

# Performance Evaluation of Public Enterprises: A Socio-Economic and Managerial Approach

By

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Public Enterprises occupy a strategic and crucial position in the Indian economy. It would be no exaggeration to say that the economy would sink or swim depending upon the efficiency with which these enterprises operate. Though public enterprises are about 2% of the total enterprises in the corporate sector, they constitute about 70% of the paid up capital of the corporate sector.

It is a common knowledge that the profitability of public enterprises, in total, is not comparable to that of the *successful* private enterprises. According to a provisional estimate during 1984-85, 84 enterprises have incurred a loss of Rs. 1305.15 crores thereby reducing the profit of 105 enterprises (2261.27 crores) to a net profit of Rs. 956.12 crores only. This has attracted criticism for a long time and has acquired greater importance with the present government committing itself not to allow the public enterprises to incur losses. "We are not here to squander the money of the poor people. We must not let that happen" said Mr. Rajiv Gandhi. The Budget (84-85) has envisaged over Rs. 6000 crores by way of internal resources and the Finance Minister said that the public sector must gear itself to the task of generating these resources. On the other hand the planning commission has approved an outlay of Rs. 1,80,000 crores for the public sector in the seventh plan.

The union Minister for Industry Sh. N. D. Tewari called upon the public sector enterprises to draw up time-bound programmes for increasing production and profitability

because the seventh five year plan has placed great responsibility for generating the public savings, almost wholly, through public sector undertakings.

Shri T. Anjaiah, Minister of State for Labour said that higher production should be achieved through better capacity utilization and higher productivity rather than additional investment.

### **Non Comparability between the two Sectors**

Though public enterprises are expected to follow methods and techniques developed by private enterprises yet the two cannot be equated on account of the following reasons :

“...the real difficulties arise when either out of sheer desperation or as a part of wilful design the efficiency of all public undertakings is sought to be tested with the profit norm which is primarily a laissez-fair encumbrance and relevant only to conditions a pure competition which invariably are non-existent.”

In such a situation high profit is not a sign of efficiency but of a disequilibrium monopoly. It is argued that even in private sector ‘Profit’ alone is not measure of success.

One of the important development in the last several years is the acceptance of social responsibilities by the private sector enterprise. It is no longer fashionable for the business corporation the world over to take gleeful pride in making money. What is more fashionable is to show that it is a great innovator, more a specifically a great public beneficial and very particularly that it exists to serve the public. But it is largely another method of advertisement meant to keep up the rate of return, if not to increase it.

A public enterprise which is located in a backward region which is economically not viable or an enterprise for which an unprofitable technology has been chosen, (due to national or political exigencies) cannot be expected to be commercially profitable. Against the naphtha based technology available in the international market, we have opted for coal-based technology from East European Countries, for some of our fertilizer plants.

Public enterprises operate under a blaze of publicity. Reports from CAG and from the Parliamentary committees, in addition to those from other diverse sources are enough to expose the weak spots of any P. E. The contrast with the immunity enjoyed by private enterprises in this regard, is indeed a marked one. In a private enterprises the son is expected to follow his father's footsteps otherwise it is taken as a mark of eccentricity or possible madness while the same will not be tolerated in a Public Enterprises. The fact that the public at large feels a sense of proprietorship over P.E. adds to the problems. It is not only expected to fulfill the letter of the law but also its spirit.

The establishment and continuance of a P.E. is a political decision and its operations are controlled at strategic points by a system where the politicians have the final say.



"It is not often realised how the general level of corruption has lowered the comparative efficiency of public enterprises, which, for instance, cannot take the advantage of the 'open market' to meet their needs of raw materials which are subject to price restrictions. In private enterprise, shortage of scarce raw materials does not often affect the continuity of production as it could in a public enterprise. Lack of 'Slush Funds' directly affects public enterprise's performance. A few of the examples brought to the notice of the author may be cited here. A repairing shipyard found itself helpless in greasing the palms of the Captain of the vessels to be repaired, to the extent of 1% of the repair bill, as per the accepted international practice. In another case, the engine driver for coal loading wagons became a stickle about the time fixed for loading the wagon, unless obliged in the usual way. In a port, the crane operators would refuse to show the required priority for difficult shipments, delaying movements, unless their palm is tickled.

Public Enterprises are trying to meet the situation through feeble means like nominal entertainment allowances to top executives and in some cases by permanently stationing their clerks, stenographers and officers in the ministries and allowing benefit of company transport to concerned officials .... But such normal business dealings were exposed by the govt. audit."

Mr. S. N. Sinha in his paper 'Contribution of Public Sector undertakings to General Revenue calculated the total returns to the public exchequer by way of dividends, interest and taxes. Benefit of lower prices enjoyed by govt organisations is another point.

According to R. L. Patale the products of govt. activities affect the level of profitability in the private sector and therefore analysis of public sector performance by itself may not be correct. Investment of the govt in railways, steel, engineering, chemicals and petroleum sectors are some of the examples of it. The supply of electricity at low prices to industrial concern and supply of water for irrigation at 'No Profit No Loss' basis by DVC or of cheap credit by the S.F.Cs are examples of deliberate policies of low profits. In such cases, although parental undertakings sustain losses in their earnings, yet they bring far greater gain to the economy as a whole.

According to FICCI, it is true that the effort of private enterprise has been supplemented by the public sector in the field of infra-structure in which profit motive is weak or the requirements of resources is too large.

Public sector in the developing societies has to provide the infra-structure, social overheads, capital and lay emphases on pioneer investments in addition to supplementary and regulating activities of private sector with the object of accelerating economic growth consistent with the socio-economic objectives of economic policy.

Moreover size of a public enterprise is comparatively very large involving complicated managerial problems and the public accountability of a P.E. makes the management 'procedure oriented' rather than 'result oriented'.

It is also suggested that 'Attempts.....should be made to quantify.....the social costs of the commercially profitable projects and services, e. g. the cost of smoke emitting power stations and noisy aircraft should be quantified and added to their commercial costs in appraising investment in such projects.

It should not be forgotten that a large number of companies in the private sector are struck off from the Register by the registrar every year. Loss of investment of a large number of shareholders, waste of country's resources, consequential unemployment inconvenience to the consumer through the closing down of these companies are not taken into account while comparing the performance of the public enterprises, with that of the private enterprises.

### Collective entity

Public enterprises are an instrument of public policy, it is therefore, necessary to evaluate their performance as a collective entity.

An irrigation project may be judged more by the total average for which assured water supply becomes available, the post office by the number of towns and villages served, a power house by whether it can insure an adequate supply of power for the growing requirements of agriculture & industry. Thus the appraisal of the public enterprises in a mixed economy has to be in the light of (a) its role in the provision of infra-structure (b) its role in helping the establishment of a socialist society and minimising the concentration of economic power and (c) its role in developing backward regions (d) its role in providing customer's satisfaction (e) its role in research developments (f) its role in developing effective managerial styles for long term success of the enterprise. Development is a crucial criterion of productive efficiency. It has to be objectively calculated as to how much of the planned output has been achieved from year to year by individual public enterprises.

".....In a sense development (is a) more important criterion than over all profitability for the mature corporation in the private sector, as well as the monopolistic or oligopolistic state corporation, in as much as, the techno-structure i. e. the brain of the enterprise including the top executives and experts of a corporation, is more interested in the development of the corporation than profits for the unknown shareholders or anonymous govt., who are the legal owners".

According to Florence and Walker "the prime measure of efficiency of a public enterprise is slightly more than breaking even at the greatest possible aggregate of production." Social purpose, therefore should receive due weightage in any scheme of evaluation but economic viability is also in itself, a social purpose.



## **Economic Viability**

In case of many statutory corporations the parliament has laid down that they should act on 'business principles'. That clearly emphasizes the need of economic viability. This requirement of economic viability is further strengthened by the fact that most of the enterprises have been established as Joint stock companies so that they can have autonomy in their operations like private enterprises.

Should economic viability be equated with profit? Because profit is the difference between price and the cost of production. Low profits may be because of low prices or higher cost of production. 'No profit no Loss' was the hallmark of the pricing policy of the public enterprises till the beginning of the third plan. It is the draft of the third plan that envisaged that the profits should be large enough for "financing the expansion programmes of these enterprises" Thus low profits, to the extent, they were the result of lower prices, on account of govt. policy, should not be a measure of the efficiency of a public enterprise. But if it is a result of the higher cost of production, compared to the average of the industry or the standard cost (in case of a monopoly enterprise), it is the reflection of lower efficiency.

## **Dynamics of Management**

"Efficiency in the final analysis depends upon the quality of the management, including its vitality and dynamism." According to Peter F Drucker, managers are the basic & scarcest resource of any business enterprise.

Most underutilised resource in any organization is the capacity of people to improve their performance in a creative and an imaginative way.

Positively motivated work force is an asset. Positive motivation is an investment that yields return in the long run. High standards of productivity cannot be maintained without positive motivation.

Negative motivation is frustration and depression. Frustration leads to aggressiveness like strikes, sabotage, theft. Depression leads to apathy, alienation, low morale.

Poor motivation will cause low productivity, absenteeism and higher turnover.

It is generally known that the incidence of conflict between executives and employees in public enterprise is not very high. At the same time, mutual trust, cooperation, motivation, productivity, commitment, morale are not too high. Attitude of indifference, alienation, hostility and confrontation are quite common, resulting in low productivity. Employees in the public sector view their management as unsympathetic, wooden-headed, rule-bound,

insensitive to human considerations and inefficient. The executives are usually perceived by employees as 'status conscious' and averse to cooperative working.

An ineffective management style may lead to increased activity in the short run but may destroy the morale and climate of the organization. There may be increase in labour turnover, absenteeism, accidents, and grievances.

"So long as undefined and undetermined mixing up of non-economic and economic variable continues, efficiency evaluation would remain elusive"

### The Task

The task therefore is to measure both the 'Public' & the 'enterprise' aspects of a public enterprise.

There are three ways in which the economic and non-economic variable can be defined and taken into consideration.

I. Determination of the cost of social obligations and the Govt. compensating the public enterprise for the same.

The British Select Committee on Nationalised Industries was of the view that govt. as the custodian of social and public interest should earmark the social obligations, that a public enterprise has to follow, defining its nature and the extent to which it should be fulfilled, so that the enterprise concerned is accountable to the Parliament for the same. The enterprise concerned should receive financial compensation for such obligations so that evaluation of performance, then, can be made on commercial principle. This involves quantification, in money value, the external costs that an enterprise has to incur on, or of the benefits that an enterprise has to forgo on account of the social purpose. It is of interest to note the instances of uneconomic obligations imposed on British Public Enterprises for which they were compensated : the National Coal Board was reimbursed the losses incurred in deferring the closure of certain unremunerative collieries at the instance of the British govt., the London Transport which postponed fare increases was compensated for the consequential loss of revenue, and arrangements in the nature of capital reconstruction or suspension of interest charges were agreed for the British European Airways to compensate it for the Govt. refusal to allow it to purchase American Aircraft.

For a developed economy this criterion may have some merit but for a developing economy, provision of additional funds to an existing enterprise, for the purpose of evaluation of efficiency, would be less advisable.



II. Investment of the Public enterprises on non economic objectives should be excluded from the total investment.

But this will not measure the effect of Public accountability, employment of scheduled cast and tribes people, developing backward regions, degree of morale and motivation level, communication system etc. are dynamics of management would be outside the scheme of devaluation of efficiency, which, we have already argued, should be measured together.

III. cumulative average of the percentage of the targets achieved

The object of this paper is to propose the calculation of a rate of return in term of the percentage of that which was expected of it or of the average of the Industry and to weigh it with the percentage achievement of the other non-economic goals (which should have been clearly defined) and also the managerial effectiveness (in term of human resources development, quality of management, degree of moral, motivation level of workers etc.) as shown in the chart 1.1.

PERFORMANCE APPRAISAL CHART 1.1

A. Achievements of Economic Goals

Evaluation

- |  |  |
|--|--|
| 1. Gross profit as % of sales  | % of the expected or standard target of average of the Industry. |
| 2. Sales as % of the total asset (fixed as well as working capital but excluding idle assets as well as investment in townships).                        |  |
| 3. Return on capital employed (Earnings before interest & taxes on capital to share as well as loan capital, excluding capital investment in townships). |  |
| 4. Cost of production per unit of output/service (in case of monopoly the landed cost of imported item should be the base).                              |  |
| 5. Total production in units.  |  |
| 6. Avoidance of Abnormal waste   |  |
| Volume of discarded scrap  |  |

Unit losses of energy

Labour turnover

Absenteeism

Preventive Maintenance.

7. Capacity Utilization.

8. Competitive prices.

Total (A)-----

9. Export Earnings.

Average (A)-----

**B. Achievements of other goals of the Enterprise**

1. Employment Targets.

2. Model Employer.

3. Employment of Scheduled Caste/Tribes.

4. Import substitution.

5. Provision of Infra-structure for Industrial Development.

6. Development of Backward region.

7. Research & Development programmes.

8. Saving Environment from pollution.

9. Customer's satisfaction.

10. Outside interference in performance.

Total (B)-----

Average (B)-----

Average (A + B)-----



## **C. Achievement of Managerial Effectiveness Goals**

### **1. Human Resource Development**

- a) Time taken in making appointment
- b) Competence of the people recruited
- c) On the job training facilities for freshers
- d) Further training facilities to improve the lot.

### **2. Quality of Management**

- a) Are managers aware of their external environment, policies and priorities of the organisation ?
- b) Are they aware of the economic, political social and technological trends likely to affect work unit ?
- c) Do they translate them into work unit activities ?

### **3. Degree of Morale of the Employees**

- a) of the managers
- b) of the supervisory staff
- c) of the workers.

### **4. Motivation level of the work force**

- a) of the manager
- b) of the supervisory staff
- c) of the workers.

**5. Organisational structure**

- a) Definition of Roles & responsibility
- b) Extent of Delegation
- c) Attention to time schedule of all activities
- d) Flexibility in resource allocation (so that men, money & materials are shifted to where they do the most good).

**6. Communication Network**

- a) Top to down—How clear
- b) Down to top—How effective
- c) Latest methods—Used or not

**7. Superior - subordinate relations**

- a) Satisfaction of Supervisor.
- b) Satisfaction of subordinates.

Total (C)-----

Average (C)-----

Average (A + B ÷ C)-----

Referring to item A-1 if the gross profit as % of sales in the industries is 20%, and the enterprise concern, has achieved a return of 18% then it is deemed to have achieved 90% of its target and the figure 90 should be written in the final column 'evaluation'. In case it is a monopoly enterprise then a standard should be laid down in the beginning of the year, and performance should be evaluated against the target. Similar should be the treatment of sales as % of the total assets, but in the calculation of total assets idle assets as well as investment in township should not be taken into account. Return on capital employed should be calculated on the aggregate of share capital as well as loan capital, because that is a better measure of efficiency of management. Here also the investment in township should be excluded. Cost of production per unit should be compared with that of the average of the Industry, and



in case of monopoly against the landed cost of similar imported article (sometimes this may also require adjustment on account of the peculiar conditions of the exporting country) or where standard is in operation, comparison may be made against the standard cost. For evaluating 'avoidance of abnormal waste', standards of normal waste have to be laid down. If the standards stipulate that 10% of the total material input has to be discarded and the concerned public enterprise has been able to keep this rate upto 10% only then it is deemed to have achieved a 100% of the target and the figure 100 should be written in the 'evaluation' column. If its scrap is 15% then a figure of 50 should be written in the final column. If its scrap is 20% then 'zero' will be written in the evaluation column. If scrap is 25% then (-50) should be written in the evaluation column. Hence the inefficiency on one account will correspondingly reduce the total achievement.

If the enterprise has been allowed to charge competitive prices then a figure 100 should be written in the evaluation column. If the prices are 20% below the market prices then a figure of 120 should be written in the final column so as to give due weightage. In case the prices are 20% above the average prices, the figure 80 would be written in the evaluation column (This is meant for private enterprises who may be charging higher prices than the average. This chart is proposed to measure the comparative performance of a private and public enterprise too).

Evaluation of all items in category 'A' be summed up and divided by the number of items to know the average evaluation. A figure above 80 in the opinion of the author should be regarded as a fair achievement. This evaluation can be done after the end of every accounting year, called an accounting period.

Similarly non-economic goals mentioned in category 'B' will be required to be quantified and percentage of achievement recorded in the 'evaluation' column. Services of technical experts, economists and management science experts will have to be obtained for the purpose. Evaluation for category 'B' goods can be done after every three years, called a short period.

Average of the average percentage achievements of goals 'A' and goals 'B' will be a better indication of comparative performance, in the short run. However for evaluating efficiency in the long run, 'Managerial effectiveness goals' as mentioned in category 'C' would have to be quantified and achievements recorded in the 'evaluation' column. A composite figure of evaluation as indicated by the averages of the averages of A, B and C, should indeed serve as a composite criterion of evaluating performance of a public enterprise in the long run that should be comparable to that of a Private enterprise.

Numerous problems are going to be faced in the quantification of various targets particularly the 'non-economic' goals and still more as regards the 'managerial effectiveness goals'. But if the validity of the logic, (that a comparative evaluation should include all three category (or more) of the goals) is accepted then a beginning can be made in this direction.

The chart would have to be improved upon as regards its contents, categorisation etc. (which are nothing but stray thoughts put together) Method of recording evaluation as suggested, is not sacrosanct. What is required is the criterion of measuring both the 'public' and 'enterprise' aspects of a public enterprise, together.

While the stakes of the public sector are mounting in terms of total volume of investment as well as the image in the public mind it is certainly imperative to dispel the fog around this vital sector of the economy. It is no less important that ailing units are restored of their proper health and true reputation. All this involves the enumeration of criteria for assessment based on the wider connotation of efficiency with the standpoint of human society.

The above suggestion is an attempt in this direction.

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