MEETING OF EXPERTS ON ADMINISTRATION OF PUBLIC ENTERPRISES IN LATIN AMERICA AND THE CARIBBEAN

Santiago, Chile, 17-22 November 1969

IMPROVING PROFIT PERFORMANCE OF PUBLIC ENTERPRISES IN DEVELOPING COUNTRIES

Paper prepared by the Public Administration Division of the United Nations
1. The historical annals of the developed countries of today present an early case example of controversy over the appropriate criteria of effective performance or success indicators for public enterprises. This is the case of the Prussian Seehandlung enterprises. The director of these enterprises, Christian Von Rother, it is significant to note, maintained throughout his tenure (1820-1848) that profit and loss should not be the criteria of his success. Rother wanted to set up "model enterprises" that would set an example of modern techniques to private enterprise; to reverse the decline of obsolete industries like the rural linen manufacture; and to promote the industrial development of the "depressed areas" east of the Elbe. Yet even if the Seehandlung's performance is evaluated against Rother's measuring stick, its results were mixed. His factories did no better and often worse than comparable private works; his attempts to reverse the course of industrial revolution and to alter the economic patterns of location were largely a misallocation of resources and his prejudices against vital innovations such as the railway and the joint-stock company were hardly calculated to accelerate Prussian economic development.\(^1\)

2. Observing the contemporary scene of public enterprises in the developing countries of today, one gets the same sense of "unresolved controversy" and "mixed results" that characterized this historical episode. Measuring public enterprise performance is frequently conflicted between exclusively stressing the commercial profitability criterion and exclusively stressing some "national profitability" criterion. For private enterprise, at least from the vantage point of private investors, the commercial profitability criterion is the most conclusive measure of performance. In relating to shareholders, the private enterprise management is normally free from uncertainty about the foremost criterion of performance measurement. Commercial profitability refers to a

\(^{1}\) W. O. Henderson, The State and the Industrial Revolution in Prussia, op. cit., chapter VII.

/generally accepted/
generally accepted and widely used general measure of performance. Performance results are gauged in terms of the net profit after taxes and all costs, including depreciation. It is usually expressed as a percentage annual return upon the share or equity capital invested. When the ownership control function is exercised by governments, the conclusiveness of the commercial profitability criterion is not readily accepted nor firmly established. A variety of practices obtains which neither totally discard the commercial profitability criterion nor conclusively uphold it. Either a multiplicity of "non-profit" success indicators are handed down by the supervising authorities or the profit results are supplemented by adjustments designed to reflect differences in costs or benefits to the economy. Consequently, some dilution of managements' profit-consciousness is almost inevitable. And a greater degree of uncertainty is experienced by public enterprise managers concerning what is expected of them.

3. The attitudes of supervising authorities towards the commercial profitability criterion frequently exhibit a good measure of ambivalence. In Ceylon, for example, they simultaneously exhibit a strong welfare-distributive-service-orientation, while shunning deficits and advocating surpluses. Reluctance to make hard choices, to trade away welfare for capital formation, and immediate distribution for sound growth account for a state of paralysis, disorientation and lack of direction. This, in turn, filters down to the operating level perpetuating uncertainty and eroding profit-consciousness. The profit-consciousness of public enterprise managers which is frequently observed to be lower than is the case with private enterprise management partly mirrors the ambivalence of public authorities.

4. In many situations, public enterprise performance has been, and still remains, a highly controversial issue around which there is sharp polarization of opinion. There are always the votaries and the critics. The controversy might be open or muted and suppressed. But it is raging in one form or another. In the prevailing climate of opinion in some countries, any measurement of public enterprise performance in terms that
would invite ready comparison with private enterprise is likely to be resisted by the votaries and advocated by the critics. Such comparisons are, not infrequently, fraught with intended or unintended distortions. To use them for indicting public enterprise is only matched by the defensiveness of its votaries about the validity of the commercial profitability criterion altogether. Questioning this validity, qualifying this measure and watering down its significance could well provide defense mechanisms against making unfavourable comparisons or evoking embarrassing controversy.

**Signs of Profit Revival**

5. However, in several developing countries observed, the sentiment of supervisory authorities is increasingly more favourably disposed to the commercial profitability criterion. In India, to begin with, public enterprise was characterized, when development planning was instituted, as "actuated by basic development objectives". In the earlier days of development planning, there was evidence of official hostility to the notion of commercial profitability. More recently, a different doctrine has been enunciated, namely, that public enterprises should behave so as to generate surpluses or profits for self-financing of their capital expansion. Proponents have pointed out that self-financing out of retained earnings has been a major source of capital formation in private industry in developed countries. Reference has also been made to the fact that state enterprises in the Soviet Union and other centrally-planned economies are conducted so as to yield a "profit" for financing high rates of capital formation. The shift away from the practice of "no profit, no loss" in the British nationalized industries together with the renewed emphasis on profit in the recent Soviet reform programme have reinforced

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2/ The Indian economist R.K.R.V. Rao, one of the chief proponents of the new doctrine states: "Public enterprise must be carried on a profit-making basis, not only in the sense that public enterprise must yield an economic price ... but also get for the community sufficient resources for financing a part of the investment and maintenance expenditure of Government ... This involves a price and profit policy ... which goes against accepted opinion". *Prices, Income, Wages and Profits in a Socialist Society*, Ool Seminar, May 30-June 5, 1959 (Papers Discussed) New Delhi, 1959, p. 174.
this trend of official thinking. The profitability criterion, it seems, has now become the accepted official doctrine. Lately public enterprise performance has often been criticized, in and outside the Parliament, because they did not show financial profits. Turning from enunciating the new official criterion to its application, some government agencies have suggested that public enterprises in the utility field raise their prices to a profit level of "not less than 10 per cent".  

6. In Ceylon, the National Planning Council has endorsed the profit criterion in principle, but has been quite inconsistent about applying it in specific fields. A belief in the merits of higher profits is also becoming prevalent in Pakistan. In the other South Asian countries where public enterprises under direct state management are largely in the utility field, operating under a promotional policy, either the question is not discussed or the weight of opinion continues to

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3/ This criterion was endorsed by the Ooty Seminar cited above in 1959. "The Seminar emphasized that ... public enterprises will have to serve as the main instruments for providing the state with the resources it requires for development". Ibid., pp. 31-32. The Planning Commissio was for a time hesitant to take a stand, but in the Third Plan it came out strongly in favour of the new criterion. The Comission urged making profits large enough for "financing the expansive programmes of these enterprises", Government of India, Planning Commission, Third Five Year Plan, New Delhi, 1961, p. 97. The Reserve Bank of India has made plain its endorsement of public enterprise surpluses as "another source for mobilizing savings ... required to attain the maximum tempo of development without excessive inflationary stresses", see, Report of the Central Board of Directors for the year ended June 30, 1962, August 1962, p. 12.

4/ Lok Yodyog, several issues, published by the Bureau of Public Enterprise.

5/ "This will, we hope, enable (the state electricity boards) to put to reserve for further expansion enough of their current earnings to finance a substantial part of the expansion", Government of India, Report on the Energy Survey of India Committee, New Delhi, 1965, p. 158.

6/ "It is particularly important ... that these public enterprises set themselves the objective of earning adequate surpluses for further capital formation". Ceylon, The Ten Year Plan, p. 53.

7/ See Ibid., pp. 419ff.
favour a low-price, low-profit policy. In Latin America, mixed enterprises, even those involving a majority share for the government are almost as profit-oriented as private enterprise is. By contrast, the directly managed component, largely in the utility field, is still conducted on the basis of a low-price, low-profit promotional policy, yielding at best 4-5 per cent rate of return. Not infrequently, this segment of the population of public enterprises is caught in cost-profit squeeze which is inhibiting its capital formation capability. The promotional pricing policy, reinforced by the opposition of private interests to higher prices, and the difficulty of raising administered prices in pace with the rise in the general price level, combine to hamper a change in practice.

7. In the United Arab Republic, following a period of questioning the rationale of commercial profitability as a valid performance indicator for public-sector enterprises, a tacit acceptance of it has been established with the institution of a profit-sharing scheme for workers in these enterprises. To supervising authorities, the profit showing of the nationalized enterprises was the only expedient measure of demonstrating the success of nationalization. This is evident in the wide publicity given to the post-nationalization profit performance of the public enterprise sector. Advocates of discarding commercial profitability in favour of plan fulfilment projected little, if any, influence, on actual practices. The plan, essentially a public investment programme, remained unrelated to public enterprise operations except in connexion with assigning new investment projects. Workers' sharing in appropriate profits has, in a sense, reinforced the present commercial profitability practice which is essentially a carry-over from the pre-nationalization system. A continuity of pre-nationalization practices, reinforced by the workers' state in a profit showing and the interest of authorities in maintaining the profit showing of nationalized enterprises, have in many instances, cushioned a shortfall in profit performance.

Pressures for Improving Profit Performance

8. This shifting sentiment in favour of profit as a performance criterion for enterprises under direct state management, as observed in several situations, can be traced to a number of influences, other than, as noted, the demonstration effect of foreign practices. The prompting obviously has come from managers of the national exchequer, who have been confronted with the task of finding additional resources for public expenditure, developmental and otherwise, without a resort to deficit financing. Concern with mounting inflationary pressures has helped the profit criterion rise on the coat-tail of stabilization programmes in several situations. The pressures of a persistent capital shortage combined with the growing recognition of the limits of alternative methods of financing development such as raising taxes and floating debts have been working to underscore the need for generating a public enterprise surplus. Under the growing pressures of development financing and mounting inflation, the economic viability of a persistently deficit public enterprise has become increasingly questionable, building at the operating level, in many instances, a "profit motivation" which may not be less strong than what is usually found in private or mixed enterprises.

9. The profit policy of an expanding public enterprise sector under direct state management, except for the small utility sector geared to promotional pricing, has come to be considered a part of the broader problem of stabilization. Increasingly so in situations of government concern over mounting inflationary pressures. For a public enterprise is necessarily contributing to inflation or to deflation by making losses or profits. A public enterprise puts money into circulation by paying for materials, wages, services and other input requirements, and takes money out of circulation by charging for its products and services. The rule that a public corporation should make neither a loss or a profit, after meeting all capital charges, which was advocated in the early practices of nationalized industries in Britain, rested on the desirability of such "neutral" effects on money income. See, for example, Arthur Lewis, "The Price Policy of Public Corporations" in W.A. Robson (ed.), Problems of Nationalized Industry, Oxford, 1952, pp. 181-182. It is only neutral with respect to its money income effect to the extent that it breaks even - making neither a loss or a profit. Any

/deficit incurred
deficit incurred by a public enterprise is inflationary in effect unless it is being deliberately offset in some other part of the economic system or by a budgetary saving. If some enterprises make losses while others make profits, they may cancel each other out. If the consolidated accounts of the public enterprise sector show a deficit, then the treasury must to the same extent levy upon the public higher taxes than it would otherwise require, in order to restrain inflation. To illustrate the need for such a consolidated look at profit performance, for stabilization purposes, table I classifies enterprises not only by ministerial affiliation but also by profit performance outcomes.

Table I

A HYPOTHETICAL CONSOLIDATED ACCOUNT OF PROFIT PERFORMANCE OF THE PUBLIC ENTERPRISE SECTOR

<table>
<thead>
<tr>
<th>Classification by Ministries</th>
<th>Ministry</th>
<th>Ministry</th>
<th>Ministry</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Classification by Profit Performance</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loss-making</td>
<td>-10</td>
<td>-20</td>
<td>-15</td>
<td>-45</td>
</tr>
<tr>
<td>Breaking-even</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Profit-making</td>
<td>8</td>
<td>10</td>
<td>5</td>
<td>23</td>
</tr>
<tr>
<td>Total</td>
<td>-2</td>
<td>-10</td>
<td>-10</td>
<td>-22</td>
</tr>
</tbody>
</table>

10. The net consolidated deficit of -22 million in this hypothetical example does not represent the ultimate inflationary effect of the public enterprise sector. For the income immediately generated 22 millions will be partially spent generating a second round of income and so on. The ratio between the initial deficit of 22 million and the additional final money incomes created through these successive rounds of income generation—
spending is the multiplier, by which the initial deficit is to be adjusted. The lower the propensity to save, the higher is the multiplier and the greater is the inflationary contribution of a deficit-generating public enterprise sector. The inflationary pressures on domestic production might be offset by a higher propensity to import - shifting the pressure to the balance of payment. The extent to which this expansion in money income will be matched by more goods or by higher prices will depend on the extent of idle capacities and the expandibility of supply of domestically produced goods. The extent to which such expansion in money incomes will affect the investment plans of the private sector — the so-called accelerator effect is another factor to take account of. But all this adds up to a two-fold conclusion. In the first place, a deficit-making, sizeable public enterprise sector can prove to be a powerful "engine of inflation". In the second place, this inflationary impact can be fairly accurately predicted given a consolidated account and an estimate of the relevant parameters.

11. Available evidence testifies to the significance of the magnitude of the inflationary effect of a low profit-performance public enterprise sector. This is particularly evident in inflation-prone economies, as in several Latin American countries. In Argentina, for example, the inability of successive governments to balance their budgets with a view to effect a stabilization policy has been a notorious feature. The causes have been found to "include such items as an ineffectual tax system, grossly inefficient public enterprises whose current as well as capital deficits have to be met by the treasury, and periodic over-valuation of the exchange rate".

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10/ Suppose income recipients as a result of the initial deficit spend 4/5 of extra income, then the initial deficit of $22 million will result in a second round of income creation amounting to 22(4/5) and so on. Ultimately, the total expansion in money income will be 22 multiplied by \((1+4/5+4/5)^2+4/5)^3 \ldots\) which adds up, after an infinite number of rounds to spending, to \(\frac{1}{1-4/5}\) i.e. $5 million.

In this case, the multiplier is 5.


/12. Not
12. Not only that the pressures of the situation has rendered questionable the economic viability of deficit-making public enterprises, but also their "political viability" in turbulent environments has also proved highly questionable. The recent situation in Mali provides a pertinent example. The new regime which is out to reverse a trend of so-called "uncompromising socialism" is yet to retain what it describes as some of the "successful achievements of the revolution". This is taken to mean that state enterprises that performed well will stay while those - in majority - that showed deficits are likely to feel some of the effects of the coup. The broad guidelines of the new Mali policy are yet to be laid down. The first order of business will be, as announced, to diagnose the basic causes of Mali's economic and financial troubles. Many officials now blame the strictly controlled Government distribution organizations for the failure to increase the export and exchange receipts of the country's principal export crops, such as groundnuts, especially after the devaluation. The State Tobacco Monopoly which has shown satisfactory profits in the last few years will remain in existence. But the future of some other state enterprises, including transport companies, furniture-builders and a company responsible for growing and marketing rice and cotton, remains in doubt.

Some unresolved issues

13. The use of profit as a performance criterion is still, however, inhibited by a certain lingering suspicion of its legitimacy, by certain ambiguities as to its function and certain misconceptions as to its role. In some practices, certain important difference is maintained between using profits as a criterion of success in an on-going enterprise and relying on profits as a motive for economic activity. In other practices, profit is extended further to be used as a "partial" motive for operating managers as well as for new investment decisions. In the Yugoslav practice,

12/ Joan Robinson, for example, while certainly maintaining the importance of that distinction, notes that it is rejected in present Chinese practice which maintains that the first will inevitably lead to the second. See The Cultural Revolution, Baltimore: Penguin Books, page 13.
for example, where new investments are scrutinized by an autonomous banking system directed to abide by the criterion of prospective profitability, the profit motive necessarily looms large in operational as well as investment decisions. So is the trend in newer Soviet practices. Not only is profit, in a more or less business sense, looming larger among enterprise targets; but also the "consistency of enterprise targets with economic incentives" is deemed a most important condition. Abandoning the old notion that the enterprise operates on the principle of central commands based on the plan requirements, the new management system is squarely faced with the need to ensure that it operates on the principle: "that what is most profitable to the national economy must be profitable to the enterprise and its workers". Although the potential for reconciling the two is deemed greater under a system of mandatory than indicative planning and will not spontaneously develop, profit performance and profit-based incentives are increasingly strengthened. A profit-oriented cost accounting system and market oriented price reforms are deemed to be necessary preconditions. A constellation of profit-based incentives ranging from enterprise stimulation funds, to bonuses, premia and credits are to build considerable profit motivation into the operation of an enterprise.

Although such a system of profit planning, as evolving in the new Soviet practice, entails a radical departure from the firm-by-firm physical planning system by central commands and under administered prices, it still bears significant differences with the regulated commercial profitability system. However, it is no overstatement to note that a considerable convergence on commercial profitability and on profit planning practices is already under way under systems of public enterprise operation which still can be significantly differentiated on a number of dimensions. Increasingly, the differences are on the side of emphasis. Few participants

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in the contemporary debate would seem to polarize at the conventional poles. Thus few would argue for an exclusively commercial profitability system, confining the supervising authorities' concern to an investor's concern and delimiting its role to a rather "passive" investor's role except perhaps in mixed enterprises wherein they hold a non-controlling interest. Yet few would still advocate for public enterprises in developing countries including those operating under quasi-socialized systems the already discarded notion of centralized physical target-setting-firm-by-firm. For this, among other things, tacitly projects into their situations a central planning capability comparable to that obtained in the Soviet experience. To move from a system of investment programming, whose adequacy leaves much to be desired, to a system of comprehensive production planning, calls for quite a jump in the planning capability of supervising authorities which is infrequently mustered. \[14/\]

15. In between the two poles, however, there still stand real differences of emphasis or of assumption. Overlaying such differences of principle as to the legitimacy or sordidness of appropriating, as personal income, profits, particularly those associated with an element of monopoly in product or factor markets or with consumers' and workers' exploitation, are more mundane differences. These relate to the assumed likelihood of divergences between enterprise profitability and national profitability; the measurability of the latter; the assumed capability of supervising authorities for articulating the national interest; or the assumed correspondence between planners' preferences and the public interest. Such assumptions, usually more implicit than explicit, might include the adequacy of

\[14/\] For example, Gustav F. Papenek, as a close participant-observer of the planning experience in Pakistan, notes that in 1954 the government had only one or two economists with advanced modern training. The Planning Commission was dominated by able civil servants with little formal training in economics... In the late 1960's, by contrast, the Planning Commission and its Provincial counterparts have three or four times as many well-trained economists as 15 years ago. Their work is dominated by professionals". See his article, "The Economist as Policy Adviser the Less Developed World", International Development Review, March 1969, Volume XI, No 1, p. 8.
market mechanism, as opposed to the administrative process, as a regulator of enterprise operations, and the desirability as well as the feasibility of the principle of consumers' as opposed to party or planners' sovereignty. Parallel differences of emphasis might relate to the reconciliability of enterprise and national interests through deliberate governmental interventions. To what extent should the enterprise plan of operations permit of adjustment to its capability profile as against the plan requirements or the centrally set priorities. Social obligations versus commercial profitability—which should be the rule and which the exception. All told, without really confronting the underlying ambivalence, the tacit assumptions, the ambiguous emphases and the quest for making the best of two worlds, goal disorientation, dilution of motivation and goal conflicts will continue to perplex enterprise management. Rother's dilemma, in one form or another, is bound to persist.

16. It would, indeed, be erroneous to infer from the shifting sentiment, the pressures of the situation, the enunciations of official doctrines in several developing countries that the issue of performance measurement has been resolved. On a verbal level, supervisory authorities may express concern about profit performance and may emphasize the profit criterion. When it comes to action a certain lag is frequently observed. They may be more concerned about keeping prices down to appease the consuming public,15/ or private interest groups; about expanding employment or appeasing unions; and about a host of profit-eroding, though politically appealing, goals. In some situations, profit may be the language of performance evaluation more by default than by design—simply because of the lack of any other information pertaining to alternative criteria. Beyond the broad, general objectives incorporated in a public enterprise's statute or charter which do not usually spell out operational indicators, the information that is usually available to supervisory authorities is largely that of conventional accounting practices.

15/ "In the Philippines", for example as in several other countries, "the pricing policies of state enterprises generally involve some element of subsidy to the consumer in that the prices fixed are lower than those which would have obtained had the transactions been undertaken by private traders". United Nations, ECAFE, State Trading in Countries of Asia and the Far East Region, New York, 1964, p. 5. /Current Practice
Current Practice and Profit Performance

17. The verbal emphasis on the profit criterion may be matched by the lack of formalized profit target setting. Either there is no rigorous notion of the real cost of capital on which to base a meaningful profit target, or some general rate, say 10 or 12 per cent is suggested to apply across the board irrespective of the capability profiles of individual enterprises, their operating age, their stage of growth and related considerations. A firm-by-firm profit planning practice, based on the twin principles of feasibility planning and the firm’s capability profile has yet to develop in most situations. Even where a generalized across-the-board rate of return has been verbalized, the typical profit behaviour of a public enterprise is largely to insure that current year’s profit performance does not fall short of last year’s. The lag in profit planning practice is evident in the extent to which last year’s profit performance has loomed large in the thinking of supervisory authorities in the accountability of operating managers. As a result operating management is seldom held accountable for what could have been attained. Rather, profit performance tends to be stabilized close to what has already been attained.

18. Reinforcing this profit behaviour is the observable lag in current incentive practices. The vulnerability of deficit enterprises to undue encroachments and pressures, the threats involved to their organizational viability or rather to the job security of their managements might build enough motivation into the enterprise behaviour to break—even or to show a thin margin of profit, as profit performance records have predominantly shown. Beyond that critical point a lethargic profit behaviour is more often exhibited. Neither the target-setting system, as noted, work to impel profit performance beyond avoiding the risk of a shortfall as compared with past profit performance. Nor management is impelled by strong profit incentives to attain profit results markedly beyond last year’s. For such incentives are usually lacking. The repressed hostility to profit as a performance criterion even when officially adopted shows up in the attitude to profit incentives for operating management particularly.16/ This negative attitude to profit incentives is expressed

16/ In some situations profit incentives for workers square with official sentiment than profit incentives for management. /by the
by the Indian Administrative Reform Commissions as follows: 17/ "The size of cumulative and annual losses that a number of (public undertakings) have incurred, cause concern ... There are very many reasons for this state of affairs; the principal one pertains to organization and management. A public undertaking has to be worked with public spirit. The management and labour have both to realize that public undertakings are the property of the people, to be run for general good, and that personal gain, selfish ends and sectional interests have to be eschewed". 18/ Indeed, in the absence of adequate profit incentives, any substantial improvement in profit showing over past performance might set a difficult standard for future performance, a risk that only a few achievement-motivated managers would be willing to take.

19. The virtual destruction of any profit consciousness operating management might still have is completed by a third lag in current practice, viz. the method of disposition of profits. More often than not, the prevailing practice requires the enterprise to turn over the entire profit figure to the central authorities. It retains no funds of its own for expansion, research and development, incentive payments or any other autonomous use. Therefore, even the profit-maker is almost as totally dependent as the non-profit-maker upon central government budgetary allocations for such purposes. Indeed, the profit-making enterprise may even be penalized liquidity-wise in so far as realized profits are not "cash locked in a box". The disincentive effects of this practice have been repeatedly observed in several situations. Next to posing as a deficit enterprise, nothing is more demoralizing to operating management than making

17/ Letter of transmittal of its Report on Public Sector Undertakings, op. cit., to the Prime Minister.

18/ The Commission proceeds to say: "Keeping this point of view, the Commission has made recommendations for improving administrative efficiency and industrial relations. Public undertakings have to work on business principles ..." Although the Commission made no less than 63 multiple recommendations none of them touched on management incentives. For a contrast with Soviet practice in this respect see L.M. Gatovsky's article, op. cit., pp. 219-234.
a profit only to lose control over the disposition thereof. Also, to the extent that supervisory authorities permit the retention of a significant portion of the earnings for self-financed expansion, they build into the system a mechanism for allocating expansion investment in accordance with the demonstrated profitability of individual enterprises. Simultaneously they reinforce the "acquired" autonomy of the high-performing enterprises.

20. Another lag in current practice is the lack of clear guidelines as to where and when the profit measure is likely to be a meaningful indicator of performance and where and when it is not likely to be so. As it is, the profit measure may provide supervisory authorities with a simple global check on the performance of individual enterprises. It is simple enough to administer. The practicability and feasibility, from an administrative capability standpoint of more sensitive, less crude and probably more relevant alternative indicators may not be as high as that of commercial profitability. However, the adequacy of the profit index as a measure of effective performance may be open to serious questioning in several situations. This is particularly so in situations characterized by: (i) the absence of foreign and domestic competition; (ii) by administered prices; (iii) by the fact that prevailing prices do not reflect real scarcities or opportunities costs; and (iv) by the dependence of profits on some fortuitous factors rather than on management contribution. Indeed, there are cases where the profit measure is so absurd, as a success indicator, that an alternative, and more relevant and meaningful measure has necessarily to be found.

A Case Example

21. To illustrate the influence of these factors, the Turkish State Monopolies (Tekel) may be a case in point. Tekel, actually the oldest of the Turkish Government's productive enterprises, has a monopoly on the sale of tobacco, salt, tea, and on the importation of coffee. It produces all the alcoholic beverages in the country with the exception of some wine, and makes and sells matches in competition with several private enterprises. Tekel's most important operations concern tobacco. It

/purchases tobacco
purchases tobacco from farmers, processes and manipulates it, arranges for export, manufactures all tobacco products in Turkey and wholesales and exports the finished products. These operations actually constitute three basic functions: a commodity price stabilization function, a production and marketing function and the collection of consumption taxes. Tekel is required by the central government to stabilize the price of tobacco paid to farmers. It accomplished this through purchases, at prices fixed by the central government, of about half of the Turkish tobacco crop. Thus, Tekel's purchases of tobacco are for two purposes: its own production requirements and to stabilize producers' prices. It appears that Tekel because of the latter requirement, often ends up with larger quantities of the less desirable grades of Turkish tobacco than would be the case were its procurement policy solely geared to its production requirements.

22. In 1963, Tekel showed profits of TL 762 million on a volume of sales of TL 1.72 billion, while it reported total assets of TL 3.37 billion, indicating a profit rate slightly more than 22 per cent on total assets. The meaning of this figure, however, from the standpoint of performance is open to some significant, though unresolved, questions. For one thing, the profit has to be adjusted by the cost of the support programme for whose accounting no provision is made. The price Tekel pays for

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19/ Sales and profit performance by product for 1963 are presented in Table below:

<table>
<thead>
<tr>
<th>Product</th>
<th>Sales (TL 1,000)</th>
<th>Profit (loss) (TL 1,000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tobacco</td>
<td>870 071</td>
<td>336 315</td>
</tr>
<tr>
<td>Spirits</td>
<td>412 737</td>
<td>235 724</td>
</tr>
<tr>
<td>Salt</td>
<td>16 557</td>
<td>(1) 941</td>
</tr>
<tr>
<td>Explosives</td>
<td>11</td>
<td>(16)</td>
</tr>
<tr>
<td>Tea</td>
<td>407 080</td>
<td>171 357</td>
</tr>
<tr>
<td>Matches</td>
<td>26 112</td>
<td>1 170</td>
</tr>
<tr>
<td>Coffee</td>
<td>29 916</td>
<td>19 401</td>
</tr>
<tr>
<td>Total</td>
<td>1,762 484</td>
<td>762 010</td>
</tr>
</tbody>
</table>


tobacco enters, in total, into Tekel's cost of sales with no differentiation made between the normal purchases of tobacco and the price support component of the cost. In other words, the cost of tobacco price stabilization disappears completely in Tekel's cost of goods sold and "no one in Turkey has any idea of the actual cost to the Government of the support program".21/ A similar confusion of purposes is found in the sale of tobacco products. The wholesale selling price of cigarettes includes, in principle, three elements: Tekel's cost of production, its profits and consumption taxes. The entire amounts of both the tax and the profits are turned over to the central government.22/ Actually the distinction between the tax and the monopoly profit is highly arbitrary. In fact, it has only been made recently in order to justify politically the cigarette price increases. To the Turkish government the tax and profit are one and the same thing. In addition, the total revenue contribution of Tekel i.e., of profit and tax receipts is not some performance outcome which results from Tekel's operations. The magnitude of that revenue contribution which the government desires from Tekel is set by the government's budget, in advance. Tekel is expected to adjust its operations, principally through its sales prices, to conform to that revenue goal, with considerable leeway on account of the relatively inelastic demand for cigarettes.23/

21/ Organizations and Functions of the Central Government of Turkey, Ankara: The Institute of Public Administration for Turkey and the Middle East, 1965, p. 201.

22/ It is, to be noted, that monopoly profits, of which tobacco provides the largest amount, constitutes approximately 9 per cent of total government revenue in Turkey. See Report on Tax Administration in Turkey, United States Internal Revenue Service, USAID, Turkey, 1964.

23/ On the basis of some very limited data which was obtained from Tekel, it appears that the sales of some individual brands are quite responsible to price changes, but that the total sales of all brands of cigarettes are relatively inelastic with respect to changes in Tekel's over-all price level. This is the demand pattern which might be expected for cigarettes. See Lee J. Seidler, op. cit., footnote on p. 300.
23. It is hard, therefore, to say where the profit-making capability of Tekel begins and where the taxation power of the Turkish government ends. Nor is it possible to know, as noted, how much of Tekel's profit potential is used up for the support programme. Nor is it possible to know how much of the profit actually made results from the implicit monopoly power of Tekel and how much represents a management contribution - through cost reduction or a more profitable product line or effective procurement practices. In this respect, it is also to be noted that Tekel's management has virtually no control over the price they pay for or the quantity they must buy of the largest element of their product cost, tobacco. To Tekel's management that is largely an uncontrollable cost item. Yet, that is the most strategic determinant of their cost performance. While they do have the ability to vary the prices of individual brands of cigarettes, the overall level of sales prices is determined by the central government. In other words, the major determinants of Tekel's "profitability", as it is measured by its accounting system, are not within management's control. Thus, reported profits cannot reasonably serve as a measure of management contribution or of the internal efficiency of the operation. Its profits reveal only how much its net remittances are to accrue to the government; the performance of its function as a productive enterprise is virtually unknown to supervisory authorities.

24. While Tekel may not be representative of public enterprises in developing countries, it is not atypical case. In the same Turkish situation, as in several other developing countries, the profits of many /state enterprises
state enterprises are often directly proportional to the amount of foreign exchange which is made available to them by supervisory authorities. Not only that their profitability may be largely dependent upon government action, in more than one way, but also their profit-making goals may often run in conflict with the goals of their supervisory authorities. In the general context of conserving foreign exchange, the individual enterprise may behave so as to maximize its foreign exchange intake while central authorities may be concerned with minimizing foreign exchange allotments. The managers of public enterprises thus find themselves caught in a role-conflict. As public servants, identifying with their governments at large, they should minimize the utilization of foreign exchange, while as managers of ostensibly profit-seeking enterprises, identifying with their direct organizational goals, they can usually maximize these profits by the utilization of larger amounts of foreign exchange. Since foreign exchange allocations, under a system of direct controls, are based largely upon existing capacities, one way to increase an enterprise's entitlement is to apply for expanded capacity. A strong tendency is thus created to expand already underutilized capacity in the economy as a whole. Yet this may be one facet of the role conflicts experienced by public enterprise managers in their role of running profit-seeking enterprises, as will be taken up further.

Price Reform Versus Accounting Prices

25. Certain preconditions have to be fulfilled for the profit criterion, as the above case illustrates, to provide a real check on effective performance. In addition to fostering and maintaining some degree of effective competition, whenever feasible, the question of distorted prices, has also to be resolved. This may often call for drastic reforms such as: devaluation; decontrol and liberalization of imports; relaxation of direct controls over pricing, production and investment decisions; allocating foreign exchange through competitive bidding rather than administrative discretion; doing away with administered prices and cross-subsidization /practices; laying
practices; laying off redundant workers; forcing out the persistently unprofitable enterprises whose cost structure cannot be feasible adjusted even through a major organization; shifting away from direct to indirect controls; de-emphasizing protection in favour of yardstick competition from imports and foreign competitors, emphasizing comparative costs and market viability in new public investment projects; assigning a higher priority to maintenance imports over new investment so long as unutilized capacities persist; reinforcing the price mechanism and doing away with subsidies in any form. 24/ That such measures will entail a difficult period of adjustment in the course of which the viability of many low-performing enterprises will be seriously threatened is evident in the countries which attempted such reform measures. Wherever attempted, such measures were usually prompted by the predicament of a serious foreign exchange shortage rather than by the need to correct a performance shortfall in the public enterprise sector. But the required price reforms can be made to ride on the coat-tail of such broad economic reforms.

26. Short of such drastic price reforms which may not be always feasible, or their corrective effect may be doubtful or too costly for the benefits anticipated, the alternative is to maintain "incorrect" prices but to use accounting prices i.e. hypothetical prices arrived at by assuming equilibrium between supply and demand, 25/ for ascertaining the real profitability of

24/ For example, at the overvalued exchange rate, capital equipment imports for public enterprises are in effect subsidized, even when with the payment of tariff duties on such items. So are the imported components, materials and parts. In addition to the distortionary effects of an overvalued exchange rates on prices, the attendant implicit subsidies, an overvalued exchange rate may induce public enterprise behaviour which is not conducive to the conservation of foreign exchange utilization.

25/ Jan Tinbergen defines accounting prices as those that correspond to "intrinsic values". An intrinsic value is in turn defined as the price that would equate the supply and demand for a particular factor or product, its full "equilibrium" prevailed. See The Design of Development, Baltimore; John Hopkins Press, 1958, pp. 39 ff. et passim. /public enterprise.
public enterprise. Several different kinds of accounting prices have been devised to serve different purposes. Some accounting prices are used as a basis of administrative decisions either at the centre or at operating levels; others are used purely for recording purposes or as a unit of account; still others are used as providing some kind of evaluation which may or may not be the basis of decision. Again, other accounting prices may govern incentive payments or transactions between enterprises and so on. Whatever may be the purpose, accounting prices remain a controversial tool and a debated substitute for price reform. Some critics would claim that they are indeterminate, or at best arbitrary. Their very concept implies circular reasoning; they are hypothetical prices meant to guide policy action while they very much depend on policy action. Thus the accounting prices for procuring tobacco by Tekel, in the case example cited above, will differ according to whether or not government will like to support producers' prices. Then comes the question of equilibrium at what time? One possibility might be to relate such hypothetical prices to present scarcities. Another would be to account for the effect of development through time.

Indeed, there are practical difficulties in the way of ascertaining meaningful accounting prices and applying them to countries with such "fundamental disequilibria" as exist in most developing countries. At best, they are likely to be plain guesses that are hard to verify or validate, injecting a serious element of discretion, indeterminateness and inconclusiveness in appraising profit performance. Without them, the profit measure may be meaningless, but with them it may be highly arbitrary.

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27/ For such a critique see, for example, Gunnar Myrdal, Asian Drama, op. cit., Appendix 5, pp. 2034-2039.

28/ On this Jan Tinbergen states: "It may be repeated that even if it is not possible to make any sensible estimate of an accounting price, it may be useful to make a set of alternative calculations using plain guesses for the accounting prices". Ibid. p. 86.
On the relationship between accounting prices and price reforms, the advocates of accounting prices usually exhibit considerable ambivalence. On the one hand, they often think of them as a device for ascertaining the "reality" of profit performance, without necessarily assuming that these "correct" prices will have to be established in the market. In a mixed economy, however, it can hardly be expected that private entrepreneurs will make their calculations and behave without reference to actual prices unless they are compelled to behave otherwise due to direct controls. Equally, it must be extremely difficult to get even public enterprises to base their calculations and behaviour on hypothetical prices, rather than on the prices that actually determine their costs and revenues. Private and public entrepreneurs alike are more likely to behave as the accounting prices would require them to only if accounting prices can be made a reality to them. Therefore, the proponents of accounting prices may often urge that they be translated into actual prices through policy measures if they were to influence enterprise behaviour.  

29/ 28. Again, the problem is either such correct hypothetical prices are translated into actual prices, or they are likely to be ineffective in terms of their effect on operating management behaviour. The issue remains to revolve around the feasibility of price reforms required to make the profit criterion meaningful and effective. In regard to labour, an attempt to bring wages down to their intrinsic value or correct market price may be less feasible than raising interest rates or rates of foreign exchange to their accounting prices. In the same vein, some product prices are more feasible to raise than others. There is no easy way out of the dilemma. Perhaps a combination of feasible price reforms, the partial use of accounting prices and some selectivity in applying the profit criterion in conjunction with other relevant indicators may remain unavoidable. Perhaps

29/ "This can be done by certain types of subsidy and certain types of taxing, tending to stimulate the use of abundant, and to discourage use of scarce, factors." Ibid., p. 41. "Loans to be made by the government to ... government enterprises ... might be at a rate higher than the moderate rates at which the government itself borrows, on the principle that the accounting price of capital justifies such a differential". Ibid., p. 54.
it may still remain unavoidable to devise tailor-made indicators for individual enterprises. But this will not make the task of measuring public enterprise performance any less demanding for supervisory authorities than before.

The Behaviour of Supervisory Authorities

29. Not only that the measurement issue remains largely unresolved, and Rother's dilemma persists, but also the task of how to deal with a performance shortfall remains largely pending. In no small measure, the very behaviour of supervisory authorities constitutes a part of the problem of performance shortfall. In many ways, their behaviour vis-à-vis the enterprise influences its functioning on the operating level, whence performance results are actually realized. And these influences, of which supervising authorities may be, more or less, aware could impel and more frequently could impede performance. Through their interventions - direct or indirect - they influence public enterprise behaviour and in turn its performance in ways that may not be fully explored beforehand.

30. Not infrequently, supervisory authorities, while proclaiming profitability as a criterion, may continue to saddle public enterprises with profit-eroding goals. Empirical evidence gleaned from several situations has revealed that the ever-present gripe of public enterprise managers frequently revolves around the multiplicity of conflicting goals expected of them. At one and at the same time, they are expected to "work on business principles", yet to run these enterprises "for general good". Simultaneously, they are considered as "independent units" behaving in response to the market, yet their "conformity with development policy

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20/ These were the very terms used by the Indian Administrative Reform Commission, *Ibid.*, p. (i).
and objectives", has to be assured.\footnote{Note, for example, the words of the Turkish First Five Year Plan: "In its economic activities, the state acts as an entrepreneur, financing its enterprises with the proceeds from the goods and services provided". "It is necessary that the enterprises be considered as independent units and that the prices charged for the goods and services produced correspond to current market prices". "As the enterprises are state-owned, the over-all decisions taken at higher levels must proceed from a central organ which can assure their conformity with development policy and objectives". See First Five Year Development Plan, 1963-1967, Ankara; State Planning Organization, 1963, p. 77.}{\textsuperscript{31}} Specifically, they are frequently expected to seek and to show a profit; yet to adopt a low-price policy; to incur costs which would not fall on private enterprise; to compete for managerial manpower with the private sector yet adhere to civil service rules; to improve the level of wages and to bear the costs of increasing fringe benefits; to provide more employment; to act as model employer yet reduce labour costs per unit; to compete effectively with indigenous and foreign private enterprise; to contribute to export proceeds; to conserve foreign exchange utilization; to bear the burden of cross-subsidization; to contribute to regional and community development; to generate adequate funds for internal financing; to hand over any surplus to the Treasury, and so forth.

31. The major issues and dilemmas of the "typical" public enterprise manager, as frequently observed, revolve around coping with such a multiplicity of conflicting roles, with limited resource budgets and in the face of continuous series of bottlenecks, shortages and constraints. These conflicting roles, whose ramifications for enterprise behaviour are sketched out, by way of illustration, in Table II below, continue to test the
capability of supervisory authorities for making hard choices, for setting clear-cut goal priorities, for understanding the impact on profit performance of their quest for the best of both worlds and for restraining their ever-present propensity to trade away profit performance for a plethora of profit-eroding goals. Whatever may be the appeal of such goals or the pressures of the situation, the fact remains that the hallmark of effective supervision, as field experience strongly suggests, is a sympathetic understanding of the dilemmas of the operating manager, a propensity to pose as genuine helper and to intervene to temper the conflicting pressures under which the man-on-the-firing line may be frequently labouring under. Such pressures might become apparent from Table II below.
<table>
<thead>
<tr>
<th>Role</th>
<th>Measure of Success</th>
<th>Expected Behaviour</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Business Manager</td>
<td>Maximum short-term profit consistent with long-term survival</td>
<td>Highly profit-conscious behaviour</td>
</tr>
<tr>
<td>2. Public servant</td>
<td>Maximum conformity with public and civil service rules</td>
<td>Highly sensitive to public interest and public directives irrespective of their profit implications</td>
</tr>
<tr>
<td>3. Promoter of Consumer's Welfare</td>
<td>Low-prices</td>
<td>Low-profit margins to be counter-balanced by high sales turnover, whenever feasible</td>
</tr>
<tr>
<td>4. Model Employer</td>
<td>High-wages, high fringe benefits, no layoffs, no strike record, accommodation of union demands and workers participation</td>
<td>Paternalistic labour relations, appeasing unions when necessary, lenient stance on discipline, an accommodating attitude toward manpower redundancy and a participative management style</td>
</tr>
<tr>
<td>5. Conserver of Foreign Exchange</td>
<td>Minimum foreign exchange demands</td>
<td>Relinquish profit-seeking opportunities for the sake of conserving foreign exchange</td>
</tr>
<tr>
<td>6. Export Promoter</td>
<td>Maximum contribution to export proceeds</td>
<td>For sake secure profit-making opportunities in the domestic market in favour of earning more foreign exchange</td>
</tr>
<tr>
<td>7. Effective Competitor</td>
<td>Capability of providing yardstick competition in the domestic market and coping with international competition in export markets</td>
<td>Low-cost, high-efficiency operations</td>
</tr>
<tr>
<td>8. Developer of local community</td>
<td>Identification with interests of the local community in which he operates</td>
<td>Preference for employing &quot;local&quot; rather than simply nationals, involvement in local community development efforts and opting for local community interests when in conflict with enterprise or national interests</td>
</tr>
<tr>
<td>9. Member of a national development-minded leadership</td>
<td>Identification with central authorities and &quot;national&quot; interest</td>
<td>According priority to national interest and heeding the central authority viewpoint when in conflict with local and sectional interests</td>
</tr>
</tbody>
</table>
32. Inasmuch as supervisory behaviour may frequently confront the operating manager with conflicting pressures, it could well influence his capability to cope with them. The posture of supervisory authorities determines, to a considerable measure, the extent to which certain management functions are "internalized" i.e. developed within the enterprise, or "externalized" i.e., developed without, as will be subsequently taken up. It could reduce the operating manager to a one-sided production or operations executive with undeveloped capabilities in marketing, financing and investment management. Supervisory authorities could influence the "learning rate" whereby the operating manager develops the capability to overcome the production difficulties which are often characteristic of infant enterprises striving to introduce new production systems. Through his interactions with supervisory authorities, the operating manager receives his "autonomy training". Such interactions determine to a large extent the morale of the men who manage at the operating level. More than any other vehicle of management development, the way supervisory authority relates to the operating manager merits, as field experience strongly suggests, special consideration. Less appreciative of the operating manager's role, less sensitive to his difficulties and dilemmas and less oriented to the role of helper than should otherwise be the case, the supervisory authority may well restrain rather than facilitate his development. Standing to bear more than his due share of the blame for a performance shortfall and to serve as a ready target for scapegoating, the operating manager in many situations has, understandably, expressed the feeling that he operates more or less, in a "hostile" environment. A pattern of inter-personal relationships that may be deemed healthy to effective management development in public enterprise is likely to be less fraught with the attitudes of mistrust and repressed hostility than what emerges from field observations.

Influence on Enterprise Behaviour

33. In no small measure, field observations suggest: the behaviour of the operating manager is a "conditioned response" to the posture and style of interventions of supervisory authority. From all indications, public enterprise managers tend to operate in such a way as to "satisfy" their superior agencies. Even where they are generally instructed to operate "on business principles" or to adopt a commercial mode of operation, there
is no definitive evidence that the basic goal conflict, described above, is sufficiently resolved so that they solely operate as to maximize their profit performance. To some extent the two goals may be mutually supporting and reinforcing and to some extent they may not be. In so far as a shortfall in profit performance exposes enterprise management to external pressures, harassments and intrusions, it tends, as noted, to build into the enterprise some motivation for attaining a "rate of profit" satisfying enough to supervisory authority. But such a "satisfying rate of profit" is only a means to the end of appeasing supervising authorities and of warding off the risk of readily forthcoming threats to enterprise autonomy and security of tenure. 34. Indeed, available evidence strongly suggest that nothing eventually succeeds in getting a public enterprise management to win, safeguard and defend a reasonable level of operational autonomy, to avert potentially serious threats to that autonomy or to management security of tenure and, at times, to enterprise viability, more than to get "out the red". This is more evident in the high vulnerability of deficit-making enterprises to such threats and encroachments than in how the profit-makers subsequently fare. Such a profit showing like "keeping out the red" or "battering last year's profits" is visible and demonstrable enough to be recognized by supervisory authorities. The conventional measurement of profit, as noted, may be open to serious questioning particularly in the absence of price reform and/or adequate use of accounting prices. Nor does such an outcome provide a foolhardy proof that a public enterprise is contributing to development. Nor does it, contrary to Liberman's dictum, 32/ preclude the likelihood of a divergence between what is "useful for the enterprise" and what is "useful for the state". Yet it may derive its relevance from being a satisfactory outcome to supervisory authorities and from its working to keep enterprise management out of exposure to certain pressures.

32/ Note that according to Yevsei G. Liberman's dictum: "What is useful for the state must be useful for the factory, and vice versa, what is useful for the factory must be useful for the state".

/35. To
35. To that extent the two goals of profit-making and of satisfying supervisory authorities may be congruent, mutually-supporting and reinforcing. Beyond that point of keeping out the red or maintaining last year's profits, the profit performance of public enterprise seems to be largely indeterminate. It seems to depend on varying constellations of forces promoting and/or eroding profit performance in the case of each individual enterprise. By and large, on the one hand, the pattern of management motivation remains to satisfy supervising authority, to safeguard enterprise autonomy, to insure enterprise viability, to secure job and tenure, to enhance career advancement and to win approval. This description seems to square more with the empirical reality than saying that enterprise management operates to maximize commercial profitability or to fulfill the targets of the plan - depending on the system in operation. Either one, judging by field observations and available case evidence, sounds more like a formalistic rationalization of the reality than a valid interpretation thereof. And there is nothing contrary to the precept of the Indian Administrative Reform Commission cited above, necessarily sinister, immoral or inherently anti-social in reckoning with this pattern of operating management motivation.

36. On the other hand, supervisory authorities, as observed, remain basically conflicted over profit versus a host of profit-eroding goals. Incongruities arise as the operating manager senses that bifurcated or conflicted focus.\(^{33/}\) Moved primarily by a "need for approval" he tends to receive his cue from his superordinate authority. When he receives what are, in his perception, mixed signals, as is likely to be the case, his dilemma is to strike the balance between economic performance and extra-performance results or between profit and profit-eroding results that would best minimize the risk of disapproval. The extent to which he trades away profit performance for certain profit-eroding outcomes primarily depends upon his reading of the "preference map" of supervisory authorities.

\(^{33/}\) Typical of this bifurcation is the incident reported by an African operating manager whose minister decried that he keeps complaining about manpower shortages while a lot of freedom-fighters are crying out for jobs.

/Through such
Through such reading he learns about the commitment of his supervisory authority to economic performance, its performance - "centredness", its tolerance for ineffective performance and the values placed upon certain extra-performance outcomes.

37. In his balancing act, he matches his reading of the preference map of supervisory authorities with his enterprise capability profile, his budget constraints, the tautness of the profit targets set for him and the latitudes he may have in measuring the profit results. In working out his profit plan, he opts for outcomes in between the extremes of attaining the maximum profits and of committing "the cardinal sin of incurring the disapproval of supervisory authorities". What combinations of outcomes will be open to him will partly depend upon the profit-making capability of the enterprise. Thus an enterprise with the capability of making profits above customary levels can better withstand the pressures for accommodating various non-profit goals satisfying to supervisory authorities. A public enterprise like Tekel, described above, with an implicit monopoly power, a multiple product line, an inelastic demand for cigarettes and clothed with the taxation power of the Turkish government, has profit capability enough to meet the revenue needs of the Treasury as well as to accommodate certain non-profit goals preferred by authorities such as the support programme and generous fringe benefits for workers. Enterprises whose profit performance is largely dependent upon their foreign exchange budget and which are in for the rigours of bureaucratic competition for a limited foreign exchange resources can hardly attain a satisfying rate of profit and cannot afford to accommodate much of the non-profit goals preferred by supervisory authorities.

38. These contrasting circumstances can be graphically represented in an elementary diagram as shown in Exhibit I below. The preference map depicts the preferences of supervisory authorities as to profit performance and certain non-profit goals as described in Table II above. The chore of arriving at an optimal combination of outcomes that would satisfy supervisory authorities both on a profit plane and non-profit counts is left to the operating manager. The budget constraint of the low-profit capability enterprise is HL, where it optimizes with OL profits and a modest accommodation OH of non-profit goals. A high-profit capability enterprise, with a larger

/Exhibit I
Exhibit I

Non-profit Goals

Profit Performance
pool of profit potential above the customary level, as indicated by the budget constraint JE, trades profits for a larger accommodation of non-profit goals, optimizing at M. The difference between the two enterprises, then, does not show in their profit performance differential inasmuch as it shows in their differential capabilities to accommodate non-profit goals, to provide "free goods" and to generate non-pecuniary benefits that do not figure in their income statements.

39. The two hypothetical enterprises, depicted in the above diagram, may exhibit the same degree of "economic viability", in terms of their capability to meet the profit expectations of supervisory authorities. But they may exhibit markedly different capability profiles on the plane of political viability - in terms of their capability of meeting the non-profit goal expectations of supervisory authorities. In the constant interplay between operating management and its supervisory authority these opposite influences and pressures simultaneously bear on enterprise behaviour. In striving to maintain these opposite influences and conflicting pressures in some sort of balance, enterprise behaviour represents an exercise in counterpoint. High performers tend to emerge from this exercise with a balanced set of outcomes which is satisfactory to supervising authority while heeding enterprise goals and operating management personal goals. Low performers, by contrast, tend to be overpowered by such conflicting pressures and contradictory influences.

40. Certain features of the public enterprise system may make this exercise in counterpoint so demanding that it enhances the credibility of a large performance shortfall and results in a dispersed and skewed performance curve. The greater the indifference of supervisory authorities to profit performance and their concern for non-profit goals, the greater is the dilution of profit consciousness at the operating level, and the

\[34/\] This is what Prof. Neil W. Chamberlain has denominated the concept of "economic counterpoint" whereby the business firm is "constantly subject to two pressures which must be maintained in some sort of balance". See his book, Enterprise and Environment, The Firm in Time and Place, New York; McGraw-Hill, 1968, pp. 9-10, see also pp. 211-212.

/tendency to
tendency to strike the balance in favour of the non-profit goals. Also, the less taut the profit targets set for public enterprises, the greater the multiplicity of profit-eroding targets, and the greater the discretion of operating management in reporting profits, the greater is the tendency for the balance to be struck in favour of non-profit goals. The greater the "need for approval", as differentiated from the "need for achievement", the greater is likely to be the inclination of operating management to trade away profit performance. More importantly, the vulnerability of the management process, at the operating level, to politicization so that non-profit goals are accorded overriding importance, the greater is the tendency to trade away profit performance for non-profit goals.