REVIEWS

Public Enterprise Investment Decisions in India. A. B. C. Raj. Delhi, Macmillan, 1977. 235p. Rs. 58.00

Dr. Raj deserves congratulations for producing a timely book on a subject which is largely covered in mystery. The book provides a penetrating insight into the inner corridors of decision-making in the sphere of Project Evaluation and Capital Budgeting in Government undertakings. In doing so the author's research has carried him through numerous interviews, discussions and communications with the various powers-that-be in public sector investment proposals. The result is an enriched experience in the sphere of decision-making, or perhaps better called non-decision-making, in a vital area of public sector financial planning.

Dr. Raj's book has ten chapters which cover the role of public sector enterprise in India's economy, guidelines for capital expenditure decisions, organisation for capital budgeting decisions (are expenditure and budgeting treated synonymously?), criteria for selection of projects, issues and current practice in capital budgeting decisions, and finally, the author's views about better investment decisions for the future.

We may now share some of our reactions about certain crucial aspects of the work in a little more detail. On page 16 it is mentioned that trained civilian administrators are in comparatively better position to manage ventures than private citizens. However, later in page 105 the author seriously questions the 'superman' in the civil servant and his ability to pilot and monitor capital budgeting decisions. The contradiction seems to be rather awkward. Similarly, the performance of public enterprise is criticized in pages 22-28, and the following observation occurs on page 25 : 'in spite of higher financial leverage public enterprises have fared poorly in comparison to companies in the private sector'. It is somewhat confusing to put it in that way because high financial leverage is often in practice claimed by the public enterprise to be a cause for their showing loss. It was perhaps necessary to point out the parameter for which high financial leverage should have caused public enterprises to perform better. The argument is also made that private sector firms with equally high capital intensity have shown better returns than their public sector counterparts. Some relevant examples to substantiate this point should have been cited along with comparative data.

The next important issue on which the present reviewer has failed to comprehend the consistency of the author's thesis is with respect to 'value added' as a major indicator of public enterprise effeciency. It is asserted on page 25 that 'value added per unit of capital employed' is a better yardstick than return on investment. But no definition of 'value added' is provided. The study by the

Economic and Scientific Research Foundation has been quoted on page 26 which apparently regards value added as the sum of factor payments, that is, rent, wages, interest and profits. It is claimed that capital investment decisions based on value added criterion would ensure channelising investments in the right directions. The author reverts to the value added concept in chapter 10 once again. On page 195 it is postulated that the objective of public enterprises should be the maximisation of net present worth of shareholders wealth which, for such enterprises, is maximisation of national income. Then it is argued that maximisation of national income would lead to maximisation of individual wealth since as citizens they hold equal shares in their public enterprises. This observation does not seem to be shared by many other students of economic development who assert that maximisation of G.N.P can very well be, and is, accompanied by the phenomenon of rich getting richer, and the poor becoming poorer.

The author further adds on the same page that public enterprises should aim at maximising production of goods and services at minimum cost, so that maximum output is achieved with least possible inputs. Here we run into a serious problem. After all what are the inputs made of? Obviously, they consist of wages and salaries, rent, interest and materials cost. If least cost to the enterprise is to be achieved then wages, salaries, rent, interest and materials have all be economised. But by doing so would not national income as measured by the sum of factor payments be reduced? The author reiterates his argument about maximum production at minimum cost on page 205. But a look at his example on page 215 once again shows that the confusion has not yet been resolved. In table 10.6 value added is shown as the sum of salaries and wages and profit which, in the example, are respectively 20.0 and 5.5. Supposing this net value added of 25.5 were made up as follows :

a) Rs. 50 lacs wages and salaries, plus Rs. 24.5 lacs loss, or

b) Rs. 10 lacs wages and salaries, plus Rs. 15.5 lacs profit.

In both these situations net value added is Rs. 25.5 lacs. Do these three situations mean the same thing from the enterprise efficiency point of view? According to the author's logic perhaps they would, because they also produce a 19.5 per cent rate of value added per unit of capital. In our alternative (a) will the author argue that Rs. 50 lacs being paid as wages and salaries has added more to national income as factor payment? Or would he say that the physical output of the firm has not been achieved at the least cost?

In our opinion the interpretation of value added in terms of factor payments seems to cause this unfortunate inconsistency. It might be more prudent to compute value added in a manner which is independent of the profit and loss elements. And this can only be done provided value added is taken to be the difference between sales proceeds (plus or minus adjustments in the stock position) and the throughput items like materials, power, fuel, etc. Only then one can talk of maximising value added by use of minimum inputs. Otherwise, two firms producing the same items and having the same level of capacity utilisation and material usage efficiency, could show up entirely different value added figures because of unbalanced wages structure, manning, capital structure and so on. In fact, it may lead to the ludicrous situation where higher the wages paid, interest incurred, rent paid and so on the more is the value added by the firm, although from the 'output to input' ratio viewpoint this will mean lesser efficiency.

We may also mention in passing that there is an inference on page 28 that the income differential between private and public enterprises is of the order of Rs. 27/- for every Rs. 100/- invested. But this income differential is derived from the income produced per Rs. 100/- of capital of only Hindustan Steel Ltd. And this compared against the same factor for the private sector as a whole. This is not a correct comparison.

The whole of chapter 3 is an interesting descriptive account of a project preparation manual which was developed by the American cosultant (Peat, Marwick and Mitchell of Boston), and circulated at the behest of the Planning Commission. There is not much of critical evaluation of the manual in this chapter. This chapter interestingly highlights on page 52 the manual's opinion that the national economic benefit analysis be presented as the absolute difference between the aggregate benefits and aggregate cost, rather than as a ratio of the two variables. This idea of the manual challenged by the author later in chapter 9. The author argues on page 193 that the difference measurement implicitly assumptions the fact that incremental investment in one project has no alternative use, and hence the ratio is not a correct measure. The author is right in contending that capital being scarce in a country like India, alternatives do exist and, therefore, the benefit cost ratio is better than the absolute difference suggested in the manual.

Chapters 4 and 5 reveal the whole wealth of intricate inter-departmental, inter-ministerial muddling through with respect to capital budgeting. The author rightly argues on page 61 that it would be wise to appoint the chief executives and financial advisers of new projects at the time of conception of such project and the preparation of the feasibility reports. The system of financial advisers being appointed by the Government, and working as watch dogs by reporting directly to the administrative ministry is also aptly criticised in pages 62-67. But the author perhaps carries his argument a bit too far in saying that even the best Schools of Management do not differentiate between finance and accounts. The author also points out on pages 73-74 the lack of rationale for the revised delegation of financial powers to the Boards of public sector enterprises. However, one would have liked to have his suggestion on this point which is missing. In pages 82-83, the author critically reviews the organisation structure of the Bureau of Public Enterprises. It is true that Marketing, Personnel and Industrial Relations are not indicated as such in the structure. But we find there is a general management division in it. One wonders what is its role. The author has not written anything about this. Similarly the author ends chapter 5 (page 107) by suggesting that the training needs of civil administrators should be identified on different lines than those existing today. Once again one would have liked to know from the author his views about a desirable training scheme — at least in so far as financial and capital budgeting decisions are concerned.

In chapter 6 the author argues strongly that a major reason for confused capital budgeting in public enterprises is the lack of enterprise-level objectives and goals (pages 108 and 109). In the next couple of pages the author uses a number of expressions like 'general objectives', 'macro objectives', 'profit objectives', 'proposed objectives'. While reviewing we ourselves could not appreciate the intent of the author in using several such qualifying words for the term 'objective'. A statement like (page 110) "a manager thus is unable to see at the enterprise level whether the proposed objective would help attain the commanding heights of the economy" does not seem to convey much. Is it the chief executive of the organisation or, is it a manager at any level within the organisation that the author has in mind ? A little later on page 111 the following sentence occurs : "in the interviews we conducted, the various criteria for undertaking investments mentioned were : sufficient demand for the product, operational requirements, financial justification, and priorities fixed by the top management. This indicates that there is no goal congruence and there is neither goal specificity nor role clarity". We really could not make out the import of this sentence. One would perhaps have been helped to understand the author's view if the levels in the hierarchy to which the interviewees belonged were mentioned.

The author takes to task the DGTD for its lack of proper demand assumptions, and consequent sanction for raising installed capacity, while demand steadily continued to fall. The author shows that two new plants put up by the Hindustan Machine Tools Ltd. are redundant (pages 112 to 116). It is indeed shocking to know that during his interviews the author found not a single executive to be aware of national economic benefit analysis and its purpose (page 121).

In the same chapter the author rightly points out from a certain public sector project proposal the omission of working capital for computing total investment and ROI. However, the author's argument that depreciation has not been charged may not be correct, for overheads @ 1000 per cent most probably would have included this. And, it is not understood why depreciation should be added back for ROI calculation, which is what the author argues for (page 123). A little later while we agree with the author that it is not correct to add back interest for computing cash flows on the logic of the enterprise, we also do not agree with the author's own argument for deducting it. For, if the discount rate of 12 per cent represents the cost of capital, then it includes interest as a component cost element. Therefore, there is no need to deduct interest to derive cash flows, which will mean a sort of double counting.

We agree with the author about his contention as to why we export at such great cost — especially when the foreign exchange so earned is largely used for importing capital goods (page 137).

A reading of pages 149 to 153 seems to convey that the author is advocating the 'cost centre concept', and rules out the 'profit centre' notion for public enterprises. The latter is only relevant, according to him, to capitalistic, free enterprise, private entrepreneurs. Raj argues that positive variance from physical targets of public enterprise would mean efficiency, and negative variance inefficiency. Does not the author make a big assumption that these targets are always correctly pitched ? If targets are low then positive variance will occur more often than when targets are high. What will be our verdict in such situations ? Secondly, the author argues that 'a firm fulfilling its physical targets, working at its standard cost of operations, would neither report profit nor loss but would have earned all the costs inclusive of capital and depletion cost'. The most important point about this statement is standard cost at what capacity level ? A physical target at a low level of capacity utilization will have an associated high level of standard cost if the latter is computed by taking the fixed cost of the full installed capacity. Would this standard cost be an indication of efficiency ? Moreover, it is difficult, if the cost centre logic is accepted, to see how any concern with pricing of the products is then at all relevant for project evaluation for public enterprises.

In chapter 10 (pages 210 to 212) the author does well to show how cost of capital and funds beloging to the Government could be computed according to the Eckstain model, and how a six-fold classification of public sector projects could make use of this cost of capital (which the author computes to be around 8 per cent). This portion is a useful contribution. The author is also able to use Marglin's social discount rate (that is, the growth rate estimated in the five year plans). We, however, could not fail to notice in the author's example on page 213, the necessity to work with selling price, revevue income and similar variables for computing the IRR of projects. The author might well have cleared the confusion on this issue by pointing out as to whether the cost centre concept suggested by him in chapter 7 is only for established, running enterprise ; whereas the revenue concept, and therefore pricing, are relevant only for a new project.

All in all the book feeds the reader with a considerable amout of knowledge and fresh insights into the thorny area of capital expenditure budgeting in the public sector. It is worthwhile for students, as well as managers and administrators.

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Backward Area Development—Strategies & Policies : Role of Financial and Promotional Institutions. (Proceedings of a seminar). New Delhi, Management Development Institute. 303 p. Rs. 30.00

"Balanced regional development is now an accepted basic objective of economic planning in India". It is a regret that 'the results to date of various measures appear to have been hardly commensurate with the efforts and resources expended' — ... hence the proceedings of the First Seminar on BACKWARD AREA DEVELOPMENT, STRATEGIES AND POLICIES : Role of the Financial and Promotional Institutions, held at the Management Development Institute, New Delhi, from 23rd to 25th April, 1976 (credited with the participation of top executives of financial