

Financial Management in the State Owned Enterprises in Mizoram

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Abstract: *Financial Management in the State Owned Enterprises(SOEs) in Mizoram discusses the financing, investment and the dividend decisions as applied to the five SOEs of the Government of Mizoram. The state enterprises are established to carry out activities of commercial nature while keeping in view the welfare of the people. The primary objective of these SOEs is to promote and develop the industrial sector of the state, however, the SOEs have not contributed significantly and have been incurring losses continuously. An attempt is made to study the financial management to come up with possible solutions and suggestions for improvement.*

Key word: *State-owned enterprises, Financial management, Poor managerial efficiency*

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I. Introduction

Effective financial management holds the key to the successful functioning of any organization. The main responsibility for the sound financial management of a public enterprise vests on the financial manager or the chief accounts officer or the finance director who function under the overall direction of the managing director, chairman and the Board of Directors (Mathur, 2002). The financial manager, whether the enterprise is public or private, mainly deals with three decisions - financing, investment and dividend.

A well organized financial division is essential for the efficient financial management of an undertaking. If financial data are missing or inaccurate, the firm may not be in a position to identify the problems confronting the firm in time for necessary corrective action. The roles of different finance executives should be clearly defined in order to avoid any sort of conflict or overlapping of functions (Goel, 2001). The exact nature of the organization for financial management will differ from firm to firm, it will depend on factors such as the size of the firm, nature of the business, financing operations, capabilities of the firm's financial officers and most importantly the financial philosophy of the firm. The designation of the financial officer also differs from firm to firm (Pandey,2003).

The Government of Mizoram through its industrial policies identified agro-based industries, handloom and handicraft industries, sericulture industries, electronic industries, village and cottage industries and selected consumer industries as priority industries to be developed in the State. Consistent with this, the Government of Mizoram set up five PSUs which are government companies registered under the Companies Act, 1956. They are:

- * Zoram Industrial Development Corporation Limited (ZIDCO)
- * Mizoram Handlooms and Handicrafts Corporation Limited (ZOHANDCO)
- * Mizoram Food and Allied Industries Corporation Limited (MIFCO)
- * Zoram Electronics Development Corporation Limited (ZENICS)
- * Mizoram Agriculture Marketing Corporation Limited (MAMCO)

However, these SOEs have failed to achieve the objectives for which they have been incorporated. Recommendation for improvement of performance or closure of the enterprises has been given by the Comptroller and Auditor General of India (CAG). The SOEs suffer from poor managerial efficiency, this paper looks into the financial management in particular to understand the underlying cause for failure.

II. Literature Review

Goel (2001) conducted a study on the working of financial management of selected central government undertakings in the manufacturing sector, a number of criteria such as procurement of funds, allocation of these funds, management and distribution of earnings and disinvestment policy have been used to analyse the financial management of these corporations.

Gedam (1995) provides a comprehensive theoretical discussion, pros and cons of several concepts, merits and demerits etc. of public enterprises. The value of money; 3E or efficiency, effectiveness and economy; and performance indicators as used in some of the developed countries have been dealt with. The

book provides advanced theories concerning public enterprises, and answers to several relevant questions, such as what makes organisations most efficient and how to improve performance. It deals with the performance evaluation of public enterprises, particularly 48 public enterprises under the department of Heavy Industries and Public Enterprises, Government of India.

Kabra (2008) attempts to examine the role of business and industry in the economic growth of the state of Mizoram. Tracing the factors that led to the development of business and industry in the state, he analysed the role of government in the promotion and regulation of business and industry. In the process, discussion on the role played by financial institutions and SOEs in the development of industry in Mizoram has been mentioned.

Sapru (1987) presents major explanations of the public sector enterprises' weakness as well as proposal for its rectification from the full spectrum of management. The vast number of state owned enterprises has confronted the country with the basic dilemma of how the operating and financial autonomy required for the successful conduct of an enterprise be reconciled with the need for controls to assure public accountability and consistency in public policy. The book in two massive volumes with an array of experts in the field provides an incisive analysis of the central issues in debate about the future of the public enterprise sector.

Singh (1991) writes on theory and practice of public enterprises, rationale of public enterprises in India, organisational set up of these enterprises, the need for balance in autonomy and accountability, managerial issues such as personnel management, industrial relations, finance and pricing. Finally the performance of public enterprises in the past is traced highlighting the various complexities that has resulted from state intervention. The study focuses on the SLPEs of Bihar with respect to their performance and problems has been given. The problems of continuous loss, managerial inefficiencies and excessive political interventions with no proper accountability are common problems identified in the present study.

Mittal (1992) presents a volume aimed at understanding the overall management perceptions of executives in the public sector to assess not only the specific operational tools and techniques used by these managers but what the major concerns of these enterprises are such as public enterprise and economic growth; managerial stress; controls; workers' participation and trade unionism. The book also looks into issues concerning the public sector management of SLPEs of Kerala, and the prevailing management practices of other countries such as Tanzania, Mexico, Canada and Africa.

III. Objective & Methodology

This article focus on the financial management of the state owned enterprises, to explore the practices and the applications of finance in the corporations.

The study covers all the five state owned enterprises in the state of Mizoram. The study of financial management of the SOEs has been primarily based on the data of the Comptroller and Auditor General of India (CAG) Annual Reports from 1998-2012. This seems to be logical as the state enterprises have arrears in accounts and have not finalized their financial statements for a number of years. The three SOEs ZOHANDCO, MAMCO and MIFCO were unable to provide the financial data as the chartered accountant firms have not yet finalized the audit at the time of data collection. As such, the most reliable source of information with this regard was the one that has undergone statutory audit by the CAG.

IV. Findings and Discussion:

The state enterprises are established to carry out activities of commercial nature while keeping in view the welfare of the people. The primary objective is to promote and develop the industrial sector of the state, however, it occupies an insignificant place. The SOEs are fully owned government companies, operating within the administrative precinct of the concerned administrative departments, the Board of Directors is appointed by the governor, with one member being the managing director in charge of the day-to-day management of the enterprises. The chairman is generally appointed on the basis of political considerations. Others include the departmental secretary and other such heads of the concerned departments, along with some politicians. All major financial decisions are taken by the Board of Directors with a few being delegated to the managing director. The Finance & Accounts Department would take care of the routine work and procedures.

All the SOEs under the study have a separate Finance & Accounts Department that is responsible for the day-to-day financial operations, procedures and record keeping, with the major policy decision making authority resting on the Board of Directors and the managing director. These departments are generally headed by the finance manager with two to three assistants or deputy finance manager and one accountant but in the case of ZIDCO, the finance department is the largest as the corporation is basically a financial corporation, it has a separate department that caters to loan recovery and is named accordingly. In case of MIFCO, the Articles of Association provides for the appointment and removal of financial adviser and chief accounts officer but has not been put into operation. The routine financial procedure which involves paper work and time but do not require specialized skills are generally delegated to the assistant finance manager/officer or accountants/assistant accountants. The finalization of accounts and the preparation of the financial statements are outsourced to

internal auditors from the consultancy firms approved by the CAG. The aforesaid discussion highlights the broad framework of the financial management of the SOEs.

The investment of the Government of Mizoram in the five public sector undertakings amounted to Rs. Rs. 94.98 crore as on 31 March 2009, the total investment consisted of 64.57% towards capital and 35.43% in long-term loans. The investments of the state enterprises formed a very insignificant portion of the Gross State Domestic Product (only 0.03% as on 2010) which does nothing to diminish the importance of the development of the industrial sector but actually highlights the urgency and necessity of the state enterprises. The state enterprises have been commented for the lack of control over the PSUs by Government, abnormal delay in compilation/approval of the accounts and delayed submission of the same to the Statutory Auditors by the management and delay in adoption of accounts in Annual General Meeting. The State Government investment in such PSUs remains outside the scrutiny of the State Legislature.

The financing decision perceived to be in operation as conceptualised in financial management apparently has not been practiced by these state enterprises. Finance requirements are not only unplanned in advance, they are not made available even when required by the government. Moreover, the management has not made enough effort to refinance from their own resources, they are instead wholly dependent on the government to supply their financial requirements. This defect in making proper financing decision is indeed a serious flaw on the part of the government as this could be regarded as the major cause of the sickness in these enterprises. This has been continuously pointed out by the CAG reports for the last ten years.

The enterprises have been formed as company organisation, their funds converted into share capital but the financial management criteria that is set for the company form of organisation is not adhered to or relevant as there is virtually no cost of capital charged to the enterprises by the government, the contribution is given in the form of share capital as and when funds are available, which is usually just enough for administrative and personnel expenditures.

There has been an acute lack of accountability, differences exist in the accounts of the state and the SOEs in respect of equity, loans and guarantees outstanding in the records of SOEs and the finance accounts of the State. The SOEs have not laid any concrete plans for the formation of capital structure either for the long term or short term in an effective manner. There has been repeated cases of diverting grants-in-aid for administrative expenses, this is because there is no proper planning for provision of funds for meeting short-term needs, i.e., planning the cost of working capital and providing for such requirements.

The investments of the state enterprises for the five years (2004-2009) is Rs. 422.26 crore, a loss of Rs. 24.29 crore have been incurred over the same period, the losses of the state owned enterprises are mainly attributable to deficiencies in financial management, planning, implementation of project, running their operations and monitoring. A review of three latest audit reports of CAG shows that the SOEs incurred controllable losses to the extent of Rs. 11.77 crore and infructuous investment of Rs. 3.78 crore.

As per the latest finalized accounts of the five SOEs, the capital employed worked out to Rs. 69.17 crore and total return thereon amounted to (-) Rs. 2.41 crore in 2008-09 as compared to capital employed of Rs. 49.73 crore and total return on capital employed has not shown any improvement. All SOEs were incurring losses continuously over the period of six years which resulted in increase in accumulated losses from Rs. 21.10 crore in 2003-04 to ` 40.23 crore in 2008-09. The test of a high-quality investment policy is the return on capital employed, the SOEs together have negative returns which implies the poor quality of the investment policies.

The state enterprises have yet to declare dividend even after 10-30 years, this is a serious indicator of the extent of their sickness. The Mizo people have yet to see any benefit through the declaration of dividend from these five public sector undertakings that have been apparently set for their well-being. With no effective internal control systems in place, the SOEs are ill equipped in risk management and highly susceptible to faulty financial management.

All the SOEs under the study have a separate Finance & Accounts Department that is responsible for the day-to-day financial operations, procedures and record keeping, with the major policy decision making authority resting on the BOD and the managing director. These departments are generally headed by the finance manager with two to three assistants or deputy finance manager and one accountant but in the case of ZIDCO, the finance department is the largest as the corporation is basically a financial corporation, it has a separate department that caters to loan recovery and is named accordingly.

The routine financial procedure which involves paper work and time but do not require specialised skills are generally delegated to the assistant finance manager/officer or accountants/assistant accountants. The finalisation of accounts and the preparation of the financial statements are outsourced to internal auditors from the consultancy firms approved by the CAG.

The state enterprises' financing decisions are vested in the BOD, the provisions of the AOA all lay down specific powers of finance on the BOD which are delegated to the managing director in specified degree. The BOD is commonly conferred the power to acquire property; authorise the works of capital nature; pay for

property, rights or privileges; secure contracts or engagements and make investments (MOA & AOA of the SOEs).

MIFCO and ZOHANDCO have had major differences with the government in recent years for not releasing required share capital on time and required amount. ZOHANDCO has pointed out in their annual report that the limitations faced by the enterprise in terms of performance, productions and operations is directly linked to the failure to release the required amount of share capital by the government. The annual reports have been summarized to see the trend in paid up capital, the budgetary outgo in each year for the SOEs and the outstanding loans and the sources which comes in two categories, state government, central government. This exercise has proved worthwhile for some enterprises whereas, in case of some SOEs particularly MAMCO, there has been no indication of change.

The CAG report stated that the financial statements are audited as per the information given by the SOEs. The books of accounts of the companies for every financial year are required to be finalized within six months from the end of the relevant financial year as per provisions of the Companies Act 1956. However, there are huge number of accounts in arrears with as much as 1 to 9 years arrears in finalisation of accounts. These shortcomings have led to difficulties in depicting the true financial position of the SOEs. The lack of professional staff in the accounting and finance departments has also posed a problem.

The State Government had invested Rs. 34.08 crore (equity Rs. 10.54 crore, loans Rs.10.72 crore, and grants Rs.12.82 crore in the five SOEs) during the years for which accounts have not been finalised. In the absence of accounts and their subsequent audit, it cannot be ensured whether the income and expenditure have been properly accounted for and the purpose for which the amount was invested by the State Government has been achieved or not. Thus, the State Government investment in such SOEs remains outside the scrutiny of the State Legislature. Further, delay in finalisation of books of accounts may also result in risk of fraud and leakage of public money apart from violation of the Companies Act, 1956.

The measurement of debt-equity ratio has been stated in the CAG Report as nil for three state enterprises (MAMCO, ZENICS and ZOHANDCO). MAMCO is inconsistently depicted and ZIDCO is the only enterprise that has prepared its financial statements on time for audit to the CAG and as such the only one available for scrutiny legitimately. Moreover, the CAG report on the Debt-equity ratio for the other SOEs has been nil because the debt capital is absent and the enterprises, as far as informed, are solely running on equity and grants in aid. There has been an acute lack of accountability, to exhibit this the CAG Annual Report (2009) commented the differences in the Finance Accounts of the State and the SOEs. The figures in respect of equity, loans and guarantees outstanding as per records of SOEs should agree with the figures appearing in the Finance Accounts of the State. In case the figures do not agree, the concerned SOEs and the Finance Departments should carry out reconciliation of differences. Audit observed that the differences occurred in respect of all SOEs and the differences were pending reconciliation over the period of more than ten years. The Government and the SOEs should take concrete steps to reconcile the differences in a timebound manner.

The SOEs have not laid any concrete plans for the formation of capital structure either for the long term or short term in an effective manner. There is a need for professionalism in management of these SOEs, there is tremendous scope for improvement. All SOEs have been diverting the grants-in-aid for administrative expenses. To make the point clear, MIFCO had diverted grant-in-aid of Rs. 3.92 crore relating to ongoing projects and utilised it for meeting the administrative and maintenance expenses of the company. It incurred cash loss of Rs.0.16 crore and total loss of Rs.1.64 crore during 2002-03 to 2006-07 due to under-utilisation of installed capacity.

Debt turnover ratio obligations of business in relation to its sales serves as a measure of financial stability. The SOEs have an unusually high combined debt turnover ratio of 14.17:1 in 2003-04 which increased to its highest point in the 6 years to 33.81:1 in 2006-07 and then decreased to 13.96:1 in 2008-09. There is an absolute abnormal ratio with the chances of recovery quite unlikely for the government. There is a rather nonchalant attitude about payment of overdues and in fact, as in the case of ZIDCO, the government has step in more than one situation to pay off the debts.

The financial position and working results of ZIDCO for five years period ending 31 March 2008 shows that it incurred losses in all the years under review and accumulated loss increased from Rs. 8.85 crore in 2003-04 to Rs.16.84 crore and eroded the entire paid up capital as on March 2008. The capital employed and the net worth of the enterprise became negative as on 31 March 2008. It had not evolved any system to forecast annual budgeted profitability for operation of its annual activities. ZIDCO had neither introduced any system of financial planning nor prepared business plan and resource forecasting for debt utilization of borrowed funds from financial institutions. It had not made provision of Rs.22.78 crore (31 March, 2008) for Non-Performing Assets (NPA) as per RBI guidelines. At the earlier stage of ZIDCO, there was an agreement between the Government of Mizoram and the Industrial Development Bank of India (IDBI) to make matching contribution to the share capital. However, IDBI discontinued contributing to the share capital from 1991-92 due to poor repayment of overdues of loans and refinance from IDBI by ZIDCO.

V.Conclusion

The analysis of the financial management of the state owned enterprises from the perspective of the financial, investment and dividend decisions has thrown lights into serious issues on erroneous practices. It highlights the crucial role that the financial management plays in the whole organization and is primarily responsible for either the failure or success of any enterprise. The state owned enterprises under study lacks professionalism in financial management, which is established by the fact that they do not prepare their own financial report; the accounts are in arrears for as much as 10 years; there are no proper financial plans; dividend has never been declared and no traces of profitability even after 20 years or so. Financial management principles are not applied and the internal control system itself does not justify its existence. An urgent need for restructuring the financial framework is called for.

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