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Measurement of Earning Power of Some Public Enterprizes in Nepal

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Public enterprises occupy the commanding heights of the economy in view of HMG's policy of making them as vehicles of economic development. The UN report states in this connection: 'In some countries public enterprises have been sponsored so as to occupy the commanding heights of the economy. In simple terms, this means that these enterprises either accelerate othe activities or regulate private sector operations on proper lines. To do this, they must operate at demonstrated level of efficiency'.[1] But public enterprises can a chieve this only if they are able to raise the earning power by undertaking operations in a business like manner. The false hope of using public enterprises as best way to achieve social benefits cannot be wrongly persuaded by HMG in creating a serious blow to their earning power. Politicians and ministers should clarify themselves that public enterprises are not just chartiable institutions to forgo profit planning just in the name of social benefits. There is need to revitalize the out-of-date traditional beliefs that have been built into the minds of political thinkers and ministers in general. What is required for them is to follow a realistic approach of encouraging public enterprises to pursue earning power goals so as to help them stand in their own legs in long term future for meeting their financial needs.

It is always the case in point that HMG has not been clear itself in guiding and

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1. United Nations, "Organization, Management and Supervision of Public Enterprises in Developing Countries", UN, New York, 197?, pp. 12.

directing public enterprises regarding what they want from public enterprises. The vagueness in HMG policies put public enterprises in mousetrap not knowing what to do since any decision and action taken by them may be just what HMG may not support. If public enterprises follow earning power goal just to measure its demonostrated level of efficiency, HMG may oppose as if public enterprises are going against the national policies of achieving a welfare state. On the other hand, if public enterprises forgo earning power goal on the ground of attaintaing social welfare, they are again criticized by HMG as if they are inefficient and unable to achieve desirable rate of earning power. In a country where political environment is just zigzag and where politicians use tactics to balance political interest, victimization of public enterprises by pullin in a dilemma is quite natural to happen. Mr. Joshi & Mr. Upadhyaya while sharing their experience concluded that HMG lacks clear cut policy objectives and objective approach towards instituting a control system so that an ideal compromise between corporate autonomy and HMG's control can be hardly established. Quite often, the administrative ministry is found to be lacking in sectoral planning, objectives and clear cut conception of the roles that the concerned PEs are expected to play".[2] Public enterprises have not been able to follow a suitable earning power policy just because HMG's policy direction is vague and there is undue delay in bureaucratic decision making process.

Earning Power Concept

Earning power of public enterprises is used in the sense of the decisive ability of public enterprises to pursue a goal of just, equitable and reasonable profit from the demonostrated level of operative efficiency, effectiveness and productivity. The earning power constitutes not only the ability to generate reasonable profit but it also implies that such reasonable profit must be the outcome of efficiency instead of deriving it from monopoly conditions. Again efficiency along is not sufficient since it must be guided by effective criterion. Earining power is effective if it does not exploit consumers by charging high prices and it becomes productive if it leads to greater benefits to public from a given level of efficiency. It can be presented be low:

Earning Power ---	Efficiency plus Effectiveness plus Productivity	---	Reasonable Profit Social Benefit Survival of PEc

2 Bal Krishna Joshi and Gun Raj Upadhyaya, "Control System of Public Enterprises", Pradhashan, Administrative Management Department, Pulchowk, Lalitpur, June, 1978, p. 11.

But since our interest is on the financial obligations of public enterprises, we look earning power in the light of ability of public enterprises to generate rate of return from a given investment so as to cover costs plus profit. Whatever capital provided to public enterprises mostly by government has a cost to borne, and such a cost can be recovered if public enterprises can achieve reasonable rate of return. Earning power in a financial sense designates the setting of a circular flow of funds to make public enterprises self-supporting through internal generation of funds so as to accomplish broader financial goals. Howard and upton are of the view that public enterprises can create excess of income over the costs if they follow three cardinal principles of financial success.[3]

1) Whatever funds available for utilization must be invested in earning assets.

2) The amount of profit so expected must be reasonable enough to cover costs plus provisions for expansion.

3) The direction and control employed in the utilization of funds must be effective enough to achieve priority goals of attaining desirable level of efficiency.

Public enterprises must follow a pragmatic approach to find out how best they can choose the productive assets that help in raising their earning power. There is, in fact, a close relationship between type of assets they choose for investment and corresponding benifits both in terms of financial returns and social benefits derived from the use of such assets. In many developing countries, it is the usual experience of PEs that they have no right kind of choice of assets in helping to raise the sufficient earning power. The question arises: how can the purchase of old Boeing 727 already used for several years help RNAC to achieve operating efficiency for raising earning power as it made engineers to examine many times about is working conditions before take-off ? Can't the investment in the purchase of such old Boeing lead to wrong kind of choice of assets as it needs excessive depreciation, maintenance and repairs. It is again true that many public enterprises are fond of using old assets either because they are cheap or because they are freely donated to HMG under various aid programme, public enterprises that are meant for long-term survival cannot just survive if the tendency of HMG is to pressurize these enterprises to have use of worn-out and dead-expired assets. Sometimes this sort of attitude of HMG can be mothing more than 'Penny saved, Pound lost' policy.

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3 Bion B. Howard and Upton Miller, "Introduction to Business Finance", McGraw Hill Book Company, Inc., New York, 1953, p. 9.

The other vital question is: Is HMG conscious of setting financial targets on public enterprises so as to meet the earning power both in terms of costs and obligations ? In other words, how far public enterprises have recognized the importance of achieving earning power to meet costs of investment and expansion ? The reality shows that neither the government has guided – criterias of setting profit targets nor the public enterprises are cautious to achieve profit targets. As for instance section 12 (1) of RNAC Act 1963 with third amendments in 1978 states that" it shall be the duty of the corporation to manage the concerned air transport services inside or outside the kingdom of Nepal in a safe, efficient, well-managed, economical and proper manner. The corporations may exercise its powers for developing air transport services so as to ensure maximum profitability and make available such services at cheap fares as far as possible."[4] The two terms maximum profitability and services at cheap fares are self-contradictory in this section 12 (1). But it is clear that RNAC has no fixation of financial target and actual rate of return to be derived from a given amount of investment. Again, HMG has no clear cut policy guideline to RNAC regarding how much profit to be achieved in terms of actual rate of return of financial target. We can take an instance of British nationalized industries. The white paper of 1961 on Financial and Economic obligations of Nationalized Industries insisted them in setting financial target with a full calculation of return on capital, sound system of financial appraisal and focus on self-contained financial strategy. "The nationalization stalutes are open – ended. They laid that receipts, taking one year with another, should not be less than outgoings. Good years were expected along with bad years. In good years there would be a surplus and this would be an anti-inflationary influence at a time when inflation was a danger. Similarly deficit in bad years, when the level of activity was generally low, would constitute a part of government deficit financing, which would help to reflate the economy on orthodox keynesian lines."[5] So the corporations act and byelaws are very vague in difining financial target of public enterprises and this made neither HMG conscious to provide specific guidelines of financial obligations to PEs nor the PEs themselves conscious of need to set desirable financial targets. As HMG is not fully clear of what it wants from PEs, it has failed to provide proper direction and control to PEs, Mr. Joshi is of the opinion that public enterprises have suffered from lack of proper guidelines of HMG. He states: 'However, the crux of the problem seems to

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4 Royal Nepal Airlines Corporation Act, 1963, Nepal Gazette, Vol. 12, No. 443, April 12, 1963 with Third Amendement Jan. 2, 1978, p. 5.

5 Michael Links, "The Lessons of Public Enterprise", benezer Bayles and Sons Ltd., 1963, See also White Paper 1961 emnd 1337 1961.

be either excessive interference over, or non-existence of the policy direction to the public enterprises.[6] It is an accepted fact that HMG owns the public enterprises by pouring all of the capital required to them. But HMG simply has followed bureaucratic attitudes without considering how best it should guide them by setting a well-defined financial targets to be imposed on public enterprises. This is the basic reason why public enterprises do not feel obliged to generate earning power sufficient to cover costs plus provisions for expansion.

Many experts while making investment feasibility studies before approving loans to HMG from World Bank and other international financial institutions have noticed HMG to follow a profit goal. In other words, these experts have raised consensus on the part of HMG for setting a financial target before channelizing funds for investment in public enterprises. As for instanee, the World Bank loan to Water Supply and Sewerage Board has insisted for having a meaningful internal financial rate of return on the project. The experts state: "The return on combined annually revalued water and sewerage net fixed assets is estimated to be about 1% during the project construction period of FY 1978 to FY 1981, increasing to about 4% in FY 1984 and 6% in FY 1987. The rate of return on water only in FY 1984 is expected about 6% and on sewerage barely positive".[7] Before granting loan from international financial institutions to Kulekhani Hydro Electric Project, Nippon Koei Co. Ltd. of Japan has been engaged to provide consultancy services for field investigation, engineering design, procurement and construction suqervision of the project with the World Bank acting as Executing Agency for UNDP. The Would Bank report reads as; 'HMG has agreed during negotiation that Kulekhani Hydro Electric Project world be transferred to Nepal Electricity Corporation in two stages upon completion and commission of the first and second unit and that part of the project financed with IDA funds would be transferred as debt repayable over 25 years at 8½% interest. The equivalent of Kuwait Fund loan would be transferred as debt repayable over 25 years at 6%. HMG intends to use the same terms for the balance of the cost of the project". Moreover, Nepal Electricity Corporation required under HMG's negotiation to achieve 8% rate of return. During negotiation, it was agreed as a condition of effectiveness that tariff's of Nepal Electricity Corpor tion would be increased to produce 2 % return for FY 1975/76. This will require about a 74% increase in the average price per KWH sold, bringing to this about US$ 3.3 per KWH. In

6 Nanda Lal Joshi, "Balance between Government : Control and Corporate Autonomy", Prashashan, Administrative Management. Department, Pulchowk, Lalitpur, Nov. 1976, pp 102.

7 Nepal Appraisal of the Second Water Supply and Sewerage Project, Document of World Bank, South Asia Projects Department Energy & Water Supply Division, Report No. 14209—Nep., 24, 197 , p. 3.

a like manner, further agreements were made with HMG that tariffs of Nepal Electricity Corporation would be increased to attain 4% return for FY 1977/78, rising 6% by FY 1980/81. Once this target is reached, the situation will be jointly reviewed by HMG and International Development Association with a view to attain 8% rate of return as early as possible.[8] So. must of these reports focused attention of HMG to be conscious of following financial target approach of attaining rates of return on total capital employed in public enterprises. This can be the best way to provide guideline regarding how much earning power is required for public enterprises to be optimally efficient and effective. Thus, earning power in the light of public enterprises implies the fixation of financial targets as directed by HMG in accordance with national plans and priorities without endangering financial autonomy of public enterprises This earning power is accomplished if the financial targets so fixed is attained to cover costs plus provisions for retention of earnings to finance expansion necessary for the long-term goal of maximizing social benefits.

But earning power is just not an easy goal to achieve unless public enterprise managers are deliberately known to be cautions and conscious to do so. HMG must be a action-guiding force instead of acting as decision-delaying force, and the goal of attaining power can be crowned with success only if HMG is vigilant to be cooperative in encouraging willingness to work on the part of promising managers of public enterprises It is hoped on the ground of optimism that earning power will not be a wishful thing or thirsty deer in search of cloud in the mountaints to get water. A reasonable degree of pragmatism of HMG and realistic assessment of situations by public enterprise managers would be needed if attainment of earning power is to be considered as a feasible goal.

8 Nepal Appraisal of the Kulekhani Hydro Electric Project, Power Division South Asia Projects Department, Document of the World Bank, Report No. 8339 - Nep., Nov. 25, 1975. p. ...

Measurement of Earning Power

Earning power is meaningful only if it is capable of effective measurement. Measurement is focused-approach towards empirical observation of the relationship that exists between a) Net profit and equity b) Debt and Equity and c) Interest and debt. We now present the earning power in terms of the above criterias of measurement by taking selected number of public enterprises as given below:

(a) Earning Power of 12 Selected Corporations (2035)

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S.No.	Corporations	b) Profit	Share Capital	Debt	Interest	PBIT(a
1.	RNAC	20014	53113	164803	2566	22580
2.	NIDC	7298	157767	130135	6069	13367
3.	Nepal Elect. Corp. (NEC)	1573	360176	301933		
4.	Water Sup. & Sew. Board (WSSB)	360	801302	50633		
5.	NCCN	801	3000	c)1960		
6.	Nepal Transp. Corp. (NTC)	18691	56280	11678	646	18045
7.	Janakpur Cig. Factory (JCF)	6898	40837	17659		
8.	Birgunj Sugar Factory (BSF)	5455	55218	20530	1102	6557
9.	National Trad. Ltd. (NTL)	4821	2500	138162	18471	23292
10.	Bansbari Leather Shoe Fac. (BLSF)	507	20152	270	34	541
11.	Nepal Te. Com. Corp (NTCC)	1587	72261	24157	1869	3446
12.	Brick & Tile Factory (BTF)	10	14000			

Source: Auditor's Report, Part III, 2036.

Note: a) PBIT = Profit before Interest and Taxes

b) Profit = Profit before taxes

c) Short term loan

(b) Calculation of Earning Power of 12 Selected Corporations

S. No.	Corporations	Profit as % of share capital	Debt/Equity ratio	Coverage of interest	EPSa)
		%	Times	Times	
1.	RNAC	37.68	3.10:1	8.80:1	
2.	NIDC	4.63	0.82:1	2.20:1	4 62
3.	NEC	0.44	0.11:1		
4.	WSSB	0.41	0.57:1		
5.	NCCN b)	26.70	0.58:1		26 70
6.	NTC	33.21	0.21:1	27.93	
7.	JCF	16.89	0.43:1		
8.	BSF	9.88	0.37:1	5.95:1	98.79
9.	NTL	192.84	7.48:1	1.26:1	192.84
10.	BLSF	2.51	0.01:1	15.91:1	25.15
11.	NTCC	2.20	0 47:1	1.84:1	
12.	BTF	0.07	—	—	0.71

The 12 selected corporations reflect that Nepal Electricity Corporation has the highest equity capital of Rs 36,01,76,000 while National Trading Ltd. has the lowest equity capital of Rs 25,00,000. So far as debt is concerned, Royal Nepal Airlines Corporation commands a debt of Rs 16,48,03.000 whereas Bansbari Leather and Shoe Factory has lowest short-term debt of Rs 2,70,000. National Trading has achieved fantastic rate of 192.84% on share capital and Brick and Tile Factory has just negligible rate of 0.07% on share capital. Debt position of National Trading Ltd. is 7.48 times greater than share capital and it comes to negligible debt position of 0 01 times 1 in case of Bansbari Leather and Shoe Factory. The coverage of interest payment shows that the earning power of Bansbari Leather and Shoe Factory is 15.91 times greater than interest while it was lowest in National Trading Ltd. But 4 out of 12 public enterprises have not as yet paid interest inspite of having debt and Brick and Tile Factory has no debt at all. The earning per share of National Trading Ltd. is the highest as it comes

Note : a) EPS = Earning per share

b) Short Term Loan

to Rs. 192.84 per share while it is lowest in case of Brick and Tile Factory that commands earning per share of Rs. 0.71. But National Construction Company of Nepal has negative earning per share of Rs. 26.70.

Royal Nepal Airlines Corporation has improved its profit inspite of operating at losses for past few years. It is recouping past accumulated losses from current year's profit. If we observe the rate of return, we find that this corporation achieved 37.68 per cent rate of return on share capital employed. Moreover the debt-equity ratio is 3 10 times 1. It has higher gearing capital since debt is more than three times the share capital. It is clear that RNAC has employed both internal loans and external loans. Internal loans include capital raised from Industrial Bonds and 13 years Development Bond of HMG. External loans consist of Candian dollar of Rs. 25.00 000 that is equivalent to NC Rs. 2,54,88 610. So, in view of higher financial leverage, it is crucial for RNAC to earn higher rate of return to meet costs of borrowing that includes both external and internal loans. The current profit shows that it is eight times greater than amount of interest of Rs. 25,66,000 paid on internal loan in 2034/35. But no interest as yet has been paid in case of external loan from Canda.

Nepal Industrial Development Corporation has a stable rate of growth since it is neither operating at losses nor it has shown excellent rate of performance. Being a promotional corporation, it has not profit-oriented policy. But it has recorded normal rate of return of 4.63 percent on share capital of Rs. 15,77,67,000. Debt-equity ratio maintained is just optimal as the command of debt on the capital structure comes to 0.82 times 1. It means that debt is 82 percent of shar capital. Coverage of interest payment is 2.20:1. The profit before interest and taxes is more than sufficient to pay interest on borrowed capital of Rs. 13,01,35,000. The earning power of the corporation is sufficient enough to meet obligation plus setting aside a portion of earnings for further promotion of investments. Nepal Industrial Development Corporation has recorded earning per share of Rs. 4 63.

Nepal Electricity Corporation has negligible rate of return of 0.44 percent on share capital of Rs. 36,01,76,000. It is a Public utility concern inclined towards social benefit and it has to undertake many uneconomical operations just for social reasons under the direction of HMG's priorities of national development. This corporation has employed debt amounting to Rs. 3,79,33,00 for which no interest is found to be paid. Debt is just 11 percent of share capital and NEC has insisted more on equity capital contributed by government. This is thought in view of releasing from financial obligations of debt repayment and interest thereon.

Water Supply and Sewerage Board is another infrastructural corporation that has undertaken utility functions. So its rate of return is similar to that of Nepal Electricity Corporation. The Board earned only 0.41 percent on share capital. But the debt equity ratio shows that debt represents 57 percent of share capital. The board has not paid interest on debt although it has obtained a loan of 41,50,206 that is equivalent to Rs. 5,00,85,956 in 2034/35 including the balances of loans received in last year. It means that the board higher equity capital than debt.

National Construction Company of Nepal has recorded excellent performance in past when it was managed by Isreali company. But such a prosperous company has miserable condition today as it is evidenced by loss of Rs. 8,01,000 in 2034/35. The loss comes to 26.70 percent of Rs. 30,00,000. But debt-equity ratio maintained is such that debt represents 58 percent of share capital. The loss per share is Rs. 26.70. So corrective measures should be timely taken to improve its operating performance otherwise it tends to reach a stage of liquidation in future year to come.

No other public corporation has as much worst financial position as that of Nepal Transport Corporation. It has suffered a loss of Rs. 1,86,91,000 in 2034/35 and such a loss represents 33.21 percent of share capital. It has employed a debt Capital of Rs. 1.16,78,000 which is 21 percent of share capital This corporation has heavy financial reliance on HMG contribution of share capital. It has obtained Japanese loan of Yen 26,11,33,415 which is equivalent to Rs. 1,01,29,301. But the corporation's financial position is so grave that it is doubtful whether it can meet such financial obligations to Japanese government. So, HMG has to think over this matter very seriously to have proper reorganization of this corporation so as to save it from future liquidation. It is surprising that it paid interest of Rs. 6,46,000 inspite of running at a loss.

Janakpur Cigarette Factory is one of the prosperous corporations of HMG as it is paying both taxes and dividend to government. This factory has achieved a profit of Rs. 68,98,000 which represents 16 89 Percent of share capital. Debt-equity ratio is such that it is following policy of having debt that comes to 43% of share capital. It has tried to have more equity in capital structure by emphasizing use of share capital than debt. Inspite of using debt, the factory seems to have paid no interest on debt of Rs. 1,76,59,000.

Bansbari Leather and Shoe Factory has improved rate of performance in comparison to last few years. It is showing signs of improvement as it has recorded profit of Rs. 5,07,000 in 2034/35. This profit records 2.52 percent of share capital. The factory has debt of Rs. 2,70,000 which is 0.01 times share capital. So it clearly reveals that the factory has overall dependence

on equity capital and debt is totally insignificant. The profit is 51.91 times greater than interest payment of Rs. 34,000. Moreover earning per share of this factory records Rs. 25.15.

Birgunj Sugar Factory has achieved a profit of Rs. 54,55,000 which represents 9.88 per-cent of share capital amounting to Rs. 5,52,18,000. The debt amounts to Rs. 2,05,30,000. Debt-equity ratio is maintained is 0.37:1. It means that debt constitutes 37 percent of share capital. The factory paid interest amounting to Rs. 11,02,000 on debt, The profit before interest and taxes is 5.95 times greater than amount of interest paid on debt. The factory could improve earning per share to the extent of Rs. 98.79.

Nationl Trading Ltd. has a very peculiar financial position. If we consider only return on equity, its performance is excellent. But this trading concern has suffered due to excessive payment of interest on bank loan. The return on equity of Rs. 25,00,000 comes to 192.84 percent It is suprising that the net profit of trading concern is greater than share capital as profit comes to Rs. 48,21,000. But debt is 7.48 times greater than share capital or debt is 748 percent of share capital. The coverage of interest payment shows that profit is 1.26 times interest. The earning per share of National Trading Ltd. is Rs. 192.84 per share.

Nepal Telecommunication corporation has achieved a profit of Rs. 15,87,000. This represents 2.20 percent of share capital amounting to Rs.7,22,61,000. The corporation has, at the same time employed a debt of Rs. 2,41,57,000. This debt is obtained from World Bank-IDA to an equivalent 28,91,125. Debt equity ratio comes to 0.47:1. It means that debt is 47% of share capitil and the corporation paid interest amounting to Rs. 18,69,000 in 2034/35. The World Bank report reveals that telecommunical corporation has to raise the tariffs to meet costs of World Bank credit.

Brick and Tite Factory has earned a profit of Rs. 10.000 which is 0.07 percent of share capital amounting to Rs. 1,40,00,000. This is the only factory that has unexpected fall in profit to a considerable sextent. It has virtually no debt capital. Dhe to low profit, its earning per share has been just Rs. 0.71. If measures are not taken to improve performance, there is a probability that this factory would suffer from future losses.

The study of above 12 selected corporations lead us to conclude that the most of the managers have not paid keen attention in improving the earning power except in few public enterprises like Nepal Industrial Development Corporation, Bansbari Leather and Shoe Factory

Royal Nepal Airlines Corporation, and Janakpur Cigarette Factory, But in almost all corporations managers have tred to have more equity than debt in the composition of capital structure as they think that equity contributed by HGM has no financial obligations to borns in terms of costs. But they want to avoid debt as far as practicable just to relieve from obligations of paying interest and principal. The only corporation that the given equal emphasis to both debt and equity is Nepal Industrial Development Corporation as its debt-equity ratio is 0.82:1. But National Trading Ltd. has unexpectedly highest debt-equity retio of 7.48:1. and this is the reason for this trading concern to pay excessive interest on bank loan.

Dividend Payout Ratio

Earning power determines the amount of dividend which corporations would be able to pay to HMG. The greater the earning power. the more the ability of public enterprises to pay dividend. This ratio expresses the amount of equity dividend as a percentage of earning available for equity shares after meeting all charges.9 The rate of earnings which corporations can maintain is a single best measure of enhancing the dividend pay-out ratio. We now observe the dividend payout ratio of above selected corporations.

Dividend payout ratio of 12 Selected Corporation (2035)

In 1000

S. No.	Corporations	No. of Shares	Profit	EPSc	Dividend	DPSb	Payouta Ratio
1.	RNAC		20014				
2.	NIDC	1577674	7298	Rs.4.63	505 (unpaid)	Rs.0.32	0.07 or 7%
3.	NEC	–	1573	–	–	–	–
4.	WSSB	–	360	–	–	–	–
5.	NCCN	30000	801	Rs.26.70	300	Rs.10.00	(0.37) or (37%)
6.	NTC	–	18691	–	–	–	–
7.	JCF	–	6898	–	–	–	–
8.	BSF	55218	5455	Rs.98.79	1300 (unpaid)	Rs.23.54	0.23 or 23%
9.	NTL	25000	4821	Rs 192.84	759	Rs.30.00	0.16 or 16%
10.	BLSF	20152	507	Rs.25.15	–	–	–
11.	NTCC	–	1587	–	–	–	–
12.	BTF	14000	10	Rg. 071	–	–	–

9 S. C. Kuchhal, "Financial Managemeut", Chaitanya Publishing House, Allahabad, 1979. P. 68.

Note: a Payout Ratio — DPS/EPS

b) DPS — Dividend Per Share

c) EPS — EPS Earnning Per Share

The 12 selected corporations reveal that only four corporations proposed to pay dividend to HMG. Out of four corporations also, only two corporations paid dividend to government while the other two have provided provisions for payment of dividend. But they have not paid dividend in the current year 2034/35. Industrial Development Corporation created a dividend provision of Rs. 5,05,000 from the current profit of Rs. 72,98,000. The proposed pay-out ratio is only 7% of profit and this corporation must raise the payout ratio at least to the extent of 20% of profit. It is, however, surprising that National Construction Company of Nepal is Compelled to pay dividend of Rs. 3,00,000 inspite of the fact that it suffered a loss of Rs. 8,01,000 The payout ratio is negative and it represents 37% of losses. Birgunj Sugar Factory proposed to pay dividend of Rs. 13,00,000 included Rs. 3,00,000 as unpaid balances of last year. The factory has dividend payout ratio of 23%. It is justified on equity principle since HMG has at least enjoyed optimal dividend on share capital invested in this factory. National Trading Ltd. has earned a profit of Rs. 48,21,000 and it paid dividend of Rs. 7,50,000 to HMG. The payout ratio comes to 16% of profit. It can raise the dividend to the extent of 25% since it has dividend paying ability as justified by profit.

On the whole observation, it is clear that HMG has no guided criterion of imposing dividend obligations to public enterprises.HMG has followed random or ad hoc decisions in imposing dividend obligations. There are many public enterprises which are capable of paying dividend. But they are relieved from payment of dividend. Such public enterprises that come into picture are Royal Nepal Airlines Corporation, Janakpur Cigarette Factory, Nepal Telecommunication Corporation and Nepal Electricity Corporation. But HMG has imposed dividend obligations to those public enterprises that are unable to pay it since they are operating at losses. HMG has to chalk out a policy in finding out a list of corporations with dividend paying ability as against those that have lacked dividend paying ability for a certain period of time. But HMG must raise consciousness on the part of public enterprise managers that HMG's contribution to share capital is not a chartiable fund. They should be reminded of the fact that HMG's equity contribution has a cost to be paid in the form of dividend and it is better that HMG should provide funds in the form of public dividend capital as practiced in nationalized industries of Britain. I suggest this not because public enterprises should imitate British pattern. But this is essential in view of the corporate managers thinking that government's money is easy money that bears no financia obligations. HMG has already contributed Rs. 1,32,01,49,251 in equity capital of 72 public enterprises. But these corporations paid dividend of Rs. 7,07,39,330 to HMG and

it represents 5.35 percent of equity capital.[10] Nepal Rastra Bank along paid Rs. 6,65,50,178 to HMG. If we are to exclude Nepal Rastra Bank from the definition of public enterprises, the dividend paid by other 51 public enterprises represents an amount equivalent to Rs. 41,89,152. This dividend payment is 0.31 percent on HMG's equity capital of Rs. 1,31,01,49,251. Again, it is only 13 public enterprises which paid dividend to government out of 52 public enterprises in the year 2034/35. All these facts reveal that neither the HMG has paid attention in chalking out a suitable dividend policy nor the public enterprises are conscious of the need to pay dividend to government. "Since dividends would be more attractive to stockholders, one might think that there would be a tendency for corporations to increase distribution. But one might well equally presume that gross dividends would be reduced somewhat, with an increase in net after tax dividends still available to stockholders, and an increase in retained earnings for the corporation".[11] So dividend payment is the expectation of HMG so as to make it think that public enterprises have best utilized the equity capital contributed by the government.

Tax Payout Ratio

Earning power of public enterprises has much to do in enhancing the tax paying ability of public enterprises. There exists a significant relationship between the amount of earnings and tax payment. The greater the earnings, the more the ability of public enterprises to pay taxes. "One widely used means of examining the effect of leverage is to analyze the relationship between earnings before interest and taxes and earnings per share. Essentially, the method involves the comparison of alternative method of financing under various assumptions as to EBIT."[12] It has been the objective of HMG that public enterprises should have not only self-supporting basis but also generate revenues to pay taxes to government. In short, it is the long term expectation of HMG that public enterprises would be able to pay sufficient taxes for financing the developmental expenditures incurred under national plans. Payment of taxes by public enterprises would constitute one of the major sources of revenue of the government. HMG is persuading in this respect that time has come for public enterprises to

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10. Auditors' Report, Auditor General Office, Babar Mahal, 2036, Part B, pp. 86—87.
11. Smith Dan Throop, 'Relief from Duble Taxation of Dividend Income" Harvard Business Review Boston, Jan.—Feb., 1977, pp. 90-91.
12. James C.Van Horne, "Financial Management and Policy," Prentice Hall of India, Pvt. Ltd. New Delhi, 1974, P. 250.

think over this matter. "The firm's EBIT remains the major determinant of value in a world of corporate taxes. The going concern methods of valuation largely rely on the firm's prospects for future profits. All profits are eventually reflected in the firm's operating income, or EBIT."13/ So public enterprises must give adequate consideration in finding how best they can pay taxes to HMG for meeting its costs of developmental plans. We now resolve to see how many public enterprises have paid taxes to HMG on the basis of sample as given below:

In '000

S.No.	Public Enterprises	EBIT[1]	Taxes[c]	EBT[b]	Ratio of EBIT to T	Ratio of EBT to T
1.	RNAC	22580	815	20014	27:71:1	24.56:1
2.	NIDC	13367	4785	7298	2.78:1	1.56:1
3.	NEC	1573	7835	1573	0.20:1	0.20:1
4.	WSSB	360	Royalty	360	—	—
5.	NCCN	801	1718	801	0.46:1	0.46:1
6.	NTC	18045	—	18691	—	—
7.	JCF	6869	3630	6898	1.89:1	1.89:1
8.	BSF	6577	1289	5455	5.10:1	4.23:1
9.	NTL	23292	–	4821	—	—
10.	BLSF	541	–	507	—	—
11-	NTCC	3426	5061	1587	0.68:1	0.31:1
12	BTF	10	–	10	–	–

The above 12 selected public enterprises show that only eight public enterprises have maintained provisions for taxation out of current profit while five public enterprises fail to do so. It is however, surprising that public enterprises operating at losses provided tax provisions as the case in point is National Construction Company of Nepal. But Nepal Electricity Corporation paid a royalty of Rs. 78,35,000 which is equivalent to payment of tax. In fact

13. John J. Hampton, "Financial Decision Making," Prentice Hall of India, Pvt. Ltd., New Delhi, 1977, P. 332.

Note : 1. EBIT - Earnings before Interest and Taxes

2. EBT – Earnings before Taxes but after Interest

3. T - Taxes

the royalty paid is many times greater than what EBIT or EBT taxes permit. This sort of excessive charge of royalty leads to drain the resources of the Nepal Electricity Corporation. EBIT is just 20 % of royalty paid and EBT is also the same amount as this corporation virtually paid no interest on borrowed capital. Under IDA agreement, HMG has agreed not to charge royalty or taxes before completion of Kulekhani Hydro Electric Project that is to be handed over to Nepal Electricity Corporation after completion. Payment of excessive royalty not only dilutes earning power of Nepal Electricity Corporation but it also seriously affect its financial position in future years to come.

Royal Nepal Airlines Corporation has higher earning power both in terms of EBIT and EBT. But it paid only dividend of Rs. 8,15,000 on EBIT amounting to Rs. 2,25,80,000. The payment of dividend represents 3.60% of EBIT. In short, EBIT is 27.71 times greater than dividend paid to HMG. While EBT is 24.56 times greater than dividend payment. So it is important that this corporation should pay at least 30 percent of EBT as dividend to HMG. It comes to an amount equivalent to Rs. 67,74,000.

Nepal Industrial Development Corporation has maintained a favourable tax payout ratio. This corporation paid tax of Rs. 47,85,000 out of EBIT of Rs. 1,33,67,000. EBIT is 2.79 times greater than tax paid. Moreover, EBT is 1.56 times greater than amount of tax paid to HMG. So the policy of tax payment out of profit is suitable in this corporation.

National Construction Company of Nepal has negative EBIT equivalent to an amount of Rs. 8,01.000. It is surprising that this construction company paid tax of Rs, 17,18,000 inspite of running at a loss. The negative earning before interest and taxes is 46% of taxes paid. Payment of tax at a loss tends to create shortage of working capital for this construction company.

The EBIT of Janakpur Cigarette Factory is Rs. 68,69,000 while EBT is the same as there exists no payment of interest on loan, Payment of tax constitutes 52,85 percent of EBIT. In other words, the EBIT of the factory is 1.89 times greater than amount of taxes paid, The factory has, in fact, followed an appopriate taxation policy as it has paid no less than 50% of profit as tax to HMG.

Birgunj Sugar Factory is another public enterprise that pays regular tax to HMG. The factory has paid lower amount of tax out of the current profit. The tax paid comes to Rs 12,89,000 out of EBIT of Rs. 65,77,000. The EBT is Rs. 54,55,000. The actual tax paid represents 19.60 percent of EBIT and 23.63 percent of EBT. So EBIT is 5.10 times greater than taxes

paid. Similarly, EBT is 4.23 times greater than amount of tax paid. It is desirable to raise amount of tax from 23.63 percent to 40 percent of EBIT.

Nepal Telecommunication Corporation has provided more tax provisions of Rs.50,61000 than EBIT of Rs. 34,26,000. Again, tax provision is more than EBT of Rs. 15,87,000. EBIT is 68% of tax provision while EBT is 31% of tax provision. It is thus, clear that tax provision maintained by the corporation has no any criterias of financial justification.

The five public enterprises have neither paid taxes not created tax provisions. Four out of five public enterprises have profit but yet they do not both or to pay taxes. Such puublic enterprises include Water Supply and Sewerage Board, National Trading Ltd., Bansbari Leather and Shoe Factory, and Brick and Tile Factory. But it is justified for Nepal Transport Corporation for not paying taxes as it is one of most sick units in the public sector.

On the whole observation, it is empirically proved that HMG has no specific criterias of taxation policy to be imposed on profits of public enterprises. Whatever HMG is doing is simply random or ad hoc taxation to public enterprises regardless of judging their viability and tax paying ability. Some public enterprises are compelled to pay taxes or create tax provisions even when they are operating at losses. But the public enterprises that are profitable often escaped from tax payment to HMG. So all these are attributable to the lack of sensible and criteria-guided taxation policy of HMG.

Suggestions for Improvement

Since we have discussed in detail about the impacts of earning on share capital, debt, dividend payment and tax payment, we now proceed towards some of the feasible solutions that help to boost up earning power as well as enabling HMG to have better share of corporate profits without dampening the financial position of public enterprises. Some of these suggestions for improvement of earning power of public enterprises are given below:

1. Fixation of Earning Power Target

HMG must cooperate with public enterprises in enabling them to fix earning power target. Earning power target signifies the rate of earnings which public enterprises are expected to achieve from a given volume of operations. The concerned ministeries must be assisting

factors rather than acting as hindering factors in the fixation of such earning power target. Such a target must be fixed after the overall assessment of factors that are both internal and external to the public enterprises. In case of public enterprises of social importance, HMG must clarify its policy of subsidization for undertaking uneconomical operations. The experts' opinion in respect of public enterprises reveal that it is desirable to follow a rate of return varying from 6 to 10 percent before taxes so as to recoup costs of investment plus provision for expansion. In British nationalzed industries, a real rate of return of 5 percent is fixed as a target rate of return on new investment as a whole. It is reviewed every 3-5 years. "The 5 per-cent level is based on pretax real returns as achieved by private companies and likely trend in the return on the private investment. The cost of finance to the private sector has also been taken into account along with considerations of social time preference". 14/ But, in Nepal, many government executives think that public enterprises cannot win profit as they are in public sector. It is, however, essential to synthesize that the causes of losses are often the outcomes of interferences that create a paralysis on the performance of public enterprises. The civil service domination in their board constituency has totally disturbed the managerial enviro nmant of public enterprises. The civil servants coming under deputation have neither the requi-red knowledge nor the entrepreneurial spirit of fixing the earning power target of public enter-prises. "Public sector enterprises are closely tied to HMG bureaucracy. Managers of public enterprises are often civil servants not specifically trained for the jobs they are appointed to. In trying to perform these jobs, the civil servants-cum-managers receive a great deal of inter-ference but little instruction from HMG".15/ So it is a high time to forget what had happened and to follow a pragmatic approach of fixing earning power target as realistically as possible through healthy government enterprise relationships. In view of the performances of the above selected 12 public enterprises, the following earning power target rate should be fixed.

14/ Andrew Likierman, "The Financial and Economic Framework for Nationalized Industries", Lloyds Bank Review, London, Oct., 1979, pp. 16-17.

15/ Report of the Seminar on Resource Mobilization for Development of Nepal, Centre for Economic Develop-ment and Administration (CEDA). Kirtipur, Kathmandu Nepal, Jan. 1973. p. 47. See also Pashupati S.J.B, Rana and K. Mall. The Board of Directors and Chief EXecutive Top Management Seminar, CEDA, T.U. Kathmandu, June 1972. pp. 41-52.

S.No	Public Enterprises	EPTR as % of Share Capital	Master Plan Review
1.	RNAC	10 - 20%	After 9 years
2.	NIDC	5 - 10%	After 8 years
3.	NEC	1 - 5%	After 5 years
4.	WSSB	1 - 5%	After 8 years
5.	NCCN	5 - 10%	After 2 years
6.	NTC	1 - 5%	Every year
7.	JCF	10 - 20%	After 5 years
8.	BSF	10 - 20%	After 5 years
9.	NTL	30 - 40%	Ebery year
10.	BLST	5 - 10%	Every year
11.	NTCC	1 - 5%	After 8 Years
12.	BTF	1 - 5%	Every Year

Under our grouping, there are three public enterprises that need to follow earning power target rate varying from 10 - 20%. The public enterprises under this grouping are RNAC, JCF, and BSF. Since these public enterprises have already good record of profits, it is expected that master Plan review of earning power target rate (EPTR) take place only after five years. But it does not mean that they should follow a rigid policy. According to need, they can have slight modification without losing the main substance.

The second grouping consists of public enterprises that tend to follow EPTR varying from 5 - 10% of share capital. Included among such public enterprises are NIDC, NCCN, BLSF, etc. These public enterprises have just maintained neither excessive profit nor lower profit. But of review of EPTR differs. It is desirable to have review after 8 years for NIDC since it is not a profit - oriented enterprise. What it wants is the normal profit to meet costs or borrowed capital, running expenses and a desirable amount of retention for financing in future. But NCCN needs review within every two years in view of fluctuating character of performances and greater gap in earning power from time to time. There is need for Bansbari Leather and Shoe Factory to have master plan review every year in view of its improving position of profit every year.

The third grouping includes those public enterprises that are infrastructural in character and having initial stage of growth These public enterprises cannot, therefore, maintain higher EPTR. So the EPTR is fixed from lowest 1% to highest 5%. In some cases, there may be even below 1% EPTR. The review period varies due to differences in constraints and problems which they are facing. WSSB and NTCC may review after years since they have long term implications in running the operations smoothly to raise the EPTR. But NEC can review within a period of five years since it has already existed for a long period. NTC needs to review every year in view of huge losses which it has to face seriously. Similarly, BTF has to review for suffering from declining rate of profit.

The fourth grouping includes only one public enterprise under trading sector. NTL is a trading concern and it aims to maximize profit without hindering social benefit. It is desirable for this trading concern to adopt EPTR varying from 30 – 40 percent and it has to review EPTR every year.

2. Imposition of Dividend Obligations

HMG must make public enterprise managers fully aware of their dividend obligations on share capital. It is an accepted fact that the flow of fromfunds HMG is not a free and costless capital. But time has come for managers of public enterprises to recognize that it is their duty to pay something in the from of dividend in return of capital provided by HMG. But public enterprises has to keep in view of the need for retained earnings and HMG should not impose dividend obligations in a manner that retard the growth prospects of public enterprises. Dividend obligation determines the division of earnings between payments to government as a major shareholder and reinvestment in the public enterprises themselves. "One of the financial manager's most important functions is to determine the allocation of profits between dividends and retained earnings, as this decision can have a crucial influence on the value of the firm". 16/ The dividend obligation must be imposed realistically as not drain excessive financial resources of public enterprises and how much rate of dividend must be fixed depends upon relative performance of public enterprises. But on the top of this policy, HMG must impose minimum rate of dividend either in the corporation Act or Company's Act or Development Board Act. In my view, such rate of dividend imposed must be at least 2 percent of share capital of HMG.

16/ J. Fred Weston and Eugene F. Brigham, "Essentials of Managerial Finance" The Dryden Press/Hinsdale, Illinois, 1974. p. 510.

3. Imposition of Tax Obligations

Public enterprises obtain large amount of capital from HMG. HMG has expectation that public enterprises will enable if to meet costs of development expenditure through transfer of resources to government from corporate taxes. HMG must have an appropriate corporate taxation policy to collect revenues from corporate taxes. Although in our sample of 12 public enterprises, we find that all of them have recognized their responsibilities to pay taxes to HMG. Most of them have created a provision for taxation out of current year's profit. But out of 12 public enterprises. Only four to five public enterprises have paid taxes. So HMG is suffering from effectiveness of payment of taxes as such payment is very irregular. HMG has to chalk out a taxation review plan to see how many public enterprises can immediately pay taxes as against those that cannot immediately pay taxes. There is need to clarify the misconceptions of public enterprise managers that payment of tax does not arise for social service rendering public enterprises.

Measurement of earning power of public enterprises is not a ticklish problem. Many of the misconceptions that public enterprises should not focus on earnings must be clarified with adequate pursuation and pursuit of knowledge. Earning power tends to help public enterprises to achieve efficiency, effectiveness and productivity through profit, social benefit and survival. Whatever profit earned must be sufficient to cover costs plus expansion and public enterprises are not chartiable institutions that can provide services without consideration to costs. The earning power measurement of 12 selected public enterprises give a clear picture that most of them have not been able to maintain desirable rate of profit although some of them have good record of earnings. Many public enterprises are found to rely on equity capital and managers are risk averters, i.e. avoid risks as far as possible. Dividend payment of public enterprises is relatively very poor and the same is true of corporate taxes. HMG lacks guided-criterias of profit, dividend and corporate taxes. So it is considered vitally essential to have fixation of earning power target rate, imposition of the minimum rate of obligations and adoption of a suitable corporate taxation policy.