UNIT 16 FINANCIAL MANAGEMENT IN PUBLIC SECTOR GOVERNMENT ENTERPRISES

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Structure

16.0 INTRODUCTION

We have already discussed earlier about the principles of financial management which are applicable or common to all business firms in both the the public sector and the private sector. However, business enterprises in the public sector have their special financial management features mainly due to government ownership and control. In the present unit, we will discuss the distinctive features of financial management concerning the public sector enterprises.

16.1 UNIT OBJECTIVES

- The public enterprise and its characteristics
- Objectives and rationale of the public sector enterprises
- Different forms of public sector enterprises
- Distinctive features of financial management of public sector enterprises
- Agenda for the public sector

16.2 MEANING OF PUBLIC SECTOR ENTERPRISE

Public sector enterprises or public enterprises have come to enjoy a unique position in the Indian economy in the post-independence era. These enterprises produce diverse products such as steel, coal, aluminium, fertilizers, basic chemicals, minerals, locomotives, aricrafts, ships, etc. They have been responsible for forming a strong industrial base and providing the basic infrastructure for development in the country.

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The significant growth of the public sector form of business organizations has been due to several factors, *viz.*, our philosophy of the socialistic pattern of society, the strategy of heavy industrialization, the need to prevent the concentration of economic power in a few hands, the development of backward areas, etc. This sector has assumed such importance that no student of commerce or management can afford to ignore its study.

A public enterprise may be defined as a business undertaking which is owned, managed and controlled by the State, on behalf of the public at large. According to Hansen, public enterprises means 'state ownership and operation of industrial, commercial or financial or agricultural undertakings'.

16.3 CHARACTERISTICS OF PUBLIC SECTOR ENTERPRISES

1. State Ownership

A public enterprise is owned by the Central and/or State Government

2. Service Motive

The primary objective of public enterprises is to serve the nation, while they may earn profits. In fact, there are multiple objectives like the provision of essential goods and services, the creation of gainful employment, filling gaps in industrial structure, etc. Public enterprises work for public welfare.

3. Public Accountability

In the establishment and operation of public enterprises, financial resources are provided from the State exchequer. Therefore, public enterprises are accountable or responsible to the public. Such accountability is carried out through parliamentary control on the working of these enterprises.

4. Government Control

The management of public enterprises rests in the hands of officers who are appointed by the government directly or indirectly. Even in the case of autonomous enterprises, the concerned ministry excercises a great deal of control over their functioning.

Thus, public enterprises differ from private enterprises in terms of their ownership, management, objectives, financing, freedom of management and flexibility of operations.

16.4 OBJECTIVES OF PUBLIC SECTOR ENTERPRISES

The objectives of public sector enterprises may be divided into three categories:

1. Economic objectives
2. Social objectives
3. Political objectives

1. Economic Objectives

(*i*) *Economic development*

Public enterprises are established to accelerate the rate of economic growth by setting up key and basic industries like iron and steel, petroleum, power generation, chemicals, machine building, etc. The public sector provides an essential base for faster economic growth of the country. The expansion of capital goods industries leads to the development of other industries.

(*ii*) *Planned growth*

The private sector neglects industries with long gestation periods and low rates of returns. Public enterprises step in to fill up gaps in the industrial structure by setting up industries which are economically unattractive, but nationally essential. Public sector provides infrastructural facilities for diversified and balanced growth.

(*iii*) *Balanced regional development*

Public sector concerns are designed to facilitate the growth of backward regions so as to reduce regional disparities in industrial growth.

(*iv*) *Generation of surplus*

Public enterprises are expected to generate and distribute surplus for financing five-year plans and other schemes of public welfare.

(*v*) *Provide employment*

One of the important objectives of public enterprises is to reduce unemployment by creating employment opportunities.

2. Social Objectives

(*i*) *Control monopoly*

Sometimes, public enterprises seek to check private monopoly and restrictive practices and the resulting evils like exploitation.

(*ii*) *Equitable distribution of wealth*

Public enterprises are expected to reduce disparities in the distribution of income and wealth. The reduction of economic disparities is one of the objectives of our Constitution and public enterprises are helpful in checking the concentration of economic power.

(*iii*) *Provision of essential goods and services*

An important objective of public undertakings is to provide essential goods and services for consumption at reasonable prices. This helps in improving the standard of living of people. Social control over industry ensures equitable distribution of commodities and helps to protect the consumer from exploitation by greedy businessmen.

(*iv*) *Takeover of sick units*

Closure of sick units may result in loss of employment to a large number of people and wastage of national resources. Public enterprises like the National Textile Corporation was set up to nationalize such units and to make them healthy and profitable. Public enterprises also facilitate small-scale industries.

3. Political Objectives

(*i*) *Public interest*

Public enterprises are established in the interest of the country as a whole. India has become an industrial power because of the development of public sector concerns. They facilitate self-reliance in strategic sectors.

(*ii*) *National defence*

Public enterprises are set up for the manufacture of arms, ammunition, telecommunications, oil, etc., which are essential for the safety and security of the country.

(*iii*) *Socialism*

Public enterprises are required to further the political ideology of the government as well as to serve the constitutional objectives of socialistic pattern of society.

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16.5 RATIONALE OF PUBLIC SECTOR ENTERPRISES

Public sector enterprises occupy an important place in almost all countries irrespective of their political orientation. The emergence and popularity of these enterprises in India can be attributed to the following reasons :

Arguments in favour of Public Enterprise

(*i*) *Rapid industrialization:*

Public enterprises are essential for developing basic and heavy industries which require heavy investment and have low profit margins. Private enterprise are, therefore, reluctant to enter them. Such industries, *viz*. iron and steel, coal, oil, and telecommunications, provide infrastructural facilities for the rapid industrialization of the country.

(*ii*) *Optimum utilization of national resources:*

Left to the private sector, some industries suffer from excess capacity while others have insufficient capacity. Public enterprises help in correcting such imbalances as they are not guided solely by the profit motive. In this way, they are instrumental in the best possible utilization of the country's natural resources.

(*iii*) *Balanced regional growth:*

Backward regions lack infrastructural facilities and therefore private industrialists are not keen to set up industries in such regions. This leads to the concentration of industries in certain regions. By locating plants in backward areas, public sector concerns help to remove regional disparities in industrialization.

(*iv*) *Mobilization of surplus:*

Public enterprises are not under pressure to distribute dividends. They can fully plough back their earnings for future growth and to promote socio-economic objectives.

(*v*) *Creation of employments:*

Public enterprises are required to generate employment for the teeming millions. They help to provide employment by taking over sick and closed units in the private sector.

(*vi*) *Control over monopoly and concentration of economic power:*

Private monopolies lead to the exploitation of weaker sections. Public enterprises are a countervailing power to check private monopolies and undue concentration of economic power in a few hands. They facilitate the development of an egalitarian society.

(*vii*) *Elimination of wasteful competition:*

Public enterprises help to produce socially useful goods which are in short supply. By balancing demand and supply, they eliminate wasteful competition and provide economies of large-scale operations.

(*viii*) Instrument of social change

Public enterprises serve as an important instrument of social change. They are helpful in ushering a social order free from expolitation. They can be used to further the welfare of consumers and workers. Such enterprises can serve as a model employer.

16.6 FORMS OF PUBLIC SECTOR ENTERPRISES

Public Sector Enterprises may be organized in any of the following forms:

1. Departmental Undertakings
2. Public Corporations

3. Government Companies

4. Holding Companies

The above can be shown in the form of the following chart :

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Table 16.1 *Organization of Public Sector Enterprises*

PUBLIC SECTOR ENTERPRISES

Departmental Undertakings	Public Corporations	Government Companies	Holding Companies
(*a*) Posts and Telegraphs	(a) Damodar Valley Corporation (SAIL)	(*a*) Hindustan Steel Ltd	(*a*) Steel Authority of India Ltd (SAIL)
(*b*) Railways	(*b*) Reserve Bank of India	(*b*) Hindustan Machine Tools Ltd	(*b*) Coal Authority of India Ltd (CAIL)
(*c*) Broad-casting Services	(*c*) Life Insurance Corporation of India	(*c*) Hindustan Shipyard Ltd	(*c*) International Airports Authority of India (IAAI), etc.
(*d*) Defence Establish ments	(*d*) Industrial Development Bank of India, etc.	(*d*) Bharat Heavy Electricals Ltd, etc.	
(*e*) Atomic Power Projects			

None of these forms is suitable for all types of public enterprises and in all situations. While selecting the form of organization for a particular public enterprise, the nature of the enterprise, the scale of its operations, its operational and financial requirements, the degree of competition, effect of the enterprise on the life of the community, and its contribution to the national economy should be considered.

1. Departmental Undertakings

Departmental undertaking is the oldest and the most traditional form of public sector enterprises. Under this form, an enterprise is organized as a wing of the normal government machinery. The enterprise is managed by government officials as one of the government departments. The enterprise is under the charge of the secretary and the minister concerned who is responsible to the parliament.

Characteristics of departmental undertakings

(*i*) The undertaking is established as a department or a ministry of the government. It is not a separate entity from the government.

(*ii*) The enterprise is financed by annual appropriations from the government budget and practically all its earnings are paid into the government treasury.

(*iii*) The undertaking is subject to budget, accounting and audit control applicable to other government departments.

(*iv*) The permanent staff of the enterprise consists of civil servants and their terms and conditions of the employment are determined by the government. They are all government servants subject to civil service rules.

(*v*) The undertaking is under the control of the minister concerned. The minister in charge of that department has direct control over the enterprise.

(*vi*) Being a part of the government, a departmental undertaking cannot be sued without the consent of the government.

Certain departmental undertakings are so diversified in operations that they affect several areas of the government machinery. Such undertakings are managed and controlled by an interdepartmental committee or board consisting of representatives of various ministries or departments of the governments. Sometimes, the representatives of the concerned State Governments are also included in the Committee or the Board. The main examples of board-type management are river valley projects like the Bhakra Nangal Control Board, Hirakud Control Board, All India Handloom Board, and undertakings concerned with national defence, atomic energy development.

2. Public Corporations

A public corporation or statutory corporation is a corporate body set up under a special statute. It is financially independent, its power and functions are well defined and it has a clear-cut jurisdiction over a specific field of industrial or commercial activity. The capital of a public corporation is subscribed wholly by the government. According to Herbert Morrison, 'a public corporation is a combination of public ownership, accountability and business management for public ends'.

Characteristics of public corporations:

(*i*) *Formation*. A public corporation is established under a special Act of the parliament or state legislature. The Act defines the objects, powers and functions of the corporation as also its relationship with the government.

(*ii*) *Separate legal entity*. A statutory corporation has a separate legal existence, independent of the government. It can acquire property, make contracts, sue and be sued in its own name. It is a body corporate.

(*iii*) *Government ownership*. The entire share capital of a public corporation is provided by the government or by agencies controlled by the government. It is wholly owned by the State.

(*iv*) *Public service*. Generally, the main motive of a public corporation is to work for public welfare. However, it is expected to at least break-even or make reasonable profits.

(*v*) *Management*. It is managed by a board of directors nominated by the government. The control is vested in the legislature, and the corporation is accountable to the parliament. It has its own staff and their the appointment, remuneration and service conditions are decided by the corporation itself. Employees of the corporation are not government servants and they are not subject to civil service rules.

(*vi*) *Financial independence*. The corporation can borrow money on its own. It is not subject to government rules and regulations in the matter of accounting, budgeting and audit.

(*vii*) *Public accountability*. A public corporation is accountable to the parliament or the state legislature. It has to submit an annual report on its working and its accounts are audited by the Comptroller and Auditor General of India.

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3. Government Company

Government company is that in which not less than 51 per cent of the paid-up share capital is held by the Central and/or State Government. It is a company registered or incorporated under the Companies Act.

Characteristics of government companies:

(*i*) *Incorporation*. A government company is registered under the Companies Act. It is formed by an executive rather than a legislative decision.

(*ii*) *Separate legal entity*. It has a separate legal existence independent of the government.

(*iii*) *Ownership*. A government company is wholly or partly owned by the government. But in all cases, the government is the major shareholder.

(*iv*) *Management*. It is managed by a board of directors nominated by the government. It has its own staff and its employees are not government servants. They are not subject to the civil service rules.

(*v*) *Accountability*. A government company is accountable to the ministry or the department concerned. Its report is placed every year in the parliament or state legislature.

(*vi*) *Financial Autonomy*. It is free from the accounting, audit and budgetary controls applicable to government departments. It can also borrow on its own.

4. Holding Companies

In the case of holding companies, a single parent or apex company exercises control over all public enterprises belonging to one particular industry. The parent or holding company is registered under the Companies Act and the government companies controlled by it are called subsidiary companies. The subsidiaries enjoy the freedom of day-to-day administration, but their overall policies are laid down by the holding company. The holding company is free from government interference and normal rules and procedures of government departments.

Holding company organizations facilitate centralized planning and unified control. It is able to adopt an integrated and balanced approach towards all units operating in one field of industrial or commercial activity. Each subsidiary has decentralized management and obtains the benefits of professional management by the holding company. The holding company enables the government to formulate a uniform policy for the promotion of a particular industry. It can be held for the promotion and growth of new units.

However, a holding company organization involves dangers of top heavy administration, excessive centralization of authority and conflict of interests.

16.7 DISTINCTIVE FEATURES OF FINANCIAL MANAGEMENT

The following are some of the distinctive features concerning the financial management of public sector enterprises:

1. Role of the Financial Adviser

The financial adviser occupies an important position in all public sector undertakings. He functions as the principal adviser to the chief executive of the enterprises on all financial matters. His concurrence is required regarding all financial implications of the proposals

Check Your Progress

1. Who provides the financial resources for the establishment and operation of public enterprises?
2. What are the objectives of public sector enterprises?

put forward before the Board of Directors. In some public sector undertakings he is designated as Financial Adviser and Chief Accounts Officer (*FA* & *CAO*), while others have expanded the role of the financial adviser and elevated his position by designating him as Director (Finance). The Committee on Public Sector Undertakings has specified the following functions and responsibilities of a financial adviser:

(1) To determine the financial needs of the firm and the way these needs are to be met

(2) To formulate a programme to provide the most effective cost-profit volume relationship

(3) To analyse the financial results of all operations costs so as to improve future operations

(4) To conduct special studies with a view to reduce costs and improve efficiency and profitability

(5) To examine feasibility studies and detailed project reports from the point of view of the overall economic viability of the project

(6) Performing routine operating functions as given below:

- (*i*) Coordination of the preparation and operation of budgets
- (*ii*) Determination of suitable purchasing procedures to ensure adequate control
- (*iii*) Advice to the CEO on pricing policies, interdepartmental issues, etc.
- (*iv*) Advice on all service matters, such as scale of pay, dearness allowance, bonus, gratuity, etc.
- (*v*) Maintenance of accounts, including cost and stores accounts, and internal audit
- (*vi*) Preparation of annual accounts, in accordance with the provisions of law and attending to external audit
- (*vii*) Control over cash and disbursements
- (*viii*) Handling of tax matters

2. Capital Budgeting Decision

In order to ensure the proper evaluation and implementation of the capital budgeting decision, the following points are to be given due consideration :

(1) Guidelines provided by the government

(2) Delegation of investment decision-making power

(3) Approval of public investment proposals

(1) Guidelines Provided by the Government

Major capital expenditure decisions are to be taken only after an extensive study.

Projects are generally formulated by the concerned ministries when five year plans are being drawn up. Besides, the administrative ministry which takes initiative, the Planning Commission and the Finance Ministry are also vitally concerned with the project details supported by feasibility reports. In this connection, the Project Proposal Appraisal Division of the Planning Commission issued in 1975 is a detailed manual entitled 'Guidelines for Preparation of Feasibility Reports for Industrial Projects.' According to the guidelines, every project should be appraised from the technical, commercial, financial and economic angles. The project report has to cover the following major points :

(*i*) *General information*. This covers the demand during the description of the project and alternatives available.

(*ii*) *Market analysis*. This covers the demand during the five-year plan period, present and anticipated production, present imports and exports potentials and time phasing of demand.

(*iii*) *Technical features of the project*. This includes the selection of the production process, size of the plant, raw materials, product mix, etc.

(*iv*) *Location of the plant*. This has to be studied in relation to availability of raw materials, market, water, infrastructure facilities and alternative locations available.

(*v*) *Capital cost estimates*. This includes construction cost, installation cost of the plant and the details of foreign exchange components involved in the capital cost.

(*vi*) *Operating estimates*. This includes details of the operating costs and working capital requirements.

(*vii*) *Financial analysis*. This covers preparation of cash flow and funds flow analysis, cost, benefit analysis, etc.

The guidelines suggest the adoption of the Internal Rate of Return (IRR) method for evaluating the capital investment proposal. In order to incorporate the risk factor, the technique of sensitivity is also being recommended particularly for the following variations:

(*a*) Increase in capital cost by 30 per cent

(*b*) Decrease in labour cost by 30 per cent

(*c*) Reduction in raw material input cost by 10 per cent

(2) Delegation of Investment Decision-making Power

The Bureau of Public Enterprises issues circulars from time to time authorizing the board of directors of public sector undertakings to take a decision with respect to individual capital expenditure items based on the total capital investment in the concerned enterprise.

(3) Approval of Public Investment Proposal

The Government of India set up a high-powered Public Investment Board (PIB) in 1972 to approve speedily public sector projects which are beyond the authority of the boards of public sector undertakings as given above. The Board consists of following members:

- Secretary, Department of Economic Affairs
- Secretary, Department of Industrial Development
- Secretary, Planning Commission
- Secretary to the Prime Minister
- Secretary of the Administrative Ministry concerned with the public investment proposal.
- Director General of Bureau of Public Enterprises who is the permanent invitee Secretary, Department of Economic Affairs, who is the chairman of the Public Investment Board.

The Public Investment Board appraises and recommends all projects which come under the purview of the Central Government other than those relating to departmental undertakings, *viz*., Railways, Ordnance factories, etc., which have their own procedures. The Board takes into consideration the following criteria in appraising and recommending the projects :

(*i*) The contribution of the project to economic and social objectives and adherence to the concerned policies of the government

(*ii*) The advisability of undertaking the project in the public sector, in the joint sector or leaving it to the private sector

(*iii*) Availability of plan funds, desirability of diversion of plan funds to the new projects from those already in hands

(*iv*) The plant capacity and the timing of the investment in the light of supply and demand balance including export possibilities of the product/service to be provided

(*v*) The economic benefits of the project as distinct from financial returns.

(*vi*) Crucial assumptions in the feasibility report which are likely to affect the performance of the commissioned project in relation to the claims made thereon in the feasibility report

(*vii*) The adequacy or otherwise of the internal rate of returns from the project

(*viii*) Contribution of the project to foreign exchange earnings

(*ix*) Logical sequencing of the project schedule

(*x*) Adequacy of safety and anti-pollution measures

(*xi*) Soundness of marketing strategy

The Public Investment Board is assisted by the following agencies in this work:

(*i*) The Plan Finance Division of the Ministry of Finance, which scrutinizes the proposal particularly with reference to budgetary and plan provisions. It also works as the secretariat of PIB

(*ii*) The Bureau of Public Enterprises, which examines capital costs, technical and other financial aspects

(*iii*) Project Appraisal Division of Planning Commission, which makes a social cost benefit analysis and critically examines assumptions underlying the projects

(*iv*) The concerned administrative ministry, which provides all additional information required by the Public Investment Board

In case the project is recommended by the Public Investment Board, it goes to the Cabinet through the Ministry of Finance for its approval. In case the project is approved, a detailed project report is prepared providing sufficient details regarding project costs, project schedule and other information necessary for implementing the project.

3. Capital Structure Decision

The term capital structure decision refers to the detetrmination of the debt-equity mix. In other words, it involves the identification of different sources of long-term finances, *viz*., equity shares, preference shares, debentures, bonds, etc. and the quantum of finances to be raised from each such sources of finance. The following are the special features regarding capital structure decision in the case of public sector enterprises:

(1) *Role of cost of capital*

In case of a private enterprise the cost of capital plays an important role while determining the capital structure. However, in a public sector enterprise a large portion of the funds is provided either by the government or by the insitutions controlled by the government.

Hence, the cost of capital does not play an important role in determining the capital structure of a public sector enterprise.

(2) *Debt-equity mix*

A private enterprise is required to maintain a proper debt-equity mix. It is ideal if it is 1 : 1. Financial institutions consider debt-equity mix as satisfactory for a firm even if it is 1 : 2. As regards public sector enterprises, the first government guidelines regarding debt-equity mix was issued in June, 1961, providing a debt equity mix of 1 : 1. This can be made out from the circular issued by Bureau of Public Enterprises. It stated as follows: 'Normally, when making provision for the projects in the public sector, unless there are exceptional reasons to the contrary each project will be financed on the basis of half of its capital being in the shape of equity and the rest in the shape of loans.'

However, it will not be appropriate to have uniform debt-equity ratio for all types of public sector undertakings.

The Administrative Reforms Commission and the Committee on Public Undertakings also urged the government to allow variations in the debt-equity ratio from one public sector undertaking to another depending upon whether it is a capital-intensive unit or a trading unit. According to the Committee on Public Sector Undertakings, the firms which have a long gestation period, serve a basic developmental from those undertakings which do not have these features. Hence, the debt-equity mix in case of public sector enterprises, undertakings should be based on the following parameters.

(*i*) Gestation period
(*ii*) Degree of Business Risk
(*iii*) Capital Intensity of the Project
(*iv*) Availability of Freedom as to the Pricing

(3) Sources of Finance

The main sources of finance of a public sector undertaking are as under:

(*a*) *Equity Shares*. Traditionally this has been a major source of finance of public sector undertakings. The equity share capital of public sector undertakings is either wholly held by the government itself or by the government with other institutions owned or controlled by the government. There have been some minor deviations in this respect. Some public sector undertakings have offered in the past a small part of their equity share capital to the public at large. Scooters India Limited was the first public sector undertaking to offer in 1975 a part of its equity shares to public at large. This practice of raising funds from public by offering equity shares has gained momentum after the onset of liberalization process in 1991. For instance, the State Bank of India and some of the nationalized banks have also raised funds by issue of equity shares to the general public.

(*b*) *Loans*. Public sector undertakings have also been getting substantial loans from the government to meet their requirements of long-term funds. The financial institutions have also been very liberal in granting loans to public sector undertakings because of minimum risk. It may be recalled that as back as 1961, the Government of India fixed the debt-equity ratio for this purpose as 50 : 50 in case of public sector undertakings.

(*c*) *Bonds*. Raising of funds through bonds or debentures by public sector undertakings is of recent origin. As a matter of fact, a number of public sector undertakings have in recent years raised funds by offering debentures or bonds to the general public. These include Steel Authority of India Ltd. (SAIL), National Thermal Power Corporation (NTPC), Industrial Development Bank of India (IDBI), Mahanagar Telephone Nigam Limited (MTNL), Bharat Petroleum Limited (BPL), etc. The debt equity ratio normally

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applicable to such issues has been fixed at 4 : 1. The bonds have generally a maturity period of seven to ten years. Some of these bond issues also enjoy income tax and wealth tax benefits.

(*d*) *Retained Earnings*. This has not been a major source of long-term finance of public sector undertakings, since the performance of most of the public sector undertakings in terms of profitablitiy has been extemely poor. The return on capital employed in the public sector undertakings has been abnormally poor at 3 per cent. Moreover, a large share of the profits made by the public sector undertakings come only from a few undertakings such as ONGC, BHEL, MTNL, NTPC, etc. As a matter of fact, petroleum sector alone accounts for nineteen per cent of the total gross profits by all public sector undertakings. It has been estimated that around sixty-four per cent of the total capital employed has failed to yield a reasonable return.

(*e*) *Disinvestment*. The term 'disinvestment' implies sale of the shareholdings to the extent required. The motivation for disinvestment may range from the ownership, control and management of an enterprise to introducing new partners to improve the operations or for moving into another line of business activity. In India, the disinvestment in public sector enterprises has been undertaken to correct the budgetary imbalances and achieve the objectives of economic restructuring. The onset of liberalization process in 1991 brought a revolutionary change in the Government's policy towards the public sector enterprises. It is taking effective steps for reducing its involvement in providing funds to the public sector enterprises through disinvestment of its holdings in the public sector enterprises.

The disinvestment policy, after coming into power of UPA Government in 2004 has undergone certain changes. The basic features of the new policy are as under:

(1) *Organization Structure*: The Department of Disinvestment, set up in December 1999 was renamed as Ministry of Disinvestment in September 2001. The Ministry of Disinvestment has now been converted into Department of Disinvestment under the Ministry of Finance since May 2004. The Department has been assigned the following work:

(*i*) All matters relating to disinvestment of Central Government equity in Central Public Sector Undertakings.

(*ii*) Decisions on the recommendations of Disinvestment Commission on the modalities of disinvestment, including restructuring.

(*iii*) Implementation of disinvestment decisions, including appointment of advisers, pricing of shares and other terms and conditions of disinvestment.

(*iv*) Disinvestment Commission.

(*v*) Central Public Sector Undertakings for purpose of disinvestment of government equity only.

Consequent upon change in the policy of the government, the term of Disinvestment Commission was not extended further and it was wound up with effect from 31 October, 2004.

The Secretary (Disinvestment) is assisted by three Joint Secretaries. The Department functions on the Desk Officer Pattern and the disinvestment work is handled at the minimum level of Under Secretary.

(2) *Policy on Disinvestment*: Government has decided, in principle, to list large, profitable Public Sector Enterprises (PSEs) as domestic stock exchanges and to selectively sell a minority stake in listed profitable PSEs while retaining at least fifty-one per cent of the

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shares along with full management control so as not to disturb the public sector character of the companies.

The basic features of the policy are as under:

(*i*) *Profit making companies not to be privatised*: The government is committed to a strong and effective public sector whose social objectives are met by its commercial functioning. But for this, there is need for selectivity and a strategic focus. The UPA is pledged to devolve full managerial and commercial autonomy to successful, profit-making companies operating in a competitive environment. Generally profit making companies will not be privatised.

(*ii*) *Restructuring of sick companies*: All privatisations will be considered on a transparent and consultative case-by-case basis. The government will retain existing 'navaratna' companies in the public sector while these companies raise resources from the capital market. Every effort will be made to modernize and restructure sick public sector companies and revive sick industry. Chronically loss-making companies will either be sold-off, or closed, after all workers have got their legitimate dues and compensation. The government will induct private industry to turn-around companies that have potential for revival.

(*iii*) *Raising resources from capital market*: The government believes that privatisation should increase competition, not decrease it. It will not support the emergence of any monopoly that restricts competition. It also believes that there must be a direct link between privatisation and social needs *viz*., the use of privatisation revenues for designated social sector schemes. Public sector companies and nationalized banks will be encouraged to enter the capital market to raise resources and offer new investment avenues to retail investors.

(3) *Proceeds from Disinvestment*: The amount of funds targeted and realized on account of disinvestment in public sector undertakings have been given in the following table:

Table 16.2 *Year-wise Distribution of Disinvestment Receipts*

(in Rs Crore)

Year	*Target*	*Achievement*
1991-92	2,500	3,038
1992-93	2,500	1,913
1993-94	3,500	-
1994-95	4,000	4,843
1995-96	7,000	362
1996-97	5,000	380
1997-98	4,800	902
1998-99	5,000	5,371
1999-00	10,000	1,860
2000-01	10,000	1,871
2001-02	12,000	5,632
2002-03	12,000	3,348
2003-04	14,500	15,547
2004-05	4,000	2,765

Source: Department of Disinvestment, Ministry of Finance.

During the year 2004-05, the government realized a sum of Rs 2,765 crore, out of which the major receipt of Rs 2,684 crore was from the sale of 43.29 crore equity shares of Rs 10 each of National Thermal Power Corporation Ltd. (NTPC) out of Government of India holding. A sum of Rs 64.81 crore was realized from the sale of shares to employees of IPCL.

During the year 2005-06, the Central Government hopes to mop up about Rs 500 crore *via* share sale in five companies including *BHEL*, *Maruti* and *BALCO*. The government is also toying with the idea of disinvestment in Power Grid Corporation of India.

(4) *Disinvestment Fund*: Government decided on 27 January 2005 to constitute a fund into which the realization from sale of minority and shareholding of the government in profitable PSEs would be channelized. The fund would be marnisained outside the Consolidated Fund of India and would be professionally managed by selected Public Sector Financial entities, which have the requisite experience to provide sustainable returns to the government without affecting the corpus. This fund would be called '*National Investment Fund*" to denote the permanent nature of the corpus and the objectives to which its income is to be applied. The broad objectives of the National Investment Fund will be:

(*i*) Investment in social sector projects which promote education, health care and employment;

(*ii*) Capital investment in selected profitable and revivable Public Sector Enterprises that yield adequate returns, in order to enlarge their capital base to finance expansion /diversification. The fund has come into effect from April 1, 2005.

(*f*) *Working Capital Management.* The following are some important aspects concerning working capital management in public sector undertakings :

(*i*) *Financing of current assets*. The current assets in case of public sector undertakings are mostly financed from short-term sources since often no provision is made for working capital requirements while estimating the project cost.

(*ii*) *Liberal bank credit*. The public sector undertakings get liberal credit facilities for meeting their working capital requirements from various public sector banks.

(*iii*) *Current assets to fixed assets ratio*. Most of the public sector undertakings are involved in capital-intensive industries, like steel, heavy engineering, oil refining, etc. As a result the ratio of current assets to fixed assets is rather low.

(*iv*) Low inventory turnover ratio. Most of the public sector undertakings have low inventory turnover ratio due to the following reasons :

(*a*) Manufacturing cycle is often much longer than what is desired because of lack of coordination and inordinate delays.

(*b*) The procedure for purchasing materials is elaborate and time-consuming. Hence, there is a tendency on the part of the management to maintain inventory at very optimistic levels of capacity utilization.

(*c*) The policy of playing 'very safe' is particularly followed in case of materials which are to be imported. Hence, the level of inventory of the imported items is generally on the higher side.

(*d*) Uncertainty about the availability of raw materials particularly in case of foreign collaborations, make the public sector undertakings to maintain high levels of inventory to prevent any stoppage of the production process.

(*e*) The management of public sector undertakings in general has not much exposure to financial management. The executives have a strong engineering orientation. As a result, they are not in a position to appreciate the principle of idle resources.

The study conducted by the Committee on Public Sector. Undertakings from time to time indicate that the inventory constitutes a major portion of the working capital of public sector undertakings. Even a marginal reduction brought about in the holding will repay the cost and efforts of such investigation. Hence, proper inventory management should be given top priority by public sector undertakings. Techniques like ABC Analysis and Value Analysis and Just in Time (JIT) can play a useful role in this direction. The Bureau of Public Enterprises can also provide necessary consultancy assistance in this respect.

(*v*) *Receivables policy*. Most of the public sector undertakings are not in a position to have an optimum receivables policy by manipulating the various variables like discount rate, credit period, credit standards, etc. This is because either they sell bulk of their output to the government or their output is always in short supply.

NOTES

16.8 AGENDA FOR THE PUBLIC SECTOR

The public sector enterprises are subject to severe criticisms from all quarters. They were expected to be a model for industry in technology, efficiency, innovation and serving public interests. However, they are now considered to be a drain on the national resouces and are placed at top in corruption and inefficiency. It will be therefore of interest to the readers to identify the causes of their such a sorry state of affairs and see if there can be a case for their improvement.

Causes. The following can be identified as the causes which have landed the public sector enterprises in the present difficulties :

(*i*) Profit as not the sale motive

The public sector undertakings have not been set up with profit as the main consideration. As a matter of fact, a large number of public sector undertakings with huge manufacturing capacities have been set up in the core sector, like power, steel, aluminium, copper, heavy machinery, etc. to make India a self-reliant economy. There were also industries involving large investment, long gestation periods in project implementation and consequently long periods of waiting for securing returns on investment made. For instance, the decision to go ahead with the setting up of Bharat Heavy. Electricals Limited at Bhopal was taken even when the feasibility report estimated that the rate of return on the project could be as low as two per cent on capital employed.

(*ii*) Price Controls

Many of the products made by the public sector undertakings like steel, paper, power, coal, fertilizers, were subject to price controls to meet the social objectives of making the above products available at reasonable prices to the general public. As a result, conditions never existed for the public sector undertakings to become vibrant and self-sustaining organizations.

(*iii*) Non-economic consideration

Decisions regarding setting up of new projects or diversification of the existing projects in the public sector have been on considerations other than economic. If this would have

Check Your Progress

3. When was the high-powered Public Investment Board (PIB) set up?
4. What was renamed as Ministry of Disinvestment in September, 2001?

been done on economic considerations, this would have ensured their viability and competivity in the overseas market. For instance, a few units especially relating to products like heavy machinery based on Russian technology, turned out products which were not efficient either in the use of energy or other inputs. Similarly locational decisions regarding setting up plants of Cement Corporation of India were made without keeping in mind the economic viability of the proposals.

(*iv*) Time and cost over-runs

Red tapism, bureaucratic hurdles, etc. have resulted in time and cost over-runs of unbelievable magnitude in case of a number of public sector projects. This has damaged their viability to an extent that they have become prematurely sick.

(*v*) Social objectives

The government in its unrestricted enthusiasm to meet social objectives, *viz*., maintaining employment, helping poor and the downtrodden, etc., nationalized many loss making units without bothering about the enormous burden both in the managerial and financial terms involved in such an action. The large number of sick mills in the fold of National Textile Corporation (NTC) bear eloquent testimony to this fact.

(*vi*) Lack of adequate autonomy

The public sector undertakings lack adequate autonomy in planning both their current and future operations. They are subject to a number of government restrictions which is a hindrance for their top management to take proper steps for initiating radical measures to put public sector undertakings on a viable footing.

(*vii*) Lack of funds

The public sector undertakings are suffering from lack of funds because of two reasons: (*i*) most public sector undertakings are making losses and hence do not have sufficient funds for ploughing back; and (*ii*) the budgetary support from the government is declining year after year. As a result, many public sector undertakings do not have sufficient funds needed for modernization and upgradation of technology, to improve their efficiency and also meet the competition from the private sector enterprises.

Thus, problems of public sector undertakings are not of their making only. The government is also responsible to a great extent for their dismal performance. However, it has been accepted by all that the public sector undertakings exist and will continue, to exist for several more years to come. They cannot be dismantled or sold off instantly. Hence, there is no option except to improve the performance of the public sector undertakings.

Suggestions for Improvement

It will not be out of place here to state the expectations from the public sector undertakings at this juncture before suggesting measures for improving their performance.

The expectations from the public sector undertakings are:

(*i*) They should add to government revenues by substantial profits.

(*ii*) They should not add to the internal financial deficits in the form of losses and subsidies.

(*iii*) They should reduce foreign exchange outflow by indigenisation and import substitution.

(*iv*) They should help in improving the balance of payments position.

(*v*) They should provide quality goods and services at reasonable price and serve as a model for private enterprises.

The above objectives can be gainfully achieved if the following aspects are taken care of.

1. *Objectives*

The objectives of the public sector undertakings have to be redefined. They have been so far taken as an instrument for fire-fighting operations of a diverse nature. The government has so far used for achieving certain social objectives which have resulted in heavy financial losses to them. As a matter of fact, it is difficult to believe how a social objective is achieved by a public sector undertakings if it becomes a drain on social resources. An undertaking with increasing losses can hardly serve anyone—the consumer, the State, or the society. Economic objective should, therefore, be the main objective of public sector undertakings. The social functions should be the responsibility of the Central Government, State Government, local authorities and the community at large.

2. *Structure*

The public sector undertakings have inherited a wrong structure which is unsuitable for a business undertaking. This is largely because the structure was established by the government bureaucrats in the ministries or the government departments. The procedural delays, redtapism, non-specialized and under-worked staff, have all resulted in inefficiency and corruption at different levels of the public sector undertakings. The structure of the public sector undertakings needs thorough overhauling and given a business—like outlook and approach.

3. *Capital, control and management*

In a private sector enterprise the ownership is divorced from management. The shareholders are mere rentiers of capital. The overall control vests in the Board of Directors. However, day-to-day decision-making is with the professional executives who have complete freedom regarding their operations. In a public sector undertaking, capital, control and management all vest in the government. As a result the business of the public sector undertakings is not conducted in a professional manner. There is government interference at all levels of their functioning.

It is suggested that the government should invest in a public sector undertaking only during early gestation stage of the enterprise. It should later on dis-invest its shareholding. This will be beneficial in two respects: (*i*) it will relase funds for establishment of a new public sector undertaking; and (*ii*) it will make the public sector undertakings more responsive to the general public. Mr. Prakash Tandon, distinguished and noted professional manager, suggested as back as in 1984, the reorganization of the shareholding of a public sector undertaking as follows:

Government 25 per cent; Employees 5 per cent; Financial Institutions 10 per cent; Consumer Organizations 20%; and General Public 40 per cent.

A small beginning in this direction has already been made with the government's decision to disinvest a part of its shareholding, as discussed earlier in the chapter.

At present public sector undertakings are largely governed by the Companies Act which is not of much relevance to them. It may be proper to enact a separate legislation applicable to public sector undertakings in general.

4. *Board of management*

A public sector undertaking may have a two-tier Board system:

(*i*) *Supervisory Board*. This may consist of eminent public personalities, experts from relevant field of science and technology, members of parliament, persons from consumer organizations and industry, Financial institutions and the head of concerned public sector undertaking.

(*ii*) *Managing Board*. This may consist of professionals who are fulltime officials of the concerned undertaking. Staff union representatives may also be made members of this board to develop a sense of responsibility and involvement in them. Such a system would abolish the need for the present multi-farious control in the form of Bureau of Public Enterprises, the Public Undertakings Committee, the Public Estimates Committee. the Comptroller and Auditor General, etc.

The supervisory board may conduct an appraisal review once in two years to examine and satisfy whether public sector undertaking is moving in the desired direction.

5. *Culture*

The public sector undertakings today are largely enjoying some or other type of protection from the government. Their capacity to innovate and work on competitive basis has got daunted because of almost complete absence of competition from the private sector. The consumer has been pushed to a position of complete helplessness since he has no choice to make. He has to accept the lowest quality of the product or services at the highest price. This culture has to change. The public sector undertakings should know where they stand and what is expected from them. It may be noted that the persons managing the public sector and the private sector both are of Indian origin but their performance in the two sectors is different. This is perhaps the Indian work culture is impediment to better efficiency.

Government move for strengthening of Public Sector. The Government has taken the following two steps for strengthening and reforming the public sector enterprises (PSEs).

1. ***Board for Reconstruction of Public Sector Enterprises (BRPSE).*** The government has decided to establish a Board for Reconstruction of Public Sector Enterprises (BRPSE) to advise the government on ways and means for stengthening public sector enterprises (PSEs) in general and to make them more autonomous and professional. The Board would consider reconstructing financial organizational and business - of central PSEs and suggest ways and means for funding such schemes. The Board would also advise the government on disinvestment/closure/sale in respect of chronically sick/loss making companies, which cannot be revived.

2. ***Listing of unlisted proftable PSEs.*** The government has also given ‘in principle’ approval for listing of currently unlisted profitable PSEs each with a net worth in excess of Rs 200 crore through an initial public offer (IP0), either in conjunction with a fresh equity issued by the PSE concerned or independently by the Government on a case by case basis, subject to the residual equity of the government remaining at least 51 per cent and the Government retaining management control of the PSE.

3. ***Green Field Privatization***. This term is used for the process of reducing involvement of the State or the public sector in the nation’s economy. Private sector is encouraged to play a more prominent and larger role in the industrial development of the country. The process of liberalization, which started with the introduction of the new economic policy in 1991 has given a considerable push to the policy of green field privatization. The following steps taken by the government are worth mentioning in this regard:

(*i*) The number of industries which do not require licensing is constantly on the increase.

(*ii*) The budget allocation for the public sector enterprises is constantly on the decline.

(*iii*) Indian economy is being constantly opened up for foreign direct investment and external aid.

(*iv*) Both the public and the private sectors are being given level playing field in respect of duty structure and providing of basic inputs.

(*v*) Decision-making system in public sector is being made more expedient and on commercial lines.

As mentioned earlier, the government has set up a separate Department for Disinvestment under the Ministry of Finance. A number of public sector companies have already been disinvested. They include: Maruti Udyog, Hindustan Zinc, NEPA Ltd., Jessop & Company Ltd., Hotel Corporation of India Ltd. Many more companies are on the list of disinvestment including two government airlines - Air India and Indian Airlines. Moreover, a large part of the public sector which may be termed as '*Commercial Component*' is being converted from statutory companies to companies registered under the Companies Act. They include companies in the power sector, telecommunications, financial institutions, etc. There is no denying the fact that the privatization of public sector enterprises holds the key to get out of the fiscal deficit mess. However, green field privatization will depend on the political will and support from all major political parties.

From the above discussion, it is apparent that restructuring and reforming of public sector undertakings involve a number of dimensions, *viz*., economic, social, managerial, financial, etc. The task is really stupendous. However, it can now no longer be delayed since this will make the matters more complex and irreversible. There has to be a national consensus on this issue involving all politicians, labour unions and the general public. The public sector has to be given a new shape, design and role, keeping in mind the fact that our economy has to be integrated with the global economy. Past errors of omission and commission should not work as deterrents, but rather guide us to make the public sector enterprises innovative and well prepared to face the challenges of the 21st century. This was also well stated in the Industrial Policy Resolution of 1956. It pointed out: 'Speedy decision and a willingness to assume responsibility are essential if these enterprises are to succeed. For this, wherever possible, there should be decentralization of authority and their management should be along businessline. It is to be expected that public enterprises will augment the revenues of the State and provide resources for further development in fresh fields.

16.9 SUMMARY

Meaning of Public Sector Enterprise

A public enterprise may be defined as a business undertaking which is owned, managed and controlled by the State, on behalf of the public at large.

Characteristics of Public Sector Enterprises

(*i*) State ownership

(*ii*) Service motive

(*iii*) Public accountability

(*iv*) Government control

NOTES

Check Your Progress

5. State the reasons for the lack of funds in public sector undertakings?
6. Why has the Government decided to establish a Board for Reconstruction of Public Sector Enterprises (BRPSE)?

Objectives of Public Sector Enterprises

The objectives of public sector enterprises may be divided into three categories:

(*i*) Economic objectives

(*ii*) Social objectives

(*iii*) Political objectives

Forms of Public Sector Enterprises

Public sector enterprises may be organized in to any of the following forms:

(*i*) **Departmental Undertakings:** Under this form, an enterprise is organized as a wing of the normal government machinery. The enterprise is managed by government officials as one of the government departments.

(*ii*) **Public Corporations:** A public corporation or statutory corporation is a corporate body set up under a special statute.

(*iii*) **Government Company:** A government company is that in which not less than fifty-one per cent of the paid-up share capital is held by the Central and/or State Government.

(*iv*) **Holding Company:** Under holding company form of organisation, a single parent or apex company exercise control over all public enterprises belonging to one particular industry.

Distinctive features of Financial Management

The following are some of the distinctive features concerning the financial management of public sector enterprises:

1. **Role of Financial Adviser:** The financial adviser occupies an important position in all public sector undertakings. He functions as the principal adviser to the chief executive of the enterprises on all financial matters. His concurrence is required regarding all financial implications of the proposals put forward before the board of directors.

2. **Capital Budgeting Decision:** In order to ensure proper evaluation and implementation of the capital budgeting decision, the following points are to be given due consideration:

(*a*) Guidelines provided by the government

(*b*) Delegation of investment decision-making power

(*c*) Approval of public investment proposals

3. **Capital Structure Decision:** The following are the special features regarding capital structure decision in case of public sector enterprises:

(*i*) **Role of cost of capital:** In a public sector enterprise a large portion of the funds is provided either by the government or by the institutions controlled by the government. The cost of capital does not play an important role in determining the capital structure of a public sector enterprise.

(*ii*) **Debt-equity mix:** The first government guidelines regarding debt-equity mix was issued in June, 1961, providing a debt equity mix of 1: 1. However, the debt-equity mix in case of public sector enterprises/ undertakings should be based on the following parameters:

(*a*) Gestation period

(*b*) Degree of Business Risk

(*c*) Capital Intensity of the Project

(*d*) Availability of Freedom as to Pricing (*iii*) **Sources of Finance:** The main sources of finance of a public sector undertaking are as under:

(*a*) **Equity Shares:** Traditionally this has been a major source of finance of public sector undertakings.

(*b*) **Loans:** Public sector undertakings have also been getting substantial loans from the government to meet their requirements of long-term funds.

(*c*) **Bonds:** The raising of funds through bonds or debentures by public sector undertakings is of recent origin.

(*d*) **Retained Earnings:** This has not been a major source of long-term finance of public sector undertakings, since the performance of most of the public sector undertakings in terms of profitability has been extremely poor.

(*e*) **Disinvestment:** The term 'disinvestment' implies sale of the shareholdings to the extent required. The onset of liberalization process in 1991 brought a revolutionary change in the government's policy towards the public sector enterprises. It is taking effective steps for reducing its involvement in providing funds to the public sector enterprises through disinvestment of its holdings in the public sector enterprises.

Agenda for Public Sector

The public sector enterprises are subject to severe criticisms from all quarters. They were expected to be a model for industry in technology, efficiency, innovation and serving public interests. However, they are now considered to be a drain on the national resources and are placed at top in corruption and inefficiency.

Causes: The following can be identified as the causes which have landed the public sector enterprises in the present difficulties:

(*i*) Profit as not the sole motive

(*ii*) Price Controls

(*iii*) Non-economic consideration

(*iv*) Time and cost over-runs

(*v*) Social objectives

(*vi*) Lack of adequate autonomy

(*vii*) Lack of funds

Suggestions for Improvement

The following measures are being suggested for improving the performance of public sector undertakings:

(*i*) **Objectives:** Economic objective should be the main objective of public sector undertakings. The social functions should be the responsibility of the Central Government, State Government, local authorities and the community at large.

(*ii*) **Structure:** The structure of the public sector undertakings needs thorough overhauling and given a business-like outlook and approach.

(*iii*) **Capital, control and management:** It is suggested that the government should invest in a public sector undertaking only during early gestation stage of the enterprise. It should later on disinvest its shareholding.

At present, public sector undertakings are largely governed by the Companies Act which is not of much relevance to them. It may be proper to enact a separate legislation applicable to public sector undertakings in general.

(*iv*) **Board of management:** A public sector undertakings may have a two-tier Board system:

(*a*) **Supervisory Board:** This may consist of eminent public personalities, experts from relevant field of science and technology.

(*b*) **Managing Board:** This may consist of professionals who are full time officials of the concerned undertaking.

The Supervisory Board may conduct an appraisal review once in two years to examine and satisfy whether public sector undertaking is moving in the desired direction.

(*v*) **Culture:** The public sector undertakings today are largely enjoying some or other type of protection from the government. This culture has to change. The public sector undertakings should know where they stand and what is expected from them.

From the above discussion, it is apparent that restructuring and reforming of public sector undertakings involve a number of dimensions, *viz.*, economic, social, managerial, financial, etc. The task is really stupendous. However, it can now no longer be delayed since this will make the matters more complex and irreversible. The public sector has to be given a new shape, design and role, keeping in mind the fact that our economy has to be integrated with the global economy.

16.10 KEY TERMS

- **Public Sector Enterprise:** It is a public enterprise may be defined as a business undertaking which is owned, managed and controlled by the State, on behalf of the public at large.
- **Public Corporation:** It is a corporate body set up under a special statute.
- **Government Company:** It is a company in which not less than fifty one per cent of the paid-up share capital is held by the Central and/or State Government.
- **Disinvestment:** It is a 'term' that implies sale of the shareholdings to the extent required.

16.11 ANSWERS TO 'CHECK YOUR PROGRESS'

1. In the establishment and operation of public enterprises, financial resources are provided from the State exchequer.
2. The objectives of public sector enterprises may be divided into three categories:
   (i) Economic objectives
   (ii) Social objectives
   (iii) Political objectives
3. The Government of India set up a high-powered Public Investment Board (PIB) in 1972.
4. The Department of Disinvestment, set up in December 1999 was renamed as Ministry of Disinvestment in September 2001.
5. The public sector undertakings are suffering from lack of funds because of two reasons: (*i*) most public sector undertakings are making losses and hence do not

have sufficient funds for ploughing back; and (*ii*) the budgetary support from the government is declining year after year.

6. The government has decided to establish a Board for Reconstruction of Public Sector Enterprises (BRPSE) to advise the government on ways and means for stengthening public sector enterprises (PSEs) in general and to make them more autonomous and professional.

16.12 QUESTIONS AND EXERCISES

Short-Answer Questions

1. Explain the IRR method of evaluating a public sector undertaking.
2. Define Government Company.
3. What are the various objections of Public sector interprises?

Long-Answer Questions

1. Define a public sector undertaking. What are its characteristics and objectives?
2. Explain the different forms of public sector enterprises.
3. Discuss the special features of financial management in public sector enterprises with reference to (*a*) capital budgeting decision and (*b*) capital structure decision.
4. Explain the role and functions of financial adviser in the financial management of public sector enterprises.
5. Write short notes on strategic financial planning in the public sector.

16.13 FURTHER READING

Maheshwari, S.N. *Elements of Financial Management*. New Delhi: Sultan Chand & Sons, 2008.

Maheshwari, S.N., S.K. Maheshwari, Sharad K., *A Textbook of Accounting for Management*. New Delhi: Vikas Publishing House, 2010.

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