CHAPTER - 5

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In the first four chapters of this work, our endeavour has been to highlight the financial performance of public utility concerns with special reference to Indian railways. In view of its gigantic size, this significant public utility concern was chosen for a case study of the financial structure of public utilities in the country. The pages that follow will, therefore, be devoted to having a final analysis of the financial performance of public utility concerns and finding out the ways and means to make improvements, wherever required, in the financial structure and management of these public utilities. The chapter will, thus, recapitulate the analytical study and observations made in the preceding chapters.

Finance is regarded as an important functional area in all businesses whether it is a public utility or some other kind of business enterprise. In public utility concerns, the function of finance is particularly unique in the sense that most of these public utilities are in
the nature of Government owned and managed concerns. More so because it is said that as compared to other business enterprises, public utilities lack sound financial acumen and judgement as there are no inside and outside pressures and checks as deterrents to poor financial management and performance. Additionally, the non-economic considerations and social obligations which always play important roles further complicate the evaluation of performance of these utility concerns. This we have seen while discussing the economics of public utilities in the first chapter. These characteristic features of public utility concerns make them distinct from other types of businesses mainly because they render such services to the public as are essential and indispensable for the modern day life. And as such they are known as natural monopolies. As a rule these public utilities require a heavy initial investment in plant and machinery and thus the cost structure of these utilities is greatly influenced by elements of constant cost. Non-storability of utility services, wide fluctuations in demand, enormous

amount of idle capacity, practice of differential rate fixing and pricing, regulation of prices by the centre, state and local governments, low capital turn-over ratio, low operating ratio and a heavy reliance on debt finance are some of the basic characteristics of public utilities which distinguish them from other business enterprises. In particular they have a very significant influence on the system of financing and capital structure of these utility concerns.

The financial managers of these public utilities taken as case studies have a background which is alien to financial discipline. The basic criteria for performing a financial activity in these enterprises is the achievement of a target of expenditure and not specifically good and improved outcomes with the minimum of effort and cost. The other important hallmark of the financial performance of these enterprises is the fact that they adhere more and more to the compliance of set rules and procedures without any emphasis on financial competence and efficiency. Some of these public utilities do not have appropriate machinery, mechanism and framework in which efficient and trained management
personnel could play their part. Proper accounting and auditing of accounts with fool-proof methods of compilation and maintenance of accounts and effective internal checks and audit is almost missing in these concerns. Very many of them do not have the practice of maintaining proper cost accounting and inventory control systems.\textsuperscript{2}

The net result of this is reflected in the poor financial performance of certain public utility concerns which have been chosen for study under this work. Our study of the financial structure of some state electricity boards in the second chapter clearly shows that they are operating inefficiently and the losses made by them have been showing an increasing trend year after year. These poor results are accompanied by a very high capital cost on account of delays, high overheads, mounting operating costs, and a number of other in-built deficiencies. Barring a few electricity boards, the majority of these boards do not operate with the maximum of efficiency in view of their involvement with the provision of adequate funds and working capital which is not made available to them by the concerned state government. Under the circum-

\textsuperscript{2} For details of deficiencies in these matters, refer to part II of the Report of the Comptroller and Auditor General of India, Union Government (Commercial), 1977, New Delhi, pp. 96-156.
stances the only method available to them for improving their finances is through a hike in the tariffs and negligible or no-interest bearing loans. This can be proved by taking the case of Uttar Pradesh State Electricity Board (UPSEB) which relies for its finances on the sale proceeds of electricity to the consumers. During the year 1980-81, this Electricity Board accumulated a loss of Rs. 159.46 crores which was mitigated by the Board through the process of hiking the electricity rates rather than by infusing competence and efficiency in the capacity utilisation.\(^3\) This is not only the case of Uttar Pradesh State Electricity Board, but the same trend is discernable in the data regarding the financial working of some other electricity boards like that of Gujarat, Haryana, Madhya Pradesh, Orissa, Punjab and Rajasthan. In view of this state of affairs prevailing in most of the state electricity boards, it can be recommended at this final stage of our study that the respective state governments should come forward and participate directly in providing financial accommodation to the concerned boards. This suggestion

\(^3\) See chapter-2 of this thesis.
may be put into practice if the state governments become generous and convert atleast half or more of the outstanding loans against these boards into equity. Further improvements in their financial working can be expected, if the interests on loans taken by these boards are allowed by the state governments to be properly capitalised.

An important aspect of financial performance of state electricity boards and companies is the fact that they are in the nature of state monopolies and hence it is not possible to say just how efficient they are as compared with what they might have been. A simple observation of the data set in Chapter - 2 would at once reveal that there were marked differences between different electricity undertakings. Some of them were managed as efficiently as any competitive business while others provided poor services at a very high cost. In the financial arena our task to evaluate the performance of these electricity boards becomes all the more complicated because the amount of capital to be raised depends not upon the criteria of good investment and efficient power generation of the industry as such, but upon the decision
of the central and state governments. This makes the entry of political element into the whole financial structure of the industry including the price structure of its services. Keeping in view these constraints, it may be generally concluded that although the state electricity undertakings are not required to earn a profit over and above the cost of servicing its loans, they should be operated as business undertakings, be self-reliant and self-supporting and be able to finance themselves without any reliance upon governmental support. Thus the revenues of these state electricity boards should not be less than sufficient to meet the chargeable overheads.

The financial trends in some other public utilities in the area of transport also show the same deteriorating condition as shown by the electricity companies and boards. Most of the road transport undertakings have gone into debt from 1980 onwards and have accumulated losses. On 31-3-1984 the state road transport undertakings (SRTUs) have shown a total accumulated loss of Rs. 1,298 crores.⁴

⁴. See Chapter - 2 of this thesis.
There are a number of reasons for this poor show of financial results in road transport undertakings. These can be enumerated as wrong and faulty fare structure, too many social and political pressures and heavy burden of taxation etc. It is an accepted fact that the efficiency in the operation of road transport is largely influenced by the road development in the country and the availability of other infrastructural facilities for plying transport vehicles on these roads. All these require a positive action on the part of the central and state governments to undertake measures for improving the road conditions and other factors responsible for unbalanced development of road transport in the country. An adequate financial provision should be made by the central and state governments for investment in the development of state transport undertakings. Provision of seed capital, interest free loans or low-interest loans and ultimately the creation of a specialised financial agency which will render all types of financial accommodation to state road transport undertakings will go a long way to ameliorate the poor condition of the state road transport undertakings in the country.
Unlike other industries, financial requirements of state road transport undertakings are entirely different in the sense that in these undertakings finances are required not only for development purposes but they are also needed for continuing the day-to-day operations which entail huge amounts of operating expenses with the result that the gap between the cost and revenue is rarely recovered from the prices charged. Again the matter becomes worse because of the numerous impositions, controls and regulations by the Reserve Bank of India, the Life Insurance Company and other financing agencies in respect of loans granted to these undertakings. Moreover, the loans given by these agencies and the central and state governments are in the nature of interest-bearing loans which are chargeable to the profit and loss account. This again reduces the profitability in these concerns.

The financial condition of shipping transport undertakings in the country is a matter of concern and anxiety. Of late, these undertakings are showing very poor results. They owed over Rs. 342 crores to the Shipping Development Fund Committee till the year 1986. 5

5. See Chapter - 2 of this thesis.
In order to overcome these financial strains there is a proposal to improve upon the financial weakness of this industry by establishing a separate fund under this sector. As compared to the shipping transport the financial and profitability position of air transport is quite encouraging. The profit margin in both Air India and Indian Airlines shows a positive trend in recent years. The return on capital employed in Air India shows an increasing trend from 1980 onwards. This does not suggest that there is no scope for improving upon the financial performance of these undertakings. In fact, there is a lot to be done in providing of better services to the consumers which would require that the cost of services should be reduced and operating revenues be increased in order to make them self-sufficient financially.

So far as the finances of railways are concerned it is common knowledge that a gigantic amount of investment has been made in this sector. Since 1950-51 marked structural changes can be noticed in the development strategy of railways. It has expanded to a great extent.

on all fronts. The electrified route length has increased more than 14 times, steam locomotives production which was discontinued in 1972, are being gradually replaced by electric and diesel locomotives. The undertaking has also made good progress in attaining self-sufficiency in equipments and stores. The main objective of railways in the past was to carry the projected quantum of passenger and goods traffic with a view to ensure smooth traffic movement so as to avoid disadvantages in the production process. With the introduction of planned development, very many far reaching objectives have been included in the overall development of railways in the country. In the First Five Year Plan, the special objective was the rehabilitation and replacement of the old assets. In the Second Five Year Plan, particular emphasis was laid on carrying heavy traffic generated by the new steel plants, coal and cement. There was a rise in industrial production and agricultural output and also in investment and National Income during the final year of the second plan. In the Third Five Year Plan, particular stress was made on building up additional capacity so as to be ahead of the traffic demand which could otherwise act as a constraint in the economic development. In the Fourth Five Year Plan, the focus was on modernisation of the
system to improve efficiency of operations. In the Fifth Five Year Plan cognisance was taken of the need for better utilisation of the existing railway stock capacity and higher operational efficiency through maximization of movement in block assets etc. The Sixth Five Year Plan, envisaged the development of railways as an important agency for creating better economic infrastructure for future industrial expansion in the country. The Seventh Five Year Plan is concentrating more and more on the financial improvements of the system. The railways have now adopted modern scientific and sophisticated techniques for efficient management of stores. The main objective of railway planning during the seventh plan has been to develop the transport infrastructure for carrying the projected quantum of traffic and also to meet the developmental needs of the economy.

At present, the strategy of railway development is to make it a healthy sector and laying an infrastructural base for steady and balanced growth of our economy. This can be achieved if the corporate plan for the railway development is implemented through a concerted effort made by the railway administration and the governmental support. This plan is meant for the period 1985–2000.
wherein some significant objectives have been enumerated to be attained. It has been envisaged that by 2000 AD the railways will build-up a capacity to carry 385 billion net tonne kilometres (BTKM) freight traffic and 320 billion passenger kilometres (BPXM) non-suburban passenger traffic. These targets are quite imposing and it can be argued that the present day set-up of the railways is not capable of handling the complex issues and problems involved in attaining these targeted objectives. Railway administration in its present form does not appear to be geared-up for the challenging task of giving a new look to this sector by initiating measures to solve numerous problems of technological development, administrative sophistication, financial and cost control effectiveness, personnel and industrial relations. These problems become all the more difficult and complex because of the need of reconciliation of business objectives with the non-economic, social and political pressures which play a unique role in running of this national transport organisation. In brief, it can be observed that though the railways have made steady progress since independence, a lot has yet to be achieved. There is an urgent need for a well designed programme of railway
development which should embark upon the task of building it as an institution of charge in the economic sphere of the country.

As for railway finances, they formed an integral part of the Central Government finances. They have now been separated from the general finances of the Central Government. With this development, the commitment of the railways to the general revenue have been regularly met and a portion of surplus is being diverted to numerous railway funds like the Railway Development Fund, the Depreciation Reserve Fund, the Pension Fund, Accident Compensation, Safety and Passenger Amenities Fund and Revenue Reserve Fund. The gross revenues and net revenues of railways has been showing an increasing trend. But the total working expenses have also been rising. After meeting all the expenses and also providing for dividend to general revenues the railways are enjoying a surplus all these years except for some years when it had deficit. From 1950 to 1966 the railways showed a surplus in the income and expenditure account almost every year. An era of persistent deficit started from 1966 onwards. Out of the ten years ending 1975-76, eight years' operations
showed deficit while only two years yielded surpluses. During these years due to heavy deficit the railways could not meet fully even the annual dividend liability to the general exchequer. Consequently, the railways had to rely on general revenues to meet their dividend liabilities and also to finance their expansion programmes. The factors responsible for this poor performance by the railways can be enumerated as the impact of inflation, burden of social responsibility, operational inefficiency, lack of railway wagons and rolling stock, indifferent labour attitude resulting in strikes, go slow, work to rule and other agitational approach having serious and widespread repercussions on traffic earnings. The faulty railway-rates policy has also been responsible to some extent for this financial mess in the railway sector because the most important item in the internal resource generation of the railways has been the railway rates and freights. In the determination of structure of fares and freights the railways should consider two important factors: Firstly, it should be able to obtain the necessary finances for meeting its operating expenses as well as to finance its

7. See Appendix No. 2.
expansion and development programmes. Secondly, the rate structure should be such that it gives an impetus to the smooth handling of goods and passengers which would promote trade, commerce, industry and agriculture. It is a fact that a high rate structure would result in high cost of transport and may disrupt and discourage industrialisation of the country and may lead to a tendency on the part of the users of railways to shift to alternate modes of transport like road transport etc. This would reduce the generation of finances in the system. The railways have adopted numerous rates policies and there has been an evidence of continuous reform and modification in the railway rate policy since independence but still there is a lot to be desired. The need of the hour is an appropriate rationalisation of the whole system of rate making.

Recently the figures of railway loss due to uneconomic railway lines have been provided which show that the railways incurred a loss of Rs. 78 crores during 1985-86 due to 142 branch railway lines which have been found uneconomical. The recent floods in Bihar caused a damage of Rs. 11.48 crores to the railways' property.

In order to improve upon the financial matters of Indian railways it has been suggested that there should be a separate Railway Finance Corporation to look after the public borrowing requirements of the railways.\(^9\) With such public borrowings with the issue of bonds etc. by this Railway Finance Corporation it can be hoped that the financial structure of railways will improve, ushering a new era of self-reliance reducing its dependence on budgetary support. This will also enable the railways to bargain for higher fund allocations from the Planning Commission.

At present the railways' share of total public sector funding is only 6.7 per cent. The 6.5 per cent dividend that the railways pay to the central revenues is, in fact, much less than the total returns that the money invested in railways bring. The railways have already stepped-up the share of internal resource generation in the plan funds from about 25 per cent up to fifth plan to over 50 per cent in the seventh plan. A resort to market borrowing through the establishment of the Railway Finance Corporation will further increase the share of the internal resources in the railway investment and thus help reduce

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9. This Corporation will have an initial paid-up capital of Rs. 50 crores to be raised to Rs. 200 crores.
the strain on the general budget for meeting the resource gap. Apart from raising funds from the Indian public through the issue of bonds, the railways should also explore the possibility of acquiring funds from abroad. These funds from foreign countries, international financial agencies and other institutions could be very useful because of their low interest rates. A start has already been made recently as the Asian Development Bank (ADB) has sanctioned a loan of $190 million for a project to increase the annual freight carrying capacity of Indian railways.\(^{10}\) It is, thus, clear that a mere increase in rates and fares would not be enough to take the railway finance on the right track. There should be some other measures which need to be adopted by the railways to take them out of the red. The main among such measures will be a cut in the working expenses and a reduction in their liabilities. One major area of this economy will be in the direction of wages and salaries bill which has gone up year after year. Another field of direction which needs attention is the discontinuation of uneconomical lines and other social and political burdens upon the

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railways like railway rate and freight concessions, free railway passes to political parties and individuals, preferential treatment given to certain items for low rated freight like coal, foodgrains, fodder, agricultural goods and losses on suburban and metropolitan traffics, etc.

Our analysis and examination of the financial performance and operational working of Indian railways clearly indicates that there is an urgent need to bring the financial management of this largest and oldest public utility concern in India on an even keel. A positive and well balanced growth of this enterprise is not possible unless and until sound and prudent financial management practices are adopted by the concerned managers and administrative staff of this enterprise. All these observations will also be applicable in the case of other public utility concerns like electricity boards and companies, road transport undertakings, shipping corporations and airline industries, etc.