CHAPTER I

INTRODUCTION

Public Enterprise is a broad term which includes diverse types of governmental activities. There may be public utilities in the usual sense, like the Damodar Valley Corporation of India, B.B.C. of U.K., or Tennessy Valley Authority of the U.S.A. There may also be industrial enterprises like the Hindustan Machine Tools Ltd. of India, National Coal Board of Britain or Renault Motor Factory of France. Next, there may be commercial enterprises like the Life Insurance Corporation of India, B.O.A.C. of Britain etc. Lastly service institutions like the Industrial Finance Corporation of India are another class of public enterprise.

The Public Sector in India has come to assume a very important position and covers about 60% of the incremental investment of the country. Public enterprise has been accepted to be one of the principal ways to bring about rapid economic growth of the economy and is thus looked upon as a major instrument of planned development in India. This they can do in two principal ways: by filling up the gaps in the infrastructure of the economy and secondly by creating surplus for reinvestment.
These enterprises are, moreover, organized in various ways: there are departmental organizations like the Integral Coach Factory, Chittaranjan Locomotive Works etc. Public Corporation has also been a device widely practised in the country. Damodar Valley Corporation is a case in point. Thirdly, public enterprises are also organized in the company form and public undertakings that are industrial in nature are nearly always incorporated as joint-stock companies.

In view of the large size of the public sector in India and also because of the great diversity in the activities and organization of these enterprises it would be perhaps impossible to attempt a systematic study of the working of all these enterprises. I have, therefore, taken up only one particular type of enterprise, namely, the government companies that are functioning in India now.

The joint-stock company form of organization has been adopted not only in India but in various other countries of the East and West. In Canada, France, Italy, Sweden etc. and in Pakistan, Philippines, Thailand etc., numerous examples of public enterprises formed as companies may be found*. There are certain advantages that are supposed to be inherent in this type of organization: A company can be formed easily and in a short time without going through the slow process of Parliamentary enactment. For organizing a public corporation, a special statute of the Parliament is necessary. Secondly, this is a form of organization which
is more flexible in nature than other types of organization; the capital structure of the company can be changed whenever necessary or organization of management altered without going through the lengthy process of legislative amendments of the original provisions. Flexibility in the working is also greater in comparison with other forms. This is the primary consideration why, in India, all the industrial enterprises are organized as companies. It is expected that a company form would be able to bring in business flexibility that is essential for the proper functioning of an industrial organization. The Article of Association can be drawn up in a way allowing for future changes. Further, the structure of the boards of directors may also be changed with changed circumstances.

The total number of joint-stock companies at work at present is 26,921 and total paid up capital is ₹1,593 crores. These companies share 11% of the net domestic output of the country and comprises 91% of the total production capital*. The total number of government companies is 125 and the amount of paid up capital is ₹468.4 crores while in the private sector the number of companies is 26,796 and the total paid up capital is ₹11,24.7 crores. Of these there are 44 companies of the Central Government - 31 of them exclusively owned by the Centre, 7 of them with

*Nigam and Chaudhry: The Corporate Sector in India. Govt. of India, New Delhi 1962. p.1
State Government participation and 6 other with State Government and private interests. The total paid up capital of these 44 companies is Rs. 412.37 crores only. A chart giving the break-up of the corporate sector showing the position of the Central Government is given in Appendix. Of these companies there are only 30 which have started functioning from not later than in 1956-57. A list of these companies is appended at the end of this Chapter. For the purpose of this study, however, only those companies are selected from among them which are manufacturing concerns and have been in regular operations for at least five years. In the list of companies appended these concerns are marked with asterisks. This restriction in selection is necessary, for a five year working of an industrial enterprise is the minimum period for which significant results can be reached. This is necessary also as a basis for a comparative study. It is with these objectives in view that industrial enterprises, incorporated as companies and having a record of working for five years or more are selected for the purpose of the present study.

The principal source of data for this investigation has been the published accounts of the companies along with the reports of the Lok Sabha Estimates Committee and Public Accounts Committee. These have been supplemented by the

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*1 Wigram and Chaudhry: The Corporate Sector in India. Govt. of India New Delhi 1962 - pp. 89-90.
*2 See Tables 1.1 and 1.2.
Annual Reports of the Administrative Ministries and the Ministry of Finance and other reports published by various departments of the Government from time to time. Besides, some useful information has been collected by personal visits to the Planning Commission, Department of Company Law Administration and the Parliament Library. The starting point has been to reorganize the balance sheets and profit and loss accounts of the companies into a standardized form in order to spotlight our attention on the particular items in the published accounts that are relevant for our purpose. The main items in a reformulated, standardized form of the accounts is shown below:

1. Paid up share capital
2. Loans
3. Reserves and surplus
4. Current Assets
5. Current Liabilities
6. Working Capital
7. Net Assets
8. Total sales
9. Profit after taxation, that is, net profit
10. Dividend

From our analysis of the working of these concerns it would be evident that for the major part we have depended on the annual reports of the companies, although frequently we have referred to information received from other sources.
This means that to a considerable extent we had to deal with the financial accounts of the companies. This method of dealing with financial accounts inevitably involves interpretation of the meaning of certain items in order that they may be relevant to the specific purpose. This involves interpretation of the meaning of the terms like capital, sales, profits, net income, net assets, working capital etc. By total capital employed is meant not only the total share capital, but it represents net fixed assets plus circulating assets while net assets represent net fixed assets plus circulating assets net of current liabilities i.e., working capital. By sales we include sale proceeds of both goods and services which are of permanent nature. In calculation of sales we are taking only the gross sales, since figures of net sales are often not traceable from the available literatures on the companies. It would, therefore, include inventories of finished goods, raw materials, work-in-process unless otherwise mentioned. We have not here dealt with total output or value added figure for the simple reason that it is impossible to figure out output or value added from the published accounts of the companies. This is the practice which has also been followed elsewhere1. Similarly, net profit means gross profits2 minus taxation.

1 K. Okhawa: The Growth Rates of the Japanese Economy since 1878, Kinokunija Book Store Co. Tokyo 1957, p.207
2 By gross profits is meant total receipt minus production costs and depreciation.
Further, some of the items shown above are not given in the accounts as such, but they are derived from them. In interpreting the accounts, the practice followed by the Reserve Bank of India and the Ministry of Commerce and Industry has largely been adopted, for data collected from the published accounts of the concerns had to be supplemented by information gathered from reports etc. of different departments of the Government and for the sake of comparability the items should have to have the same coverage. Thus a uniform method of interpretation is necessary.

Amount and sources of share capital, nature and distribution of shares, amount and sources of loans are important from this point of view. Generally, however, term loans are not considered to be a permanent source of capital since they are to be paid off either out of internal saving or by security financing. Nevertheless, this source too is included in calculating amount of external financing. An examination of changes in the quantity of net assets show the extent of capital formation by the company. This along with study of the movement of working capital will show the state of working capital, its sources and also whether the company is overcapitalized or not. Similarly profit and its amount will give us an idea about the return of the activities of the concern. An enquiry into the policy regarding dividend payment will show whether or not a company is following a conservative policy and will show the amount of net savings made by the company.
In this approach, there are mainly two difficulties: First, the problem of valuation of the assets and secondly, existence of excess capacity in the fixed assets. And in the present stage of our knowledge about these industries, there is not much that can be done but to depend on the figures given in the published accounts of the companies. Deflation of these figures has not been resorted to as suitable indices for deflation are not available. Moreover, we are examining data for a short period and it may be assumed that deflated values, even if deflation was possible, would not deviate much from the actual values shown in the annual reports of the companies. More important consideration is that the analysis is mainly based on ratios rather than unrelated figures and when ratios are calculated they remove to a large extent the problem of changes in values.

There are clearly two aspects of these concerns with which the present study will be concerned: the study of the financial practices and an analysis of the working of the enterprises. In any analysis of the financial practice of a company, the study of the capital structure must come first.

For the study of the working of the companies, sales figures are a key to the understanding of the earning capacity of the company, provided we are careful about the misleading behaviour of sales for higher sales figures may be the result of higher prices or they may be more than balanced by higher cost of production.
For studying the financial practices and working of the companies, indices for the figures have been calculated and compared with reference to the base year which for the present is 1958. There is nothing particularly to be said for the year; it was a normal year and the earliest one for which figures for all the enterprises were available. Examination of these broad figures help us in the analysis of the actual working of the concerns, yet ratios are preferred to unrelated figures; they provide us with more significant indicators of business efficiency than absolute figures can do and when ratios are compared between periods they give us a clearer picture of the working of the enterprises. As Professor Bray has observed 'quantity measures of output are tests of capacity, but they are not necessarily valid tests until they are related to units of inputs and supported by some measures of the ratio of output to input in terms of changing prices of each'.

Two broad classes of ratios may be distinguished: technical ratios and financial ratios. Technical ratios deal with the quantity of materials and labour used, time, characteristics of machines etc. Financial ratios on the other hand, are derived from the financial accounts of the companies. In this study primary emphasis will be on the financial ratios, for adequate data for calculating technical ratios are not available.

*F.S. Bray: Accounting ratios for the purpose of inter-firm comparison - an article in OEEC: Inter-firm Comparison 1961.*
There can be a large number of financial ratios, but it seems essential to single out those that can be regarded as most important. With this consideration in view a number of specific financial ratios are calculated and analysed. In this connection it may be mentioned at the outset, that too much importance should not be attached to any one single ratio without reference to others. They should all be considered as contributing to their part to an understanding of the working of the companies. Finally, they are always to be approached with pointer to the need of a deeper investigation. We have therefore always tried this analysis to be supplemented by facts derived from other sources.

With these considerations in view, the following ratios may be selected for the analysis:

1. Loan : Share capital
2. Reserves to Share Capital
3. Liquidity ratio
4. Sales : Net Assets
5. Sales : Working Capital
6. Net Profit : Sales
7. Net Profit : Total Net Assets

Ratios have been calculated in such a way that a higher ratio in general will mean a better situation.
This, however, is not to be strictly adhered to. In case of equity-loan ratio, we cannot say that a higher ratio will always mean better position. Equity-loan ratio shows the degree of rigidity in the financial structure and extent of interest payment obligation, while the reserves-share capital ratio shows the strength of the company in case of expansion or emergency. The Sales : Net Assets ratio serves as a guide to efforts made at securing profit while Sales : Working Capital shows the efficacy of utilizing working capital of the company. Here also, sharp and continued rise in the ratio will definitely show the danger signal, for a slight fall in the working capital may mean a large fall in the amount of sales. On the other hand, a very low sale-working capital ratio may mean that working capital is not being effectively utilized.

Utility of financial data when employed in the analysis of business economics may be questioned. Doubts have often been expressed that published accounts conceal rather than reveal the position of a company. But in all cases, these accounts are certified by independent and non-official firms of Chartered Accountants. In private sector too, the investors and creditors associate themselves with a business only on the basis of a study of their finances as revealed in the published accounts and risk their money. Since indices and ratios are calculated and analysed these
also, to a large extent, minimize the shortcomings of published accounts in terms of money. Arithmetical precision is not however to be expected from these calculations but they are reasonably dependable indicators of the trend of working of these enterprises.

Such studies, as based on the present stage of our knowledge about these enterprises cannot reach out very deep into an analysis of the underlying factor. But surely it can show us the trend of the activities and point out not only to the necessity of a more detailed and thorough investigations of these undertakings but also to the particular channel through which the investigation may be conducted.

Before we take up the analysis of these enterprises, we shall discuss, in the next two Chapters the organization of public enterprises and the concept, measurement and control of efficiency of a government company. The study of organization is necessary for a proper understanding of the working of an enterprise - its success and failures. These two Chapters will be followed by a study of the actual working of the enterprises. We shall then try to find out and classify the reasons for the lapses in their working so that in the final chapter we can suggest some organizational change that, we hope, will improve the working of the enterprises.
LIST OF 30 COMPANIES

1. *Bharat Electronics
2. Heavy Electicals
3. Heavy Engineering
4. *Hindustan Antibiotics
5. *Hindustan Cables
6. *Sindri Chemicals & Fertilizers
7. Hindustan Insecticides
8. *Hindustan Housing Factory
9. *Hindustan Machine Tools
10. Hindustan Salt Company
11. Hindustan Steel
12. *Nahan Foundry
13. National Coal Development
14. National Instruments
15. Neyveli Lignite
16. Eastern Shipping
17. Western Shipping
18. *Hindustan Aircraft
19. Indian Rare Earths
20. Travancore Minerals
21. *Hindustan Shipyard
22. *Indian Telephone Industries
24. *Praga Tools

contd.
25. Indian Oil Company
26. Indian Refineries
27. National Mineral Development Corporation
28. National Industrial Development Corporation
29. Orissa Mining Corporation
30. Orissa Road Transport Corporation