Ailing Public Sector Undertakings
Revival or Euthanasia

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This article takes a critical look at the government's decision to revive two sick public sector undertakings – Hindustan Machine Tools and Hindustan Cables. It argues that the revival measures announced will only help these stricken companies flicker for a short while as these are not backed by an overhaul of management or production.

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In the second week of February 2013, the union government approved and announced a revival scheme for two of the oldest public sector undertakings (PSUs) – Hindustan Machine Tools (HMT) and Hindustan Cables (HCL) – which are virtually gasping for life. As per this revival scheme, these two sick firms would receive a revival package, partly by cash and the balance in non-monetary consideration such as waiver of loans and interests on them. The government has, for some time now, considered entering into a joint venture or collaboration in the cable industry for HCL; but did not think of any alternative other than investing more funds in the case of HMT.

At the time of Independence, there were only five firms in the areas of strategic importance like capital-intensive oil and natural gas, heavy engineering, steel and mining. Then the country began its journey of industrialisation over various five-year plans and established about 250 central PSUs, referred to as the "temples of modern India" by Jawaharlal Nehru. This apart, many other PSUs were set up by different state governments. Rapid infrastructure building and industrialisation was the main reason for the establishment of PSUs in the initial years after Independence. As the decades passed, this changed to political considerations, which now became the main drivers for the establishment of PSUs. Other than this, nationalisation of privately-held industries in areas like textiles, tea, cement, coal, transport, etc, too added to the number of PSUs.

Generation of employment and perceived development of backward regions replaced economic considerations for the establishment and spread of PSUs all over India. Many of the 250 PSUs were in the non-core areas of newsprint production, tea trading, handicrafts and tourism. With a closed-door economy, unhindered patronage of the governments and rigid licensing policy along with ample cushioning from the government, the PSUs sailed along without any competition to speak of. Professional management was replaced by bureaucratic management with politicians often taking over as the heads of many of these PSUs.

Winds of Change

But with the tide turning with the abolition of the licensing regime and the introduction of market-based reforms, the PSUs struggled to keep up with its competitors. Their market shares were eroded mainly due to high costs of production and poor quality of products as well as unimaginative marketing techniques. Lack of professional leadership, autonomy, technological bankruptcy and inadequately trained manpower coupled with politicised trade unionism rapidly drove many of these enterprises towards bankruptcy. Since the government no longer could afford to keep them cocooned in their subsidies, the net worth of several firms eroded, signalling their bankruptcy. Eventually many were referred to either the Board for Industrial and Financial Reconstruction or the Board for Reconstruction of Public Sector Enterprises.

The core of the structural reforms was the issue of accountability which affected governance and transparency, and government brought in several changes including the stewardship of funds. Over several decades, government as the sole or majority owner has been bailing out sick PSUs which have proved unfruitful in several cases and realised that the scenario could not continue forever. The reasons ranged from lack of new equipment, technology or skilled personnel on one hand, and competition from the private enterprises on the other. The high costs of production and sales too have been a deterrent to the sustainability of the enterprises. Subsidies have been seen as a disincentive. There could be an inherent fear that subsidies would be withdrawn, if the profitability of a PSU was to be maximised. That may also have been a reason for fixing targets lower than the optimum.

Attempting Revival

The measures initiated by the government to revive the ailing enterprises were purely accounting and financial ones. A turnaround of an enterprise requires much more than just cash infusion and writing off of dues from these enterprises. Mere accounting and financial measures do not overcome the basic requirement of "change management" in terms of leadership, technology infusion, operating controls, strategic marketing and training and redeployment of manpower. No wonder, most of the ailing enterprises continue to be sick even after the "revival measures of the government".

Even before the government deliberated about HCL and HMT, 32 firms have been in receipt of the government munificence between 2005 and 2009 and a total of Rs 37,810.2 million in cash and Rs 2,60,607.8 million non-cash benefits were invested in them. While recording the success stories of the "11 Butterflies" as they were termed, the government considered only two financial parameters, viz, positive net worth and a net profit for three successive years from the year of the receipt of the revival package. Later, two more companies were added to the list. But the companies which received a lion's share, with Rs 28,035 million cash and Rs 210.490 non-cash assistance, failed to restructure themselves.

HCL, incorporated in 1952, grew from a single-product single-entity organisation to multi-product multi-unit firm manufacturing among other things jelly-filled and fibre-optic cables. It could not adapt itself to the changing technology or keep pace with its competitors and failed to achieve any turnover in the year 2011-12. HMT, assisting the green and white revolutions, had the nation singing its praises, was incorporated in 1953 with the objective of manufacturing tractors and food-processing machinery. Later, it diversified into a bewildering array of products like watches, lamps, batteries, brakes, machine tools, plastic injection, moulding machines. While HCL lost its largest customers – Bharat Sanchar Nigam (BSNL) and Mahanagar Telephone Nigam (MTNL) – due to its inability to adapt to the revolution in wireless technology, HMT lost out to private players like Escorts and Mahindra & Mahindra.

The government's decision to consider only the parameters of net worth and net profit is totally inadequate for the purposes of PSU revival packages. Net worth and net profit are the outcome of series of measures of both financial and professional management. Any revival measure taken by the government is bound to flicker for a short while and die if it is not backed by better quality of products and services, or prices.

Monitoring Revival

None of the measures based only on financial and accounting parameters can lead to sustainable revival of an enterprise. It is equally important to focus on other ratios of both liquidity and efficiency to monitor the revival of an enterprise. A study of the financial statements of the 13 "revived" firms reveals that there has been little or no improvement either in their operational efficiency or in their liquidity position. Further, the accounting regulations have resulted in the net profit escalating in the year of the receipt of the revival package, with it being treated as other income/extraordinary income and plunging immediately in the subsequent years. If these 13 were truly revived, the ratio of cost of sales to sales should have improved and reached closer to the ratio of their competitors. A calculation of Edward Altman's 'Z' scores to calculate the bankruptcy level too reveals that these companies are far from being revived. The return earned by them does not even equal the risk-free rate of return calculated from time to time by the Reserve Bank of India.

Looking at the share of HMT in the total sales of the industry, it has slid from a low 1.8% of the total industry share in 2004-05 to a negligible 0.43% in 2011-12. Meanwhile, HCL's share in total industry sales has gone down from 1.78% in 2004-05 to 0% in 2011-12 as the production was brought to a standstill. HCL's operating loss has increased from Rs 980 million in 2004-05 to Rs 1,470 million in 2011-12, while its largest competitor Sterlite Industries holds 62% of the market share. A major contributing factor to the increasing expenditure of HCL is the employee cost which stands at 77% of the total operating expenses, while both the industry average and Sterlite Industries' share is 3.8% of the same. HMT too is facing a losing battle with its share in operating profits dipping from 7.8% in 2004-05 to 0.25% in 2011-12, while the ratio of employee cost to the expenses has mounted from 291% of the industry average to 633%. Another dismal picture is the ratio of cost of sales to sales of both the firms. While HMT's cost of sales stands at 124% of its sales figure at present, HCL's ratio is zero, as there has been no sales recorded in the current year and was an astounding 94,240% in the preceding year.

Conclusions

In the absence of other measures for change management, like infusion of business leadership, technology and product upgradation, manpower redeployment and strengthening of research and development activities, the cash component of the revival package would be sufficient only to pay the arrears of wages and other operating dues, without resulting in any sustainable operating efficiency and without operating cash surplus. While it is important to pay the arrears of wages and the other operating costs, the question to be asked is, will these measures be sustainable? The opportunity cost of capital is to be studied while allocating resources for revival of the sick PSUs.

A question that would be asked by any taxpayer would be "should the government fund the restructuring schemes to the tune of Rs 360 billion which otherwise could have been used for other developmental purposes?" Would it earn the minimum interest at the risk-free rate prescribed by the Reserve Bank? Looking back at the "Greek tragedy", there could exist a possibility that a failure in PSU management could very easily trigger and lead to a failure of the economy. Why should the government believe in owning firms which are no longer of strategic importance and are a burden to the citizens? Many firms trading tea and newsprint, manufacturing salt, soaps and detergents have outlived their importance in the public sector. The government could build its capacity in areas of strategic importance instead of funding projects on which either the return on capital is insufficient or the private players have better efficiency.

All that can be said is that if HMT and HCL were to be in the private sector, no sensible businessman would have allowed the company to be eroded by the termites of inefficiency and complacency. The kindest and the most practical decision to be taken would be to pay an attractive one-time settlement to the employees and hive it off or sell the land on which it is situated, which is worth its weight in gold. This would cut down the repetitive infusion of taxpayers' funds to benefit a few hundreds of workforce with no work to do.