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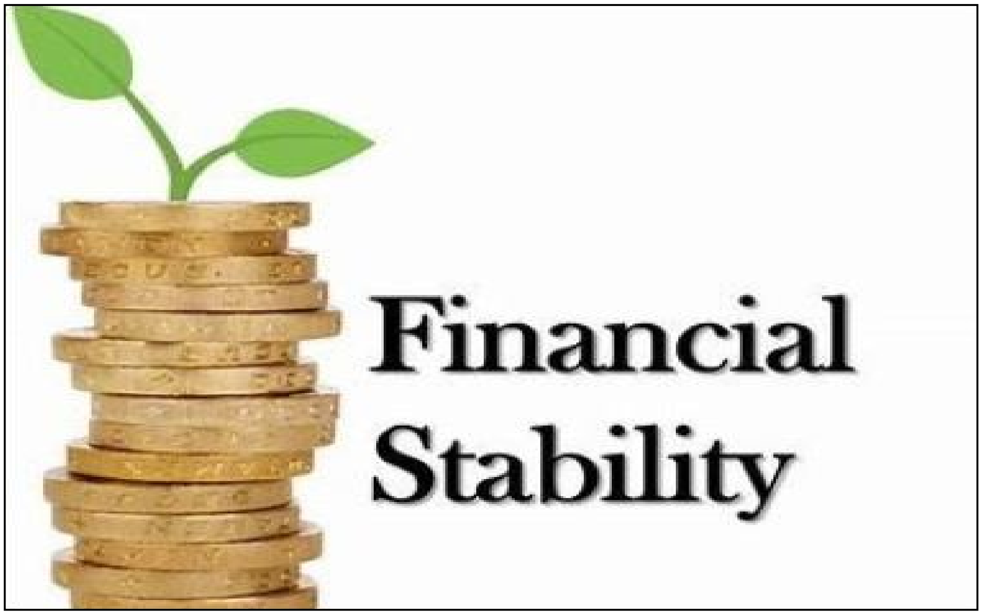
LIQUIDITY TO FINANCIAL STABILITY AT PUBLIC SECTOR ENTERPRISES: REVIEW OF LITERATURE



Mihir Kumar Jha
Research Scholar ,
Commerce
L.N. Mithila University, Darbhanga.

ABSTRACT :

Economists have contradictory views on the significance of the liquidity to financial stability. It is true that liquidity is very important for the smooth functioning of any economy and excess liquidity can be more harmful, if not tackled by the monetary authorities of the country, simulated less liquidity can also be dangerous for the smooth functioning of the economy as discussed in this paper.

KEYWORDS: Financial Stability, Liquidity, Profitability, Public Sector Enterprises.

INTRODUCTION :

Even the times of growing significance of corporate social responsibility one should not forget that the "main business of business is business". Meaning thereby, the basic objective of a business is to earn a profit which makes organization capable in performing well in all spheres of corporate life. Of course, the focal point of financial performance of any entity is "Profit" which was referring to the accounting profit.

Every organization establishes and maintains a system of accounting to accumulate the economic events, records them properly and communicate right information to the right person at the right time. The profit measured by the system of accounting using all material inputs is the most important variable in assessing the financial performance of the organization.

REVIEW OF LITERATURE

An early attempt has been made by Prof. Ramanathan on Finances of Public Enterprises in 1971, wherein he has examined and analyzed different aspects of financing of public enterprises. While focusing his attention on the profit and profitability criteria, he has explored into the impact of pricing policies on the public sector financing.

Sharma has highlighted the problems of financing the operations of public enterprises at different stages such as gestation, operation and expansion. It is observed from the study that the government was the major provider of finances of these enterprises. The pattern of financing during period was similar to the gestation period. The contribution of internal funds was far behind the potential mainly due to the poor operating profits, which led to the dependence on borrowed funds in the total capital structure of these enterprises. Singh has made an exploratory study on the performance of public enterprises during the period of ten years ending in 1979-80. He has identified a number of reasons for the performance of public enterprises, which include the long gestation periods, adoption of administered price policies, managerial inefficiencies and indifferences, accountability, role of policies in policy making etc.

Singhania and Balakrishna (1981) analyzed the relative performance of the public and private sector taking a larger sample of 16 out of the 32 companies during the period 1977-78. They found out that share capital as a percentage of total fimds employed had been fairly stable at 33 to 36 percent in the private sector while it had risen steadily from 67 to 80 percent in the public sector within five years. While tiie private sector generated and retained sizeable funds for plough back, there had been erosion of capital in public sector due to large accumulated losses. As for external finance, the private sector units mostly relied on secured loans, debentures and term loans while the public sector has brought in sizeable funds as unsecured loan from government. Utilization of funds was markedly encouraging (efficient) in the private sector than in the public.

Bagchi had made an evaluation on the role of public sector in India against the explicit and implicit objectives during the period 1976 and 1985. He has appreciated the performance of these enterprises in respect of their efficiency in generation of employment and their contribution to the net domestic savings in India, He lamented on non-implementation of different recommendations made by the different committees for the betterment of the efficiency of these enterprises. He has pleaded for restructuring the management styles and accountability aspects of these enterprises.

Bhatia[4] has made a review on different studies relating to the profitability performance of public enterprises. The studies reviewed by him have concluded that the common melody for deteriorating performance of public enterprises is the lack of commitment and lack of accountability of management at all levels.

Prakash has made an attempt to find out suitable criteria for measuring the efficiency of public sector in India. After a careful analysis of Singhania and Balakrishnan, performance of private and public sector units, the works of different authors like Sergeant Florence, Gilber Walker, Om Prakash, G.P. Keshav and others he suggested a set of different financial measures to evaluate the efficiency of public sector.

Economic Times Research Bureau (1984) presented detailed analysis of the performance 101 giant companies and 150 mini giant companies in the private sector. As regards the industries in particular it found that the major profitability ratios declined marginally in the year 1981-82 compared to 1980-81.

Rao of Reserve Bank of India has evaluated the performance of non- financial non-departmental enterprises in public sector covering a period of two decades ending in 1980-81. He observes good capital-output ratios and capital formation rates during this period. He has evaluated the productivity in operations by employing Cobb-Douuglas production fiinctions between operating surpluses and the fixed assets turnover ratios and gross figure. He found that the entire capital formation is financed through borrowing either from government or other institutional agencies. He observes that the hike in inflation rate has been reducing the operating surpluses to the extent of 0.92 percent with every one percent rise in Price Index.

Kapadia has made a study to find out the contribution of "taken over" units, in the poor financial surpluses earned by public sector enterprises during 1978-83. He observes that the taken over units account for 18 percent of total investment, 22 percent of total sales turnover and much higher 45 percent of employment of all central government enterprises. He observes that 48 taken over units are in red during the entire six-year period of the study amounting to Rs. 936 crores. He suggests for no-more takeovers of sick industrial units just for the sake of protecting the employment as these units subsequently behaving as relief undertakings and mostly is non-viable to achieve the commercial results from them.

Chalam and Murthy have made a study on the performance of public sector enterprises in India and they have attributed the poor financial performance to the excessive use of external sources in their capital structure. They have evaluated the effects of heavy external finances on net incomes and on short-term liquidity position, in turn affecting the working funds available for successful operation. They have suggested for allowing more private equity participation increasing the operating efficiency through controlling costs and improving the capacity utilization and factor such alike.

Srinivasan has made a study on some of the recent trends in financing public sector enterprises in India. He observes that the role of equity has been declining in public enterprises form 26.4 percent to 20.6 percent and interest bearing fimds have been occupying 30.3 percent to 33.6 percent of the total capital structure during 1975 and 1983. These shifts together with increasing interest rates have hiked up the interest burden of the enterprises and have adversely affected the financial viability. This is contrary to the performance of private sector enterprises that were able to bring down the share of costlier bank loans during the same period. He suggested for adopting a more realistic approach in the preparation of financing plans and adoption of irmovative modes of financing, considering the debt capacity and the available operating surpluses in public sector enterprises.

Trivedi has made an analysis on working of public sector enterprises to construct a criterion for evaluating their financial performance. While discarding the concept of profitability as traditional criterion on the grounds that this criterion suffers from the problems of accounting limitations, he has suggested a simple multiple indicator. As per his indicator, the performance, is a weighted average of labour productivity and the ratio of production to its capacity. Further he has suggested an eight step alternative measure for evaluating the performance of a unit in public sector.

Viswanathan has evaluated the performance of public sector enterprises during 1979-80 and 1984-85. Between the two categories of industrial unit, he observes that the production-oriented industries are faring in a better way than the others. In the light of loosing the entire capital base by some of the loss making enterprises, he recommends for the adoption of joint-stock concept by putting the enterprises on rails.

Shastri Mehta had made a survey on the existing literature on the working of public sector enterprises during the last three and half decades and feels that because of the interference from different quarters, from project approval to implementation, leads to lack of accountability. He estimates that the delays, poor coordination, wrong decisions, wrong selection of sites, machinery and staff will cost the nation to the extent of 10 percent of total seventh plan outlay. He suggests for writing the accumulated losses of some public sector undertaking and gives a chance to introduce a new work culture for the future betterment in them.

Gupta has made a study to find out how the investments in central public enterprises are financed. He has analyzed the role of extra budgetary provisions and the recent prominence of public sector bonds, external commercial borrowings, inters enterprise borrowings fi*om specialized coordinating committees, development funds and such others. He observes that the governments' budgetary support has been declining during the recent past. This has made the enterprises to find sources for themselves on competitive lines.

Venkatachalam has made a study on the performance of public sector enterprises especially considering the trends and relative roles of external and internal sources in public sector enterprises covering a period of nineteen years from 1960-61 to 1978-79. He has evaluated the financing patterns of public sector enterprises and found that these enterprises were increasingly dependent upon external sources of finance. The borrowing from government and semi-government agencies are continuously increasing. He has observed that the imbalances in the financial structure caused by heavy loses of debt capital has created the interest burden and it is constituting in its own way for the poor financial performance. He has suggested for improving the operating efficiency through allowing private equity participation, re-organization of capital structure and rationalization of pricing policy.'''

Chattopadyaya has brought an evaluation work on the performance of central Government enterprises covering a period of 18 years from 1969- 70 to 1986-87. He presented the criticisms leveled against the performance of ps enterprises and evaluated that the public sector units do have the potential to record much better results, provided they are run on business lines by maximizing the rate of return on capital employed. He has put forwarded a number of suggestions to improve the working of these units, including the application of principles of sound management.

Sankar and Sai have conducted a comparative study on private and public sector enterprises with respect to their financial efficiency during period between 1986-87 and 1988-89. The study identifies that the private and public sector enterprises differ in creating a surplus to the extent of 9 percent on sales. The capital employed in public sector enterprises showed a better performance. The profits earned in private sector are three times higher in size of the equity than in the public sector. Capital structuring strategy and the accumulation of reserves helped the private sector to a high financial efficiency.

Rao and Latha have made study on the Financial Management and productivity in public sector enterprises covering a period of Ten years from 1975-76 to 1985-86. Operational and financial performance of these enterprises was evaluated through various operational and financial ratios. It was observed that high capital output ratio and slow growth rates in partial and total factor productivities as explanation for poor profitability in most public enterprises during the period. It was also noticed from the study that there exists wider fluctuations in operating cost responsiveness, utilization of resources and excessive investment on fixed assets of these enterprises. The study identified lower profitability in these enterprises during the study period and suggest for improvement by allowing these enterprises work in an entrepreneurial atmosphere.

The performance appraisal of Tyre industry in India was made by Aziz by taking five important tyre units viz., Appollo Tyres limited, MRF Ltd., Dunlop tyres Ltd., Ceat Tyres of India Ltd., and Good year India Ltd.

He has used the performance appraisal techniques like ratio analysis and value added analysis. By using these techniques, he ahs analyzed the production performance; cost and sales trends, profit performance and comparative financial strength of these companies for a period of 7 years i.e., during 1980 to 1986.

Rao and Parthasaraty, (1994) in their study of Debt-service coverage ratio with reference to Andhra Pradesh state financial corporation and analyses resources of SFCs, which influence the ratio. After identifying a fluctuating trend in ratio, they suggested a ceiling on cash holding by the SFCs. Disposing of assisted sick units and careful screening of loan applications.

Singh, Arora and Anand (1994) have evaluated the performance of Haryana financial corporation, and in doing so; they have compared it with the performance of other SFCs using various ratios. They opined that its performance was commendable in developing SST's in backward regions, but its operation at efficiency and financial performance were disappointing?

Majumdar has examined a study on relative performance of public, and private sectors in Indian industry during the periods of 16 years between 1973-74 and 1988-89. The performance of these sectors was measured through growth rates in total fixed assets, working capital and human capital against the output of the respective sectors. The study results indicate that the joint sectors firms but less efficient than those of in the private sector."

Indrasena Reddy made a study on the performance of public enterprises through value added approach during the period form 1988-89 to 1992-93 selecting BHEL as a study unit. It is observed form the study that the productivity ratios in terms of value added in relation to various resources of BHEL were increasing during 1988-89 and 1992-93 except with regard to capital employed. The study concluded that there exists greater scope for fiirther improvement of value added ratios of BHEL followed suitable cost control measures.

Singh, Arora and Anand, "Reports of Haryana Financial corporations" 1993-94 Griffin (1984) has identified indices such as production efficiency, corporate structure, health of earnings, R&D, economic function, executive effectiveness, service to stockholders effectiveness of Board of Directors, fiscal policies and sales, as factors that affect the performance of organizations. Some reservations could be expressed as to the possibility of evaluating these measures effectively in view of their subjective nature. But that is a general limitation that makes social research completely different from physical science research.

Mr. V. Rengarajan (1996) has noted that the working capital management is the Blood stream in the care of any company and is an integral part of the overall corporate management. Very frequently one come across the pessimist, the imitated or the excuse finder who laments about the imponderables and obstacles of effective working capital management. Management is the art of Anticipating and preparing for risks and uncertainties and overcoming obstacles for the finance manager also is ready to play this role and has a working knowledge of the tools and techniques he can employ to carryout his tasks. The working capital sphere throws open a welcome challenge and opportunity too.

Surendar Yadhav, P.K.Jain and Sanjiv Gambir made an attempt to study the financial health of manufacturing companies in private sector. They have selected 150 private companies of 5 years from 1991 to 1994. In this study, they have analyzed the short-term liquidity and long-term solvency of these companies through ratio analysis. From this study it is observed that the current ratios have shown consistency over the periods of the study, but there is not sufficient cushion to meet current liabilities. This has also been confirmed by acid test ratios because of the fact that around 40% of current assets are in the form of inventories. As regards leverage and coverage measures, the debt equity ratio is calculated which shows a decreasing trend. When this ratio is calculated including short term loans, it shows a similar term but reveals that loans form a significant part (75%) of the total capital of a company. This means there is a fixed liability which these companies have to bear year after year. The trends in interest coverage ratios are fluctuating but above the norms required by the financial institutions. Also the debt service coverage ratio is above the norms required by the financial institutions. Also the debt service coverage ratio is above the level stipulated by the financial institutions except in one year.

Management Succession and Financial Performance of Family controlled firms by Smith, Brain-F; Amoako-Adu, Ben in the year 1999. This paper examines the immediate and long-term impacts on financial performance of 124 management successions within Canadian family controlled firms when family successors are appointed, stock prices decline by 3.20% during the 3-day (-1 to +1) event window, whereas there is no significant decrease when either non-family insiders or outsiders are appointed. However, a cross-sectional analysis indicates that the negative stock market reaction to family successors is related to their relatively young age, which may reflect a lack of management experience rather than their family connection per se. Investors are uncertain about the "management quality" of family successors who have less established reputations than more seasoned non-family insiders and outsiders. Non- family member appointments tend to follow periods of poor operating performance implying that there might be more scope for improvement when a non-family successor is appointed. Unlike the US sample in Mc Conayghy et al (1998), which indicates that the median percentage of votes held by controlling families isles than 15%, the Canadian sample indicates a more concentrated ownership with the median percentage of family controlled votes exceeding 51%. Of the firms in our sample, 62% use dual class capitalization to maintain control within the family. Driving financial performance through the du pont identity A Strategic Use of Financial Analysis and planning by Firer, Colin in the year 1999. The researcher presents an easy to understand conceptual model that provides a framework within which to explore the financial health of the firm as well as a consideration of international practices. It has been argued that the traditional layout of the du pont identity should be modified. To correctly interpret changes in the financial health of the firm brought about by changes in the management of the firm's assets, the use of net assets rather than total assets and short-term debt should be grouped together with long- term debt in the sources of fluids portion of the balance sheet. It is also shown that the concept of sustainable growth can easily be integrated into the du pont identity, providing the linkage between financial analysis and financial planning. Pitfalls in the use of some of the published sustainable growth models are identified.

The business cycle financial performance and the retirement of capital goods by Goolsbee, Austan in the year 1998 the neoclassical investment literature assumes that capital is homogeneous, lives forever, and has a constant depreciation rate. More recent theories of investment have shown that when there are distinct capital vintages with embodied technologies, depreciation and capital vintages with embodied technologies, Depreciation and capital retirement become economic decisions and this raises important problems with existing empirical work. Directing testing of these issues, however, has been rare because of the lack of micro data. This paper uses new data on the services levels of individual capital goods in the airline industry to empirically examine the impact that economic factors have on capital retirement. The results strongly support the views that retirement is fundamentally an economic decision. Retirement is much more likely in recessions, which the cost of capital is low, or when a firm has good financial performance. Factor prices and industry regulation are also important. Since many of these factors also influence capital expenditures, the results imply that estimates from the conventional investment literature, such as the effect of the cost of capital or financial performance, may substantially overstate the case since their impact on net investment may be much more modest than their impact on gross investment. The results also have implications for the measurements of productivity.

A Note on the Dimensionality of the Firm Financial Performance Construct Using Accounting, Market, and Subjective Measures by Rowe, W, Glenn; Morrow, - J-L, Jr" in the year!999. Most research in strategic management. operationalizes firm financial performance by using either accounting or market-based measures. Recently, some have suggested that subjective measures may be useful in assessing a firm's financial performance. We argue that there is a theoretical basis for viewing firm financial performance as having a higher order structure consisting of three separate yet distinct dimensions. Using second-order confirmatory factor analysis, we found that while differences exist among accounting, market, and subjective measures of firm financial performance, there is evidence to support the concept of a single underlying construct. While our finding share statistically significant and thus support our hypotheses, the substantive nature of our results suggests that much more research is needed before we fully understand the dimensionality of firm financial performance.

Corporate Governance And Financial Performance: A Study of German and UK initial public offerings by Goergen, Marc in the year 1998. Analyzes the ownership of both German and UK companies that went public during the 1980's, the evolution of ownership from the flotation to six years afterwards, and the consequences for corporate value. Provides an overview of institutional arrangements in Germany and the United Kingdom and analyzes whether possible differences in the listing rules and inheritance tax explain the observed differences in ownership of British and German firms studies the evolution of ownership and control in the German initial public offerings (IPOs) compares German IPOs with UK IPOs using two matched samples, one matching German with UK firms of the same size and the other matching German with UK firms in the same industry.

Develops an econometric model to analyze the evolution of ownership and control in the two matched samples and explains different ownership structures between the firms and coteries by levels of risk, the personal liquidity needs of the initial shareholders, the pre-IPO ownership concentration, and the involvement of the founder in his firm. Analyzes whether firms of different ownership structures levels of financial performance derives policy implications.

V.P. Seetharaman has made a study on the "financial performance of public sector enterprises in India 'with reference to selected Heavy and Medium engineering enterprises. This study covers a periods of 21 years from 1975-76 to 1995-96, He has taken the tools like capital-output ratios; value added, capital formation, trends in productivity and management of funds and productivity. The results of the various indicators favoured the BHEL of Heavy engineering and BEL in case of Medium engineering enterprises and their performance was found to be good during the study period next to the two sample units, the respective groups during the study period. All the other sample units did not have progressive performances.''

Sudha has made a study in the year 2001 on Financial Performance of public sector enterprises and New Economic Policy". From the study, it is observed that the financial performance of public sector enterprises have been much better than what one expected after NEP. The general contention that all public sector enterprises are loss making and are best privatized is not the most appropriate conclusion that can be understood on logical terms. From the study, it is quite clear that public sector enterprises made good provisions to gear up against the challenges of competition and a rather hostile wave against them. It is thus commendable that despite all the charges of sluggish performance and growth, all public sector enterprises are taken tighter at the end of the day make profits.

Voulgari, Fotini made a study on "Size and Financial Performance in The Greek Manufacturing Sector" in the year 2002 this purer explores the financial aspects of the manufacturing sector in Greece and investigates differences in the financial performance between small and medium sized enterprises (SMEs) and large sized enterprises (LSEs). Financial panel data are utilized covering a period of nine years. The ANOVA and MANOVA tests were used to examine whether the mean scores differ significantly between the two-size groups based on selected performance measures. The research revealed that Greek SMEs have significantly different performance from LSEs. More specifically, they exhibit higher liquidity, lower profitability, inefficient inventory management and lower net profit margins compared to the large sized firms of the sector.

Hamill, Philip, A. Mcilkenny, Philip, Opong, and Kwaku, K, made a study on "Directors' share Dealings and Company's Financial Performance" in the year 2002. This paper examines the response of security prices to the share dealings by directors of small capitalized firms in the United Kingdom and tests as to whether the share dealing contain information with regard to the firm's future financial performance. The results of the study indicate that investors respond positively to the information signals of directors' equity purchases. Researchers find little evidence to suggest that directors' equity sales possess significant information content. The results suggest that there is a positive association between financial performance and the type of trade directors engage in.

CONCLUSION

The Government departments and financial institutions have their own audit sections/departments. However, corporate entities, excepting a few have not given importance to such internal audit system. In the changed global environment an internal audit team with Qualified Personnel is a must. The internal audit reports should be processed honestly and remedial actions for the irregularities should be pointed out. Internal audit must be looked upon as a tool for the top management to manage their activities and to know how their administration and operational departments are functioning. Some scholars have earlier advanced a rather holistic argument saying that a good way of measuring performance is by a complete review and evaluation of the organisation's total set of activities. It was further argued that by doing so, factors that impinge on organizational performance and identified and evaluated.

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