Having launched a business concern and set it going, it begins giving returns on the investments in due course of time, and such returns are called 'Earnings' of the concern. Before earnings can be discussed in a precise manner, a distinction has to be made between 'Gross Earnings' and 'Net Earnings'. In a business concern, from total net sales (sales as reduced by returns and allowances, etc.) or operating revenues is deducted the cost of sales or operating expenses. This item includes cost of materials and supplies, labour and other manufacturing or trading expenses and depreciation and the resultant figure is called gross profit.

Depreciation, although, is not an out of pocket expense, all the same it constitutes an important element of cost and unless proper and adequate provision is made for depreciation trading results of business cannot be adequately determined. It is an operating expense and has the effect of reducing earnings realised in the current accounting year. Of the total investments in a business, a substantial portion is invested in 'Gross Block' which is used in carrying on the normal manufacturing or trading activities. Such fixed assets get worn out and lose their value in the normal course of business. Such wearing out and shrinkage in value of fixed assets is called depreciation. It measures the amount by which the value of an asset falls through time and therefore must be included in
There are various reasons why an asset may deteriorate in value even though it is well maintained. First, portions of the asset may be consumed in the process of use; for example, rubber tyres are worn away. Secondly, the physical yield of the asset may decline; for example, the physical output of most radio valves declines with use. Thirdly, the asset may become more costly to operate, either because it uses more labour or materials per unit of output, or because it breaks down more often and maintenance costs rise. Fourthly, a new machine may be invented which is cheaper than the existing machine ever was, whether because it is cheaper to build and install, or because it requires a smaller input of labour or materials per unit of output. And fifthly, the asset may lose value because new products come in the market which the buyers prefer.

There are different methods of providing for depreciation. Some make use of the diminishing value method while others use the straight line method. The defect of these methods is that they are based on historical cost and do not take into account the replacement cost of the asset at current prices. In a period of inflation, such as has been prevailing in India since the 1940's, the depreciation of 'Gross Block' at their original cost will provide only a small fraction of the cost of renewing such assets. The soundest view is that depreciation should be related to the replacement of plant and equipment at current prices and not on the basis of their historical cost.
All public enterprises in India make provision for depreciation on their fixed assets before arriving at their gross profit. There is no set policy in regard to the method of depreciation to be followed. Generally, depreciation is provided on the diminishing value method. But of late, there is shift in favour of straight-line method. The amount of depreciation provided by running concerns of the Central Government during the five years (1961-66), is indicated below:

<table>
<thead>
<tr>
<th>Years</th>
<th>1961</th>
<th>1962</th>
<th>1963</th>
<th>1964</th>
<th>1965</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1966</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Number of running concerns:</th>
<th>32</th>
<th>35</th>
<th>36</th>
<th>37</th>
<th>40</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount (Rs. crores)</td>
<td>43.10</td>
<td>50.39</td>
<td>54.70</td>
<td>64.88</td>
<td>73.69</td>
</tr>
</tbody>
</table>

Source: Annual Reports.

Detailed account of depreciation provision made by these public enterprises is given in Annexure VII.

From the gross profit so determined different expenses of business such as selling, general and administrative, obsolescence allowance, interest charges on loans and income tax, etc., are deducted to arrive at the net earnings of the concern.

A distinction has to be made between depreciation and obsolescence of fixed assets. Depreciation is based on mere physical durability and longevity of the asset concerned while obsolescence is that loss in value which is due to the competition of new inventions. In the age of fast developing technology and scientific development
the chances of loss on account of obsolescence are much greater. Therefore, in such industries which are subject to rapid technological changes maintenance of an obsolescence reserve is an absolute necessity. Obsolescence of stores and spares is much more in aviation industry because of constant technical improvements being made in the various items.

The two aviation corporations—Air India and Indian Airlines—maintain obsolescence reserve by providing funds out of profit and loss account each year. The amount so provided by these two corporations during the years 1961-65 is indicated below:

<table>
<thead>
<tr>
<th>Year</th>
<th>Air India</th>
<th>Indian Airlines</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961-62</td>
<td>48</td>
<td>30.49</td>
</tr>
<tr>
<td>1962-63</td>
<td>39</td>
<td>80.00</td>
</tr>
<tr>
<td>1963-64</td>
<td>44</td>
<td>69.00</td>
</tr>
<tr>
<td>1964-65</td>
<td>54</td>
<td>28.25</td>
</tr>
</tbody>
</table>

Source: Annual Reports.

The provision towards obsolescence of spares is made after taking into consideration the following factors:

1) the cost of spares for each type of aircraft;
2) the period for which the aircraft fleet is expected to be in operation;
3) the expected sale proceeds of aircraft and spares on retirement;
4) the provision already made for obsolescence reserve.
It is a sound principle of business finance that the whole of the net profit earned by a concern should not be used in the distribution of dividends. Some part of such divisible profits must be retained in business to strengthen the finances of the concern and to meet any unforeseen contingencies that might arise in future. Ordinarily, such reserves are created by appropriating ad-hoc sums of money every year and transferring them to the general reserve. In a seminar\(^1\) held in 1966 it was pointed out that a suitable return on owners' capital or net worth should be about 20 per cent of which about 8 per cent should be ploughed back. According to Mr. Rose,\(^2\) it is not safe to divide more than two-thirds of the profits earned, the remaining one-third being retained in the business. Under the provisions of the Indian Income tax Law a Development Rebate Reserve is required to be maintained if the business concern wishes to avail of the concession in taxation on account of rebate admissible on different types of plants and equipment installed in business. Development Rebate will be allowed on the condition that 75 per cent of the amount of such rebate is transferred to a Reserve Account out of which no dividend is distributed and no remittance outside India is made during eight subsequent years. Such general and other reserves are a source of finance for the development and

\(^2\) Mr. T. Rose-- The Internal Finance of Industrial Under-takings (1963) Pitman-- page 103.
expansion of the business. Depreciation funds and Reserves together constitute a significant source of internal financing of capital investment. As discussed earlier in chapter II (Project and Financial Planning) India's Third Five Year Plan laid considerable stress on the creation of such reserves. Total funds so generated during the period of Third Plan amounted to Rs. 287 crores consisting of depreciation Rs. 217.8 crores and retained profits Rs. 69.2 crores.

So far public enterprises have not been earning sufficient profits and therefore their capacity to create such reserves has been limited. But as these undertakings get stabilised and begin earning profits there will be greater opportunities for the creation of such reserves. Position of profits retained (amounting to Rs. 69.2 crores) by running public enterprises in India during the five years 1961-66 is given in Annexture VIII.

DIVIDEND:

That part of the net profit that is distributed to the Equity shareholders is called dividend. An investor would like to invest his funds in a business concern only when he is assured of handsome return. This criterion may not exactly apply to public enterprises wherein funds are invested by the Government and profit making is not the only objective of such undertakings. At the same time it does not mean that state should get no return on the funds so invested. Government has to raise loans on interest in
the domestic market and abroad to provide finances to public enterprises, therefore, it is necessary that return on such investments is made to the Government. Payment of dividend will depend on the net profit earned on net worth. The Perspective Planning Division of the Planning Commission estimated a return of 10 per cent on investment and in its latest publication has taken credit for a sum of Rs. 750 crores (1970-71) from public enterprises for developmental work.

Under the present circumstances these estimates of return on investment seem to be on the high side particularly for capital intensive industries like Iron and Steel, Heavy Engineering, Heavy Electricals and mining etc. In connection with Hindustan Steel its Economic Adviser said that it will not be possible to give a return of more than 2.9 to 3.5 per cent after interest charges upto 1970-71. Before charging interest the figure would not be more than 3.8 to 4.8 per cent.

Anyway, from the above it becomes clear that some return from public enterprises is a must. Some of the public enterprises in India have been paying dividends on their paid-up capitals and the amount so paid during the period 1961-66 is given in the following table:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(Rs. crores)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of undertakings:</td>
<td>8</td>
<td>11</td>
<td>12</td>
<td>18</td>
<td>19</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amount:</td>
<td>1.21</td>
<td>2.10</td>
<td>2.70</td>
<td>3.80</td>
<td>2.75</td>
<td>12.56</td>
<td></td>
</tr>
</tbody>
</table>

Sources: Annual Reports.

Detailed account of dividends paid by each undertaking with the rates of dividend is given in Annexture IX.

During 1961-62, eight companies declared dividends amounting to Rs. 1.21 crores which work out to 6.7 per cent of the corresponding paid-up capital; rates of dividend varied from 10 to 3 per cent. During 1962-63, eleven undertakings declared dividends amounting to Rs. 2.1 crores, the rates of dividend varying from 10 to 2 per cent. The total dividends declared work out to 6 per cent of the corresponding paid-up capital. During 1963-64 twelve concerns paid dividends amounting to Rs. 2.7 crores, rates of dividend varied between 10 to 3.5 per cent. The total dividends declared work out to 6 per cent of the corresponding paid-up capital. During 1964-65 eighteen undertakings declared dividends amounting to Rs. 3.8 crores, rates of dividend being 10 to 2.5 per cent. The total dividends work out to 6.1 per cent of the corresponding paid-up capital. During 1965-66 nineteen undertakings declared dividends amounting to Rs. 2.75 crores, the rates of dividend varying from 15 to 2 per cent. The total dividends declared work out to 4.5 per cent of the corresponding paid-up capital.

According to the latest information available 20 undertakings declared dividends amounting to Rs. 7.41 crores during the year 1966-67, the rate of dividend varying from 15 to 2 per cent.
Company-wise account of dividends declared and profits retained during the period 1961-66 is given below:

1. **STATE TRADING CORPORATION**

From among the dividend declaring undertakings this Corporation has consistently been declaring dividends at 10 per cent since 1960-61. Besides paying dividends, the Corporation has been ploughing back profits and the amount so retained during the Third Plan period amounted to Rs. 5.96 crores. Accumulated total of Reserves and Surpluses as at the end of 1965-66 was Rs. 10.57 crores.

2. **HINDUSTAN MACHINE TOOLS**

This company paid dividends at 10 per cent till 1964-65. Thereafter due to general economic recession in the industry the company did not earn enough profits to declare any dividends. The company made a name for itself by ploughing back its profits. The total profits retained for self-employment amounted to Rs. 7.06 crores during 1961-66. The accumulated total of Reserves and Surpluses at the end of 1965-66 stood at Rs. 5.32 crores after writing off deferred revenue expenditure.

3. **HINDUSTAN ANTIBIOTICS**

The company paid dividends at 6½% during the years 1961-62 and 1962-63, thereafter at 10 per cent on the paid-up capital. The company has been ploughing back its profits and a total sum of Rs. 2.47 crores was retained during 1961-66. The accumulated total of Reserves and Surpluses as on 31.3.66 was Rs. 4.77 crores.
Through all the years 1961-66, the company paid dividends at 6 per cent. Profits have also been retained and employed in business. The amount so retained during 1961-66 amounted to ₹. 66 lakhs. The total of Reserves and Surpluses as on 31.3.66 was ₹. 73 lakhs.

The company paid dividend at 3.5 per cent in 1961-62, 4 per cent in 1962-63, 4.5 per cent in 1963-64, 5 per cent in 1964-65 and 6.5 per cent in 1965-66. Profits retained during 1961-66 amounted to ₹. 1.66 crores and the total of accumulated Reserves and Surpluses was ₹. 2.37 crores at the end of 1966.

The company started paying dividend from the year 1962-63 and since then has been paying at 6 per cent. Profits retained during the period 1961-66 amounted to ₹. 65 lakhs. The total of accumulated Reserves and Surpluses was ₹. 1.24 crores at the end of 1965-66.

During the years 1961-62 and 1962-63 the company declared dividend at 7.5 and 6 per cent respectively. No dividend was declared for the year 1963-64. For 1964-65 and 1965-66 dividend at 7.5 percent was paid. Profits retained during 1961-66 amounted to ₹. 36 lakhs and the total of Reserves and Surpluses at the end of 1965-66 was ₹. 2.29 crores.
8. **AIR INDIA**

The company started paying dividend from the year 1962-63 and for the years 1962-63, 1963-64 and 1964-65 paid dividend at 5 per cent. For the year 1965-66 because of decline in profits dividend at 4 per cent was paid. Retained profits during the period 1961-66 amounted to Rs. 8.39 crores and total of accumulated Reserves and Surpluses was Rs. 9.82 crores at the end of 1965-66.

9. **NATIONAL PROJECTS CONSTRUCTION CORPORATION**

The Corporation started paying dividend from the year 1963-64 and for the years 1963-64 and 1964-66 declared dividend at 6 per cent. For the year 1965-66 rate of dividend declined to 4 per cent. Profits retained during 1962-66 amounted to Rs. 72 lakhs and accumulated total of Reserves and Surpluses was Rs. 1.03 crores at the end of 1965-66.

10. **INDIAN RARE EARTHS**

For the first time dividend at 4 per cent was paid in 1962-63 and thereafter for the years 1963-64, 1964-65 and 1965-66 it was paid at 7 per cent. Profits retained during the period 1961-66 amounted to Rs. 24 lakhs and total of Reserves and Surpluses as on 31.3.1966 was Rs. 13 lakhs only (after making prior period adjustments).

11. **NATIONAL NEWSPRINT AND PAPER MILLS**

The company started paying dividend from the year 1963-64 and dividend at 6 per cent was paid for the years
1963-64 to 1965-66. With-held profits during the period 1961-66 amounted to Rs. 1.38 crores and accumulated total of Reserves and Surpluses at the end of 1965-66 was Rs. 98 lakhs (after writing off deferred revenue expenditure and prior period adjustments).

12. TRAVANCORE MINERALS:

The company declared dividend at 5 per cent for the years 1961-62 to 1963-64. Thereafter it was merged with the Indian Earths. Retained profits amounted to Rs. 6 lakhs only.

13. BHARAT ELECTRONICS:

The company declared its first dividend at 5 per cent in 1964-65 and the rate rose to 6 per cent in 1965-66. Retained profits during 1961-65 amounted to Rs. 1.77 crores. Accumulated balance of Reserves and Surpluses at the end of 1966 was Rs. 1.51 crores (after making prior period adjustments).

14. NATIONAL INSTRUMENTS:

Dividend for the year 1962-63 was declared at 3 per cent, for 1963-64 at 3.5 per cent and for 1964-65 at 2.5 per cent. No dividend was paid during 1965-66. Retained profits during the period 1961-65 amounted to Rs. 18 lakhs and balance of Reserves and Surpluses as at the end of 1966 was Rs. 15 lakhs only (after writing off deferred revenue expenditure).

15. PRAGA TOOLS:

Dividend was declared for the years 1964-65 and 1965-66 at 4 and 3 per cent respectively. Profits were
16. MAZAGON DOCK:

Dividends at 4.5 per cent were paid for the years 1964-65 and 1965-66. Retained profits during 1961-66 amounted to Rs. 36 lakhs and accumulated balance of Reserves and Surpluses was Rs. 45 lakhs as at the end of 1966.

17. AIRLINES CORPORATION:

Dividend at 5 per cent was declared for the year 1964-65 only. Profits retained during the period 1961-66 amounted to Rs. 3 crores, and the accumulated total as at the end of 1966 was Rs. 3.03 crores.

18. HINDUSTAN HOUSING FACTORY:

Dividend at 3 per cent was paid in 1961-62 and then again at 6 per cent in 1965-66. For the intervening years no dividend was paid. Profits were retained to the extent of Rs. 12 lakhs during 1961-66 and accumulated total was Rs. 19 lakhs at the end of 1966.

19. MINERALS AND METALS TRADING CORPORATION:

The Corporation declared its maiden dividend for the year 1965-66 at 10 per cent. Profits retained during the period 1963-66 amounted to Rs. 1.28 crores and the total of Reserves and Surpluses was Rs. 1.33 crores at the end of 1966.
20. HINDUSTAN STEEL WORKS CONSTRUCTION LTD.: 

The company started working in 1965-66 and declared dividend at 15 per cent during the very first year. Profits were retained to the extent of Rs. 56 lakhs during the same year.

21. HINDUSTAN TELEPRINTERS LTD.: 

First dividend at 2 per cent was declared for the year 1965-66 and a sum of Rs. 19 lakhs was retained out of profits. Accumulated balance of Reserves and Surpluses was Rs. 14 lakhs at the end of 1966 (after making prior period adjustments).

22. GARDEN REACH WORKSHOPS LTD.: 

Dividends for the year 1964-65, 1965-66 were declared at 5 and 6 per cent respectively. Profits retained during the period 1961-66 amounted to Rs. 33 lakhs. Total of accumulated profits was Rs. 79 lakhs at the end of 1966.

23. SAMBHAR SALTS LTD.: 

Dividend of 5 per cent was paid during 1965-66. Profits retained amounted to Rs. 6 lakhs and that was the total of Reserves at the end of the year.

24. CENTRAL ROAD TRANSPORT CORPORATION: 

The Corporation paid a sum of Rs. 20 only as dividend for the year 1965-66. Retained profits amounted to Rs. 2 lakhs only.

In Britain the statutory duties of nationalized industries are set out in the nationalization Acts. To make such requirements more specific further directions and guidelines are issued by Government from time to time.
Such guidance for the industries was set out in the White Paper on the Financial and Economic Obligations of the Nationalized Industries in 1961 (Cmnd. 1337). The Paper contained guidance in regard to pricing policy, charging of interest, making of provision for depreciation, to make further provision for the difference between depreciation at historic cost and replacement cost and allocations to reserve sufficient to make some contribution towards the industry's future capital development programme and as a safeguard against premature obsolescence and similar contingencies. The Government expects the nationalized industries to use the best possible methods of appraisal. Discounted cash flow techniques are recommended for all important projects. The rate of discount must be sufficient to ensure that resources are efficiently used, and represents the minimum rate of return to be expected of commercial concerns.

Thus financial objectives of nationalized industries are given out in clear terms (see table below) and this is very necessary because industries know what is expected of them by the Government. They serve both as an incentive to management and as one of the standards by which success or failure over a period of years may be judged.

Table indicating Financial Objectives of Nationalized Industries

| National Coal Board | To break-even after interest and depreciation including £10 million a year to cover the difference between depreciation at historic cost and replacement cost. |
Electricity Boards (England & Wales)  
Average 12.4 per cent gross (Income before interest and depreciation, expressed as a percentage of average net assets).

Gas Boards  
Average 10.2 net (Income before interest but after depreciation at historic cost, expressed as a percentage of average net assets).

British Overseas Airways Corporation  
12.5 per cent (Income before interest but after depreciation at historic cost, expressed as a percentage of average net assets).

British European Airways Corporation  
6 per cent net (as above).


From the above it becomes clear that nationalized industries in England are made aware of their financial obligations to the nation and detailed guidelines are available to them in the matter of pricing, interest, depreciation, reserves and return on investment, etc., etc.

On the other hand, here in India, no such guidance is available. Various Acts establishing statutory Corporations are generally silent on duties of such corporations; Memorandum and Articles of Association, in the case of Government companies, contain no provisions with regard to the obligations of these companies. Administrative Ministries of the Government have not issued any directions for the guidance of public enterprises in the matter of pricing,
depreciation, reserves, dividends, etc., etc. Therefore, here, no national policy in these matters has yet been formulated. Each individual concern has been left free to frame its own policy.

As in Britain, Government of India, should take initiative in laying down financial objectives of public enterprises. Broad guidelines should be framed regarding the pricing policy, depreciation policy—historical cost or replacement cost—, maintenance of reserves, ploughing back of profits, dividend policy, etc., etc. Public enterprises should know what is expected of them. That will also provide a standard for performance evaluation of these enterprises.

In the absence of such a policy, things will remain fluid and financial appraisal of different enterprises becomes unreal.

**SUMMARY AND CONCLUSION**

Gross profit of a business concern is arrived at after deducting the cost of sales from the total net sales. Depreciation is an essential element of cost and must be provided for before arriving at the gross profit. Depreciation should be provided at replacement cost and not on the historical cost basis. In an inflationary economy, historical cost method will not provide adequate funds for the renewal of the asset.

From the gross profit are deducted other expenses of business such as selling, distribution, administrative,
interest charges, obsolescence allowance, etc., to arrive at the net profit.

Obsolescence allowance is provided to safeguard against loss that might arise on account of technological changes.

The whole of the net profit should not be distributed as dividends. Some portion of such profits must be retained to strengthen the finances of the concern. Ordinarily not more than two-thirds of the profits should be distributed as dividends and the remaining one-third should be ploughed back.

In India, public enterprises provide depreciation, every year, on gross block. The amount so provided during the five years (1961-66) amounted to ₹ 287 crores.

Public enterprises, being newly established, have not yet stabilised. They did not earn enough profits and, therefore, their capacity to retain profits and to distribute dividends has been limited. During the five years (1961-66) the total amount of dividends distributed was ₹ 12.56 crores and profits retained amounted to ₹ 69.27 crores.

As in Britain, financial objectives of public enterprises have not been laid down. No guidance is available in the matters of pricing, depreciation, obsolescence, reserves or dividends etc.

It is suggested that Government of India should set out the financial objectives of public enterprises.
Broad guidelines should be framed regarding pricing policy, depreciation policy, maintenance of reserves, retaining of profits and dividend policy, etc., etc.