PART III

CONCLUSIONS
CONCLUSIONS AND RECOMMENDATIONS

The economic and social objectives set out among the Directive Principles of the State Policy have been attained to a large extent through the instrument of 'Public Sector'. This conclusion is based on the study of the public sector and the progress made during the past twenty years. It has made a significant contribution to the country's economic development. Big industrial complexes in the fields of steel, Machine tools, Heavy Machine Building and Engineering, Fertilizers, Mining and Minerals, Heavy Electrical equipment manufacturing, Fuel and Power, Heavy Chemicals, etc., have been set up and thus necessary infra-structure has been created for the sound economic development of the country. Extension of the public sector helped in reducing the regional imbalances through a planned dispersal of new industries and provided opportunities to the less developed and backward areas to grow. It also helped to reduce the concentration of economic power and wealth in a few private hands.

The study of the financial organisation and working of forty running concerns of the Central Government engaged in industrial and Commercial activities reveals that in regard to financial organisation and working the results are not encouraging. Profitability picture and return on investment is disappointing. The
nation expected much better results from the performance of these enterprises. The Perspective Planning Division of the Planning Commission had estimated a return of 10 per cent on investment, or normally a return of 20 per cent on net worth is expected from business enterprises. The actual returns made by these enterprises are nowhere near these figures as is revealed by the table given below.

### RUNNING CONCERNS

<table>
<thead>
<tr>
<th>Years</th>
<th>Percentage of Gross Profit on Capital Employed</th>
<th>Percentage of Net Profit on Net Worth</th>
<th>Percentage of Net Profit to Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961-62</td>
<td>Loss</td>
<td>Loss</td>
<td>Loss</td>
</tr>
<tr>
<td>1962-63</td>
<td>2</td>
<td>Loss</td>
<td>Loss</td>
</tr>
<tr>
<td>1963-64</td>
<td>4</td>
<td>Loss</td>
<td>Loss</td>
</tr>
<tr>
<td>1964-65</td>
<td>4.8</td>
<td>2.5</td>
<td>2.4</td>
</tr>
<tr>
<td>1965-66</td>
<td>3.7</td>
<td>1.0</td>
<td>0.9</td>
</tr>
</tbody>
</table>

The above table shows that the maximum return of gross profit on capital employed was 4.8 per cent, percentage of net profit on net worth was 2.5 and 2.4 per cent, as net profit on equity during the year 1964-65.

The reasons for poor performance are: Faulty planning, inordinate delay in execution of projects, lack of technical know-how, inexperienced management, bad industrial relations, over staffing and defective inventory control, etc., etc. On the top of every thing confused thinking of the Government and lack of clear policy in the matter of profit making has been responsible for such state of affairs.
In the matter of project planning Indian public enterprises have been very deficient. Many public enterprises were set up without awaiting for the feasibility report or decisions were taken on very meagre data. Such hasty decisions resulted into heavy financial losses. In many other cases detailed project reports were not prepared. The absence of such reports led to schedule slippages, cost over-runs, and contractual difficulties. Sometimes it caused excess purchase of plant, prolongation of period of construction, delay in the attainment of production targets and cost escalation.

In regard to financial planning the experience of Indian public enterprises has not been happy. Financial estimates in many cases proved to be wrong and had to be revised. In some cases the upward revision has been as high as 83 per cent of the original estimate. The study further reveals that several important items such as consultancy fees, customs duty, training of personnel, townships, financing charges, working capital, enabling works, etc., were not included in final estimates and were responsible for subsequent revisions.

The capital requirements of public enterprises, in India, have been largely met by the Central Government either in the form of equity or long term loans. The study discloses that the funds so provided amounted to 95.4 per cent of the total investment at the end of 1965-66. In a few cases and to a limited extent, funds have also been provided by foreign collaborators. This contribution (Annexure VI and Chart facing page 70) was 3.3 per cent only of the total
investment at the end of 1965-66. Public participation in the share capital has been little and it was only one per cent of the total investment (Chart facing page 71).

Public enterprises being new and of capital intensive character with long gestation period cannot retain enough profits out of their earnings to provide original capital. For their own expansion purposes funds have been retained and ploughed back by them. Upto the end of 1965-66 total of internal resources generated by different running concerns right from their inception was Rs. 360 crores (Chart facing page 55), i.e., 15 per cent of the total investment of Rs. 2,415 crores.

In tailoring a suitable capital structure the prime consideration should be (a) that an enterprise is not burdened with heavy interest charges during its early life; (b) that it is given such financial incentives as are necessary to ensure its smooth progress within the minimum time and (c) that it contributes to the process of capital formation as soon as possible. Judging from these standards the capital structure of Indian public enterprises is defective. Of the total investment of Rs. 2,415 crores as it stood at the end of 1965-66, the share of the Central Government was Rs. 2,304 crores of which Equity Capital was Rs. 1,352 crores and long term loans Rs. 952 crores, giving an overall ratio of 1 : 0.7 between Equity and Debt. Many of the public enterprises such as Hindustan Steel, Heavy Electricals, Fertilizers and Chemicals
Travancore, Fertilizer Corporation of India, National and Coal Development Corporation, National Mineral Development Corporation and many others could not show profits because of defective capital structure carrying heavy interest burden on their revenues. Category-wise capital structure at the end of 1965-66 was as under—

<table>
<thead>
<tr>
<th>Category of the Undertaking</th>
<th>Total Investment (Crores)</th>
<th>Equity Capital (Crores)</th>
<th>Loan Capital (Crores)</th>
<th>Ratio between Equity &amp; Loan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Undertakings under construction</td>
<td>331.7</td>
<td>198.4</td>
<td>133.3</td>
<td>1 : 0.67</td>
</tr>
<tr>
<td>Running Concerns:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hindustan Steel</td>
<td>960.1</td>
<td>528.00</td>
<td>432.1</td>
<td>1 : 0.82</td>
</tr>
<tr>
<td>Other than Hindustan Steel</td>
<td>899.2</td>
<td>502.5</td>
<td>396.7</td>
<td>1 : 0.79</td>
</tr>
<tr>
<td>Promotional &amp; Developmental Undertakings</td>
<td>217.10</td>
<td>132.90</td>
<td>84.2</td>
<td>1 : 0.64</td>
</tr>
<tr>
<td>Financial Institutions</td>
<td>6.9</td>
<td>6.5</td>
<td>0.4</td>
<td>1 : 0.06</td>
</tr>
<tr>
<td>Total</td>
<td>2,415.0</td>
<td>1,368.3</td>
<td>1,046.7</td>
<td>1 : 0.77</td>
</tr>
</tbody>
</table>

Financial Control—internal and external is a must. To have a real and meaningful internal financial control, comprehensive budgetary control, costing system and internal audit need be introduced in all industrial and commercial undertakings.

This study brings out in abundant measure that in all these aspects of internal financial control, Indian public enterprises are deficient. In many of the concerns no proper system of costing or budgetary control is in operation. There are wide variations between the budgetary
estimated and actuals. Either no internal audit system has been introduced or it is found to be ineffective. Materials management has been found to be poor.

Concept of 'Public Accountability' gives rise to external financial control. Necessary machinery is set up to collect reliable information for the Parliament to enable it to scrutinise the working of public enterprises. Such a financial control should aim at performance evaluation by undertaking 'Efficiency Audits'. Such audits should be performed only by a team of experts ranging from Engineers to Social Scientists. At present Comptroller and Auditor-General of India undertakes such efficiency audits without having any expertise in this regard. For such an audit a team of experts in different areas such as financing, costing, management accounting and engineering, etc., is required. The Comptroller and Auditor-General's organisation may not have such experts. Therefore, Comptroller and Auditor-General is not in a position to discharge this function of performance evaluation in an efficient manner.

It is revealed that Government of India deputes officers, from Government service, to act as Financial Advisors in public enterprises to perform watch dog services and to exercise financial control on them. Such a policy has not proved to be helpful. It stands in the way of developing of cordial relations within the management team. Such officers, however, good may have been in Government do not necessarily prove adequate for business enterprises.
Public enterprises have no defined policy of pricing their products and they enjoy varying degrees of autonomy in this regard. In main the policy is to earn 20 per cent on net worth and the formula adopted is 15 per cent below the landed cost of comparable goods.

Government of India has not laid down financial objectives of public enterprises in regard to pricing, depreciation, reserves and dividends etc., etc. Public enterprises are not aware of their obligations.

With a view to remove the various deficiencies and drawbacks discovered in the financial organisation and working of public enterprises and to improve their working it is recommended that no project should be approved by Government without getting the feasibility report. To make the feasibility and detailed project reports comprehensive and all embracing a check list of all aspects be drawn up for the guidance of all those who have to deal with the planning of projects. Although, absolute uniformity was not possible but information such as demand projections, raw materials, size and technology of the project, location, profitability, however, is basic and should be included in all feasibility studies.

Further it is suggested that a Piloting Committee consisting of representatives of the various Ministries and agencies concerned be set up to undertake a concurrent and collective examination of detailed project report to expedite and to facilitate quick decisions. Once a project has been
approved systematic and thorough planning of the construction programme should be chalked out before starting actual construction. When such a plan of construction has been drawn up, a suitable agency should be set up to see the plan through. The net-work techniques like PERT or CPM should be adopted for monitoring the progress of construction. All these steps will ensure efficient and speedy execution of projects.

On completion of each project, a project completion report should be drawn up. Such a report may be of immense use for other projects in future.

Too much reliance should not be placed on foreign experts in the preparation of project reports and now when competent persons are available within the country, they should be associated with the preparation of detailed project reports. This will prove very helpful in the execution of projects with economy and efficiency.

To remove the deficiencies in financial planning it is recommended that project estimates should be prepared realistically after taking into account all possible items of expenditure. It is further suggested that there should be a standing committee of experts in the areas of economics, finance, engineering and statistics to scrutinize the public sector projects not only at the planning stage but also afterwards. They should not function from their headquarters rather should tour throughout the country visiting various projects at site and look into their working and progress.

To enthuse general public and to create in them a sense of belonging and partnership in the national
projects, at least 25 per cent of the share capital should be offered to the general public, particularly the employees of the public enterprises. To make such an offer attractive a certain minimum return may be guaranteed on such share holdings till the concern becomes remunerative. Recent trend in many of the European countries is towards greater public participation in public enterprises.

Internal financial control system with all the modern tools of management accounting should be vigorously enforced in all public enterprises. For the purposes of effective external financial control a special Statutory Commission on the French system, with a number of boards consisting of experts, be set up for the purpose. The Comptroller and Auditor-General should have representation on the Commission. Only such persons who possess some knowledge of principles and practices of financial management should be appointed as Financial Advisors. They should not be imposed from outside the organisation rather they should be trained and developed from within.

Pricing policy should be such as to earn sufficient profits for further investment. Sometimes products may have to be sold at a loss if it helps in stimulating economic growth. On the whole the public sector should aim at 'Net Value Added' to the national economy and maximisation of national income. In a developing economy average cost concept appears more valid (so as to recover full cost—fixed and variable) as
Adequate provision for depreciation on fixed assets on the replacement cost basis should be made before arriving at the gross profit of business. In an inflationary economy, such as has been prevailing in India, depreciation at historical cost will provide only a small fraction of the cost of renewing such assets.

Some portion of the distributable profits should be retained in business to strengthen the finances and to meet unforeseeable contingencies. It is generally agreed that at least one-third of such profits must be ploughed back.

It is necessary to give some return to Government on their capital investment in the form of dividends.

As in Britain, Government of India, should lay down financial objectives of public enterprises. These enterprises should know what is expected of them and that will also provide a standard for performance evaluation.

If the above recommendations and corrective measures are adopted, it is hoped, they will go a long way in toning up the management of public enterprises and a more pleasant picture of profitability and return on investment will emerge and the public sector will become an efficient instrument of achieving Socialism.