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MAJOR ISSUES FOR DISCUSSION

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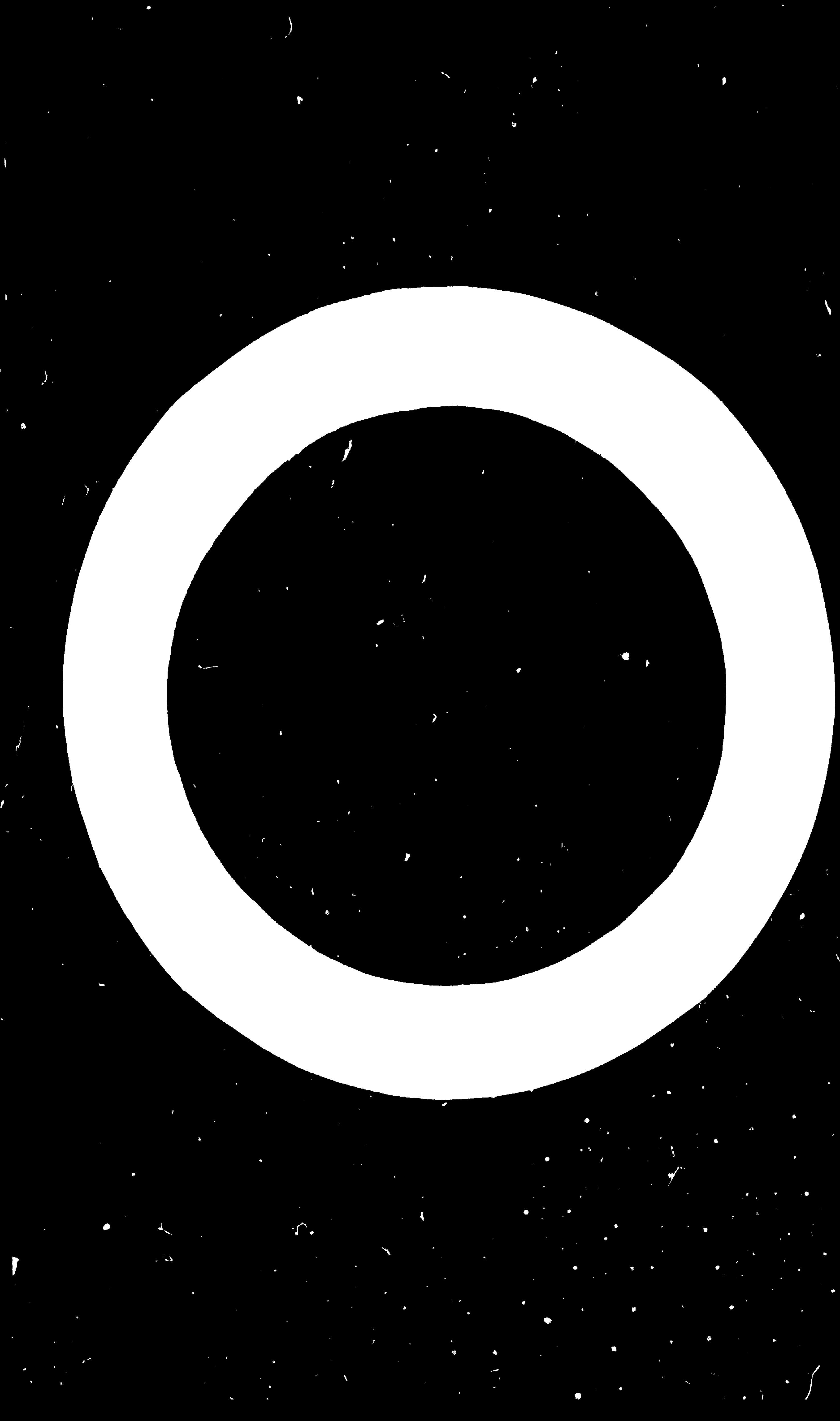

INTRODUCTION

1. Public manufacturing enterprises exist in a number of developing countries. The establishment of these enterprises is generally motivated by the special conditions and circumstances prevailing in different countries. The purpose of this paper is not to review the justification for the existence of public manufacturing enterprises, but to focus attention on a few financial policy measures and their implications for enhancing the operational efficiency of these enterprises.

2. A number of issues emerge from the consideration of the financial policies of public manufacturing enterprises. These issues may be grouped under four major headings, namely:

(a) Capital structure and financing

(b) Capital budgeting

(c) Pricing policies

(d) Profit and efficiency criteria

In some countries, especially the industrially-advanced ones, specific policies for improving efficiency in the operations of public manufacturing enterprises have been formulated and implemented with varying degrees of success. In many of the less developed countries definite policy measures may not have been adequately designed and consistently applied, with the result that enterprise management are in many instances guided by *ad hoc* decisions of supervisory authority.

3. The issues raised in this paper are only intended to stimulate discussion and therefore do not claim to cover all the problems faced by developing countries in this field nor do they offer solutions to these problems.

Panel document No. 1

CAPITAL STRUCTURE AND FINANCING

Two major sources of industrial finance are Domestic (government appropriations, business and household savings) and External.

A. Domestic financing

1. In the area of domestic financing it is noted that capital endowment comes directly from national budgetary allocations, or through the intermediary of investment and development banks, industrial development corporations and from the capital markets. The endowment may take the form of an outright grant, a quasi-equity investment, a loan capital or a combination of these.

   Q.A. In the experience of the Seminar, what are the relative advantages and disadvantages of each of these forms of domestic financing vis-à-vis the operations of public manufacturing enterprises?

   B. Where a public enterprise is equipped with both equity-type capital and loan capital, what proportion should one form of capital bear to the other, and what should be the criteria for determining this proportion?

   C. What form does the national budgetary appropriations (direct government financing) take and what are the terms and conditions of this source of financing?

2. The distinction between loan capital and outright grant is not always clear, especially in a case where an enterprise is financed with a non-interest bearing, non-repayable loan. More usual cases are where public enterprises are financed with loans carrying considerably lower rates of interest than the current rate in the country.

   Q.A. Does the Seminar see any justification for the provision of discriminatory loan capital (i.e. especially favourable terms) to public manufacturing enterprises, and if so, in what specific cases should such a practice be justified?

B. Is the Seminar in favour of competition between public and private enterprises for access to capital? If so, how does the Seminar envisage this form of competition and their implications? If the Seminar is not in favour of competition what form of coordination should exist between the two sectors in drawing on the available domestic resources?

3. Auto-financing is the ploughing back of retained earnings or surpluses of an enterprise. The extent to which auto-financing of public manufacturing enterprises is possible and/or should be encouraged depends on the nature of the enterprise, the level of profits that the enterprises are allowed to accumulate and the portion of the profits that could be retained.

Q.A. Assuming that public manufacturing enterprises are profit oriented, how does the Seminar see the relationship between auto-financing and profit policies?

B. In the experience of participants what are the advantages and disadvantages of auto-financing in relation to both capital formation and the need for national allocation of scarce resources in developing countries?

4. In addition to direct government financing and auto-financing, public manufacturing enterprises may be involved in mobilizing domestic private capital. This may take the form of inviting the general public to subscribe to minority of the enterprise's share capital or to the loan capital by purchasing stock bearing a fixed, government-guaranteed rate of interest, or the government itself mobilizing private capital (household and small business savings) through the issuance of bonds and channelling the proceeds into specific industrial enterprises.

Q.A. To what extent have these methods of mobilizing domestic private savings for public manufacturing enterprises been applied in developing countries? What difficulties have they encountered and what measure of success have they achieved?

B. What specific recommendations may be considered to assist government and management of public enterprises in the formulation of effective policy measures for mobilization and channelling of domestic private capital into public manufacturing investment?

5. It is often stated that investment capital is in short supply in developing countries. Coupled with this situation is the fact that many of these countries have not yet fully developed their capital markets, which in developed countries assume responsibility for Capital "rationing" to achieve optimum economic results. Consequently public authorities of developing countries assume overall responsibility for capital rationing.

Q.A. In the absence of capital markets to measure scarcity of investment capital and to give it a "price", what principles and methods will the Seminar recommend for regulating government capitalisation of public enterprises?

B. External financing

6. External sources of industrial finance consist on the one hand of bilateral and multilateral aid and on the other hand of loans from foreign private financial institutions and equity capital.

Q.A. What are the views of the Seminar on the effectiveness of these external sources of financing public manufacturing enterprises? Are these forms of financing complementary, and if so, how does the Seminar visualise this complementarity?

B. Does the Seminar favour one form or the other of these external sources of financing in relation to the balance of payments situation in developing countries?

7. The view is generally held that there is a limited absorptive capacity of external indebtedness as far as developing countries are concerned.

Q.A. What is the opinion of the Seminar on this view?

B. How could the increasing need for external resources to supplement domestic savings be reconciled with the limited absorptive capacity for external indebtedness?

8. Foreign private capital often takes the form of equity capital, loan capital, technical collaboration and suppliers' credits.

Q.A. What are the views of the Seminar on the possibility of financing public manufacturing enterprises from any or all of these forms of foreign private financing?

B. What difficulties, if any, are inherent in attracting these forms of financing, and what measures could be taken at both ends to resolve these difficulties and thereby stimulate the increased flow of foreign private capital into public manufacturing enterprises?

Panel document No. 2

CAPITAL BUDGETING

1. The concept of capital budgeting involves three main elements, namely: the objective of the enterprise, sources of funds and uses of funds. In its broad sense, capital budgeting may include both long-term and short-term movements of all funds in the enterprise, while in a narrow sense it may be limited to the process of planning and controlling the long-term movements of funds.

   Q.A. What elements may be taken into account in planning the long-term movement of funds in a public manufacturing enterprise? How are these fund movements affected by the special objectives of manufacturing enterprises in the public sector?

   B. Are the techniques of capital budgeting for public manufacturing enterprises different from those of private enterprises? If so, what are the basic differences, and to what can these differences be attributed?

2. Capital budgeting in Public Manufacturing Enterprises are essential for the purpose of facilitating ministerial control, for ensuring proper and adequate forecasting of financial requirements, and for enhancing effective managerial control.

   Q.A. How is ministerial control of public manufacturing enterprises effected through capital budgeting? What type of information should be presented in order to make capital budgeting an effective instrument of national economic planning?

   B. On what principle should a public enterprise budget be constructed in order to achieve an effective managerial control?

3. In its advanced form an enterprise budget based on isolation of certain "cost centres" and the estimation of unit costs could very well serve as an instrument of effective managerial control. Such a budget becomes a performance budget by means of which an enterprise may regularly measure in quantitative terms the degree of its success or failure in the performance of its assigned tasks?

Q.A. At what stage will the introduction of performance budgeting in the operations of public manufacturing enterprises in developing countries be considered appropriate, and what are the essential prerequisites to the introduction of such a system?

4. Public manufacturing enterprises are often assigned special objectives which in turn affect their sources of financing and the application of their funds.

Q.A. How is the capital budgeting process of public manufacturing enterprises affected by:

i) the fact that these enterprises are expected to achieve special economic and social objectives;

ii) the fact that a large proportion of their financial requirements is provided by the government with or without cost;

iii) the fact that all or part of their operational surplus is returned to the government, which also provide subsidies to cover operational losses.

B. Does the Seminar see any differences in the application or uses of funds within public or private enterprises as far as the process and techniques of budgeting are concerned? If so, what are these differences, and how are they related to managerial efficiency of the two types of enterprises.

Panel document No. 3

PRICING POLICIES

1. If a public manufacturing enterprise operates in a fully competitive field its pricing policies will normally be dictated by the forces of the market. To make a profit the enterprise will have to satisfy its consumers at prices comparable with those offered by its competitors. For this condition to prevail the government should take steps to preserve the freedom of the market, to ensure that public enterprises do not enjoy any special privileges, and to refrain from imposing on the public enterprises, without adequate compensation, unremunerative responsibilities from which the private sector enterprises are exempt.

   Q.A. Is the policy of "competition setting prices" for all manufacturing enterprises (public and private) in the same field of operation a sound one for developing countries?

   B. If not, what alternative policies will the Seminar recommend and what measures should be taken to implement these policies?

2. In general, public manufacturing enterprises in developing countries enjoy a "sheltered market" for a number of reasons: sometimes they are the only manufacturing enterprises in their particular fields, sometimes the industrial licensing system tends to "freeze" the division of the market among both public and private enterprises, and sometimes the excess of effective demand over actual supply is such that a more-or-less permanent "sellers' market" is created. Such a situation tends to create the need for "administered" prices, although such a practice has often been criticised by those who believe in a free market system.

   Q.A. Does the Seminar consider "administered" prices necessary or unavoidable in developing countries and if so, at what level of authority should such prices be determined?

3. As a matter of general principle, public enterprises in many developing countries determine their prices by adding an unspecified "margin" to average costs. Some use "import parity prices" as a standard, and others attempt the application of "marginal cost pricing".

Q.A. In the absence of a consistent pricing policy for public manufacturing enterprises in developing countries, what general principles and methods of price determination will the Seminar recommend? (The Seminar may also examine what impact such methods may have on (a) the operational efficiency of the enterprise and (b) the national distribution of resources in the economy as a whole.)

B. What are the criteria that ought to determine pricing policies in the different industrial sectors, and what changes in institutions and procedures will the Seminar consider necessary to facilitate the adoption of more rational policies?

Panel Document No. 4

PROFIT POLICIES AND EFFICIENCY CRITERIA

1. In order to review the various issues raised by profitability and efficiency of public manufacturing enterprises one has to examine the principle as to whether public manufacturing enterprises should or should not be profit motivated.

   Q.A. What are the views of the Seminar on such a principle?

   B. If by their nature some public manufacturing enterprise cannot be expected to make profits what criteria should determine those that should and those that should not make profits?

2. There are different types of situations in which a public manufacturing enterprise may operate: in an economy where public enterprises constitute the main engine for industrial development; in an economy where both public and private sectors are more or less equally divided, or in a situation where public manufacturing enterprises play only a catalystic role.

   Q.A. How does the relative strength and importance of public manufacturing enterprises in an economy affect their operational policies, particularly pricing and profit policies?

3. Operational surpluses depend on both the pricing structure and cost determination.

   Q.A. What elements of cost do public manufacturing enterprises take into account in calculating their profit margin?

   B. How are these costs determined and what measures should be considered for improving cost consciousness in public manufacturing enterprises?

4. Efficient allocation of resources means investing where the return to the economy as a whole is greatest. This calls for a common measure of return on new investments.

   Q.A. What measures can be used to assess the optimim allocation of resources to public manufacturing enterprises?

B. How far in the opinion of the Seminar is the setting of target rates of return on capital a realistic device for public manufacturing enterprises taking into account their special social obligations?

5. In many developed countries public manufacturing enterprises are subject to the "discipline" of competition; thus profitability is not only expected but taken, at least, as a rough-and-ready measure of efficiency. In developing countries competitive conditions are either non-existent or extremely imperfect, particularly in those lines of production in which public manufacturing enterprises tend to specialise. Profitability therefore is neither correlated with efficiency nor regarded as a means of measuring it. Where expected, it is deliberately planned for as a means for providing self-generated resources for expansion and re-equipment or as a contribution to general capital-formation in the total national economy.

Q.A. Does the Seminar consider the setting of "profit-targets" for public manufacturing enterprises a realistic and meaningful device for developing countries? If so, how should these targets be set and by whom?

B. Should the attainment of profit-targets be regarded as a measure of enterprise efficiency? If so, would an enterprise that fails to meet its targets and yet increases its output per man be regarded as inefficient?

C. Does the Seminar consider the generation of surpluses by public manufacturing enterprises a necessary engine of economic growth, and if so, what policy measures could be recommended to stimulate and encourage profitability among public manufacturing enterprises?

6. Operational losses incurred by public manufacturing enterprises are covered by a variety of methods, including straight-forward subsidization by the government, interest-free loans, waiver of service charges on outstanding loans or moratorium on loan repayments, the application of enterprise reserves, the use of depreciation funds. The common practice in many developing countries is to cover enterprise losses by subsidy from national budgetary funds.

Q.A. Taking into account the fact that part of these losses may have resulted from managerial inefficiency, what recommendations may be offered regarding the circumstances under which subsidization may be legitimately employed, and what technique could be used in calculating the amount of the subsidy?

7. Like the coverage of operational losses, net profit or surplus distribution is governed by a variety of practices in different countries.

Q.A. Taking into account the effects of profit distribution on management performance and personnel morale, what general principles should govern the disbursements of surpluses made by public manufacturing enterprises?

8. Operational efficiency can be measured only in relation to defined objectives. In choosing objectives, defining them in quantitative terms and for facilitating the task of checking performance, many developed countries have adopted the devices of Discounted Cash Flow and Cost-Benefit calculations.

Q.A. Does the Seminar consider such devices practicable for public enterprises in developing countries, and if so, what practical measures should precede the introduction of such devices?

B. How could the development of techniques such as efficiency "profile" for public manufacturing enterprises help in identifying operational weaknesses and correcting them?

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