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HARMONIZING THE SOCIAL AND THE BUSINESS DIMENSIONS OF PUBLIC ENTERPRISES - THE DIFFERENTIAL PRICING APPROACH TO SYNTHESIS

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ABSTRACT

Public enterprises play a vital role in the planned development of a country like India. They have stood the test of time braving the tide of privatization and liberalization. Now they look as if they are the saviour of the global economy hit by recession and financial meltdown. At the heart of their origin, public enterprises have two big but opposing dimensions - social and business. Both the dimensions directly impinge on their objectives, policies and strategies. In the interest of their efficiency and effectiveness there is an urgent need for harmonizing these two conflicting dimensions of public enterprises. In this background, the paper seeks to examine the dimensions along with their policy implications and suggest a satisfactory model for solution.

Introduction

Public enterprises (PEs) are important instruments of planned economic and social development based on national priorities and objectives. They are subsystems of the broader public sector which comprises all types of social and economic activities undertaken, funded and controlled by the government to achieve desirable development. For conceptual unity, a public enterprise is defined as an organization which is engaged in the production and marketing of goods and / or services on business principle and which is owned and controlled by the government to achieve national and organizational objectives.

As a vehicle for development strategy, PEs have been playing an important role in the socio-economic transformation of developing countries. They have a fairly good presence also in some developed countries such as Italy and France.[1] Even today, as the global economy is passing through a difficult phase of slowdown due to financial meltdown and recession, economists are looking to the public sector for a viable solution. In India, following the government policy of expanding the public sector for over four decades, PEs have emerged as a powerful device for industrialization of the country and stabilization of the economy. Even though the new industrial policy has scaled down the role of the public sector in India, it still occupies a leading position

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in the economy providing a much needed support to the government for steering the course of development on desired lines.

From the conceptual point of view, a public enterprise, as the name suggests, has two broad dimensions - social and business. The social dimension is reflected by the 'public' part of the name and the business dimension is implicit in the 'enterprise' part. Both the dimensions directly impinge on the philosophy, goals, operations and activities of PEs. But, the dimensions have very different connotations and policy implications which are often contradictory in nature. Evidently, one of the persistent problems facing the decision makers of PEs revolves around the age-old question of how to harmonize their countridictory characteristics. In this context, this paper seeks to examine, on the basis of available literature and analytical insight, the two conflicting dimensions of public enterprises along with their policy implications and suggest a suitable model for arriving at the synthesis which is theoretically sound and practically feasible. It is important to note in this connection that harmoniziation of social (or public) and business (or enterprise) dimensions of PEs is necessary for increasing their efficiency of operation and effectiveness of result. For PEs, social dimension explicitly implies social obligations which are, in effect, mandatory social responsibilities. Needless to say, they impose a severe constraint on the profitability of PEs. Since private enterprises have no such obligation they can go for wealth maximization for their owners. Obviously, the effectiveness of PEs depends, to a great extent, on the satisfactory performance of their mandatory social responsibilities. Therefore, striking the right balance between the two conflicting dimensions is extremely important for the future success and survival of PEs.

Public Dimension

As indicated just before, the public dimension of PEs essentially reflects the social orientation and social obligation of PEs. According to Narain[2], the term 'public' as an attribute has different connotations. It is often used to signify the accessibility and benefit to the general public as the terms 'public services', 'public parks' and 'public libraries' imply. It is also used to denote ownership by members of the public at large as is evident from the usage of the term 'public limited companies'. There is still a third sense, in which it is frequently used to mean the ownership and control by public authorities in the interest of the society at large. It is precisely in this sense that we use the term 'public enterprise'. Therefore, the third meaning of the term, 'public' is of great practical value to us for understanding the fundamental nature of PEs.

Expanding the ideas contained in the third meaning of the term 'public', we can visualize four essential characteristics of PEs. They are (a) public purpose, (b) public ownership, (c) public control, and (d) accountability to the public. Let us now examine these basic criteria of 'publicness' of public enterprises one by one.

(a) Public Purpose : It is the fundamental reason for the existence of public enterprises anywhere in the world. The basic reason for the creation of PEs in India, for example, is to establish a strong industrial base for rapid economic growth well as to provide 'social good' to the masses.[3] The public purpose of public enterprises is evident from the fact that they have, by and large, a large dose of social obligations which sometimes overshadow their business considerations. Nigam[4] argues that PEs in India have been set up for social considerations, located under social compulsions and are operated to achieve social goals along with economic objectives.

(b) Public Ownership: It refers to the ownership of the paid-up equity capital of the enterprises by the central, state, or local governments or by government organisations. Generally public ownership implies that more than 50 per cent of the equity capital is held by the public authorities. But in the light of the thinking gaining ground in some parts of the world it transpires that even if the extent of ownership declines below 50 per cent of the equity capital, the enterprise could nevertheless retain its public character, if such minority ownership is accompanied by an adequate measure of public control and public management. The United Nations has already indicated that 'mixed enterprises' in which government has minority shareholding but dominant control belong to the domain of public enterprise.[5] The view gathers strength when eminent authors like L.P. Jones and V. V. Ramanadham define public enterprises as productive entities which are predominantly controlled by the public authorities with either majority ownership or minority ownership. In the UK, the introduction of concept of 'Golden Share' in the privatized industries has given the government unprecedented power to outvote all other shareholders on important issues such as takeover and sale of assets.[6] In India, however, an enterprise cannot be considered to be a public enterprise unless the government holds more than 50 per cent of the paid-up equity capital.

(c) Public Control : It is another critical test of the public character of the public enterprise. A public enterprise must satisfy the test of public control in addition to the public purpose and public ownership. Even though an enterprise is predominantly owned by the government and set up eminently for public ends, it would not be treated as a public enterprise unless it fulfills the criterion of public control. As a matter of fact the concepts of public ownership and public control are closely interrelated.

Public control literally means control of the management of an organization by the government. In the context of public enterprise, it refers to the exercise of broad direction by the government over the plans, policies, and strategies followed by the enterprise for achievement of goals and evaluation of its financial and social performances.

The concept of public control has been the centre of heated controversy for long as it leads to inefficiency, bureaucratic control, and inflexibility of operation. As a result, the concept of public control has been considerably watered down in recent years to make PEs more and more autonomous with regard to their day-to-day administration as well as policy decisions. This is because the basic purpose of public control over PEs is to subserve the interest of efficiency and effectiveness which require autonomy of management.[7]

(d) Accountability to the Public : As a corollary of public ownership and public control, accountability to the public is the fourth crucial test of 'publicness' of public enterprise. It refers to the obligation of public enterprises to give an account of their conduct, performances, and achievements from time to time to the government or its designated agencies and to the parliament which in a democratic country represents the authority of the public.

Since PEs are created and owned by the State, it is but natural that they should be made accountable to the government and the parliament for proper utilization of public fund and national resources placed at their disposal with a view to meeting the national objectives and priorities. Under democracy, as in India, not only are PEs answerable to the parliament which is the supreme guardian of the people, but the government also has an overriding responsibility of reporting and explaining the rationale of their activities, including the performances of public enterprises to the people's representatives. The accountability to the public is also known as the social accountability of PEs. The main object of accountability is to ensure that the enterprises function as efficiently as possible and deliver to the nation maximum economic and social gains possible under the given conditions.

The Enterprise Dimension

The enterprise dimension of PEs suggests that they are essentially business enterprises and as such they should be run on business principles as far as practicable. The business principles demand that the capital employed in PEs has an element of risk and should be managed with utmost prudence and care so as to ensure a satisfactory return to the investors. It is generally argued that profit is the acid test of business success and PEs, being business units, are no exceptions. But this sweeping generalization looses its force as soon as we begin to consider their multifaceted social dimensions. It is generally accepted that public enterprises cannot be run like private enterprises because of their mandatory social obligations and the influence of government administration that tends to rob them much of their business character. Therefore, Ramanadham[8] suggests that the enterprise dimension of a public enterprise should be interpreted in terms of two parameters, viz., (a) financial viability, and (b) the cost-price equation.

(a) Financial Viability : This implies conscious effort on the part of an enterprise to raise net revenue with a view to yielding a surplus. In theory, this would in effect mean net revenue maximization or net profit maximization. But in practice several limitations exist on the way of reaching this goal, even for a private enterprise. For a public enterprise, it is suggested that such an amount of net revenue can be sought as (i) does not damage the long term financial interests; (ii) does not encourage competitive threats; (iii) does not provoke labour unrest; (iv) does not cause consumer protests; (v) does not amount to restrictive trade practices; (vi) does not create environmental pollution beyond permissible limits; and (vii) does not arouse public antipathy towards the enterprise in respect of its product or activities.[9] In view of these limitations, a public enterprise generally aims at a 'minimum satisfactory return', though a private enterprise will invariably have a tendency for net revenue maximization. The 'minimum satisfactory return' is interpreted to mean the net revenue that is considered as reasonable in the context of the constraints mentioned here.

However, the goal of earning 'minimum satisfactory return' will not automatically lead to financial viability of a public enterprise. The viability factor calls for a strong determination on the part of the management to be able to survive in the long run without budgetary support from the government. It does not matter if an enterprise fails to achieve viability during gestation period or during periods of bad business. But, the important point is that there must be an intention to earn profit and be viable in the long run, or else it does not qualify to be an enterprise in the public sector.

Another implicit element of the viability concept is risk taking which may begin right from the point of investment decision. Ideally, if the goal of maximising net revenue is to be achieved even in the long run, the most profitable decisions, even though they involve some risks, are needed in respect of investments, prices, costs, and outputs. But a public enterprise may not enjoy such a wide latitude .of freedom in decision making because of government regulation and social obligation that set the most significant external constraint to its operation. Even then public enterprises may resolve to go beyond the prescribed limit of 'minimum satisfactory return' by stepping up their revenues through prudent risk taking within permissible limits. A public enterprise which does not aim at financial viability in the long-run and is averse to normal risk taking within its limits of decision making loses its business character and ceases to be a business unit. In all fairness, it should be classified as a non-business activity of the government.

(b) The Cost-Price Equation : The enterprise concept, strictly speaking, goes beyond financial viability and is concerned with the way in which viability can be achieved This is generally achieved through sales activity, no doubt, but what is more significant is the relationship that prices bear to costs. Under the normal business principle an output can not be sold, if it does not meet the cost involved. Yet, extreme caution is to be exercised before arriving at such a decision because under certain circumstances products may have to be sold at a price which covers only variable cost plus a part of the fixed cost. Moreover, excessive overpricing or excessive underpricing of the product is open to challenge by the consumers or competitors adversely affected by such pricing or the issue may be challenged before the MRTP Commission on the ground of unfair trade practice. Thus pricing a product is not as easy as it seems.

In the final analysis, there is a need for judicious balance between the 'public dimension' and 'enterprise dimension' of a public enterprise. The balancing is a delicate exercise and requires careful consideration of all the issues involved. The figure 1 shows the various elements of the nature of public enterprise and the paramount need to strike a balance or synthesis between the two prominent but conflicting dimensions, viz., the 'public' and the 'enterprise' dimensions.

Figure 1 : Dimensions of public enterprise requiring synthesis

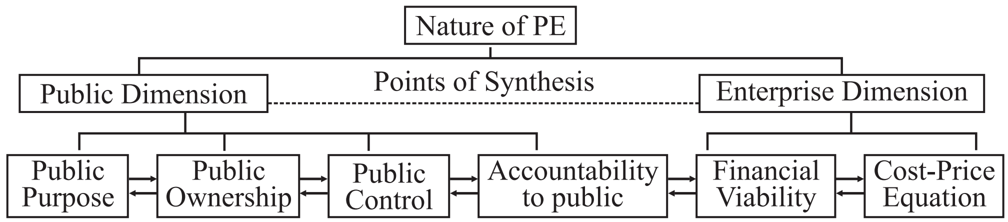


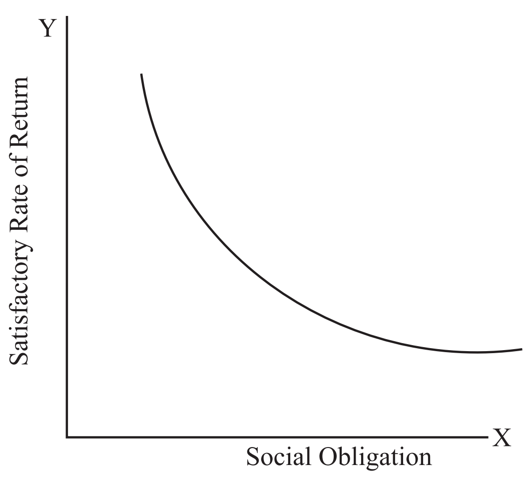
Figure 1 shows that the nature of public enterprise is multidimensional and that there is, indeed, a compelling need to harmonize or synthesize the two basic dimensions in such a way as to ensure at least a 'minimum satisfactory return' in the interest of the long-term viability which should really be the goal of a public enterprise. However, the synthesis may take place either in favour of the 'enterprise' dimension or in favour of the 'public' dimension, depending on the basic thrust of the government policy and purpose of the enterprise. It may even lie on a point of equidistance from the both. In any case, striking the right balance is a delicate task and calls for sufficient caution on the part of the managers. In this context, we present the differential pricing approach which, to our mind, appears to be the most important approach to harmonizing the two contradictory dimensions of a public enterprise.

The Differential Pricing Approach to Synthesis

The differential pricing approach to synthesis applies essentially to social decision making on the one hand and financial viability on the other. In view of their contradictory nature, the former has the implication of adversely affecting the latter. The expansion of socially beneficial services of a public enterprise at less than cost price with or without subsidization under a benevolent policy of the government will definitely eat into the revenue earning capacity of the enterprise and may also tell on its overall efficiency. For example, there will be a revenue loss or a cost enhancement when the Government of India decides that products like petrol, diesel, kerosen,e and cooking gas will be supplied to the consumers by public-sector oil companies below the cost price for social reasons. The loss may however, be offset by way of direct subsidy from the government or by adopting a programme of cross-subsidization within the enterprise, under which the deficit incurred in a particular product may be offset against surplus generated from other product or products Alternatively, the enterprise may charge differential prices for different segments of the market for the same product or service to make good the revenue shortfall arising from unfavourable cost-price equation in respect of a particular market segment comprising people of low-income group.

For arriving at a synthesis under the differential pricing approach, the enterprise should first aim at optimum financial viability and work out the maximum possible expected rate of return, keeping in mind the internal and external limitations. Then, an allowance may be made for every social obligation that is placed on it leading to the reduction in the optimum rate of return. The process will finally lead to the determination of the 'satisfactory rate of return' which will truly reflect the synthesis of the social obligations and the 'enterprise' requirements of a public enterprise.[10] It is admittedly difficult to estimate, in the case of a public enterprise, the amount of net revenue or net profit that can be considered as the maximum possible earnings under the circumstances. Nevertheless, experience coupled with improved forecasting techniques can indicate a reasonable range of figures towards which managerial effort can be deliberately directed. Under this approach, whenever a social obligation is imposed on a public enterprise, an attempt should be made to ascertain its effect on the net revenue. Then the satisfactory rate of financial return can be arrived at by deducting the cost of social obligation from notional revenue expectation. The figure 2 presents diagrammatically the usual pattern of a hypothetical curve of the satisfactory rates of financial return based on the synthesis of financial viability and social obligations of a public enterprise embodying a wide range of possibilities.

Figure 2 : Satisfactory rate of return curve (under synthesis approach)



In Figure 2, the Y-axis represents the satisfactory rates of financial return that a public enterprise can earn after considering the impact of social obligation under synthesis approach. The X-axis represents the social obligations imposed on it by the government policy as well as its own policy decisions. The slope of the curve shows that the return is the highest when the social obligation is the lowest and the vice versa.

The management of a public enterprise will have to strike a balance at the point which best reconciles its enterprise expectation with the requirement of social obligation. The point of coincidence is a dynamic one and will vary from time to time depending on changes in the magnitude of social obligation and revenue potential of the enterprise. The point of coincidence illustrates the satisfactory rate of financial return that a public enterprise can expect to earn after fulfilling the social obligation. Under conditions of stress emanating from external and internal limitations, the satisfactory rate of return is modified so as to bring it to the level of 'minimum satisfactory return' which is essential for the long-term viability of a public enterprise, and more importantly, for retaining its basic enterprise character. Without having the potential of yielding a minimum financial return in the long run, an enterprise of the government ceases to be a public enterprise, at least in theory.

Figure 2 is also applicable to the private enterprise which also owes an obligation to the society. Since the social obligation of a private enterprise .is not binding, it can go for the goal of maximizing the net revenue without caring much for social obligations. In contrast, PEs are under public and political pressures to ensure financial return on the one hand and social justice on the other. Therefore, the profit cannot be the sole criterion of measuring their performances.[11] Even when a public enterprise is working under conditions of monopoly, it is not possible to maximize the profit because of its commitment to social purpose.

The differential pricing approach has got wider acceptance because of its proven merits. It makes necessary the computation of the financial consequence of every social obligation externally imposed on the public enterprise. This makes the government think at least twice, if not more, before superimposing a social decision on the enterprise. Moreover, it keeps the management under pressure to earn a fairly defined figure of net revenue, notwithstanding the presence of social obligation. The approach can be a valuable tool in the hands of PEs to synchronize their seemingly opposite characteristics.

Conclusion :

Public enterprises are a deliberate creation of the State to fulfill the goals of economic development in a desired fashion. They occupy a prominent position in our economy performing a wide range of economic and social activities touching on many aspects of our lives. Their efficiency and effectiveness have a major impact on the quality of our lives and pace of progress. To improve their overall performance it is necessary to bring about a synthesis between their social obligations and financial profitability which, because of contradictory nature, pose a big challenge to the management of PEs.

As the name itself suggests, the term 'public enterprise' embraces two key concepts : public concept and enterprise concept. Each concept represents an important dimension of the organization. The public concept of a public enterprise involves public purpose, public ownership, public control, and accountability to the public. These elements of public concept essentially reflect the social ownership, social orientation, and social obligations of PEs in general. The enterprise concept, on the other hand, is based on the assumption that a public enterprise is essentially a business organization and as such it must be run on business lines and commercial principles as far as practicable. In the interest of their efficiency and effectiveness, the management of PEs must try to bring about a synthesis of two contradictory dimensions of social obligations on the one hand and business requirement of earning a minimum satisfactory return on the other. To this end, differential cost pricing approach can play a useful role. However, the task is not an easy one and the management will have to address the problem with all the skill and intelligence that the situation may demand. It is important to keep in mind that the application of this approach to synthesis will be largely determined by the policy of the government which now appears to emphasize the business character of PEs for financial viability and increasing profitability on continuing basis in a competitive market economy.

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