Performance Differential between India’s State Owned Ratna Companies and Private Owned Enterprises

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ABSTRACT

It is generally believed that state owned enterprises are less profitable and efficient compared to private owned enterprises (POE). The objective of this study is to examine whether there is any difference in the profitability and efficiency of India’s state owned Ratna companies and POE. The period in this study spans from 2007 to 2016 and the sample consists of 71 Ratna companies and 332 POE. Return on shareholders fund, return on total assets and productivity of capital are used as measure of performance. The findings show that Ratna companies perform worse that POE.

Keywords: Performance, Private Owned Companies, Government Linked Companies

JEL Classification: G

1. INTRODUCTION

Central public sector enterprises (CPSEs) are those companies in which not <51% of the paid up capital is held by Indian Central Government or other CPSEs. There are currently 244 operating CPSEs under 43 different ministries and departments of Central Government. Ministry of Heavy Industries and Public Enterprises has the maximum CPSEs under it (33), followed by Ministry of Petroleum and Natural Gas (23) and Ministry of Railways (20). The CPSEs were set up to serve the broad macro-economic objectives of higher economic growth, self-sufficiency in production of goods and services, long term equilibrium in balance of payments and low and stable prices besides meeting certain socio-economic obligations. The CPSEs are key and strategic actors in the nation’s economy providing essential goods and services and holding a dominant market position in critical sectors such as petroleum, mining, electricity and transportation.

To identify and delegate enhanced powers to CPSEs having comparative advantage and the potential to become global players the Indian government began to classify certain CPSE as Ratna (Jewel) companies. In July, 1997 the government first introduced the Navratna scheme. In October 1997, the Government introduced the Miniratna scheme in order to make promising profit making CPSEs more efficient and competitive and to grant enhanced autonomy and delegation of financial powers subject to certain eligibility conditions. The Miniratnas companies are in two categories, namely, Category I and Category II. The Government introduced Maharatna scheme in February, 2010 with the objective to delegate enhanced powers to the Boards of identified large sized Navratna CPSEs so as to facilitate expansion of their operations, both in domestic as well as global markets. Currently there are 7 Maharatnas, 17 Navratnas and 73 Miniratnas CPSEs. These Ratna companies operate in both service and manufacturing and mining sector. Service sector Ratna companies operate in various industries like telecom, warehousing, trading, logistics, consultancy etc. Those is manufacturing and mining sector operate in industries like oil and gas, coal mining, power, steel, heavy machinery etc. The Ratna companies account for about 18% of India’s GDP and 12% of stock market capitalization.

It is generally believed that Ratna companies are less profitable and efficient compared to private owned enterprises (POE). There are several reasons due to which Ratna companies may perform poorly compared to POE. Many times Ratna companies have to forego profit in favour of social obligations. Also many times management of Ratna companies have to take decisions under political pressure. This study analyses the financial performance of the Ratna companies over the period 2007-2016 and compares their performance with POE.
2. LITERATURE REVIEW

Boardman and Vining (1989) compared the performance of private corporations, state owned enterprises and mixed enterprises among the 500 largest non-US industrial firms. The results provide evidence that large industrial mixed enterprises and state owned enterprises perform substantially worse than similar private corporations. These results indicate that there are performance differences between public and private companies in competitive environment.

Picot and Kaulman (1989) compared the performance of government owned and privately owned industrial corporations from six countries. The database comprised of Fortune’s “The Fortune 500” for the years 1975-1984. The empirical evidence presented in this study confirms that privately-owned large industrial corporations exhibit superior performance compared with their government-owned counterparts, especially with respect to productivity and profitability (even after accounting for size, industry and country effects).

Dewenter and Malatesta (2001) used various net-income-based measures to show that government-owned firms are significantly less profitable than privately owned firms. The difference in profitability was not only significant but also large. Moreover the difference in profitability was present in a sample spanning over 20 years and several business cycles. The study concluded that government firms are less efficient than private firms, at least to the extent that profitability and efficiency can be equated.

Wei et al. (2002) studied the relationship between ownership types and performance measures for 1036 firms in China. It was observed that state owned enterprises were consistently less profitable than mixed enterprises, collective owned enterprises, joint ventures and foreign owned enterprises. The state owned enterprises and foreign owned enterprises are also less productive than mixed enterprises, collective owned enterprises and joint ventures. The surprisingly low productivity for the foreign owned enterprises may result from learning curve for international investors doing business in China.

Goldeng et al. (2008) examined difference between private companies and state owned enterprises, with an emphasis on the effects of market structure. The study used a comprehensive panel covering in principle all registered companies during 1990s in Norway. Return on assets as well as costs relative to sales revenue were used as measures of performance. It was noted that privately owned enterprises perform significantly better than state owned enterprises.

Bhatt (2015) examined whether there was any significant difference in performance between government linked companies and private owned companies. It was found that there was no significant difference in performance level between government linked companies and private owned companies.

3. DATA

The objective of this study is to examine whether there is any difference in the profitability and efficiency of India’s Ratna companies and POE. The period considered in this study spans from 2007 to 2016. Out of the 97 Ratna companies, financial services companies and companies for whom data for all the 10 years was not available are excluded. So total 26 Ratna companies are excluded from this study. The sample of POE was derived from S&P BSE 500 Index companies. The S&P BSE 500 Index represents nearly 93% of the total market capitalization on BSE and covers all major industries of the economy. The S&P BSE 500 Index consists of both 65 public sector enterprises. These companies have been ignored while arriving at the sample of POE. Also financial services companies and companies for whom data for all the 10 years was not available are excluded. So a total of 168 companies from the S&P BSE 500 Index companies are excluded from this study. Thus the final sample consisted of 71 Ratna companies and 332 POE.

Summary statistics are measured to indicate the size of the Ratna and POE. The median of sales for the POEs was ₹ 25.8 billion and for the Ratna companies was ₹ 41.2 billion. The median of assets for the private sector companies was ₹ 32.7 billion and for the Ratna companies was ₹ 92.1 billion.

- To measure the difference in profitability following two profitability ratios are computed
- Return on shareholders fund = (net income)/(shareholders fund)
- Return on total assets = (net income)/(total assets)
- To measure the difference in efficiency the following ratio is computed
- Productivity of capital = (sales)/(total assets).

The data for this study is obtained from Prowess database of Centre for Monitoring Indian Economy. Prowess includes all companies traded on the National stock exchange and the Bombay stock exchange, thousands of unlisted public limited companies and hundreds of private limited companies. It also includes a number of important business entities that are not registered companies. The Prowess database is built from annual reports, quarterly financial statements, stock exchange feeds and other reliable sources.

4. RESULTS

Univariate analysis was done to find out whether there is any difference in the profitability and efficiency of Ratna companies and POE. Table 1 shows the average return on shareholders fund for the period 2007-2016. The average return on shareholders fund is 0.1448 for the Ratna companies and 0.1717 for the POE. This difference is significant at 1% level for a two tailed t-test.

Table 2 shows the average return on total assets for the period 2007-2016. The average return on total assets is 0.0563 for the Ratna companies and 0.0818 for the POE. This difference is significant at 1% level for a two tailed t-test.

Both the profitability ratios return on shareholders fund and return on total assets are significantly lower for Ratna companies compared to POE. Lower profitability ratios imply that the profitability of Ratna companies is lower than POE.
To identify whether there is any difference in efficiency of Ratna companies POE productivity of capital ratio is calculated. Table 3 shows the average productivity of capital for the period 2007-2016. The average productivity of capital is 0.6663 for the Ratna companies and 0.8972 for the POE. This difference is significant at 1% level for a two tailed t-test.

The lower productivity ratio of Ratna companies compared to POE imply that they are less efficient and require higher capital than POE.

5. CONCLUSION

This study compared the profitability of India’s state owned Ratna companies and POE. The sample consisted of India’s 71 Ratna companies and 332 POE. The period considered in this study spans from 2007 to 2016. Univariate statistical technique is used in this study. Two profitability indicators return on shareholders fund and return on total assets and one efficiency indicator productivity of capital are considered in this study.

The results provide evidence that Ratna companies perform substantially worse than POE. In terms of profitability indicators and efficiency indicators the Ratna companies perform badly compared to POE. The results indicate that there is performance difference between Ratna companies and POE.

In recent years there has also been a decline in the profitability of the Ratna companies. The average net profit margin of Ratna companies has declined from 17.26% to 7.67% from 2007 to 2016. Thus there is an urgent need to halt this decline in profitability of these companies. To achieve this objective the Indian government needs to regularly monitor the performance of these companies to avoid them from becoming sick enterprises. The government can also think of merging certain Ratna companies to improve their profitability through economies of scale. The Indian government had resorted to strategic disinvestment of certain CPSEs during the period 1998-2004 and there has been an improvement in performance of these CPSEs post disinvestment. The government can once again resort to strategic disinvestment of certain Ratna companies to improve their operating performance and the funds generated from disinvestment can be utilized for development of public infrastructure.

REFERENCES


