this concession should not make the government earn an income (a total of dividend, interest and income tax) on the whole which is lower than the cost at which the government procured the fund from others after necessary allowance is made for the risk involved (see Ch. III, p.93). A debt-equity ratio is normally raised in order to lower the cost of capital of a firm in the private sector. But there is a limit to this ratio at a given revenue flow. It seems that there cannot be any difficulty in fixing up this debt-equity ratio, after considering the
But, contrary to what have been stated above with reference to the question of fixation of debt-equity ratio it may be recalled how cases have been detected where Central government companies have been found to raise debt capital by borrowing even in the face of the company incurring a loss. The government injected borrowed capital in the capital structure of Central government companies being inspired by its desire, not evidently to reduce cost of capital, but to have uniform policy of providing funds to the public sector undertakings by maintaining 1:1 ratio between debt and equity. The other arguments of the government in favour of having debt capital had been that it would bring into record, at least partially, true financial cost of a project. It has already been said that it will bring the check on the operational activities of Central government companies in as much as they would exert themselves at least to meet the fixed cost of debts and would prevent the managers of Central government companies in having an easy time making profit.

These arguments cannot altogether be disregarded. But, even if cost of equity cannot be ascertained with the help of quotations in a stock-exchange, the debt-equity ratio be fixed in such a way that, in view of the estimated total earnings, the earnings per share remains at least above the cost of debt capital. The difficulty however that may be experienced in reducing this suggestion into practice
is that the estimated profit may not be sufficient parti-
cularly in view of the social obligation to be attended to
by the Central government companies. But for this purpose
it is desirable that their products are sold at a competitive
price. A lower price may only help the producers who uses
the product of the Central Government companies as their raw
materials. That is, the whole society does not enjoy the
benefits of the reduction of prices. Under the circumstances
what is necessary is that their product should be sold at
an economic price and the debt-equity ratio should be ascer-
tained by the company itself on the basis of profit estimated
on the expectation of the same economic price. For this
reason different criteria have been fixed or recommended for
different public sector companies of different countries of
the world including our own (pp.87-91 Chapter III). It,
therefore, does not stand to reason that freedom of mana-
gerial activities cannot make change of capital structure
of Central government companies respond in the same way as
that of other companies under the same circumstances. The
securities of the Central government companies are not
such that they, unlike those of other companies, cannot be
amenable to individual managerial treatment. The want of a
capital market in the latter case possibly, cannot stand
in the way.

Even if the total cost of capital, in case of
Central Government companies, cannot be determined because
their shares are in general not quoted in the market, still
it cannot be denied that their capital must have a cost
(pp. 78-85 Chapter III). In fact shares of many companies in the private sector also are not quoted in the market. Nevertheless, those companies in the private sector practice management of the capital structure, by some process, by which optimisation of the same is sought to be achieved by an attempt to minimise the cost of capital. Those companies may very well help the Central government companies as a guide in dealing with the management of the capital structure. That profit should remain above the cost of borrowed capital, as suggested above, is one of the ways how the desired goal may be achieved. At least this will not make the average cost of capital (equity and debt combined) exceed the internal rate of return on the total capital employed. But one point that requires to be emphasized in this connection is that the Central government companies as separate enterprises must have the option of choosing the source of borrowed capital. It need not be the Central Government in every case. It will on the one hand, reduce the cost of borrowed capital to the maximum without government being required to reduce the rate of interest charged by it on its lendings and, on the other, indicate the popularity earned by the Company concerned among the public as stated in Chapter VI, pages 179-180. A part of the debts may well be converted in Preference shares, as suggested in Chapter V, pp. 149-151 in order to reduce the fixed cost further if necessary, without foregoing the facilities otherwise enjoyed out of
borrowed capital. This will encourage private participation on the one hand, release fund on the other, originally lent by the government for investment in new companies as by-products. Reducing the face value of shares of Central government companies by way of capital-reorganisation, may go a long way in securing private participation in their capital structure as stated in pp.173-174, Chapter V. For the said purpose, the shares may be issued at a discount also.

The Retention and the Dividend Policies

It was pointed out in Chapter VIII how the dividend policy which was discussed in that Chapter was so intimately related with retention policy dealt with in the Chapter previous to that. But it must have been observed in the said chapters, that under the existing conditions, neither of them, that is the dividend policy or the retention policy was practically the source of any problem with the Central government companies in general. A systematic negative retention over a consecutive number of years, indicates that the companies in general were infested with losses. It is of course the over-all result that is obtained after taking the profit or loss of all the companies together. In fact some of the companies, particularly those which had subsequently been taken over by the government, earned profit and some of them declared dividend also. Some of them, without paying dividend, created a huge quantity of reserves also. For the purpose of bringing about a similarity of structure by removing signs of under-capitalisation and thereby inspire private participation
in government companies it was suggested in Chapter V, pp.158-159 that those excess reserves are converted into bonus shares. An active policy regarding dividend payment and retention may be required to be invoked only when, according to present suggestions, and proposed managerial independence, the old conditions of working are changed. That is to say without any regard being paid to the so-called social or national need, the companies are allowed to work on economic basis under which 'competition' is expected to have a free play. In that case the companies would be expected to earn a reasonable profit which would require to be divided into retention and cash dividend by the induction of a bold and effective financial management policy. It, however, requires to be mentioned that so far as dividend payment is concerned in case of a company which borrows fund from the same Central Government the next moment, it is better that the whole of the profit is retained as already suggested at the conclusion of Chapter VIII.

If conditions of working are restricted and reorganised as suggested above, it may be expected that the capital structure of the Central government companies may take shape of that of private sector companies provided the two remain in the same form initially and are subject to the stress and strain of the same economic situation.