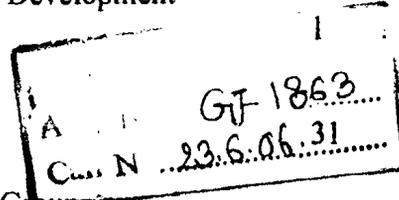


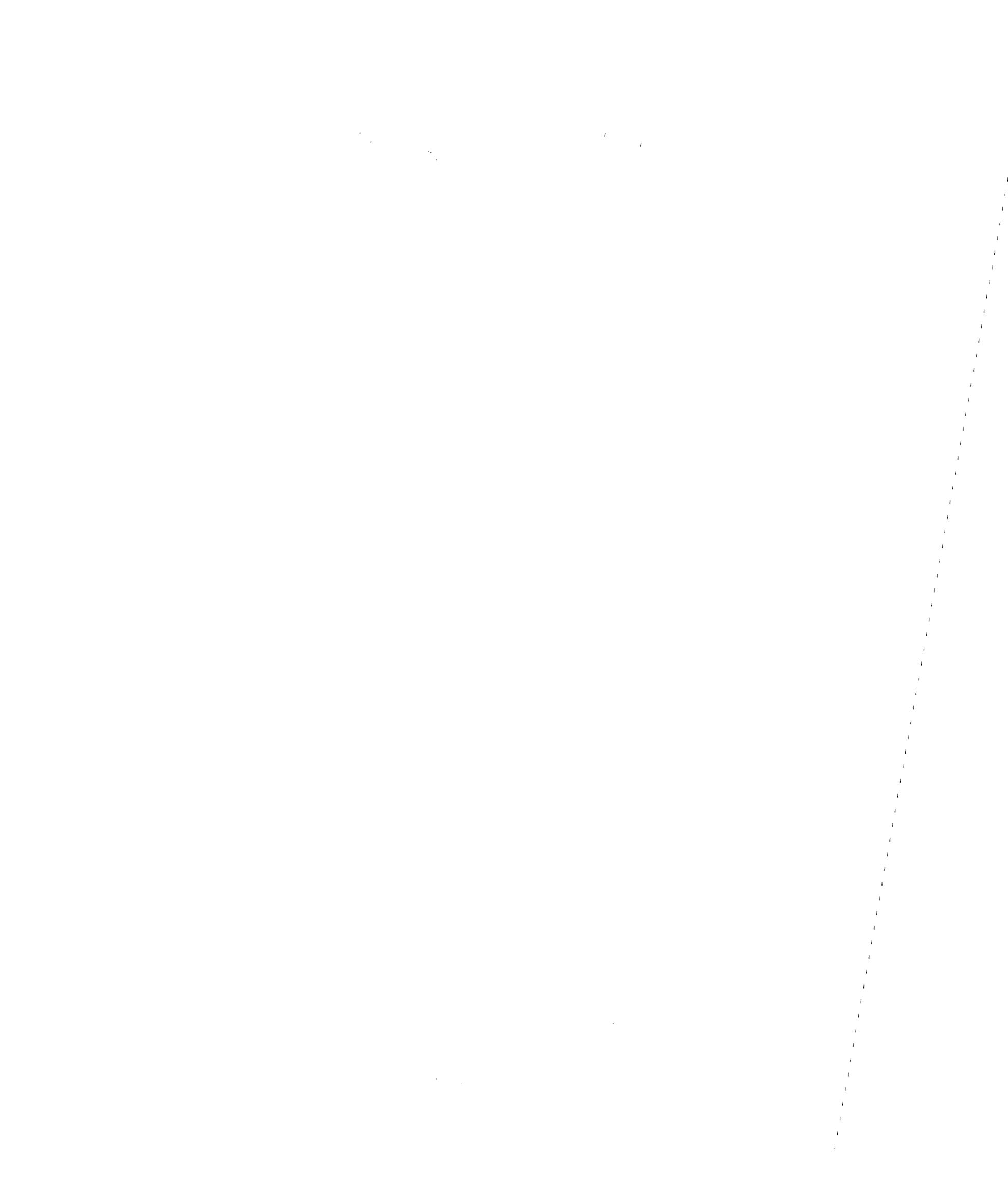
Contents

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Page No.

1. An Agenda for a Research Study on an Interlocking Approach to Accounting, Economics and Finance :
The Perspective of socio-economic Development
Dilip Kumar Sen
 2. Hedging Foreign Exchange Risk
Jita Bhattacharyya
 3. Marketing Strategies for Self Help Groups:
Problems and Perceptions of Sholapith Producers
Samirendra Nath Dhar & Satyaki Mitra 50
 4. Risk Management in Indian Banks
Bharati V. Pathak 65
 5. Enforcement of Accounting Standards in India :
The Regulatory Framework
Satyajit Dhar 73
 6. Measures of Corporate Performance - A Discussion
Arindam Gupta & Amit Majumder 85
 7. An Analysis of the HR Perspective of
Corporate Governance
Partha Sarkar & P.K. Tripathy
 8. Disinvestment of Public Sector Enterprises :
Issue and Concerns
Goutam Bhowmik 112
 9. The Impact of Technological Progress on the
Performance of Banks in India
Amitesh Chowdhury 124
 10. Networks of Progress - Towards a New India
Debashis Kundu 136
- Communication**
- Accounting Standard - An Insight
Rudrajit Raychaudhuri 149





EDITORIAL

Subha Nababarsha! I convey my heartiest greetings to all of you on the occasion of Bengali New Year. By the turn of the year when you are replacing old calendar by the one for 1412 B.D. we present you this tenth volume of our Journal. Gradually through this journal we have been able to stretch our happy association with you for a decade; it is getting nourished by you to step into its adolescence. We expect this association to be stronger and longer.

This issue, significantly bigger in volume and richer in quality, contains ten articles. We congratulate all the contributors for their contributions. We also remember those contributors whom we could not accommodate for technical reason in relation to the blind review system. We specially appeal to them for continuing their cooperation. Prof. Dilip Kumar Sen (from Bangladesh) writes on an 'Interlocking approach to Accounting, Economics and Finance' in the context of socio-economic development. Two authors in two different perspectives have dealt with risk management issue-Prof. Jita Bhattacharyya on 'Foreign exchange' risk and Dr. Bharati V. Pathak on 'Indian banks'. There is another study by Mr. Amitesh Chowdhury on 'The impact of technology on the performance of banks'. Prof. S.N.Dhar (jointly with Mr. Satyaki Mitra) and Mr. Partha Sarkar (jointly with Dr. P.K.Tripathy) have addressed two functional management areas of 'Management' and 'Human Resource' respectively. Different dimensions of corporate issues which are of current relevance like 'Disinvestment', 'Accounting Standards', and 'Performance measures' have been brought into focus by Mr. Goutam Bhoumik, Dr. Satyajit Dhar, and Dr. A.Gupta (jointly with Mr. Amit Majumder) respectively. Mr. Debashis Kundu has presented a sketch of 'Progress towards a new India'. Apart from the above articles, a *communication* from Mr. R. Roychowdhury based on his experience in chairing a seminar session on 'Accounting Standards' organized by our Department in 2003, has also been appended at the end.

Once again I gratefully acknowledge the academic help and cooperation received from the learned Reviewers and the contributors and hopefully juxtapose our demand for the same in future years. I can't but appreciate the similar cooperation extended by my younger colleagues including Dr. A.Gupta, the Executive Editor, who deserves special mention for his unstinted efforts towards all round improvement of the journal. Dr. Jayabrata Chatterjee, the proprietor of M/s. Computer Point, deserves equal credit for compressing the printing time.

I leave with a promise to reappear and with a hope that this issue will also be well accepted at both the academic and professional levels.

Dated: Midnapore
The 26th April, 2005

S/d. **K.C.Paul**
Editor-in chief

AN AGENDA FOR A RESEARCH STUDY ON AN INTERLOCKING APPROACH TO ACCOUNTING, ECONOMICS AND FINANCE : THE PERSPECTIVE OF SOCIO-ECONOMIC DEVELOPMENT

*Dilip Kumar Sen**

Abstract

This paper is an agenda for a research study, which aims to portray an interlocking approach to Accounting, Economics and Finance in the perspective of socio-economic development of the SAARC countries. In other words, this paper endeavors to focus on how the approaches to the three disciplines of Accounting, Economics and Finance can be integrated for the purpose of socio-economic development of the SAARC nations, in particular. This paper encompasses in its canvas theoretical perspectives, problem statement in terms of different research questions pertaining to three disciplines; and objectives, methodology, scope, rationale and probable limitations of the proposed study. The paper concludes with the statement that the proposed study is expected to throw some new light on the integration of these three old disciplines and this would be an area, that would lead to expanded socio-economic growth and development as well as value addition.

Theoretical Perspectives: Genesis of the Problem

The history of Accounting-Economics-and- Finance has shown that there are reasons to believe that Accounting, Economics and Finance are not entirely professional subjects, nor are they meant exclusively for professionals. All lovers of Accounting, Economics and Finance including professional accountants, economists and financial experts themselves recognize this fact. The idea that they have no time or inclination to deal with the theoretical implications of the subjects is absolutely wrong. As a matter of fact, it is the professional accountants, economists and finan-

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cial experts who, either in the capacity of being such or academicians or all as a body are mainly responsible for whatever progress on the side of theories has been achieved up till now. Accounting, Economics and Finance are by all means sciences and so there is always, as admitted by many experts, a scope for re-thinking on these subjects. Such a re-thinking is expected to make these disciplines more useful as scientific tools for social studies and also to improve upon the enterprise accounting as well as the methodology of Economics and Finance. For this there are undoubtedly immense possibilities. The disciplines of Accounting and Finance are destined to prove their worth with exception to none and earn, without contradiction, their full status of academic disciplines just like Economics, which was also once frowned upon by many. The basic principle of double entry has undeniably stood the test of time and necessity. If some explanations of its working appear to be vague and remote from truth or confusing or if they cannot be justified without the help of analogies or imageries, it cannot be due to the fault of the basic rule of double entry itself. It may all be due to the defects in interpretations, which deserve reconsideration (Roy, G.D., 1963:1-2). In the process of this reconsideration, certain thoughts may occur in the mind of researchers while they review the literature related to the existing accounting concepts, principles, practices and ideas.

The rapid economic technical and social changes that have been taking place in the societies for the last several decades received much conceptualized attention of economists, sociologists, and many others including business executives. J.K. Galbraith, the well-known Harvard economist, wrote about forty years ago on the post-industrial revolution in his monumental work *The New Industrial State* (1967). Daniel Bell, the Harvard sociologist, identified in his study *The Coming of Post Industrialized Society* (1976) significant and enduring changes that occurred in the economy. Several other scholars have tried to come to grips with neo or post-industrial socio-economic and structural modifications. According to Enthoven (1985: 6-7), the post-industrial society is becoming an information society. Information is essential not only for the area (system) of enterprise accounting but also for governmental and national or macro accounting. These three systems of accounting are, in fact, interacting. In addition, the information is required to serve a multiplicity of stakeholders in a society. The linkage between microeconomics and micro accounting, as well as macroeconomics and macro accounting tends to become closer in

order to meet the social needs and demands. Accounting information, therefore, has to be more and more socio-economically useful and relevant, keeping in view social responsibility accounting needs. Macro accounting (also known as socio-economic, national or even social accounting) aims at describing systematically and quantitatively the structure and activities of an economy/region/sector during a certain time span, and of its assets and liabilities at a particular time. This accounting takes into account the economic position and operations of an aggregation of entities in a community. This forms an effective means by which to assess the past, present and projected economic performances of a country or region. This is essential for devising effective economic analysis, planning and policy, and also for evaluation of business operations (Enthoven, 1985: 8). Enthoven's point of view is again considered significant here:

The relationship between micro accounting and macro accounting points moreover to the urgent requirement to develop a uniformly valid accounting system and theory, including a better set of concepts, standard, and instruments, from which various types of micro and macro accounting subsystems can be derived. An understanding of social (national) accounting will spur the development of the much needed interdisciplinary approach, and a unified frame of reference covering enterprise, government and social-accounting activities and data requirements, ... Economic planning or programming is the preparatory evaluation and decision-making process of a forward-looking character for an economy in which alternatives have to be measured, weighted and outlined; and priorities for the use of resources established. It is more than a description and analysis of economic transactions and stocks as reflected in the social accounting, although these accounts consolidate a very important element of development planning. A well organized accounting (and statistical) systems is essential for the proper formulation, evaluation and execution of development plans and projects supplying information of a past, current and future nature. The information is to be accurate, realistic,

complete, efficiently presented, and timely (1985:9.)

Accounting in most countries, has the private shareholders' interests as its main focus, while the socioeconomic significance of accounting information measurement and reporting is not given due consideration, as yet. Accordingly, the accounting tasks within the socioeconomic environment need to be expanded to make accounting a more useful and relevant discipline in the societies of developing countries including SAARC belt, in particular. The social welfare or social well-being function (e.g. the national profitability measurements) requires greater attention, whereby society has more than a set of individual interests, involving nationally oriented measurements and reports. It does require a different set of amended measurements and instruments, and the reorientation of accounting methodology in turn may beneficially influence social welfare in economy whereby Accounting then tends to become an economically active force instead of a passive one. Socio-economic accounting, therefore, clearly means the measurement of socioeconomic costs and benefits (e.g. indirect and secondary costs/benefits). This measurement has gradually become a principal concern for accounting since such externality measurements are necessary for both micro and macro economic appraisals. Such Accounting does require profound economic insight including analyses of national accounting data. Societal conditions (e.g., socioeconomic, cultural and so on) impact both the nature and activity of this socio-economic-accounting. The more the days are passing, the more the world is recognizing that Accounting can play an active role in the process of economic development although what exactly generates economic development is still debatable (Enthoven, 1985: 27). However, it is evident from the above discussions that Socio-economic-accounting has the potential for assessing a wide range of effects of changes in the accounting measurement system. This accounting, unlike normal accounting system, takes into consideration macroeconomic and social consequences. This Socio-economic-accounting is treated as operating in a socio-economic vacuum to take care of the extended dimensions and impacts of societal changes involving economic consequences in an enlarged structural and institutional environment (Cooper and Sherer, 1984: 3-4).

Bangladesh economy is in the process of reforms and liberalization. Trade barriers are being lifted and Bangladesh economy is getting more and more inte-

grated with the other economies of the world. Bangladesh companies are raising funds abroad and some have even got listed in foreign stock exchanges. The rapidity with which foreign fiscal policies and economic conditions affect Bangladesh economic scenario may make one feel that the time when share price will be guided by a universal sensitive index is not far away. To remain competitive in today's environment, organizations need leaders who support innovation and emerging technology to act as a catalyst to bring change. According to John H. Humphrey, transformational leaders support emerging technology, and therefore, are better suited in today's economic and technological scenario (Gupta 2001: Editor's Desk: page no. not available).

Modern business has continuity— never ending flow of economic activities. Therefore, accounting has grown to meet a social requirement and to guide the business and industry accordingly. Accounting is moving away from its traditional procedural base of encompassing record-keeping, preparation of final accounts, and budgets to the adoption of a role, which emphasizes its social importance. Here a quote from Welsh and Anthony (1971:19) seems pertinent:

The growth of business organizations in size, particularly publicly held corporations, has brought pressures from stockholders, potential investors, creditors, governmental agencies, and the public at large, for increased financial disclosure. The public's right to know more about organizations that directly or indirectly affect them (whether or not they are shareholders) is being increasingly recognized as essential. An open society is one that has a high degree of freedom at the individual level and typically evidences an effective commitment to measuring the quality of life attained. These characteristics make it essential that the members of that society be provided adequate, understandable, and dependable financial information from the major institutions that comprise it.

The concept of value added is another dimension, and it requires profound expansion. It serves both micro and macro accounting and economic purposes. This is used as an effective measure of performance of an entity. Many consider it conceptually sounder and more reliable than return on investment since, value added

clearly breaks down the contributing elements, i.e., labour, capital consumption, interest, taxation and profit. In this connection, Enthoven's point of view (1985:15) seems very much relevant:

The Value Added Statement in Corporate reports provides a very good measure of the size and importance of the company. The statement also reports the company's contribution to the national income. It therefore has a potential role in the management of the national economy since a major goal of economic policy is economic growth and development. Another advantage from the inclusion of a Value Added Statement in corporate reports are that the introduction of the productivity schemes based on Value added in thereby facilitated. However, the historically based Value Added Statement understates the share of the employee group in value added. When their share is measured in "real" or inflation-adjusted terms, it is even higher than the apparent historical percentage.

Profit computation is now no longer a simple comparison of financial values at the beginning and end of a transaction or series of transactions. It is these days related to a complex set of allocations and valuations pertaining to the operational activities of a business enterprise. The concept of accounting has now become very broad and its utility value is unimaginably great for decision-making purposes; it has also been working well. However, the development of a comprehensive theory, with a secure intellectual relationship to its operating economic environment, has hardly begun in most countries (Enthoven, 1985:11). Refinements in cost and management accounting came latter in the twentieth century along with large-scale production and high capital investment. These developments created a need to allocate costs correctly over the units of production and also to provide a measure of productivity and efficiency. Therefore, Cost Accounting evolved naturally to meet recognized managerial refinement of costing and pricing for comprehensive purposes, and to determination and setting forth of operational information for decision-making purposes. Traditionally, Government accounting was linked to taxation and revenue control, and to the recording of accountability for receipts and expenditures. The 20th century development in budgeting gave a much larger scope to the area of Govern-

ment accounting. The budget became a managerial and policy-making instrument and developed into a mechanism for the forward planning of receipts and expenditure. Budgeting now-a-days has developed in such a manner that it forms one of the bases of, and is closely associated with economic planning and programming.

Accounting has evolved throughout recorded history to meet the needs of those who conduct economic transactions. Naturally, as business has developed international dimensions, accounting has kept pace. For example, the growth of international commerce in Northern Italy during late middle ages (and the desire of Government to find ways to tax commercial transactions) led to the creation of the double entry book keeping, which appeared in Venice in 1492. Since then, at an accelerated rate, business has become more international and the associated accounting issues have become more complex. The development of the British Empire created unprecedented needs for British Commercial interest to manage and control enterprise in the colonies, and for the records (of their enterprises) to be reviewed and verified. These needs led to emergence of the organized public accounting profession in Scotland and England during 1870s. Since then there has been a mutual interaction between auditors and accountants to find a generally accepted framework of accounting procedures and techniques that would allow accurate and understandable financial statements to be reviewed and reported (Zimmerman, 1984: 3-16).

Historically, Accounting has shied away from longer term measurements and reporting; however, the societal needs and demands, aided by better information networks, requires this discipline to be more future-oriented. Especially, decision-making accounting (that is, Accounting for planning and control) needs to measure and report future projected implications. In capital budgeting, the requirement is to make feasibility studies incorporating long-range projections and forecasts. It also considers in its compass a needed shift from verifiable financial accuracy towards economic relevancy (Enthoven, 1985: 6)

Accounting has been remarkably successful in its ability to be transplanted from one national setting to another while allowing for continued development in theory and practice worldwide. Development in telecommunications and computer technology allow information to be recorded and transmitted with a speed and accu-

racy that was all but unimaginable just a few years ago. The World Wide Web, almost unheard-of in the early 1990s, is now indispensable for obtaining international financial information.

The history further shows that the birth of Accounting Science synchronized almost with the introduction of money as a medium of exchange. Accounting, like other sciences, has come to its present form through an evolutionary process. It has passed through different phases of refinement. Needless to say, it is no longer limited to bookkeeping and financial statement preparation. It has, in its present form, developed into an **information system**, which furnishes economic information to decision-makers not only within the firm but also outside the firm. It guides management not only in performing day-to-day operations but also in designing plans and policies for the future. Several decades ago, however, most accountants and financial executives were indifferent to the global dimensions of accounting and financial reporting. With the growth and expansion of world trade and the emergence of a large number of multinational companies on the global scene, they realized the presence of a host of controversial issues in the arena of global accounting. Today, it is a well-established area of specialization (Rathore, Shirin, 1996:1). However some authorities such as Samuels and Piper (1985) have argued that there is nothing new about International Accounting. Accounting has always been international, from the time it emerged some thousands of years ago, because of its concern about international trade as well as spread of ideas across countries. Choi and Mueller (1979) also observe in the same tune: the heritage of accounting is indisputably international and, therefore, today's concern for multinational accounting is more a renaissance than a new idea. Parker's view is also very much identical: "modern accounting is not the invention in its scope" (1983). Though it is evidently true that international trade existed in the good old days when caravans used to cross national borders for selling their wares, it is equally true that the last few decades have witnessed a dramatic change in both character and volume of global trade. The modern means of transportation have replaced the caravans, and the volume of trade has increased manifold, leading to creation of new international markets. This great expansion of international trade has given rise to unique accounting problems demanding a distinct branch of accounting have international dimension (Alhashim & Arpan, 1988, Evans, Taylor & Holzmann, 1985 and Rathore, 1996).

Along with an increasing international dimension has come the realization that Accounting does not serve only the interests of business managers and owners. Government, labor and commerce groups, environmentalists and other social activists, and creditors – all have interests (economic and otherwise) in the activities of businesses. They, as well as managers and owners, need access to complete and accurate financial information.

Today, Accounting is moving from a national economy towards a world economy. In a world of growing interrelatedness in political, social, and especially economic affairs, it has become imperative to appreciate the importance of accounting issues in a global context. In particular, the growing internationalization of markets and corporations coupled with the stimulus for economic integration and development pose a variety of new and pressing challenges (Radebaugh and Gray, 1997: 667). Many of the most interesting issues in accounting result from its international dimensions. The explosive growth in cross-border transactions and the rapid increase in companies seeking capital in international markets have made international accounting problems a daily fact of life for people in business around the world (Choi, Frost and Meek, 1999: 5). These days multinational enterprises are spreading all over the world. The rise and spread of multinational enterprises is not limited to developed countries. More and more enterprises of developing countries (for example, those of India, Brazil, Bangladesh, Pakistan etc.) are spreading their wings abroad. An important accounting impact is the enhancement of the body of knowledge referred to as international or multinational accounting. The activities of the International Federation of Accountants (IFAC) and the International Accounting Standards Committee (IASC), complemented by the activities of the United Nations (UN) and World Bank have been impacting the discipline of Accounting. Accounting as a scientific discipline and body within such a world economy, tends to become more and more homogeneous (Enthoven, 1985:6). Globalization and liberalization are these days the buzzwords in the world scenario, and International Accounting is one of the most important aspects of information technology in promoting the expansion of business enterprises and flow of capital from one country to another. Without knowledge in International Accounting, a country is handicapped in expanding the resources and accomplishments of its people in furnishing goods and

services to improve the standard of living of all citizens. Shirin Rathore (1996:376) confirms the importance of International Accounting dimension in the following words:

The flow of capital across national borders has increased manifold over the last decade or so. The deregulation of capital markets in central and Eastern Europe and some Asian countries has led to further integration of World financial markets. This accelerating globalization of the capital market holds profound implications for accounting practices and policy. The problems that a reader would encounter in analyzing global financial standards would differ in nature and magnitude from those faced in dealing with domestic statements. The problems of reliability and timeliness of information, language and terminology, format and content and currency of annual reports may be considered trivial, and require little effort on the part of the analyst. The more complicated issues before the analyst relate to conceptual issues such as consolidation, revaluation of assets, accounting for inflation and investment in affiliates. Measurement of profits is closely related to national characteristics such as management philosophy, structure and development of capital markets, legal requirements, tax laws and extent and effectiveness of professional accounting standards. Hence, considerable diversity prevails in this regard. Similarly, a host of differences exist with regard to disclosure and presentation of relevant information for the decision-making. The global investor has, therefore, to wrestle with a host of cross-border differences while performing stupendous task of comparing and contrasting potential opportunities before making any investment decision.

When today's economic planners are mapping out blueprints for fostering national growth, they need to think that the time is ripe—over ripe indeed—for a rapprochement between the accountant and the economist. Even after retention of enough scope for activities within their respective spheres of specialization, the accountants and the economists may have much common ground to work together.

But, instead of having two approaches to each of the common problems, one through accountancy and the other through economics, “We need”, says Prof. Arnold Plant (as cited by Bray, 1947:35) “more economist-accountants and accountant-economists, and permanent organization for joint investigation of the unsettled questions of our time.” Above all, it may be observed that many are of the opinion that accounting, besides being used as a means for controlling enterprises, may itself be looked upon as a tool for economic analysis. The points of contact between the accountant and the economist have increased both in number and magnitude and there has been a considerable amount of fusion of their respective functions. As economists are using, more and more, terms employed particularly by accountants, studying their methods and working on data, supplied by them, so are accountants gaining knowledge from economic ideas such as theory of cost, marginal concepts, diagrammatic presentation, forecasting, efficiency concepts and other theories to help them both in internal accounting and costing (Roy, G.D., 1963:3-4).

Today Inflation Accounting is the world economy’s old friend. Currently, almost none of the economists and accounting scholars is heard to speak about it, although in the past professional accounting bodies of the U.K. in particular, and many accounting scientists such as H.W. Sweeney (1936), S.J. Broad (1948), W.T. Baxter (1949,1950), B.J. Davis (1953), L.A. Wilk (1960), R.S. Gynther (1961,1966), G.D. Roy (1963), R.J. Chambers (1966,1973), Stephen A. Zeff (1962), F.K. Wright (1963), Raymond C. Dockweiler ((1969), Robert T. Sprouse (1970), Zvi Griliches (1971), P. Chattopadhyay (1975), Adolf J.H. Enthoven (1985: 16-17) and so on used to express their concern over the need for inflation accounting. That concern as well as enthusiasm is now on the ebb. It is true that inflation accounting shakes the fundamental accounting concepts of profit, charging of depreciation and the like. Nevertheless, there is no denying the fact that accounting people may ignore inflation but inflation seldom ignores accountants. Fixed assets stated at historical cost in respect of acquisition dates over time tends to make the balance sheet sham, the farthest from the reality. Inventory of material and finished goods also represent a mixture of values of **takas** (or any other monetary units) that affected purchasing power with respect to their dates of acquisition. Therefore, accounting scholars’ community together with accounting profession has responsibility to display the facts of inflation in accounting reports of industrial organizations, however unpalatable these facts

may be. It is somewhat heartening to note that the old realization of giving effect to inflation in accounts is reviving, though very slowly. International Accounting Standard (IAS) 15, which is under adoption process to be initiated in Bangladesh, has given recognition to this reality by permitting to reflect the effects of changing prices on the measurements used in the determination of an enterprise's results of operation and financial position (ICAB:103). The obvious reason for revival of the past concern to reflect inflationary effects in accounting reports may be observed from the statement of an eminent accounting scientist of India:

As regards the quality of information available in the annual reports, educated users of corporate financial statements agree that the balance sheet provides very little information useful for investment decisions. Uneducated users do not understand why the values and why shareholder's equity has no relationship with the market value of the shares (Bhagwati Prasad, 1988:3)

A Word on Environmental Issues

Both economists and accountants are concerned with these issues. In the late 1980s, environmental concerns, which had long remained dormant suddenly appeared in the minds of people, the world over. Concerns over the impact of greenhouse effects, destruction of rain-forests, acid rain, high level pollution and depletion of natural resources spread far and wide. Companies' initial response was defensive. They tried to deflect the attention of green pressure groups, and to comply with law. However, opportunities came with the advent of the green consumers, who were willing to pay a premium for products, which were perceived as 'environmentally friendly', however dubious the real situation. Green investment started to be more prominent. When companies got greener, it became simultaneously inevitable for the accounting profession to consider their response to the newly emerging green agenda. As a consequence, a new discipline branched out of accounting with the nomenclature of Environmental Management Accounting (EMA), which has become a part of Managerial Accounting, in the modern broad sense of the term. Researchers in the fields of both Economics and Accounting automatically have now a new responsibility to help this new discipline grow more and more. For them, hard work is a need of the hour to develop theories and models for quantifying the non-quantifiable aspects.

Economists are much worried about the environmental problems in these days, Accounting researchers need to share the worries with the economists. Environmental degradation threatens the productivity of agriculture and forest resources upon which developing countries (including SAARC nations) depend greatly for their economic growth. The problem is most pervasive in the poorest countries, where poverty and population pressures compel people to deplete the natural resources to meet their immediate needs for survival. Forests are burned to make room for food crops, the soil is depleted when cow dung has to be used for cooking fuel instead of fertilizer—and both the environment and prospects for economic betterment suffer. Observation tells that much environmental damage is the result of either shortsighted policies or lack of knowledge, as when insecure land tenure, artificially low farm prices, and illiteracy keep farmers from practicing soil conservation. Here lies the need for an analysis of the relation between environmental factors and economic development. The analysis needs an accounting methodology. Researchers need to focus on how developing countries can protect and even improve the economic and social welfare of their people. This is what the World Bank observes (Schramm and Warford, 1989:1-199).

Economists, Accountants and Finance Experts have to reorient their outlook in the light of changing global environment. The thrust of accounting and finance researchers need newer priorities and focus. Professional bodies of these fields have already revised their thinking and are also making sincere efforts to upgrade their professional role.

For efficient operation of a business, there is necessity for prudently obtaining and effectively utilizing funds. Financial Management does these jobs. Basically, therefore, Financial Management centers around fund raising for business in the most economical way and investing these funds optimally so that maximum return can be obtained for the shareholders. Since all business decisions have financial implications, Financial Management is interlinked with all other functions of the business (Sen, 1997:1). To add a word from Gitman (1997: 4): the field of Finance is broad and dynamic. It directly affects the lives of every person and every organization, financial or non-financial, private or public, large or small, profit-seeking or

not-for-profit. Financial managers perform such varied tasks as budgeting, financial forecasting, cash management, credit administration, investment analysis and fund procurement. Of late, the changing economic and regulatory environments have increased the significance and complexity of the financial managers' duties. In the sequel, many top executives in the industry and government get to know by heart the techniques of Finance. According to Jeff Madura, an understanding of International Financial Management is crucial not only for the largest multinational corporations with numerous foreign subsidiaries but also for other firms that conduct international business. Multinational corporations (MNCs) competing in the global marketplace must not only be properly managed to apply their comparative advantages in foreign countries, but also manage their exposure to the various forms of risks as they capitalize on their international business opportunities. Their exposure is specially pronounced in developing countries where currency values and economies are volatile. In general, changes in international conditions make International Financial Management more challenging. Multinational corporations respond by meeting the challenge rather than retreating. Those multinational corporations that are most capable of responding to changes in the international financial environment will be rewarded. The same can be said for the students today who may become the future managers of MNCs (Madura, 2003: XVI &2).

The twentieth century having been over, one may be tempted to focus the vision on the new millennium. The world has been witnessing a variety of changes. Technology is impacting the life style in a big way. The developments in the fields of transportation and communication, more particularly in information technology have shattered physical distances, while the globalization is making political boundaries irrelevant. Countries all over the world are searching for their core strengths, and in the sequel, regional blocks such as SAARC have been formed. These developments are expected to provide quantum boost to international trade and commerce. A new era is unfolding before the nation (i.e. Bangladesh), raising hopes as well as challenging situations. No country and no branch of knowledge can remain unaffected by these developments. The present study focuses on some of the issues of a few branches of knowledge, aiming to examine how far they, in an integrative process, are conducive to economic development in regional blocks such as SAARC including Bangladesh in particular.

In the foregoing discourse, an attempt has been made to highlight the theoretical perspective of three broad disciplines: (1) Accounting: financial and managerial, (2) Economics and (3) Finance. Now to pinpoint the significance of this background study: the disciplines referred to over here are full of complexity, both at the level of theory and at the level of practice. The inflationary trend, and technological as well as population explosion that the industrial or business world has been living with have added new dimensions to the complexity. In the context of a developing country like Bangladesh where the need for a socio-economic-accounting development, economic growth, capital formation and poverty alleviation provides further dimensions, some issues of the above disciplines, appear to be a relevant field of inquiry and research. Without efficient techniques and tools of **Accounting: Financial and Managerial, Economics and Finance**, efficiency, higher productivity, economic and financial growth and concomitant social development will be lacking. Hence, in the fitness of things, a desperate need for commissioning an in-depth research study on some issues of Socio-Economic Accounting, Economics and Finance, as well as their utility value in a developing country like Bangladesh.

Statement of the Problem

Economics is, in fact, a mother discipline from which Accounting and Finance along with their different tributaries have emerged as different important disciplines. Researchers are researching on multiple issues of these different disciplines. The mission is to go into the depth of some of the important issues and discover how far they are really useful to human beings for their good—social and economic.

Accounting: Financial and Managerial, Economics and Finance have grown into discrete intellectual disciplines with a core of knowledge in each of them and a large body of literature emerging for highlighting different issues and problems in each of these areas. As is quite usual, branching out, and formulation of propositions, theories and concepts have been the accompanying features in each of these cases. When branching out, in most cases, the proponents of these disciplines have generally undermined the stem from which all these disciplines have over time branched out.

This study proposes to highlight the stem and underline the relevance of

each of these disciplines for attaining a common purpose. This purpose is broadly akin to achieving rapid progress in economic development. The fundamental aspects working behind economic development on the one hand, and on the other hand, the methods and processes of containing the forces unleashed by this process have not always been given the care and attention that is due. This study, therefore, purports to identify the trunk, the branches and the sub-branches as also the leaves which sustain the trunk through generation of chlorophyll while the roots struck into the ground derive sustainability. Thus, thinking of the tree, one can stress that both the leaves and the roots contribute to the strength of the tree and its longevity. This study is based on the assumption that the trunk of the tree is the society at large, the roots are the historical processes of development of the theories, concepts and principles, the leaves are the varieties of topics and problems in each discipline area and the techniques of keeping the stated issues centripetal. Too many issues in each of these areas have immanent centrifugal forces which call for a counteractive element to bring them back on track.

The subject areas chosen for the study (such as Accounting: Financial and Managerial, Economics and Finance) have one common objective to maximize social good. They have not only a distant linkage but also a much closer connection as veins and arteries are transmitting blood for sustaining the body. Though apparently unconnected, these subjects, apart from the common root, sustain each other in a process of give and take. For instance, while Financial Accounting deals basically with the earning and spending activities of a company, a summation of all such companies along with non-corporate activities comprise the macroeconomic phenomenon—the subject matter of study of Economics. On the other hand, Finance focuses on the functioning of financial management that contributes to efficient deployment of resources of a productive unit. And Socio-Economic-Managerial Accounting seeks to tell Management beforehand the ways and means of deployment of funds for realization of social good while still generating a surplus from the operations. To make economic development sustainable, care has to be given to ensure that the disbenefits do not outweigh the benefits.

Apparently, as has been stated earlier, professional links between the differ-

ent disciplines under reference are inadequate, hampering their potential functions in the total socioeconomic framework. Presumably, this suffers from insufficient professional interest, inadequate government encouragement, and lack of support by and compliances with private and public institutions. Furthermore, effective dialogues and co-ordinations between the enterprise accounting profession and the governmental and economic agencies appear to be minimal. Hence, to safeguard the national and regional interest a closer coordination or integration between the accountancy bodies and the bodies of other disciplines is warranted.

It would, in the circumstances, appear that the subjects while looking unconnected have a relationship that runs through the entire economic system. This study, therefore, seeks to pinpoint the issues of convergence and divergence of these subject areas and the manner an integrated understanding of all these areas help better appreciate the quantum and timing of release of steam so that the growth engine moves on, and moves on the track laid down for this purpose. Integrated analysis of different issues attempted here projects the unison inherent in them. Integration of all these different strands submits itself to three approaches: (1) the broad questions that have to be asked and answered with reference to each of the subject areas and the ways of integration, (2) the integrated process establishing the common linkage and the manner of convergence of divergent issues, (3) whether the interlocking approach brings out the synergistic effects which the individual disciplines are incapable of realizing. The dis-aggregative approach in reference to each of these disciplines relates to the topic areas highlighted in the approach statement.

To end up the background study of problem statement: it may be mentioned that practically no work encompassing different subject issues is known to have been done thus far in SAARC belt, including Bangladesh in particular. In other words, an interlocking approach to different issues of different disciplines as a crucial study for economic development is lacking. Here lies the research void or problem of the present study. Hence, the need for an integrating approach to different issues of different disciplines in the perspective of economic development.

From this perspective, the problem of the study may be enunciated in terms of the following questions of different disciplines:

Accounting: Financial and Managerial

- 1) What is the rationale of financial accounting as a culminating process of a year's operations as it has evolved over time?
- 2) How does one deal with Accounting in times of changing prices?
- 3) How important is to integrate ethical consideration with accounting practices in the perspective of economic development?
- 4) What are the essential considerations in corporate social reporting in the context of Bangladesh economy?
- 5) What are the distinctive elements in Value Added Accounting? How does it affect economic growth?
- 6) How does one highlight the socio-economic aspects of Managerial Accounting and for what purpose?
- 7) Since Managerial Accounting relates to helping management with the decision-making process, how does the Management Accountant make the decision-making phenomenon responsive to both business and social needs? How important are the roles of C-V-P relationship analysis, transfer pricing, Strategic management accounting, Responsibility accounting, Cost audit, Social audit, Management audit and so on in this regard?
- 8) Since managers make the future today, how does the Management Accountant prepare his/her database to help management? Is accounting for Executive Information Systems (EIS) helpful in this connection?
- 9) Activity-based costing is supposed to highlight some of the hitherto-untouched areas, especially for stopping cross subsidization of overhead facilities— how does the Management Accountant compare ABC costing with traditional costing methods and end with what effect? What is the importance of throughput costing in this respect?
- 10) How does fraudulent financial reporting adversely affect economic growth and development? How to check it?
- 11) How can accounting education and research be conducive to economic development?
- 12) Is creative accounting a curse or blessing for an economy like Bangladesh?
- 13) How does budgeting help in controlling investment and performance? Has Zero

based budgeting any role to play in this regard?

- 14) What role does the Management Accountant play with respect to non-profit organizations, especially in pegging the revenues as near as possible to the costs?
- 15) Why is harmonization of global accounting principles and policies needed?

Economics

- 1) Is there any conflict between the approaches of the Economist and the Accountant?
- 2) How effective are the critical factor relationships to deal with poverty and environment?
- 3) How does one analyze poverty alleviation simultaneously with social justice?
- 4) What is the impact of environment on sustainable development?
- 5) How does social and environmental accountability impact economic development?
- 6) Is it time to replace traditional budgeting?
- 7) What are the implications of in equal mobilization of bank funds?
- 8) How should one approach the question of employment maximization as against enhancement of remuneration *a la* Marx? Can Marxian philosophy contribute to economic development of Bangladesh?
- 9) What are the indicators of demographic and socio-economic characteristics of a slum area population?
- 10) Savings in Bangladesh, What about its trends, determinants and policy options?
- 11) How should be the Socio-economic transformation for twenty first century?

Finance

- 1) What financial management tools are normally used in judging operational efficiency and financial position in Bangladesh? How are they effective and efficient?
- 2) How is the investment environment in SAARC nations with particular reference to Bangladesh?
- 3) Is working capital management efficiently done in Bangladesh?
- 4) How does capital budgeting technique work in Bangladesh situation?

- 5) How is lease financing working in Bangladesh economy?
- 6) What are the students' and practitioners' attitudes towards the ethical acceptability of earnings management in the context of Bangladesh?
- 7) What is the impact of dividends and retained earnings on the market price of shares?
- 8) How should one match cost and benefit of production, profit and social good?
- 9) What benefits can accrue to Bangladesh from portfolio management and mutual funds?
- 10) What is the position of international financing in Bangladesh and how does one reconcile the motivations behind mergers and acquisitions as against development on entrepreneurship?
- 11) How does one minimize foreign exchange risks in conditions of partial and full convertibility of Taka?
- 12) How does one account for off-balance sheet items, especially options and derivatives?

Objectives of the Study

The broad objective of this proposed research study is to examine whether an interlocking approach to Accounting, Economics and Finance can be of some use in accelerating economic development. The specific objectives are four-fold:

- 1) to study some issues of socio-economic-financial-and-managerial accounting ;
- 2) to analyze some issues of economics and finance;
- 3) to find the relationship among the above disciplines in the light of their important issues to be dealt with in the study;
- 4) to examine the utility value of interlocking the referred disciplines in the context of socio-economic development of Bangladesh in particular, and of other SAARC nations in general.

Methodology and Work Organization

Available literature will be the main source of the proposed study. In certain cases, data will be collected partly by administering questionnaires and partly through mailing of questionnaires.

Descriptive as well as inferential statistics will be used wherever necessary, for the purpose of analysis.

The proposed study will be organized into three sections seeking to provide a consolidated approach to three disciplines: section-I will dwell on some issues of Financial and Managerial Accounting, section-II will focus on some issues of Economics and finally, section-III will analyze different aspects of Finance.

The study will be directed to show how an integrated approach to different aspects of different disciplines can be conducive to economic development.

Scope of the Study

The proposed study is designed to cover some issues of (1) Accounting: Financial and Managerial, (2) Economics and (3) Finance. It will encompass both global and Bangladesh perspectives. In regard to global perspective, the emphasis will be given on SAARC nations. In addition, developed and other developing countries may also be referred to in order to make the study more informative, useful as well as interesting. The issues to be covered in the proposed study refer to the research questions raised earlier under **Statement of the Problem**.

Rationale of the Study

Some individuals may hypothesize that a consolidated approach to different issues of these broad disciplines- (1) Accounting: Financial and Managerial, (2) Economics and (3) Finance may be useful to company managers, decision-makers, national economic planners, tax authorities, accounting experts and financial analysts, environmentalists and many others in their works in respective fields. But so far no such study is known to have seen the light of day in the SAARC belt including Bangladesh in particular to substantiate or refute such contention.

Financial Executives, Managers, Financial-Cost-and-Management accountants, as well as other interest groups will hopefully find in this study clear explanations and assessment of the theories and practices of socio-economic managerial accounting and financial management. This research is expected to provide them

with the information and criteria for evaluating and improving their performances. They will find in it a comprehensive and up-to-the minute summary and exposition of accounting and financing techniques from both a theoretical and a practical viewpoint. The study may provide powerful aids to present-day planning and decision-making. It may also play a role in the discussion and exemplification of traditional techniques and tools used by accountants (financial and managerial) and finance managers. On the whole, the national economic policy makers, economists, accounting experts and financial analysts will hopefully find this work useful and intellectually stimulating.

Above all, the study is likely to provide an interesting exercise to academic scholars concerned with the issues to be addressed in the study.

Limitations of the Study

The proposed study is subject to the following limitations:

First, for a research study, usually a small area is chosen and an in-depth study is made thereupon. But here the proposed study aims to bring within its range multiple issues of three broad disciplines. This is apparently a deviation from the normal principle of research methodology. Nevertheless, undeniably, the endeavor is to study how divergent issues of three different disciplines can work together as complementary to each other in the perspective of a common goal, i.e. economic development. This study will, therefore, be possibly a new focus on a path-breaking research.

Secondly, since the proposed research study plans to cover multiple issues of different disciplines, it is going to be a very lengthy one, which may not be very interesting to those who are not serious readers.

Thirdly, the proposed study may not be completely immune from the unavoidable repetition of certain things. The proposed work may involve repetition of certain basic ideas in some places, but this repetition may help the readers in getting a firmer, clearer and unequivocal idea of what the study is planning to establish. This repetition of certain things will probably serve a useful purpose in making the interpretation logical and coherent, and the conclusion evident.

Fourthly, despite the author's most strenuous efforts to survey a good many works (like articles, papers, books, research studies, doctoral dissertations etc.) in

the related areas of the study, many studies may escape his net by sheer oversight and ignorance. Besides, the limitation of financial resources, time constraint and other problems may preclude access to the entire existing stock of literature scattered in every nook and cranny of the world.

Fifthly, the author may have no other alternative but to quote the secondary references (instead of original ones) in certain places, and also he may fail to mention the page numbers of some works in case of both in-text and bibliographic documentation because of non-availability of original works to him. He may not avoid those works because their contents may help him make his discussions more sound, more powerful and more logical.

Concluding remarks

It is evident from the preceding discussions that this paper is the scheme of a research study, embracing the idea of integrating the three disciplines of Accounting, Economics and Finance in the direction of socio-economic development of the developing world with particular reference to SAARC belt. The issues to be dealt with in the proposed research study reflect the broad range of material relevant for the disciplines referred to earlier. The objective of the proposed study is to investigate the interface among Accounting, Economics and Finance in the context of the dynamics of change being experienced in the global economy, particularly in the economies of SAARC countries. The main issue of the study is to examine how these disciplines relate to each other in attaining the goal of socio-economic development. The triangulation is possible if there is a deep insight into each of these three disciplines and knowledge about the frontier issues that these are dealing with in the context of liberalization, globalization and development of these sciences themselves. This may allow identification of interlocks— how one feeds into, and in its turn, is inferred by the other disciplines. Hopefully, this study would help build a more effective triangular framework and theory, which is of course subject to profound study, as well as a required body of knowledge that can efficiently deal with the combining aspects of the three disciplines to serve integrated broader and deeper societal trends and needs. And ultimately this study is expected to throw some new light on the integration of these old disciplines and this would be an area that would lead to expand socio-economic growth and development as well as value addition. Accomplishment of this goal requires expertise to determine what information is relevant,

identify suitable measurement criteria, collect complete information, design a proper information base, processing and reporting system and related procedures, evaluate information structures and processes, measure efficiency and effectiveness, and setup and carry out micro and macro economic-accountancy –and- financial management programs and appraisals.

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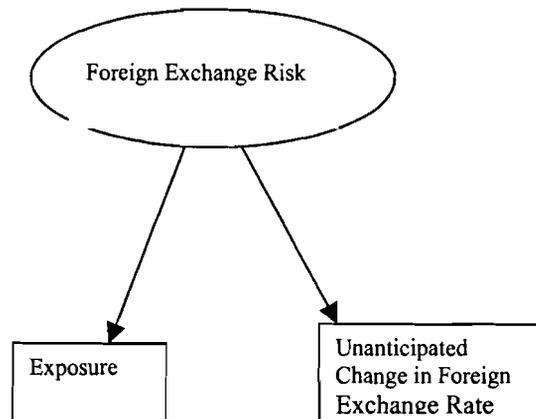
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HEDGING FOREIGN EXCHANGE RISK

*Jita Bhattacharyya**

Concept of Foreign Exchange Risk

Foreign exchange risk refers to the possibility of adverse changes in the value of the firm arising out of unanticipated exchange rate changes. Foreign exchange risk arises due to random fluctuations in foreign exchange rates. It can be measured by the variance in the value of monetary as well as real assets and liabilities and the operating income of a company that is caused by unanticipated changes in the exchange rates (Dufey and Giddy, 1997). In other words, foreign exchange risk is measured by the variances in the domestic currency value of an asset, liability or operating income that is attributable to unanticipated changes in exchange rates (Levi, 1996). According to this definition, volatility in exchange rates is responsible for exchange rate risk only if it results in volatility in the real domestic currency values of assets, liabilities or operating income. This means that foreign exchange risk is dependent on exposure as well as unanticipated changes in the exchange rate. Exposure by itself does not imply foreign exchange risk if exchange rates are perfectly predictable. Again, unpredictability of exchange rates does not mean exchange rate risk for items that are not exposed.



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Exposure

It is apparent from the discussions in the aforesaid paragraphs that it is the value of the firm which is at risk. It is this value which is known as exposure. Conventionally, exposure refers to those elements of a firm's physical and financial position which are generally located outside the relatively safe home base and which are denominated in foreign currencies. It is therefore, necessary to identify exactly which assets, liabilities, income flows and cash flows are denominated in currencies other than that of the parent and where these are located (Holland, 1993). There are three conventional classes of exposure, viz., (a) economic exposure, (b) transaction exposure, and (c) translation exposure.

Economic exposure is concerned with the effect of exchange rate changes on the uncertain foreign currency stream of corporate cash flows and how this affects the value of the firm. There are two aspects of economic exposure – the competitive or operating aspect and the transaction aspect.

Transaction exposure is the uncertain domestic currency value of an open position denominated in a foreign currency with respect to a known transaction.

Translation exposure is the uncertain domestic currency value of a net accounting position denominated in a foreign currency at a certain future date (Wihlborg, 1980). Transaction exposure and translation are together known as *accounting exposure*. Some experts, however, prefer to restrict the term *accounting exposure* only to the translation exposure.

According to Alder and Dumas (1984), exposure is a correlation coefficient. If home currency returns are regressed on foreign exchange rates, then the correlation coefficient will measure the sensitivity of these returns to foreign exchange rate changes. Exposure is therefore reflected by the sensitivity of these cash flows and returns to exchange rate changes. Viewed from this angle even a wholly domestic firm with little or no importing and exporting business can be exposed to currency risk. This may happen if majority of a company's customers are importing and exporting firms whose activities are influenced by exchange rate changes; the firm's operations will then be exposed to exchange rate risk. This implies that there are very few firms that are free from currency risk (Alder and Dumas, 1984).

The concept of exposure is therefore applicable to the wholly domestic firm, the domestic firm engaged in export and import, and the full MNC.

Unanticipated Changes in Foreign Exchanges Rates

Unanticipated changes in the foreign exchange rates are a source of foreign exchange risk. The emphasis here is on unanticipated changes, as anticipated changes in the foreign exchange rates as well as other available information are already reflected in market prices.

Fluctuations in the exchange rates that cause deviations from purchasing power parity (PPP) constitute a risk specific to international involvement, which is called exchange risk. Exchange rate changes cause exchange risk only to the extent that they represent deviations from PPP. If exchange rate changes ensure that PPP holds, then they do not constitute exchange risk (Pilbeam, 1994). In other words, if inflation changes and exchange rate changes do not completely offset each other over a short-term period, then firms may be exposed to exchange rate risk.

Hedging Foreign Exchange Risks

An internationally involved firm is often faced with considerable foreign exchange risk. As a result, foreign exchange risk management has become very important for such firm. One important technique the firm adopts for this purpose is hedging.

Hedge means to 'protect oneself from loss, by compensatory transactions, e.g., bets on the other side'. In everyday English, the word has come to signify any kind of defensive or guarded behaviour. Thus, hedge is the purchase of a contract that will rise in value and offset a drop in value of another contract, thus protecting the owner from loss. A derivative instrument has become an important tool in the hands of the firms for risk management purposes. A derivative is a financial contract which derives its value from some underlying asset such as a financial instrument, index, equities, interest rates, and currency. The common currency derivatives are futures, options, forward contracts, swaps, etc., which are used for hedging purposes. All of these instruments are some forms of contractual arrangements, which make the firm and the other party liable to fully discharge the contract. These instruments generally fall into two classes: (a) those, which are customised or tailored according to the requirements of the firm, and (b) those, which are standardised and available through exchanges. Besides these derivative instruments, money market transactions are also used for hedging purposes.

Forward Market Hedge

Forward market hedge involves entering into a forward contract to buy or sell a specified amount of a foreign currency at a specified rate and on a specified future date. A trader who is required to make payment of a specified amount of foreign currency in the future would take a *long position* in the forward market. This means agreeing to buy the foreign currency. On the other hand, a trader who is expecting to receive a specified amount of foreign currency on a specified future date would take a *short position* in the forward market. This means agreeing to sell the foreign currency.

The advantage of the forward market hedge is that the rate of conversion of the foreign currency receivable or payable is determined before hand and the amount of the loss (or gain) is known in advance. Any further change in the foreign exchange rate in the future is immaterial.

However, forward market hedge has the following limitations:

- (i) The trader would not be able to take advantage of favourable exchange rate fluctuations, if any, in the future.
- (ii) Failure to receive foreign currency receivable on the appointed date may result in loss for the firm as it is compelled to meet its obligations under the forward contract. Moreover, the foreign currency receivable would now remain exposed.
- (iii) Since the forward contract is for a future period and can be settled only on maturity, default risk is there. In this respect it compares unfavourably with a futures contract which is settled on a daily basis.

It is pointed out that often the amounts involved are quite large, which makes forwards unsuitable for small businesses.

Illustration

On 1st April, Indco of India imports books from Britco of the UK for which £10 million is payable on 30th June. The spot rate on 1st April is Rs.81.90/£ while the 3-months' forward rate is Rs.82.10/£. Indco wants to hedge its transactions exposure by entering into a forward contract.

The Steps Involved

Indco should take a *long position* in the forward exchange market on 1st April and agree to buy £10 million forward on 30th June. The company would thereby incur a forward discount of Rs.2 million ($.20 \times 10,000,000$) which is the maximum amount of loss to be suffered by it. The company would be required to pay Rs.821 million on 30th June.

If the company had not hedged its foreign currency exposure, it would be required to spend Rs.824 million. The company is therefore able to reduce its loss by Rs.3 million (i.e., Rs.5 million notional gain – 2 million discount).

Money Market Hedge

A money market hedge involves simultaneous borrowing and lending activities in two different currencies so as to lock in the home currency value of a future foreign currency cash flow (receipt or payment). The steps involved are as follows:

(a) When a *foreign currency amount is expected to be received*, the firm should

- (i) immediately borrow the corresponding amount in terms of foreign currency for the corresponding period,
- (ii) convert the foreign currency loan amount into home currency at the current spot rate, and
- (iii) invest the home currency amount immediately.

The loss or gain would be limited to the difference between the home currency value of the interest to be paid on the foreign currency loan and the interest to be received on the home currency investment. The foreign currency loan would be paid off on receipt of the foreign currency receivable.

(b) When a *foreign currency amount is to be paid*, the firm should

- (i) immediately borrow the corresponding amount in terms of home currency for the corresponding period,
- (ii) convert the home currency loan amount into foreign currency at the current spot rate, and
- (iii) invest the foreign currency amount immediately.

The loss or gain would be limited to the difference between the interest to be paid on

HEDGING FOREIGN EXCHANGE RISK

the home currency loan and the value of the interest to be received on the foreign currency investment. The foreign currency investment would be used to make payment on the appointed date.

Instead of borrowing the home currency, the firm may pay out of its own funds if (1) the cost of borrowing is higher than the rate of return, and (2) working capital of the firm is not affected.

Money market hedge may become costly for the company due to the bid-ask spread involved. Borrowing from one bank and investing in another may make the company to lose on the spread. In such a case, forward market hedge may be a better alternative. However, if the borrowing and lending is a matter of company policy, this will suit the company.

Illustration

On 1st July, XYZ of India purchases electronic goods from PQR of the USA worth \$20 million to be paid on 31st December. The current spot rate is Rs.44.80/\$. XYZ decides to execute a money market hedge. The interest rates in India and the USA are 5.5% and 4.5% respectively and (b) the 3-months' forward rate is Rs.45/\$. The spot rate on 31st December is Rs.45.10/\$

The Steps Involved

B of India should take the following steps:

1. Borrow Rs.896 million on 1st July at an interest of 5.5%, i.e. Rs.24.64 million.
2. Convert the amount of Rs.896 million into \$20 million at the current spot rate of Rs.44.80/\$
3. Invest the amount of \$20 million at an interest of 4.5% in the euro currency market.
4. Enter into a forward contract to sell the interest amount of \$0.45 million ($20 \times 0.045 \times 0.5$) forward at the rate of Rs.45/\$.
5. On 31st December, receive the amount of \$20.45 million and pay the amount of \$20 million to PQR of the USA.
6. The interest amount of \$0.45 million would fetch Rs.20.25 million whereas interest payable on the loan would be Rs.24.64 million
7. The difference of Rs.4.39 million would be loss to XYZ.

If XYZ does not execute the money market hedge, it would have to pay Rs.902 million. XYZ therefore reduces its loss by Rs.1.61 million (i.e. 6 – 4.39).

Hedging via Futures Market

Futures contracts are substantially the same as forward contracts but their use is more complex because they are standardised and traded on futures exchanges. Moreover, the profit and loss is determined on a daily basis. Currency futures are contracts to buy/ sell specified quantities of given currencies on the floor of a futures exchange. Trading takes place in designated areas, known as 'pits,' on the floor of the futures exchange through a system of open outcry in which traders announce bids to buy (i.e., take long positions) and offers to sell (i.e., take short positions) contracts. Long positions are matched with short positions. Trading also takes place on electronic trading platform as the GLOBEX in the case of the Chicago Mercantile Exchange (CME). Futures are available only in certain currencies like the British Pound, Canadian Dollar, Swiss Franc, Japanese Yen, Australian Dollar, New Zealand Dollar, South African Rand, Russian Ruble, Swedish Kronor, Norwegian Krone, Brazilian Real and the Euro. Futures are traded in standardised sizes, e.g., one futures contract in the Chicago Mercantile exchange is for 62,500 pounds sterling, 100,000 Canadian Dollars, 125,000 Euro, 100,000 Brazilian Reals, 12,500,000 Japanese Yen, etc. Futures contracts have only few value dates. For example, most currency contracts at CME go through a physical delivery process four times a year, i.e., on the third Wednesday of March, June, September and December.

Each futures exchange has an exchange clearinghouse whose purpose is to match and record all trades and to guarantee contract performance. A buyer or a seller of a futures contract is required to post a *margin* (now referred to as *performance bond*) in a margin account.

The most advantageous feature of a futures contract is that settlement is made on a daily basis and therefore the possibility of default risk is minimised. Default risk is also almost eliminated by the guarantee provided by the clearing house. Daily settlement allows flexibility to the trader. It is claimed that they are cheaper to use than forward contracts and suitable for hedging smaller amounts, but the problem is that they are available for fewer currencies than forward contracts. Again, because the contract size is standardised, it is often not possible to hedge for the exact amount required by the user.

Illustration

On Monday morning, an investor takes a *short position* in a pound futures contract that matures on Wednesday afternoon in the next week. The agreed upon price is \$1.8850 for £62,500. At the close of trading on Monday the futures price rises to \$1.8900. At Tuesday close, the price falls to \$1.8820. At Wednesday close, the price rises to \$1.8860. On Thursday close, the price further rises to \$1.8920. The margin required is \$1890 while the maintenance level is \$1,400. The daily settlement process is given below:

Statement Showing Daily Settlement with a Futures Contract

Date/Time	Opening/Settling Price	Amount	Profit/ Loss (Margin Adjustment)	Margin Contributed/ Withdrawn	Balance in Margin Account
	\$	\$	\$	\$	\$
Monday (opening)	1.8850	117,812.50	0	+1890	1.8900
Monday (Close)	1890.00	118,125.00	-312.50	0	1577.50
Tuesday (Close)	1.8820	117,625.00	+500.00	-187.50	1890.00
Wednesday (Close)	1.8860	117,875.00	+ 200.00	-200.00	1890.00
Thursday (Close)	1.8920	118,250.00	+ 375.00	-375.00	1890.00

Hedging via Options Market

A currency option is a contract that gives the buyer the right (but not the obligation) to buy or sell a specified amount of currency at a given future date at a given exchange rate. An option that gives the right to buy (or go long) is known as the *call option* while the option that gives the right to sell (or go short) is known as the *put option*. The two parties to the option are the buyer or *holder of the option* and the seller or *writer of the option*. The price at which the option is to be exercised is the *exercise price* or the *strike price*. The price paid by the holder for purchasing the option is known as the *premium*.

Options are available in the over the counter market and also in the options exchanges such as the Philadelphia Stock Exchange (PHLX), European Options Exchange, Amsterdam, Singapore International Monetary Exchange (SIMEX), etc. Options are generally of two types – *European* option (which can be exercised only at maturity) and *American* option (which can be exercised at any time up to and including the maturity date).

The greatest advantage of an option contract is that the holder can exercise the option only if it suits him or cancel the contract if it does not suit him. In cancelling the option, the holder only loses the premium money.

Options are an important hedging instrument. Numerous types of options are available, e.g. Cap, Floor, Collar, Straddle, Strangle, Chooser Option, Look back Option, etc. Different types of options provide different types of benefit to both the hedgers and the speculators.

Illustration

A USA company is expecting to receive an amount of €1,000,000 after 3 months. The trader decides to hedge the foreign exchange risk by using a European options contract. The trader immediately buys a September put option on euro at an exercise price of \$0.7650/€ for a premium of \$0.03 per euro. The current spot price is \$0.7665/€. Contract size is £31,250. His gain or loss at the time of expiration of the option is given below assuming that exchange rate in 3 months moves to: (i) \$0.7520/€; (ii) \$0.8080/€; (iii) \$0.7665/€ .

The Alternatives

Spot Rate (\$/€)	0.7520	0.8080	0.7665
Exercise Price (\$/€)	0.7650	0.7650	0.7650
Exercise Option	YES	NO	Indifferent
Sell Euro for \$	0.7650	0.8080	0.7650
\$ Received	765,000	808,000	765,000
Less Cost of Option (Premium) (\$)	30,000	30,000	30,000
Net Receipt (\$)	735,000	778,000	735,000

Hedging *via* Swaps

Swap is a very versatile instrument. Though the main purpose of using a swap is to gain access to new markets for funds and reduce borrowing costs, it can also be used to hedge interest rate risk and currency risk. The term 'Swap' literally means 'exchange' but in the world of finance, swap may be defined as 'a contractual agreement to exchange a stream of periodic payments in the future between two or more counterparties with opposite and matching needs'.

Types of swaps – Swaps may be of numerous types but the most commonly used swaps are the *interest rate swaps* and the *currency swaps*. An interest rate swap consists of the exchange of interest payment streams (but without exchanging the principal) of differing character based on the underlying notional amount denominated in the same currency.

Interest rate swaps may be classified into: (a) Coupon swap, in which one party agrees to exchange interest payment at a floating rate against interest payment at a fixed rate, and (b) Index or Basis swap, in which one stream of floating rate interest is exchanged for another stream of floating rate interest, e.g., exchange of LIBOR against TIBOR.

Currency swaps are agreements between two parties to exchange cash flows denominated in different currencies at one or more certain times in the future. The cash flows are based on a pre-determined formula reflecting rates of interest and an exchange of principal.

Currency swaps may be of two types: (1) straight currency swap and (2) cross-currency interest rate swap.

Illustration

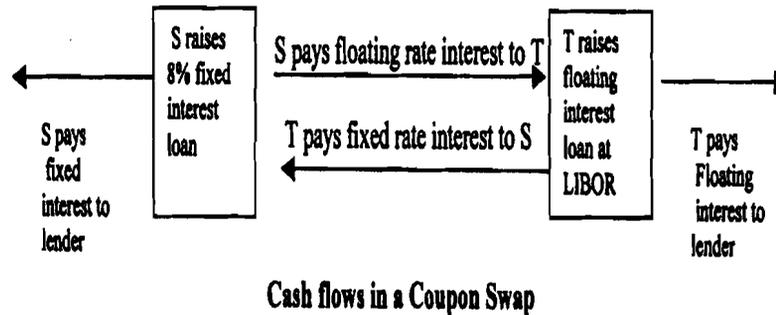
A year ago, S had borrowed \$10 million in the Eurocurrency market by the issue of 5-year 8% Eurobonds. However, in view of current developments, it has reasons to believe that the interest rate will decline in the future. In order to gain from the declining interest rate, it decides to exchange the fixed interest rate obligation for floating interest rate obligation. But it is not possible for S to change its balance sheet by redeeming its fixed interest rate bonds and issuing floating interest rate bonds instead. On the other hand T is on the look out for \$10 million loan at fixed interest of less than 8.5% for 4 years. T raises \$10 million at LIBOR+1% and swaps it with S.

The Steps Involved

1. S raises \$10 million fixed interest loan for 5 years
2. After 1 year, S decides to swap the fixed interest rate obligation for floating interest rate obligation
3. T raises \$10 million floating interest loan at LIBOR+1% for 4 years
4. S and T enter into a swap agreement whereby S decides to swap the fixed interest obligation for the remaining 4 years with the floating interest obligation on loan raised by T for 4 years.
5. S pays interest at LIBOR+1% to T, which T uses to pay to the lender.
6. T pays fixed interest to S which S pays to the lender.

S thereby reduces its interest rate burden.

A diagrammatic representation of the swap is given below.



The advantage of the swap is that S is able to convert its fixed interest rate bond into a floating interest loan.

Risk Management *via* Currency Swaps

Illustration

An Indian importer imports goods worth £10 million from the UK and pays by taking a 6 months' loan of £10 million. Interest on the loan is payable at a fixed rate. The Indian importer wants to convert the Sterling loan into a Rupee loan. The

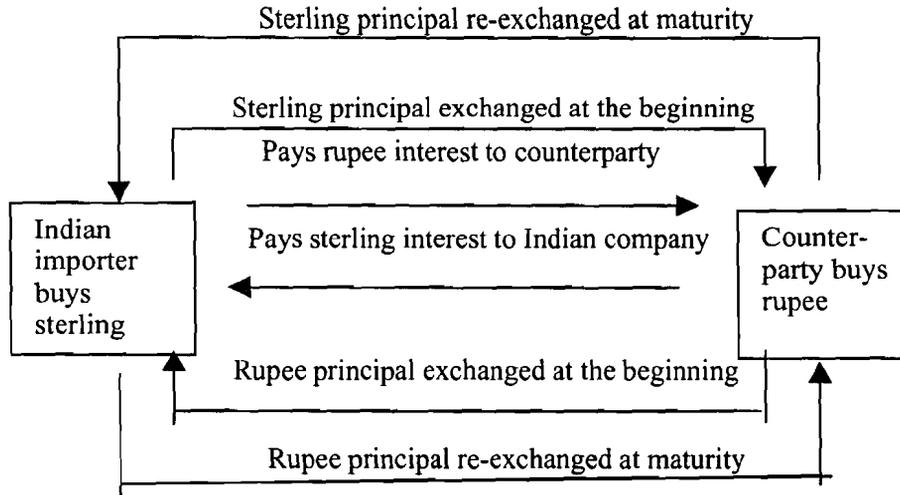
Indian importer buys the £10 million in the spot market and enters into a swap with a counterparty who wants sterling for 6 months.

The counterparty pays Rs.810 million at the current spot rate of Rs.81.00/£ and agrees to swap the principal after 6 months at the same exchange rate. Interest on the sterling and the rupee are payable at fixed rates determined under the swap.

The Steps Involved

1. The Indian importer enters into a swap agreement with a counterparty who wants sterling £10 million for 6 months.
2. The Indian importer buys fixed interest sterling £10 million at the current spot rate of Rs.81.00/£.
3. The counterparty pays Rs.810 million at the current spot rate of Rs.81.00/£ and agrees to swap the principal after 6 months.
4. The Indian importer uses the Rs.810 million received to pay for the purchase of sterling.
5. The interest payable to each other is also determined.
6. The Indian importer will pay rupee fixed interest through the swap and will receive sterling fixed interest.
7. At maturity, the Indian importer will pay Rs.810 million to the counterparty and receive the sterling principal of £10 million in exchange.
8. The Indian importer will use the £10 million and interest received through the swap to repay the loan.

The Indian importer thereby eliminates exposure to sterling.
A diagrammatic representation of the swap is given below.



Cash flows in a Currency Swap

Hedging Methods Compared

The following paragraphs give a brief comparison of the various hedging techniques. Forward contracts are easy to use and can be tailored to suit the exact requirements of the users in terms of currency, amounts and dates of delivery. They help to eliminate currency risk completely (subject to forward premium/ discount) but at the same time completely prevent the possibility of currency gains arising out of favourable movements in exchange rates.

Futures contracts are in a sense similar to the forward contracts but they are also different in the sense that they are standardised and traded on futures exchanges. It is claimed that they are more suitable for hedging smaller amounts than forward contracts and are more flexible because of the daily settlement process. But they are available for fewer currencies than forward contracts and because of the standardisation of contract size, hedging for the exact amount required by the user is not always possible. Money market hedges can be executed in any currency in which the user can lend or borrow. Since no minimum contract size is specified, they are considered more suitable for small businesses than forward or future contracts. They are similar to forward contracts in their ability to minimise currency losses but at the

same time completely prevent the possibility of currency gains arising out of favourable movements in exchange rates. Moreover, the existence of the transactions costs (bid-ask spread) may sometimes make them less desirable than forward market hedges.

Currency options are better than the previous three methods, as they allow the hedger protection against losses while enabling him to take advantage of possible gains. However, the main disadvantage of these instruments is their cost, which is the premium paid to buy the option.

Swaps are versatile instruments with risk management being one of its objectives. The main problem associated with a swap is the difficulty to find a counterparty with opposite and matching needs.

The Indian Scene

In India hedging foreign exchange transactions by the use of foreign exchange derivatives is governed by the *Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000*. The aforementioned regulations define a foreign exchange derivative contract in the following words – ‘Foreign exchange derivative contract’ means a financial transaction or an arrangement in whatever form and by whatever name called, whose value is derived from price movement in one or more underlying assets, and includes :

- (a) a transaction which involves at least one foreign currency other than currency of Nepal or Bhutan, or
- (b) a transaction which involves at least one interest rate applicable to a foreign currency not being a currency of Nepal or Bhutan , or
- (c) a forward contract.

The Regulations allow an Indian resident to enter into a foreign exchange derivative contract to hedge an exposure to risk in respect of a permissible transaction.

A distinction is made between (a) hedging through a forward contract, and (b) hedging through a Contract other than Forward Contract. Distinction is also made between hedging by residents and hedging by a person resident outside India.

Hedging through Forward Contract

An Indian resident is allowed enter into a forward contract with an authorised dealer in India to hedge a genuine exposure to exchange risk in respect of a permitted transaction for a period not exceeding the maturity of the underlying transaction and in the currency of his choice as per rules prescribed. Both cross-currency forward contracts and rupee forward contracts are permitted.

Rupee Forward Contract

The rupee forward contracts market has been growing rapidly with increasing participation from corporates, exporters, importers, banks and Foreign Institutional Investors (FIIs). The dollar-rupee forward market has typical daily trading volumes like \$1.5 billion, which makes it one of the biggest financial markets in India today.

Till February 1992, forward contracts were allowed only against trade related exposures and these contracts were not permitted to be cancelled except where the underlying transactions failed to materialise. In March 1992, the restrictions were withdrawn and unrestricted booking and cancellation of forward contracts for all genuine exposures, whether trade related or not, were permitted.

Hedging through Contract other than Forward Contract

An Indian resident is allowed, as per provisions of the *Foreign Exchange Management (Borrowing and Lending in Foreign Exchange) Regulations, 2000*, to enter into an Interest Rate Swap, Forward Rate Agreement (FRA), Foreign Currency Option or Interest rate cap or collar with an authorised dealer in India or with its branch outside India for hedging his loan exposure and unwinding from such hedges provided that the contract does not involve rupee.

An Indian resident, who owes a foreign exchange or rupee liability, is also permitted to enter into a contract for foreign currency-rupee swap with an authorised dealer in India to hedge long term exposure. A person resident in India may enter into a foreign currency option contract with an authorised dealer in India to hedge foreign exchange exposure of such person arising out of his trade. The contingent foreign exchange exposure arising out of submission of a tender bid in foreign exchange is also eligible for hedging. A Registered Foreign Institutional Investor (FII) may enter into a forward contract with rupee as one of the currencies with an authorised dealer in India to hedge its exposure in India.

Rupee interest rate derivative products

The RBI has introduced interest rate derivative products – both over-the-counter (OTC) and Exchange traded. In July, 1999 permission was granted to Scheduled Commercial Banks (excluding Regional Rural Banks), primary dealers and all-India financial institutions to undertake Forward Rate Agreements (FRAs) and Interest Rate Swaps (IRS) as a product for their own balance sheet management and for market making purposes. Corporates were also allowed to use IRS and FRA to hedge their exposures.

In June 2003, the RBI issued guidelines to permit banks/primary dealers/FIs to transact in exchange-traded interest rate futures. As a beginning, the Securities and Exchange Board of India (SEBI) has decided to introduce anonymous order driven system for trading in Interest Rate Derivatives (IRDs) on The Stock Exchange, Mumbai (BSE) and National Stock Exchange (NSE). Consequently, a number of interest rate derivative products have evolved in the domestic interest rate market:

Over the Counter (OTC) Rupee Interest Rate Swaps (IRS)

These are basically plain vanilla fixed to floating swaps where a market determined benchmark rate is used as the floating rate. The alternative floating rate benchmarks which have evolved are:

- Overnight Index Swaps where the Floating rate is usually the overnight call rate polled by National Stock Exchange [NSE MIBOR (Mumbai Interbank Offer Rate)].
- MIFOR (Mumbai Interbank Forward Offer Rate) Swaps where the Floating rate is the implied rupee interest rate derived from USD/INR forward rates.
- Swaps with floating rates linked to Government of India Security (GOI) yields.
- Rupee Swaps with LIBOR (London interbank Offer Rate) rate based benchmarks.

Forward Rate Agreements (FRAs)

FRAs can be used to hedge floating rate interest rate risk. FRAs can be used with reference to any floating benchmark rate.

Exchange Traded Rupee Interest Rate Futures (IRFs)

NSE introduced cash settled Interest rate futures in June 2003. Currently there are three types of contracts:

- Futures on 10-year Notional GOI Security with 6% coupon rate
- Futures on 10-year Zero Coupon Notional GOI Security
- Futures on 91-day Treasury Bills.

Contracts are available for maturities up to 1 year.

There has been considerably large volume of transactions in the IRS market during the current financial year so far. Available data show that such transactions amounted to Rs.3,83,866 crore for 14,748 contracts as on October 17, 2003.

Currency Swaps

In India, the RBI has permitted banks to arrange currency swaps with one currency leg being Indian Rupee. The most popular currency for swapping debt is the US Dollar, with the Japanese Yen coming in second. However, the USD/INR forward foreign exchange markets are illiquid beyond one year. Since currency swaps involve the forward foreign exchange markets also, there are limitations to entering the Indian Rupee currency swaps beyond twelve months. Moreover, banks are also not permitted to take risk or run open swap books i.e., they have to locate counter parties with matching requirements; e.g. one desiring to swap a dollar liability into rupee liability and the other wishing to exchange rupee debt servicing obligation for dollar obligations. No limits are placed on the authorised dealers for undertaking swaps to facilitate customers to hedge their foreign exchange exposures. However, limits of USD 50 million have been placed for swap transactions facilitating customers to assume a foreign exchange liability, resulting in supply in the market.

Foreign Currency-Rupee Options

Rupee Currency options are new in the Indian scene. The RBI allowed trading in rupee options from July 7th, 2003 with customers on a back-to-back basis subject to certain terms and conditions. To begin with, authorised dealers were permitted to offer only plain vanilla European options.

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MARKETING STRATEGIES FOR SELF HELP GROUPS : PROBLEMS AND PERCEPTIONS OF SHOLAPITH PRODUCERS

*Samirendra Nath Dhar **

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Abstract

Swarnajayanti Gram Swarojgar Yojana (SGSY) in India provides for the most desired marketing support to the Self Help Groups (SHGs). Authors suggest that SHGs should follow strategies like market penetration and market creation. This study investigates into the marketing strategy being followed by the SHGs in a part of the Coochbehar district of West Bengal, which deal in sholapith products.

Nearly half a decade has elapsed since the implementation of the Swarnajayanti Gram Swarojgar Yojana (SGSY) in India. Since its inception in April 1999, the number of Self Help Groups under this scheme has grown at an exponential rate. The quantum jump in the number of Swarojgaris assisted under this scheme and the number and variety of economic activity taken up especially by rural women speak well of the popularity of the scheme. SGSY is holistic scheme covering all aspects of self-employment such as organization of the poor into Self Help Groups, training, credit, technology, infrastructure and marketing. The scheme aims at establishing a large number of micro enterprises in the rural areas. Establishing a large number of viable micro enterprises implies that the products churned out by them can be readily marketed at proper prices. In absence of markets, the capital invested by the Swarozgaries will not be adequately turned over and consequently the rate of return on the investment made out of the finance provided by the schemes under SGSY will be low.

Keeping these aspects in view the provisions of SGSY have emphasized on providing marketing support to the Self Help Groups. The SGSY guidelines state :

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Some useful Websites

<http://www.igidr.ac.in>

<http://www.rbi.org.in>

<http://www.sify.com>

“For any goods or services that are produced, existence of a suitable market is essential. Traditionally, the self-employment programmes concentrated on the inputs rather than the outputs and their marketing. It was not uncommon to find production strategies in place overlooking the marketing aspects. One often finds that the recommendation of an activity is not preceded by the much needed market survey. There is a false notion that market surveys are not required in case of the self-employment opportunities for the rural poor. In fact, it is as critical, if not more, for the poor. For, he or she cannot sustain the loss arising out of a lack of market even for short periods. It is therefore necessary that the project profile of every key activity identifies the market availability. The forecast of the incomes to be earned by the Swarozgari must take into account this factor and forecast the incomes only on the basis of an assured market. This would be a critical factor in the choice of the key activity itself.” The guidelines also stress the importance of exploring rural markets, urban markets, role of intermediaries for marketing SHG products outside the district and support of the State Government and the Khadi and Village Industries Commission for marketing. Emphasising on the importance of urban markets the guidelines state : “The emerging urban markets can be a good area for developing clientele for the rural products. Provision of marketing infrastructure in these areas can go a long way in enabling the rural poor to market their goods and at the same time building an identity for the products. The self-help groups can be encouraged to try out these markets on their own so that they slowly develop marketing skills. They can also start marketing the goods of the individual Swarozgaris. Infrastructure Fund can be used for strengthening marketing infrastructure and related activities.” Again highlighting the role of KVIC, the guidelines specifically point out “Organisation like Handicrafts Boards and Handloom Corporations and also KVICI can play a prominent role in promotion of SGSY. The marketing outlets of KVICI KVIB must be made use of for SGSY products. Keeping the market trends in view, linkages with apex bodies can ensure a stable market at remunerative prices. Such a link will also result in quality improvements while reducing the market risks to the poor.” The guidelines also stress upon the role of NGOs in providing vital marketing support to the Self Help Groups.

Researchers like Hofstede et al. (1996) have pointed out that working in remote villages far away from market centers limits the scope for identifying and initiating viable income generating activities. To usher in economic development they need markets where people with disposable cash will buy goods and services. The authors stress on promoting micro enterprises near markets in semi-urban areas, market centres and larger villages. Satyamurti and Haokip (2002) pointed out that it was important to design background interventions that build the market for micro finance clients. Adolph (2003) has observed that most programmes appear to have developed policies to concentrate primarily on organizing the poor through the SHG mechanism. The savings and credit mechanism promoted can not only be the mechanism to promote economic activities. In order to make these programmes effective at the base layer (e.g., at SHG level) there must be a secondary intervention strategy. Such a strategy can be in the form of other business promotion programmes such as marketing assistance of business advisory services and technical (skills) training. Purushotham (2004) found out that in want of innovative marketing support, savings of many Self Help Groups were either underutilized or unutilized, as these could not be channelised into viable economic avenues. He suggested that SHGs could follow strategies like market penetration and market creation. The present study investigates into these aspects and tries to find out the marketing strategies followed by SHGs in a certain area in Coochbehar district of West Bengal. Before delving into the main findings of the study, it is necessary to have a bird's eye view of the growth of SHGs in the district.

Growth and activities of self-help groups in Coochbehar district

This district is located in the eastern side of West Bengal and is bordered by Assam in the East, Bangladesh in the West and South. The district covers an area of 3386 square kilometers and is divided into 12 blocks and 128 gram panchayats. As per the 2001 census the population of the district is about 25 lakhs, out of which nearly 50% are women. The SGSY movement did not gain much popularity in the initial years. But with the passage of time, the number of SHGs under this scheme grew by leaps and bounds.

During the year 2000-2001, only 46 women self-help groups (SHG) were formed and 174 of existing DWCRA groups were rejuvenated. Total 3169 women beneficiaries were benefited from this scheme. Rs. 16.71 lakhs were released as Revolving Fund to 127 SHGs after they qualified in Grading-I. Only six groups were eligible for Bank Loan, but the same could not be disbursed due to their failure to undergo skill development training. Out of 383 families assisted during 2000-'01, 199 families belong to Scheduled Caste (SC) & Scheduled Tribe (ST) communities. In other words, the coverage of SC & ST families during the year constitutes 52% of total number of families assisted against SC & ST population constituting 52.36 % of the total population in the district. During this period, 155 women beneficiaries were assisted out of the total number of 383 swarozgar families. In other words, DRDC achieved 40.5% in covering women beneficiaries against the target of 40%. However, it could not achieve due coverage in handicapped category against the norms of covering at least 3% of the total number of swarozgaris [Source : DRDC, Coochbehar]. The number of groups has increased since then and there are more than three thousand groups in the district now. The only regional rural bank in this area, i.e., Uttarbanga Kshetriya Gramin Bank has taken the lead role in promotion and formation of SHGs in this area. From only about two hundred groups at the middle of 2001, the number of groups linked with the bank has grown to 2490 at the end of March 2004. The cumulative deposit of these groups with the bank has exceeded Rs. 78 lakhs. Out of the total groups, 981 have been credit linked. [Source UBKGB].

Scope and objective of the study

The study was carried out in the villages under Bhetaguri gram panchayat I and II in Dinhata block of Coochbehar District. At the end of January 2004, there were 135 SHGs formed in these two blocks. Out of these, more than 90% were exclusively women groups and 49 groups had passed the first grading and had received the revolving funds. These groups were linked to Uttar Banga Kshetriya Gramin Bank. Most of these groups were engaged in micro entrepreneurial activities like making of flat rice (*Chira and Muri*), goatery, poultry, dairy, jute and bamboo products, ready made garments, pottery, retail shops, etc. Some groups were manufactur-

ing handicrafts and decorative items out of Sholapith i.e., stem of the plant which bears the botanical name *Aeschynomene Aspera* (of *Papilionaceae* family). Since these were the only products, which were being sold even outside the state, therefore all groups engaged in manufacturing these products were chosen for the study.

The main objectives of the study were to investigate into the following aspects:

- (i) The type of products being produced by the Sholapith workers;
- (ii) The markets in which these products were being sold;
- (iii) The prices which these products did command and the strategies to have competitive prices;
- (iv) The difficulties which the Swarozgaris perceived to have regarding production and marketing of Sholapith products;
- (v) The role of Government agencies and NGOs in promoting marketing;

Methodology of the study

For the purpose of the study a mix of different methods of conducting field studies were used. In addition to a small questionnaire that was personally administered to 55 swarozgaris engaged in making Sholapith items, informal discussions were made with these respondents, their trainer, members of the SPAR (Society for Participatory Action and Reflection, the only NGO in this area), DRDC officials and owners of some shops in Coochbehar. In addition to this, direct observational techniques were used to find out how the items were manufactured, how raw materials were procured and stored and how the finished products were sent to the markets. The facts and data generated are therefore primary in nature. These are presented in the next section.

Findings of the study

The findings of the study are presented in different sub-sections, i.e., Products and production techniques, Raw materials, Markets and prices, Training, Role of NGOs and Government agencies and perception of the Swarozgaris.

Products and production techniques

Sholapith items produced by the members of the SHGs can be broadly categorized into two types: traditional items and decorative items. Traditional items refer to those items that are used for religious and other festivals in the rural and semi-urban areas. These items include garlands, faces of goddesses, shola hats used for Hindu marriage festivals and other occasions, ornaments made for deities, etc. Some of these items, like faces of goddesses are used as decorative items in the urban areas. Traditional items are generally not enclosed in any type of packs or cases. Decorative items on the other hand comprise of items that are enclosed in glass cases and lined with fine bamboo frames. These items include different types of flowers, different types of boats (known as *Mayur Panksi*, *Bazra*, *Pal Bazra*, *Kerala Boats*, etc.), faces of deities like Durga, Kali and Ganesha. The members have taken up plans to make greetings cards and Friendship Bands (*Rakhees*) very soon. Nearly all products are handmade. The industry is labour intensive and the members mainly use small knives to give shape to the products. The producers are skilled in the trade and use their artistic sense and skills acquired through training to produce the items.

Raw materials used and their availability

The main raw material used is Sholapith. Items like gum, beads, thread, coloured paper, velvet paper, glass sheets and bamboo are also required. The main raw material is procured from the local markets and from Kolkata. As gathered from the artisans, the quality of raw material available locally is inferior to that obtained from Kolkata. The Sholapith procured from Kolkata is much whiter in colour and the finished products look better. The local prices rule at about Rs. 30/- for a bundle of 80 wet sticks and Rs. 100/- to Rs.120/- for a bundle of 80 dry sticks. Only dry sticks can be procured from Kolkata at an average price of Rs. 150/- per bundle. However, the members of the groups can procure the materials from Kolkata only when they go there for attending trade fairs. They cannot again procure these materials in bulk because they do not have adequate storage space and they cannot afford to block much capital in raw materials. It has to be pointed out here that there are no

Government or private agencies to procure raw materials for the micro entrepreneurs. This leads to substantial hazards for these people in the process of getting good quality raw materials at affordable prices.

Marketing avenues and marketing problems

In this section, at first the marketing avenues will be described, followed by the marketing strategies and finally the problems that they face while marketing.

The finished products are sold in various ways. Traditional products find their way into rural markets i.e., weekly haats, fairs or melas and local retail shops (known as *Dasakarma Bahanders*). For traditional products the lion's share of sales are based on orders received from wholesalers from areas like other towns of Coochbehar district, Jalpaiguri district, and Darjeeling district and even from other states like Assam. The wholesalers take delivery of these items from the doorsteps of the swarozgaris. The size of orders ranges from Rs. five thousand to Rs. one lakh for the groups. There is no dearth of orders especially during the festive seasons. The DRDC officials, their chief trainer and SPAR (NGO) often help them in procuring orders. The average prices at which these items can be sold are: garlands Rs. 25 to Rs. 50, marriage hat sets Rs. 100 to Rs. 160, other festival hats Rs. 30 to Rs. 50, Faces of goddess Kali, Durga, etc. Rs. 50 to Rs. 100 depending on the size of the products. However, there are fluctuations in price depending on the quality, finishing, and the season. The swarozgaris earn a margin of about 25 to 50% on the price of the products.

Decorative items are produced in lesser quantities and are only made when the swarozgaris attend any trade fair. As disclosed by them, they set up stalls in different parts of West Bengal including Kolkata. State Government undertakings like "Manjusha", "Bangashree" buy their products from the fair "Kolkata Expo" every year and export these to Japan, Iran, Germany, Oman, UAE. The District Rural Development Cell plays an active role in sending the artisans to trade fairs. This government-cell disseminates information about different trade fairs to the swarozgaris and even sponsors their rail fares for journey to distant places for attending trade fairs. An indication of the prices commanded by the products in these types

of fairs may be made in the following table.

Price list of decorative sholapith products sold by SHGs in trade fairs

Name of the Product	Size of glass case with bamboo lining	Price per piece (Rs.)
Rose (small)	15*7*4 cms = 420cc	60
Rose (medium)	21*7*5 cms = 735 cc	80
Rose (big)	25*11*5.5 cms = 1512.25 cc	100
Mayur Pankshi	44*37*15 cms = 24420 cc	350
Bazra (big)	22*20*6 cms = 2640	125
Bazra (medium)	17.5*15*4 cms = 1050 cc	80
Baba Bazra	9*7*3 cms = 220.5 cc	30
Pal Bazra	13.5*9.5*4 cms = 513 cc	55
Special Bazra	24.5*22*8.5 cms = 4581.5 cc	150
Chandra Mallika flower	27.5*15.5*3.5 cms = 1492 cc	140
Face of Durga (big)	49*36*8 cms = 14112 cc	500
Face of Durga (medium)	29*20*6 cms = 3480 cc	175
Face of Durga (small)	20*15.5*4 cms = 1240 cc	100
Face of Ganesh	22*17*4 cms = 1496 cc	150
Kerala Boats (big)	29*9*5 cms = 1305 cc	150
Kerala Boats (medium)	20.5*8*4.5 cms = 738 cc	75
Kerala Boats (small)	13.5*9.5*4 cms = 513 cc	55
Ganesha (big)	35*28.5*9.5 cms = 9476 cc	500
Ganesha (small)	19*17*6.5 cms = 2099 cc	275
Durga full idol	77*49*15 cms = 56595 cc	5000
Mayur pankshi (big)	61*77*31 cms = 145607 cc	2000

Source: Field Study on SHGs engaged in Sholapith works

It can be observed from the table that the prices increase or decrease to some extent with the size of the product. In order to objectively test the relationship between price and size of the product (measured in cc), prices of the products were regressed on the size of the products. When all the 21 products were taken the regression coefficient stood at 0.631, which was significant at 1% level (D.W. statistics 2.258). The results signify that the size of the products can explain up to 63% variation in prices. The last two products command very high prices. As explained by the

artists it is because of the intricate designs and sale of few peices that the prices had to be kept high. In another attempt to test the regression, the last two products were eliminated from the analysis. In this case, the regression coefficient improved to 0.760. The results were significant at 1% level of significance and the D.W. statistics improved to 1.26. Statistically the variation in sizes could explain the variation in prices to the extent of 76%. Corroborating the results, the artisans said that larger the products, higher was the raw material consumption and labour time devoted and more difficult was the craftsmanship. Though the swarozgaris had not ventured to calculate the cost of each type of product, they have the idea that from the decorative items they earn a return on investment of about 35%. When questioned whether higher prices could be charged for the products, most of them replied that minor increases could be made, but any major increase would make the products non-competitive. However, for foreign customers they expected that higher prices could be charged for quality products. Though no objective method was found for fixing the prices, guidance for fixing the prices was often given by their chief trainer.

Therefore, it is clear that pricing cannot be one of the major strategies for promoting their products. The major strategy for increasing sales of traditional items is to convince the wholesalers to give them more orders. The swarozgaris opine that it is by improving the quality of the products only that they can secure larger orders from other districts and states. The quality of the products depends on factors like quality of the raw materials and skill of the craftsman. Skill regarding both traditional and decorative items can be improved by training. DRDC has appointed a chief trainer at a remuneration of Rs.4000/- per month. The trainer has received the State Award for his craftsmanship. The reputation of this man is also instrumental in bringing many orders for the Self Help Groups.

However, the problem lies with estimating the number and size of the orders and even the delivery time mainly in case of traditional items. To meet rush orders, the swarozgaris either tend to work for extra hours or store large quantities of finished goods. Storage is usually a problem because on the one hand the storage spaces are inadequate and on the other, the problem of leaking roofs multiply during the monsoons. The lead-time between receiving the orders by the swarozgaris and the

delivery to wholesalers follow no standard pattern often leaving the artisans in bewilderment. This problem is more or less absent in case of decorative items as these are sold in trade fairs and the artisans get information much ahead about the place and dates of the fairs from the DRDC, or SPAR or their master trainer. Usually a team that visits trade fairs carries with them about sixty pieces of decorative items on an average. For expensive items carrying price tags of Rs. 2000 and above, the number of items is usually five to ten. Swarozgaris say that most of these items are sold in local trade fairs in the district including the Raash Mela in Coochbehar (a very large fair that goes on for 15 to 20 days in the month of November).

Problems arise when they participate in larger trade fairs like Kolkata Expo. Since other Sholapith producers arrive from different parts of the state, the competition is sometimes stiff. The competitors take the leading edge with better quality products. Their products are better because the raw materials used are better and the craftsmanship and varieties in design are also better. The swarozgaris feel that supply of better raw materials and receipt of more training in these arts could have equipped them with better skills in making the products. A study of their perceptions is given in the next section.

Another problem that these people sometimes face is dealing with the financial aspects of marketing. Though they prefer to receive their sales revenue in cash, the wholesalers often give them outstation cheques or drafts and there are substantial difficulties in many cases in encashing these cheques and drafts. Last year these groups had received an order worth Rs. 80,000/- and had duly delivered the goods. But when the cheque was received it took more than five months to encash it. As a result the groups were in substantial difficulty as their capital was blocked and they could not buy raw materials for their next lot of production. Because of these problems the groups sometimes have to refuse orders where the mode of payment is by cheques or drafts.

In order to objectively find out the perceptions of the swarozgaris, a five-point scale was used where a variety of statements were administered to the respondents. The scales were : strongly agree, agree, no opinion or do not know, disagree, strongly disagree. Each category was assigned score in the following manner: 2 points for strongly agree, 1 point for agree, 0 for no opinion, (-)1 for disagree, and (-)2 for strongly disagree. The results are given below :

Perception of Sholapith Manufacturers regarding Marketing Avenues and Support Systems

Statements	Strongly agree (2)	Agree (1)	No opinion (0)	Disagree (-1)	Strongly disagree (-2)	Mean score
Sales amount is sufficient for your livelihood		15	4	31	5	- 0.65
Sales volume should increase	8	38	9			0.98
Sales of Traditional items should be emphasized more than decorative items	3	29	11	8	4	0.34
Quality of products needs to be improved	14	30	8	3		1
Training is necessary for quality improvement	8	36	7	4		0.87
Training facilities are somewhat inadequate	6	28	11	8	2	0.69
DRDC should arrange for more training programmes	6	38	7	4		0.84
DRDC should give more sponsorship for attending trade fairs	3	32	15	5		0.6
Facilities should be made for transportation of goods to local melas and haats	14	34	3	4		1.05
Government should take steps for advertising the products	12	34	7		2	0.98
DRDC should also help in acquiring good quality raw materials	18	34	3			1.09
Bank officials help them in sorting out problems relating to cheques / drafts	9	29	8	6	3	0.64

Statements	Strongly agree (2)	Agree (1)	No opinion (0)	Disagree (-1)	Strongly disagree (-2)	Mean score
Media should give more coverage to their art and problems	10	26	9			0.83

Note: Figures in the columns (other than last one) denote number of respondents

The information presented in the table discloses many interesting facts. Though most of it is self-explanatory, some points need to be highlighted. The highest mean score for any statement can be 2 showing that all the respondents are very positive about the statement; on the other hand a mean score of (-)2 shows that all respondents have a negative attitude about the statement. The mean scores lie between these two extremes. The first two statements show that on an average the respondents agree that an increase in sales is necessary for them. However, many respondents are not very sure whether sale of traditional items should be given priority over decorative items though more than 50% of them agree to the statement. Respondents are quite positive about the fact that in order to create more market demand there is a need to improve quality and get more training for quality improvement. This aspect needs attention because the motivation to capture more market through quality improvement needs to be continuously nourished in the minds of the swarozgaris. Many of them agree that DRDC should arrange for more training programmes for them. The respondents are quite keen on Government support regarding procurement of raw materials for them and transportation of finished goods for them to the local trade fairs. This shows that the members of the group feel that their marketing efforts can definitely improve if the support mechanisms of the Government agencies improve. This is also corroborated by the response that they want the Government agencies to advertise for them and the media to disseminate more information for the products.

Policy prescriptions

The facts detailed out in the preceding sections amply point out that members of self help groups who are engaged in micro economic activities are not free

from constraints and hassles of marketing their products. The case of Sholapith artists as members of Self Help Groups is an illustration of what problems can arise for micro enterprises in general when they are in search for markets for their products. Despite the emphasis made on marketing in the SGSY guidelines, there are several gaps between what is said and what is really done. On the basis of the findings of the study certain suggestions for improving the marketing strategies of Self Help Groups should be undertaken. Some of these are:

- The Government agencies and NGOs should undertake detailed studies of the micro entrepreneurial problems of different types of activities and products and understand the specific marketing problems related to them. Steps should be taken by DRDC and NGOs for helping the SHGs in market creation and market penetration. SGSY Guidelines provide for expenditure up to Rs. 5 lakh annually by each DRDCs for management of professional input to marketing research, value addition or product diversification or any other input which would facilitate marketing of the products resulting in additional income to swarozgaris. DRDCs have been permitted to incur expenditure on organizing exhibitions, fairs and fund promotion and sale of SGSY products.
- Enhancing the quality and packaging of the products made by SHGs can help in market creation and market penetration.
 - DRDC should arrange for multiple training programmes so that the artisans belonging to the SHGs can develop the capability to make quality products at competitive costs.
- As revealed by the Sholapith workers, there is a need by the Government agencies to develop strategies for assuring supply of good quality raw materials at cheap prices to the SHGs and arrange for transportation of their finished goods.
- DRDC should disseminate timely information about melas and trade fairs to the SHGs and sponsor their traveling expenses.
- Government should urge upon the media to give adequate coverage to the products manufactured by the SHGs and generate public awareness that these products are good and affordable and can contribute to the social cause of helping micro enterprises in the rural areas.

➤ Since literacy levels are low in rural areas and swarozgaris are not always apt in dealing with the financial complexities of transactions, banks should offer special assistance when SHGs bring drafts or cheques for encashing .

In this context the observations of the Standing Committee on Urban and Rural Development (2004) on marketing of products manufactured by SHGs need to be heeded. They feel that the quality of the products produced by the SHGs has to be improved. The Committee feels that State Governments should provide protection to locally produced items and a survey should be conducted in this regard to find out to what extent SHG products are being sold in the local market. The Committee suggests that the State Governments may be asked to provide protection to the SHG produced items and to find out the success in sale of SHG products in local markets.

It must be reiterated that it is through effective marketing strategies that the micro enterprises launched by SHGs can sustain in the long run. If turnover is ignored, then the return on investment will be low, the investment will gradually drain off and the loan and subsidy pumped in from the SGSY scheme will be misutilised. It is therefore suggested that the Government agencies, NGOs and above all the SHGs, clusters of SHGs and Federations of SHGs lay utmost importance to marketing strategies for the products made by SHGs.

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RISK MANAGEMENT IN INDIAN BANKS

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Abstract

The Reforms in the banking sector have changed the face of banking in India. The profitability, productivity and asset quality of the Indian banking system have improved but it faces many risks due to regulation and globalization. The first half of the paper outlines the reforms and measures undertaken to improve the efficiency of the banking system. The second half discusses the different risks involved in banking, Basel II recommendations and issues in implementation.

The banking sector is the lifeline of any modern economy. It is one of the important financial pillars of the financial system, which plays a vital role in the success/failure of an economy. The strength of economy of any country basically hinges on the strength and efficiency of the financial system, which, in turn, depends on a sound and solvent banking system. Looking to the importance of this sector, the first phase of comprehensive reforms in the banking sector were undertaken in June 1992 by implementing the recommendations of the Narasimham Committee I (1991) on the financial system. The recommendations of the Committee aimed at creating a competitive and efficient banking system by improving the policy framework, financial health and institutional infrastructure. Improvement in the policy framework has been undertaken by reducing the reserve requirements, changing the administered structure of lending rates, enlarging the scope of priority lending and linking the lending rates with the size of advances.

At the macro level, the statutory preemptions in the form of Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR) have been brought down from 38.5 percent and 15 percent in 1991-92 to 25 percent and 5 percent respectively. Secondly, interest rates have been deregulated gradually. Except lending to small borrowers and a part of export finance, all lending rates have been deregulated. The number of administered interest rates on bank advances has been reduced from 20 in

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1989-90 to just 2 by 1994-95. Interest rates on loans above Rs.2 lakh are fully deregulated. Prime lending rates have declined from 19 percent in 1991-92 and the benchmark PLR now, in respect of five major banks is in the range of 10 to 11 percent. Interest rates on deposits are now almost free except for prescription in respect of savings deposits. The interest rates on government borrowings are also market determined. Directed credit schemes have been streamlined to avoid inefficient use of credit.

At the micro level, prudential norms to ensure financial safety, soundness and solvency of banks were introduced. These norms strive to ensure that banks conduct their business activities as prudent entities, that is, not indulging in excessive risk taking and violating regulations in pursuit of profit. Prudential norms relating to capital adequacy, income recognition and provisioning were introduced. Capital to risk-weighted assets ratio of 8 percent was introduced which is now 9 percent. A capital adequacy ratio below this stipulation indicates the inadequacy of a bank's capital compared to its assets (largely loans advanced and investments) weighted against the risk they carry. In other words, the capital for these banks does not match up to the risk profile of their loan advances. Except for two scheduled commercial banks, all banks have a capital adequacy ratio exceeding 9 percent. The ceiling on exposure to a single borrower has been reduced from 20 percent to 15 percent of the bank's capital funds.

Non-Performing Assets in Indian Banks:

Under the prudential norms laid down by the Reserve Bank, income should not be recognized on non-performing assets on accrual basis but should be booked only when it is actually received in respect of such accounts. An asset is considered as 'non-performing' if interest or instalments of principal due remain unpaid for more than 90 days. Any NPA would migrate from sub-standard to doubtful category after 18 months. It would get classified as loss asset if it is irrecoverable or marginally collectible. With effect from March 31, 2005 an asset would be classified as doubtful if it remained in the sub-standard category for 12 months. The banks should make full provision for loss assets, 100 percent of the unsecured portion of the doubtful asset and 20 percent to 100 percent of the secured portion depending upon the period for which the asset has remained doubtful. If the asset has remained doubtful for one year, the provisioning requirement is 20 percent; if doubtful up to three years, the

provisioning requirement is 30 percent and for more than three years, it is 100 percent with effect from March 31, 2005.

The Non-Performing Assets of the banking system amounted to Rs.63246 crore with the public sector banks accounting for 79 percent of such NPAs during 2003-04. The NPAs erode current profits through provisioning requirements and result in reduced net income. The Government of India and the Reserve Bank of India have initiated a number of steps for expediting the recovery of NPAs. Banks have been advised to devise one time compromise settlement schemes. Lok Adalats have been setup to help banks to settle disputes involving accounts in 'doubtful' and 'loss' category with outstanding balance of Rs.5 lakh. Debt Recovery Tribunals(DRTs) have now been empowered to organize Lok Adalats to decide on cases of NPAs of Rs.10 lakhs and above. Debt Recovery Tribunals have been vested with new powers such as power to attach defendant's property /assets before judgement, penal provisions for disobedience of Tribunal's order or for breach of any terms of the order and appointment of receiver with powers of realization, management, protection and preservation of property. At present, there are 25 DRTs and 9 Debt Recovery Appellate Tribunals but they have hardly made a dent on the recovery process. The Reserve Bank also publishes a list of borrowers with outstanding aggregating Rs.1 crore and above and against whom suits have been filed by banks and financial institutions for recovery of their funds as on March 31, every year. The Reserve Bank has also advised the public sector banks to examine all cases of willful default of Rs.1 crore and above and file criminal suits in such cases. Corporate Debt Restructuring (CDR) has been institutionalised in 2001-02 to provide a timely and transparent system for restructuring of corporate debts of Rs.20 crore and above with the banks and financial institutions. The Credit Information Bureau of India Limited (CIBIL), an entity promoted by HDFC and SBI, collates historic borrower data and this credit information is shared among banks and financial institutions. However, loan agreement clauses of the past do not allow banks to share details regarding their borrowers with any other entities. This inhibits the functioning of CIBIL. The Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest (SARFESI) Act, 2002 has been enacted which provides statutory support for the enforcement of creditors' rights and paved the way for the establishment of Asset Reconstruction Companies. The Asset Reconstruction Company (India) Limited, the first asset reconstruction company has acquired 196 assets aggregating USD

1.90 billion face value of debt. The SARFESI Act has juxtaposed three concepts - Securitization, Asset Reconstruction and Security Enforcement in the context of dealing with NPAs. However, the Act suffers from certain ambiguities such as the problem of stamp duty and larger powers granted to creditors. The Act has been subject to challenges before various courts which has delayed the process of recovery.

Risk In Indian banks

Banking is the business of money where high risks are involved. Banks have been exposed to greater risks on account of deregulation, globalization and increased competition from within and outside the country. Further, banks have diversified into non-traditional businesses such as insurance, mutual funds and derivatives, which have increased the complexity of banking business. Information technology and innovative products such as internet banking, e-commerce and credit cards have added new dimensions to risk. The banking system faces different types of risks such as credit risk, market risk, technological risk and operational risk. Credit risk arises due to default in payment or delayed payments. Market risk arises from adverse movements in interest rates and exchange rates. Technological changes give rise to technological risk. Operational risk covers a broad range of risks that are internal to the firm and arises out of deficiencies in internal systems and control, systems failures and non-adherence to prescribed procedures. The Basel-I accord addressed only credit risk and hence was found to be inadequate. The Basel Committee on Banking Supervision (BCBS) announced the new framework in June 2004. The New Basel Accord (Basel-II) focuses on three pillars.

Pillar-I : Minimum capital requirements

The new Accord has elaborated the credit risk measurement methods. Basel II has recommended three approaches - Standardized Approach, Foundation Internal Risk Based Approach (IRB) and Advanced Internal Risk Based Approach (AIRB) for estimating capital for credit risk. It has emphasised the measurement of both market and operational risk. One of the most noteworthy features of Basel II is assigning capital charge for operational risk. Three approaches namely, basis indicator (BI), standardized (SA) and advanced measurement (AMA) approaches have been recommended for estimating capital for operational risk. Advanced measurement approach calls for significant investment as compared to the other two approaches.

Based on the Recommendations of BCBS, the Reserve Bank of India has issued guidelines for assigning explicit capital charge for market risks. Market risk is defined as the risk of losses in on-balance sheet and off-balance sheet positions arising from movements in market prices. These guidelines seek to address the issues involved in computing capital charges for interest rate related securities in the trading book, equities in the trading book and foreign exchange risk (including gold and other precious metals) in both trading and banking books. Trading book includes securities included under the 'held for trading' (HFT) and 'available for sale' (AFS) category, open gold and foreign exchange position limits, trading positions in derivatives and derivatives entered into for hedging trading book exposures. The banks' overall minimum capital requirement will be the sum of capital requirement for credit risk including counter party credit risk on all OTC derivatives and capital requirement for market risks in the trading book. The minimum capital requirement is expressed in terms of two separately calculated charges : (i) specific risk - charge for each security to protect against an adverse movement in the price of an individual security owing to factors related to the individual issuer, and (ii) general market risk - charge towards interest rate risk in the portfolio. The Basel Committee has suggested two broad methodologies for computations of capital charge for market risks - the standardized method and the internal risk management models. The Reserve Bank has advised banks to adopt standardized duration method to arrive at the capital charge.

Pillar II : Supervisory review

This process emphasizes the need for banks to develop sound internal processes to assess the adequacy of capital based on a thorough evaluation of its risks and set commensurate targets for capital. The internal processes would then be subjected to supervisory review and intervention. The supervisors would be responsible for evaluating the way the banks are measuring risks and the robustness of the systems and processes. A Board for Financial Supervision has been set up with an Advisory Council to strengthen the supervisory system of banks and an independent Department of Banking Supervision has been set up in the Reserve Bank to assist the Board.

Pillar III : Market discipline

Market discipline can be bolstered through enhanced disclosure by banks.

Basel II has set out the disclosure requirements in several areas, including the way in which banks calculate their capital adequacy and their risk assessment methods. The transparency and disclosure standards recommended in the International Accounting Standards have been implemented in a phased manner. Banks are required to ensure that there are no qualifications by the auditors, in their financial statements for non-compliance with any of the accounting standards. Banks are now required to disclose maturity pattern of deposits, borrowings, investments, advances, foreign currency assets and liabilities movements in NPAs, lending to sensitive sectors, total advances against shares, total investments made in equity shares, convertible debentures and equity oriented mutual funds and movement of provisions held towards depreciation of investment.

Banks were advised to classify investment portfolio into three categories, viz. Held to Maturity (HTM), Available for Sale (AFS) and Held for Trading (HFT), effective from September 30, 2000 in line with international best practices. Securities in HTM are not marked-to-market and therefore no provision has to be made on HTM securities following a fall in bond prices (or rise in interest rates). However, securities in AFS and HFT have to be marked-to-market.

Issues in implementation of Basel II

- (i) Indian Banks still do not fully disclose requirements relating to capital adequacy market and credit risk. Requirements relating to operational risk and qualitative disclosures on risk management are not disclosed at all.
- (ii) Indian banks will face a stiff competition from foreign banks once Basel II is implemented. Foreign banks by using sophisticated risk management practices will compete not on size but on ability.
- (iii) The capital base of most Indian Banks is relatively low. Most banks will need to raise a large amount of funds to meet the regulatory capital, allocation for risk in future and upgrading technology systems.
- (iv) Banks will need a new set of human resource with distinct skills and training which will be difficult at the outset. Hence, banks will require capital resources to invest in training and upgrading of employees.
- (v) In India, there are only four external rating agencies, which will be insufficient to rate around 100 commercial banks. Moreover, banks do

not have robust rating systems which could lead banks to loosen their own credit rating models when implementing these standards.

- (vi) Small banks would be at a competitive disadvantage against large banks as the small banks will not have the resources to implement advanced methodologies. Thus, the objective of Basel II to ensure competitive equality will not be achieved.

Interest rate risk and Indian banks

Banks are now exposed to market risk as interest rates have bottomed down. Moreover, there is an expectation of upward trend in interest rates due to a surge in inflation, three consecutive hikes in the Federal Reserve rate of 25 basis points each and a hike in the CRR of banks. The yields on bonds have risen, leading to a fall in bond prices. With several banks holding 40 to 50 percent of their investible assets in government securities, banks reported a substantial fall in trading profits during the first quarter of 2004-05.

The 10 year government security yield went up from 5.15 percent as on March 30, 2004 to 5.83 percent in June 2004 and above 7 percent in October 2004. In order to provide a cushion against rising interest rates, the Reserve Bank, in a special dispensation, permitted an additional onetime transfer of government securities upto the minimum SLR limit (i.e., entire 25 percent of the SLR requirement) in to the HTM category at market value during the current financial year. Any additional holdings of government securities over and above the SLR limit would have to be classified under 'available for sale' or 'held for trading'. Bonds in HTM are not marked-to-market and therefore, no provision has to be made on HTM securities following a fall in bond prices (or rise in interest rates). However, bonds in AFS and HFT have to be marked-to-market. Thus, a bank can avert a higher provisioning and a possible loss by transferring more gilts to HTM. The banks, total AFS and HFT category investments are over 75 percent of the total portfolio size of around Rs.70,000 crore. Banks were prone to depreciation provision by around Rs.7000 crore which would have eaten away the consolidated net profit of the banking industry. Hence, to insulate banks from making marked-to-market provisions, the Reserve Bank allowed one additional transfer of securities to HTM category.

The Reserve Bank had earlier advised banks to gradually build upon Investment Fluctuation Reserve (IFR) of up to 5 percent of their HFT and AFS portfolio to help manage interest-rate risk. As at end-March 2004, most Indian Banks have built up an IFR of at least 3 percent of their investment portfolio.

Conclusion

In the last few years, the health of banking system has improved in terms of profitability, productivity, asset quality and capital adequacy. The profitability of banks had increased due to a surge in treasury income. But a very high dependence on treasury earnings is not a sign of strength in earnings growth. Banks should focus on their core business, increase their fee-based income and cut down their costs. They will have to develop risk-mitigating systems and invest in risk-management technologies. For this, they will have to expand their capital base which will be possible either through tapping the capital market or through mergers and consolidations. With India predicted to emerge as a global economic power in the near future, the Indian Banks will have to restructure their organisation structure, adopt the global best practices of risk management and corporate governance.

ENFORCEMENT OF ACCOUNTING STANDARDS IN INDIA: THE REGULATORY FRAMEWORK

Satyajit Dhar *

Abstract

Issuing Accounting Standards by the Institute of Chartered Accountants of India has not been uniform over time. It was spectacularly hectic during the last three years. Regulatory requirements as to the compliance with those accounting standards were in a mess before 1998; this aspect was looked into only by the ICAI through ethical norms. Now the companies Act has been amended in 1998 keeping an eye over this aspect and the Securities and Exchange Board of India has also come up to enforce the application of the standards. This paper deals with the various issues with regards to that.

Introduction

Last three years have witnessed a hectic formulation of Accounting Standards (AS) by the Institute of Chartered Accountants of India (ICAI). Moreover, most of the standards are made mandatory with staggered time frame for different types of entities. Regulatory requirements as to compliance with accounting standards are not very clear. In this paper an attempt is made to spell out and present status of different standards regarding their mandatory application. This paper starts with a brief history of formulation of standards in India. Next section gives regulatory requirements as prescribed in the Companies Act, 1956 and in the listing agreement. Due to enforcement through multiple agencies there are confusions regarding applicability of standards on different types of accounting entities. Section III describes the present status of different accounting standards regarding their enforceability for preparation of financial statements. The paper ends with problem with enforcement of standards to avoid divergent interpretation in actual application.

Brief history

Earlier to 1970, there was virtually no effort, systematic or otherwise, on the part of any of the components of accounting establishment to even set the ball of

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standard setting rolling. "Even if there were some efforts in this direction, they were sporadic in nature, too obscure to evince notice, feeble in impact, and episodic in form and focus" (Khanna, 1991).

The Institute of Chartered Accountants of India (ICAI), being the member of the International Accounting Standard Committee (IASC) [predecessor body to International Accounting Standard Board (IASB)] has taken the lead in standard setting endeavour in India. The ICAI, recognising the need to harmonise the diverse accounting policies and practices constituted an Accounting Standard Board (ASB) on 21st April, 1977. The main function of ASB has been formulation of Accounting Standards so that the Council of the ICAI may establish such standards. It is also recognised by the ICAI that due consideration need be given to International Accounting Standards, issued by the IASC (ICAI, 1979). Due to such mandate, the Accounting Standards (AS) formulated by ASB generally conform to corresponding International Accounting Standards subject to modifications made to take into considerations the applicable laws, customs, usages and business environment. In the initial years of its working, the intention was to concentrate on basic matters. The endeavour was to confine Accounting Standards to essentials and not to make them so complex that they cannot be applied effectively and on a nation wide basis.

The ICAI issued its first standard in November, 1979. Since then a number of accounting standards has been issued by the ICAI from time to time. Appendix I gives details of the standards chronologically, along with the date of issue in respect of 29 standards issued by the Institute so far. Further, Appendix II gives details of Accounting Standard Interpretation (ASI) issued by the ICAI time to time to provide clarification on applicability of any accounting standard and interpretation thereof.

Regulatory framework of enforcement of accounting standards

Standards are of little value unless they are observed. The real challenge, therefore, lies in adoption of the standards. Accordingly, one of the major functions of any standard setting body is to propagate the accounting standards and persuade the concerned parties to adopt the standards in the preparation and presentation of financial statements. However, enforcement of standards for their uniform application is always a contentious issue and requires regulatory backing. In India before amendment to the Companies Act, 1956 by the Companies Amendment Act, 1998 there was no legal requirement as to compliance with accounting standards in prepa-

ration of financial statements (except preparation of cash flow statement). Before the said amendment, only the ICAI through professional ethics requirements made those standards applicable. Regulator of the securities market, the Securities & Exchange Board of India (SEBI) has also taken interest in enforcing the standards as a part of its endeavour to protect interest of investors. Hence, the regulatory framework has been discussed under three heads viz., Professional Ethics requirements of the ICAI, the Companies Act requirements and the SEBI requirements.

(a) Professional ethics requirements of the ICAI

Part I of Second Schedule to the Chartered Accountants Act, 1949 specifies the circumstances in which chartered accountants in practice would be deemed to be guilty of professional misconduct. Clause 9 of Part I of Second Schedule specifies that chartered accountants in practice would be deemed to be guilty of professional misconduct on his failure to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances. Accordingly, it would be duty of the members of the institute to examine if the 'Statements' relating to accounting matters is compiled with in the presentation of financial statements covered by their audit. In the event of any deviation from the 'Statements', it will be their duty to make adequate disclosure in their audit report. It is clarified by the ICAI that the duties of members of the Institute in relation to mandatory accounting standards are similar to those in relation to 'Statements' relating to accounting matters (Gupta, 1999).

Thus, the ICAI ensures compliance with mandatory accounting standards through disclosure in audit report for non-compliance. However, such requirements do not guarantee compliance as management of a company may not comply with the requirements and accept qualificatory remarks in their audit report.

(b) Requirements of the Companies Act, 1956

The Companies (Amendment) Ordinance, 1998 promulgated by the President of India on October 31, 1998 (this Ordinance with certain modifications has become the Companies Amendment Act, 1999, contains provisions requiring companies to prepare profit and loss account and balance sheet in accordance with the accounting standards. Section 211(3c) of the Companies Amendment Act, 1999 provides that standard of accounting specified by the ICAI shall be deemed to be the

Accounting Standards until the National Advisory Committee on Accounting Standards (NACAS) is established and starts functioning [Section 210 A(1)].

- NACAS although established in June 2001 (vide Notification No. 1/5/2001-Cl.V dt. 15.06.2001 issued by the Ministry of Law, Justice & Company Affairs, Department of Company Affairs), it is yet to endorse any accounting standard. Hence, companies are required to prepare financial statement in respect of accounting year closing on or after October 31, 1998 in compliance with the requirements of the accounting standards that are specified by the ICAI. At present, the ICAI has issued 29 standards and specified dates for mandatory application of those standards. Where there is non-compliance with applicable accounting standards, following matters should also be disclosed [Section 210 A(1)] :

- (a) the deviation from accounting standards;
- (b) the reasons for such deviation; and
- (c) the financial effect, if any, arising due to such deviation.

Moreover, a requirement to include “Directors’ Responsibility Statement” in the Directors’ Report is introduced through Section 217 (2AA) of Companies Amendment Act, 2001. Now, the Board of Directors of a company is required to state and confirm that in the preparation of the Annual Accounts, the applicable Accounting Standards have been followed along with proper explanation relating to material departure.

- Regarding applicability of standards certain points need elaboration for better appreciation of the legal position.

- Section 211 (3C) of the Companies Act, 1956 read with section 217 (AA) only mandates compliance with accounting standards in preparation of **profit and loss account and balance sheet** (emphasis added). But certain standards like AS 3 on Cash Flow Statement & AS 25 on Interim Financial Reporting are not applicable for preparation of profit and loss account and balance sheet. Hence, those standards are not mandatory for the companies under the requirements of the Companies Act.

- The framework of working of the NACAS envisages that it will work as an advisory body for endorsing the standards but the authority of formulation of standards would vest with the ICAI.

(c) SEBI requirements

The requirements to comply with accounting standards are introduced by the SEBI as a part of its endeavour to enhance quality of continuous disclosure in the

financial statement by listed companies. SEBI has power under section 11 B of the SEBI Act, 1992 to direct stock exchanges to implement any matters that it considers necessary in the interest of investors, or orderly development of securities market. SEBI has used this power on many occasions to order changes in the listing agreement. The listing agreement is the standard agreement between a company seeking listing of its securities and the stock exchange where listing is sought. Any stock exchange has power under clause 39 of the listing agreement to alter the clauses of the listing agreement unilaterally and companies listed with that exchange are bound to accept such changes to enjoy the facility of listing. In effect, the listing agreement makes only the company to agree and be bound by its provisions (Vishwanath, 2001). Thus, whenever the SEBI suggests any change, it is incumbent on the listed companies to follow such a change.

Requirements of the listing agreements regarding compliance with accounting standards are as follows (Ramaiya, 2003):

- Clause 32 of the listing agreements requires preparation of cash flow statement in conformity with AS 3 along with annual report from October 1995.
- Compliance with Accounting Standards on “Related Party Disclosure” and publication of audited Consolidated Financial Statement in the Annual Report are also made mandatory from 31.08.2001 (Clause 32)¹.
- Clause 41 of the listing agreement requires publication of unaudited quarterly results. Segment reporting (AS 17) and Deferred Tax Accounting (AS 22) are also mandatory for quarterly reporting purpose under Clause 41.²
- Newly introduced clause 50 of the listing agreement provides that all the standards introduced by ICAI would be mandatory for listed companies.³

Thus, AS 3 and AS 25 are also mandatory for listed companies (vide clause 50), although those standards are not required to be complied with under the Companies Act, 1956. However, there would arise confusion regarding applicability of recommendatory standards (i.e., those standards that are not made mandatory at present by the ICAI). Clause 50 of the listing agreement does not make any distinction between standards that are made mandatory or recommendatory by the ICAI. Clause

1. In accordance with the directive of the SEBI vide its letter ref. SMDRP /POLICY / CIR - 44/01 Dt. 31.08.2001.

2. *Ibid.*

3. *Ibid.*

50 is reproduced below.

“ Companies shall mandatorily comply with all the Accounting Standards issued by the ICAI” (emphasis added).

Now, it is not clear whether clause 50 requires compliance with standards issued by the ICAI that are recommendatory in nature.

Present status of different accounting standards

As stated earlier, one has to consider the requirements of the listing agreement, the ICAI pronouncement and the legal status of the reporting entity to find out applicability of particular standard.

As per present scheme of legal requirements entities may be divided into following categories:

- 1) Listed Companies,
- 2) Other corporate entities,
- 3) Entities having turnover of more than Rs.50 Crores.
- 4) Other entities.

The requirements of compliance with different standards may be described for four categories of entities as below:

1) Listed Companies

Such entities have to comply with all accounting standards except AS 24, 25, 28 & 29. Mandatory application of AS 24, AS 28 & AS 29 would start from accounting period commencing on or after 1.4.2004. Requirements of AS 3 on Cash Flow Statement would be applicable as per clause 32 and clause 50 of the listing agreement and not as per the requirements of the Companies Act, 1956. Standard on Interim Financial Reporting (AS 25) is not applicable as clause 41 of the listing agreement requires publication of quarterly result instead of fullfledged interim financial report.

2) Other corporate entities

Requirements of compliance with accounting standards are different for that of listed corporate entities in the following respects:

(a) Requirements of AS 3, AS 17, AS 18, AS 21, AS 23, & AS 25 would not be applicable to them. ASs 21 & 23 are not considered to be applicable with the

assumption that the company does not present Consolidated Financial Statement (CFS) voluntarily. Generally CFS is not mandatory in India for non-listed company.

(b) Requirements of AS 20 on Earnings Per Share need to be complied with as a company is required to disclose EPS as per Schedule VI (Part IV) of the Companies Act, 1956.

(c) Requirements of AS 24, AS 26 & AS 28 would be applicable only from accounting period commencing on or after 1.4.2004, 1.4.2004 & 1.4.2005 respectively.

(d) Applicability of AS 29 will depend on the size and nature of the enterprise as discussed elsewhere in this article.

However, requirements of AS 3, AS 17 and AS 18 may be applicable under the turnover criteria. AS 26 & AS 28 may also be complied with from an early date under the turnover criteria as detailed below.

3) Entities having turnover of more than Rs. 50 Crores

Such entities would be required to comply with all the accounting standards that are applicable to listed entities as detailed above. Moreover, timeframe of mandatory application would be similar to that of listed companies. However, requirements of AS 20, AS 21 & AS 23 are not applicable for a noncorporate entity. It may be noted that non-corporate entities are not required to comply with accounting standards as per any legal requirement. But, if such an entity fails to comply with mandatory accounting standards the auditor of such an entity would qualify the audit report while attesting the financial statement.

4) Other entities

All other entities not falling under above mentioned three categories and in the nature of commercial, industrial or business enterprises would be required to comply with AS 1, AS 2, AS 4 to AS 16, AS 19 & AS 22 as per professional ethics requirements. Moreover, requirements of AS 24, AS 26 & AS 29 would be applicable from accounting period commencing on or after 1.4.2005, 1.4.2004 and 1.4.2004 respectively. Applicability of AS 28 would start from 1.4.2006.

A non-profit seeking entity is not required to comply with the requirements of any accounting standards when its activities are not of commercial, industrial or business nature. However, such entities may be doing any form of business as a part

of its operation. In such cases applicable accounting standards as detailed hereinbefore are required to be complied with for all the activities of an enterprise although such business operation may be a very small proportion of the activities of the enterprise.

Special features regarding applicability of certain standards

It is observed that AS 19 on all lease transactions and AS 26 on intangibles have transactions- specific prospective applicability. It is provided that AS 19 would be applicable on lease transactions that are entered into on or after 1.4.2001. Similarly expenditure incurred on intangible items during accounting period commencing on or after 1.4.2003 would be covered by AS 26. In effect, existing leased assets or intangible assets that are in the books of accounts of an entity before 1.4.2001 and 1.4.2003 respectively may be accounted for without complying with the requirements of concerned standards.

AS 29 would be applicable in its entirety for listed compnies, banks, financial institutions, insurance companies and entities having turnover of more than Rs.50 crores or having borrowings of Rs. 10 crores.However, for other enterprises paragraphs 66 and 67 of the standards regarding disclosure would not be mandatory and may not be complied with.

Conclusion

Apart from formulation, it is important to make the standards applicable for preparation of financial statement of the entities. ICAI being a professional organization lacks such authority. SEBI's role in this regard is commendable. As discussed earlier, the SEBI was instrumental in introducing disclosure of Cash Flow Statement through incorporating changes in the clause 32 of the listing agreement. Another more important requirement has recently been introduced through changes in the clause 50 of the listing agreement on the basis of directive of the SEBI vide its letter ref. SMDRP/POLICY/CIR-44/01 Dt. 31.08.2001. Recently introduced clause 50 of the listing agreement provides that all the standards introduced by the ICAI would be mandatory for listed companies. Thus, those standards that are not mandatory for compliance, e.g., AS 25 on Interim Financial Reporting under the requirements of the Companies Act, 1956 are now required to be complied with by the listed companies. The process of the SEBI has resulted in a changed regime for imposititon of

financial disclosure requirements that is quick and does not require lengthy process of legislative changes. However, there is no formal enforcing body to enforce compliance with accounting standards and to ensure quality of corporate financial report. Qualitative improvement in preparation and presentation of financial statement is possible through uniform compliance with the requirements of the standards. The Naresh Chandra Committee has recommended setting up of Quality Review Board (QRB). It is recommended that the QRB would periodically examine and review the quality of the assurance and related services provided by the accounting, secretarial and cost accounting firms. The ICAI introduced Peer Review for ensuring quality of audit services. It appears that there is plethora of agencies but the roles of different agencies are not clearly defined. Therefore, we suggest that effectiveness of regulatory framework should be strengthened by clearly defining the role of different agencies / bodies associated with regulation of corporate financial reporting. SEBI can provide yeomen service through establishing an appropriate cell under its Regional Offices to ensure quality of corporate financial reporting in India.

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ENFORCEMENT OF ACCOUNTING STANDARDS

Appendix- I

List of Indian Accounting Standards

Number	Name	Month of Issue
AS 1	Disclosure of Accounting Policies	November, 1979
AS 2	Valuation of Inventories	June, 1981
AS 3	Changes in Financial Position Cash Flow Statement (revised)	June, 1981 March, 1997
AS 4	Contingencies & Events Occurring after the Balance Sheet Date	November, 1982 (revised in 1995)
AS 5	Prior Period and Extraordinary Items	November, 1982 (revised in 1996)
AS 6	Depreciation Accounting	November, 1982 (revised in 1994)
AS 7	Accounting for Construction Contracts	December, 1983 (revised in 2002)
AS 8	Accounting for Research & Development	January, 1985
AS 9	Revenue Recognition	November, 1985
AS 10	Accounting for Fixed Assets	November, 1985
AS 11	Accounting for Effects of Changes in Foreign Exchange Rates	June, 1989 (revised in 1995)
AS 12	Accounting for Govt. Grants & Disclosure of Govt. Assistance	August, 1991
AS 13	Accounting for Investments	September, 1993
AS 14	Accounting for Amalgamation	October, 1994
AS 15	Accounting for Retirement Benefits	January, 1995
AS 16	Borrowing Costs	May, 2000
AS 17	Segment Reporting	October, 2000
AS 18	Related Party Disclosure	October, 2000
AS 19	Leases	January, 2001
AS 20	Earnings Per Share	April, 2001
AS 21	Consolidation of Financial Statement	April, 2001
AS 22	Accounting for Deferred Tax	June, 2001
AS 23	Accounting for Investments in Associates and Joint Venture	July, 2001

Number	Name	Month of Issue
AS 24	Discontinuing Operations	February, 2002
AS 25	Interim Financial Reporting	February, 2002
AS 26	Intangible Assets	February, 2002
AS 27	Financial Reporting of Interest in Joint Venture	February, 2002
AS 28	Impairment of Assets	June, 2002
AS 29	Provisions, Contingent Liabilities and Contingent Assets	November, 2003

Appendix – II

Accounting Standard Interpretations

Number	Name	Relevant Accounting Standard	Month of Issue
ASI 1	Substantial Period of Time	AS 16	June, 2002
ASI 2	Accounting for Machinery Spares	AS 2 & AS 26	December, 2002
ASI 3	Accounting for Taxes on Income	AS 22	December, 2002
ASI 4	Losses under the Head 'Capital Gains'	AS 22	December, 2002
ASI 5	Accounting for Taxes on Income in the situation of tax holiday under section 10A and 10 B of the Income Tax Act, 1961	AS 22	December, 2002
ASI 6	Accounting for Taxes on Income in the context of section 115 JB of the Income Tax Act, 1961	AS 22	December, 2002
ASI 7	Disclosure of deferred tax assets and deferred tax liabilities in the balance sheet of a company	AS 22	November, 2003
ASI 8	Interpretation of the term 'Near Future'	AS21, AS23 & AS 27	November, 2003
ASI 9	Virtual Certainty Supported by Convincing Evidence	AS 22	November, 2003
ASI 10	Interpretation of Paragraph 4(e) of AS 16	AS 16	November, 2003
ASI 11	Accounting for Taxes on Income in case of Amalgamation	AS 22	November, 2003

ENRORCMENT OF ACCOUNTING STANDARDS

Number	Name	Relevant Accounting Standard	Month of Issue
ASI 12	Applicability of AS 20	AS 20	March, 2004
ASI 13	Interpretation of paragraphs 26 and 27 of AS 18	AS 18	March, 2004
ASI 14	Disclosure of Revenue from Sales Transactions	AS 9	March, 2004
ASI 15	Notes to the Consolidated Financial Statement	AS 21	March, 2004
ASI 16	Treatment of Proposed Dividend under AS 23	AS 23	March, 2004
ASI 17	Adjustment to the Carrying Amount of Investment	AS 23	March, 2004
ASI 18	Consideration of Potential Equity Shares	AS 23	March, 2004
ASI 19	Interpretation of the term 'Intermediaries'	AS 18	March, 2004
ASI 20	Disclosure of Segment Information	AS 17	March, 2004
ASI 21	Non- Executive Directors on the Board – whether related parties	AS 18	March, 2004
ASI 22	Treatment of Interest for determining Segment Expense	AS 17	March, 2004
ASI 23	Remuneration paid to key management personnel	AS 18	March, 2004
ASI 24	Definition of 'Control'	AS 21	March, 2004
ASI 25	Exclusion of a subsidiary from consolidation	AS 21	March, 2004
ASI 26	Accounting for Taxes on Income in the Consolidated Financial Statement	AS 21	March, 2004
ASI 27	Applicability of AS 25 to Interim Financial Results	AS 25	March, 2004
ASI 28	Disclosure of parent's / venture shares in post acquisition reserves	AS 21 & AS 27	March, 2004

MEASURES OF CORPORATE PERFORMANCE – A DISCUSSION

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Abstract

In this article, a host of traditional measures like ROI, RI, Eps, Ceps, Dps, Dividend yield, P/E, Dividend payout, Growth in assets, Growth in sales, M-Cap. and non-traditional measures like EVA, MVA, Balanced Scorecard, Benchmarking, WAI, Stakeholders' Measure, Tobin's Q and Value Reporting has been discussed keeping in view the changing pattern and significance of corporate performance measures. Generally the inclination of the companies for measuring corporate performance is towards traditional measures over the non-traditional ones. However, a growing trend of the companies towards adopting non-traditional or innovative measures of corporate performance is observed recently. The article concludes that measurement creates focus for the future and communicates important messages to all the organizational units and employees and to take full advantage of this power companies should integrate their new measures into a management system.

Introduction

Performance is the end result of activities. Hence, the objectives of strategic management to attain profitability, market share, sustainable competitive advantage, cost reduction etc. can only be appraised by measuring corporate performance. If the company does not have performance standards and adequate information system against qualified objectives, it runs into obvious control problems. So performance standards will also help in subsequent controlling of strategies. Performance measurement is also an area of concern to the analysts, researchers, stakeholders, competitors and the regulatory agencies. Moreover, corporate performance measures should be carefully selected and delineated by the management so that it can fairly reflect the result of the concern. Armstrong and Baron (1998) have laid down several criteria regarding performance measures. They are of the opinion that performance measures should:

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MEASURES OF CORPORATE PERFORMANCE

- be related to the strategic goals and measures that are organizationally significant and drive business performance.
- be relevant to the objectives and accountabilities of the teams and individuals concerned.
- focus on measurable outputs, accomplishments and behaviors that can clearly be defined and for which evidence can be made available.
- indicate the data or evidence that will be available on the basis of measurement.
- be verifiable by providing information that will confirm the extent to which expectations have been met.
- be as precise as possible in accordance with the purpose of the measurement and availability of data.
- provide a sound basis for feedback and action.
- be comprehensive, covering all the key aspects of performance, so that a number of measures are available.

A number of performance measures which are mostly financial in nature are on the air, some are designed for management internally and some others are designed both for external and internal use. From the viewpoint of financial statement analysis, corporate performance may be measured in terms of liquidity, long-term solvency, profitability and activity. However, different stakeholders, who are not shareholders are interested in different such areas. Only the shareholders among the stakeholders along with other interested parties are interested to know about corporate performance from all such areas as well as some other areas which may not be essentially financial in nature. Again, among the financial measures, investment-related profitability ratios are of special significance both to the insiders as well as to the outsiders. In nutshell, all these measures may be classified into two large captions – ‘Traditional measures’ and ‘Non-traditional measures’. Here an attempt is made to discuss such measures with their interpretations.

Traditional measures of corporate performance

The following are some traditionally known measures of corporate performance which mainly expose the financial strength or weakness of a company:

Return on Investment (ROI)

'Return on Investment' expresses profit as a percentage of investments of the organization. It is measured in two ways. One is Return on Assets (ROA) and the other is Return of Capital Employed (ROCE). The main difference between the two versions lies in the denominator of the two ratios; the former measures profit as a percentage of total assets and the later measures profit as a percentage of capital employed.

$$\text{ROA} = \text{Net Profit after Tax} / \text{Total Assets.}$$

$$\text{ROCE} = \text{Net Profit after Tax} / \text{Total Capital Employed.}$$

It is a comprehensive measure and captures all the factors which influence figures in the financial statements. This measure of corporate performance is also very easy to calculate. Moreover, it also helps in easy inter-firm comparison.

Residual Income (RI)

CIMA official terminology defines RI as "Pretax Profit less an imputed interest charge for invested capital."

$$\text{RI} = \text{Profit before tax} - (\text{weighted average cost of capital} \times \text{invested capital}).$$

This method is superior to ROI since consideration of weighted average cost of capital leads to choosing profitable investment ideally.

However, calculation of fair figure of imputed cost of capital is varied and subjective and hence may lead to ambiguity.

Earnings per share (Eps)

This is calculated by dividing the net profit after tax of the company (less any dividends on preference shares) for a given year or period by the number of equity shares outstanding at the end of the year. Earnings per share is always looked into as the prospective source of dividend by the shareholders who obviously invest for long term.

$$\text{Eps} = \frac{\text{Earnings available for distribution to the equity shareholders}}{\text{(No. of equity shares outstanding)}}.$$

Cash earnings per share (Ceps)

Cash earnings per share is obtained by adding "non-cash charges" such as

depreciation to the net profit after tax (adjusted for preference dividend). The cash earnings per share is this cash earnings divided by the number of shares outstanding at the end of the year. Ceps is also important to the long-term shareholders for a more possible source of dividend.

$$\text{Ceps} = (\text{EAT} + \text{Non-cash charges}) / (\text{No. of equity shares outstanding}).$$

Dividend per share (Dps)

Dividend is the reward of investing money in equity shares of a concern. Here, dividend per share may be calculated as the amount of dividend declared by the company divided by the number of shares outstanding at the end of the year. Dps is also a market-oriented performance measure of the company because it is widely believed by the fundamental analysts to have a very positive impact on share price.

$$\text{Dps} = (\text{Amount of dividend declared by the company}) / (\text{No. of equity shares outstanding}).$$

Dividend yield

Dividend yield may be calculated as the amount of dividend received per share divided by the closing market price of the share in that year / period. It indicates the return an investor receives by way of dividends from his investment in the equity share of concerned company. Thus, it indirectly exposes the true yielding strength of the company.

$$\text{Dividend yield} = (\text{Dps}) / (\text{Market price per share}).$$

Price Earning Ratio (P/E Ratio)

The P/E ratio may be calculated as the closing market price of the share at a particular point of time to be divided by the earnings per share of that particular year or period. This is a reciprocal of the earnings yield ratio. This ratio has two-way implications for the shareholders. The long-term shareholders desire a relatively low P/E ratio with a comparatively greater emphasis on Eps whereas the speculators desire a high P/E ratio with a comparatively greater emphasis on earnings. This measure has a special significance for the market goes for this reason.

$$\text{P/E Ratio} = \text{Market price of the equity share} / \text{Eps}.$$

Dividend Payout

The "Dividend Payout" may be calculated as the dividend per share (Dps)

divided by the earnings per share (Eps). It signifies the amount of earnings that a company pays out as dividends to its shareholders.

$$\text{Dividend Payout} = \text{Dps} / \text{Eps}$$

However, this does not take into account pro-rata payment of dividends for rights, bonus shares etc.. This measure also gives us an idea of the company's future plan of expansion and growth through retention of earnings.

Growth in assets

Here, the nature of corporate performance may be estimated through observing the growth in total assets during some successive accounting years.

Growth in sales

By observing the growth in sales during two successive accounting years, the nature of corporate performance may be indirectly inferred about. Increase in the figure denotes potential higher profitability if other things remain unchanged.

Market capitalization (M-cap.)

Market capitalization (M-Cap.) is used to reflect the perception of overall market towards a company's performance. M-Cap. is obtained by multiplying the shares outstanding at the time of calculation by the share price on that time. According to many experts, M-Cap. depends on the perceived and anticipated quality of earnings.

$$\text{M-Cap.} = (\text{Share price}) \times (\text{No. of shares outstanding}).$$

Non-traditional measures of corporate performance

The following are some non-traditional measures of corporate performance which expose the strengths or weaknesses of a company on financial as well as other dimensions:

Economic Value Added (EVA™)

EVA™ is defined as a company's net operating profit after tax (NOPAT) minus the weighted average cost of capital (WACC) on total economic capital employed (TECE).

$$\text{EVA}^{\text{TM}} = \text{NOPAT} - (\text{WACC} \times \text{TCE})$$

where,

MEASURES OF CORPORATE PERFORMANCE

$$\text{NOPAT} = (\text{PAT} - \text{Non-Recurring Exp.} + \text{Revenue Expenditure on R \& D} + \text{Interest} + \text{Provision for tax}) - \text{Non-Recurring Income} - \text{R \& D Amortization} - \text{Cash Operating Taxes.}$$

$$\text{Cash Operating Taxes} = (\text{Provision for Tax} - \text{Tax Benefit of Non-Recurring Exp.} + \text{Tax Benefit / Savings of Interest Expenses} - \text{Tax on Non-Recurring Income}).$$

$$\text{Economic Capital} = \text{Net Fixed Assets} + \text{Investments} + \text{Current Assets} - (\text{Non-Interest Bearing Current Liabilities} + \text{Misc. Expenses Not Written off} + \text{Intangible Assets} + \text{Cumulative Non-Recurring Losses} + \text{Capitalised Expenditure on R \& D}) - \text{Revaluation Reserve} - \text{Cumulative Non-Recurring Gains.}$$

Stern & Stewart invented this particular financial performance measurement technique. If EVA™ is positive, it indicates growth / addition in shareholder value. On the other hand, when EVA™ is negative, it indicates decrease in shareholder value.

EVA™ provides an absolute value. The concept suggests that positive EVA adds to shareholder value. There is no minimum value or specified value of EVA. Moreover, computation of weighted average cost of capital is subjective.

Market Value Added (MVA)

MVA is defined as the absolute rupee spread between a company's market value and its invested capital. Stewart coined the term "market value added" (MVA) to measure shareholders' wealth.

$$\text{MVA} = \text{Market value of the firm} - \text{Book Value of Equity, Debt and Reserves and Surplus.}$$

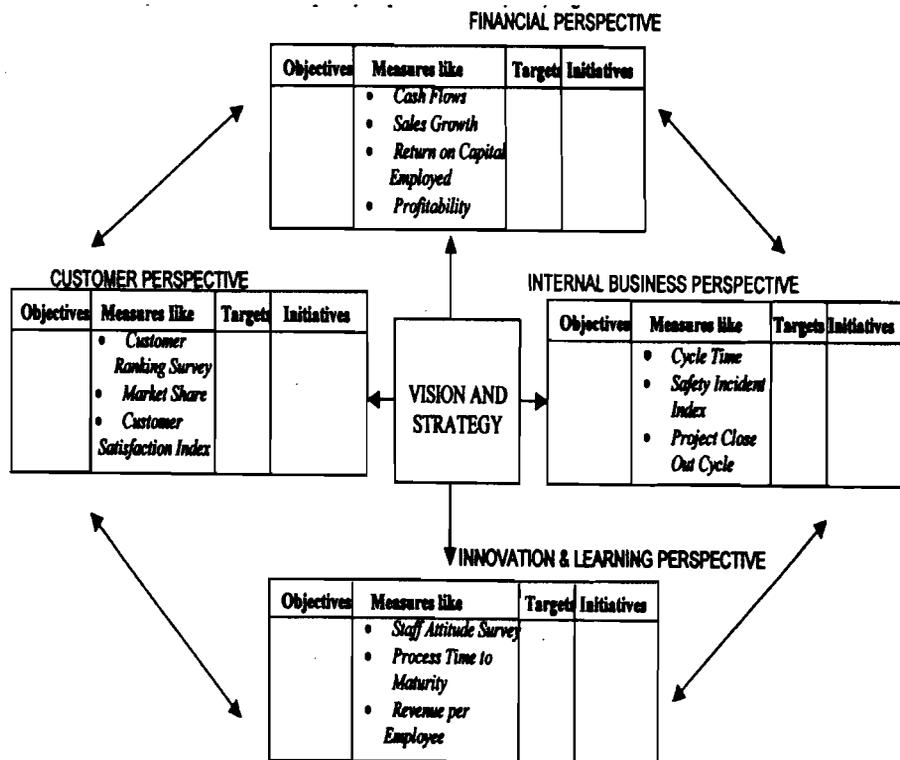
Here, market value of the firm has been taken as the sum of market value of equity and debt at the end of the financial year.

According to many experts, the long term-success of the management can best be measured by MVA. However, MVA cannot be computed for private-owned firms and non-profit companies because their shares cannot be traded.

Balanced Scorecard (BSC)

The BSC shows how to link the organizational vision to critical success factors or

outcomes and key performance indicators, representing all perspectives of the business. This compels the senior management team to operate as unified team, balancing competing objectives to achieve the optimum result for the organization as a whole. The innovative management performance measure indicated by Kaplan & Norton embraces four strategic perspectives like financial, customer, internal business and innovation and learning. Financial perspective centres on the question that to succeed financially what kinds of financial performance we should provide to our investors. Customer perspective embraces that for achieving the vision of organization how customers should see the business. Internal business perspective focuses on enquiring the business process where the business must excel to satisfy shareholders and customers of the concern. Finally, innovation and learning perspective shows the way for sustaining the ability to change and improve. However, the BSC is practically a performance management technique rather than performance measurement method. Here one diagram of BSC as developed by Kaplan & Norton (1996) is given as follows:



[Source: Kaplan, R. S. and Norton, D. P. (1996), "Using the Balanced Scorecard as a Strategic Management System", *Harvard Business Review*, January-February, pp.75-85.]

Benchmarking

Benchmarking is a continuous systematic process of measuring one's output and / or work processes against the nearest and toughest competitors or those recognized best in industry (service) where they are performing. It is a comprehensive measurement system designed to help an organization continuously assess and understand its evolution, carried at the detail process level. By comparing process performance against best practices, competition and the market force in general, a company can identify problem areas, set new targets and begin to improve performance. It can be a very effective tool for increasing the firm's efficiency, productivity and earnings.

Wealth Added Index (WAI)

WAI, a trademark of Stern, Stewart & Co. is a period measure that reflects wealth created for all equity shareholders over and above the risk adjusted required return. WAI measures the increase / decrease in share prices over the period less the required rate of return. It adds the benefits accumulated over the period of the index in terms of the dividends payouts of the company. WAI may be calculated by adhering to any one of the two methods –

Method-1

$$WAI = \Delta \text{M-Cap.} - \text{Required Return} + \text{Dividends} - \text{Shares issued.}$$

where, $\Delta \text{M-Cap.} = \text{M-Cap.}_{\text{end of period}} - \text{M-Cap.}_{\text{beginning of period}},$

Required Return = $[\text{M-Cap.}_{\text{beginning of period}} \times \text{Cost of equity}] + [\text{New shares} \times \text{cost of equity (time adjusted)}].$

The cost of equity calculation is based on CAPM. Here, wealth added is adjusted for dividends, shares issued, spin-offs, stock splits and any other corporate action.

Method-2

$$WAI = (\text{Total Shareholders Return} - \text{Cost of Equity}) \times \text{M-Cap.}_{\text{beginning of day.}}$$

The second method requires less data input but calculation on a daily basis.

WAI is built on the intuitive understanding that wealth is created for share-

holders only when their returns exceed their “cost of equity”. This is the return that WAI uses as a benchmark. Companies appear to create wealth only when their returns exceed this required rate of return of investors. On the other hand, the companies are destroying the wealth of the shareholders when they are returning less than the required rate of return. WAI also incorporates expectation of investors who have purchased new issues through time adjusted expected return method.

Stakeholders Measure

These measures concern issues relating to customers, suppliers, financial community, employees, government, local community and environmentalists. This innovative corporate performance measure is firstly introduced by Freeman, R. F. in his book “Strategic Management: A Stakeholder Approach”. Here, a brief account of it is being provided as follows:

A Sample Scorecard for “Keeping Score” with Stakeholders

<u>Stakeholders Category</u>	<u>Possible near-term measures</u>	<u>Possible long-term measures</u>
Customers	Sales New customers Number of new customers’ needs met	Growth in sales Turnover of customer base Ability to control price
Suppliers	Cost of raw materials Delivery time Inventory Availability of raw materials	Growth rates of raw materials costs Delivery time of inventory New ideas from suppliers
Financial Community	Eps Stock price Number of ‘buy’ lists ROE	Ability to convince analysts with strategy Growth in ROE
Employees	Number of suggestions Productivity Number of grievances	Number of internal promotions Turnover
Government	Number of new legislators that affect the firm Access to key members and staff	Number of new legislations that affect the industry Ratio of “Co-operative” vs. “Competitive” encounters
Consumer Advocates	Number of meetings Number of ‘hostile’ encounters Number of fines	Number of changes Number of C.A. - initiated calls for help

MEASURES OF CORPORATE PERFORMANCE

Environmentalists	Number of coalitions	
	Number of legal actions	
	Number of meetings	Number of changes in policies due to environmentalists
	Number of times coalitions are formed	Number of environmentalists' calls for help
	Number of 'hostile' encounters	
	Number of EPA complaints	
	Number of legal action	

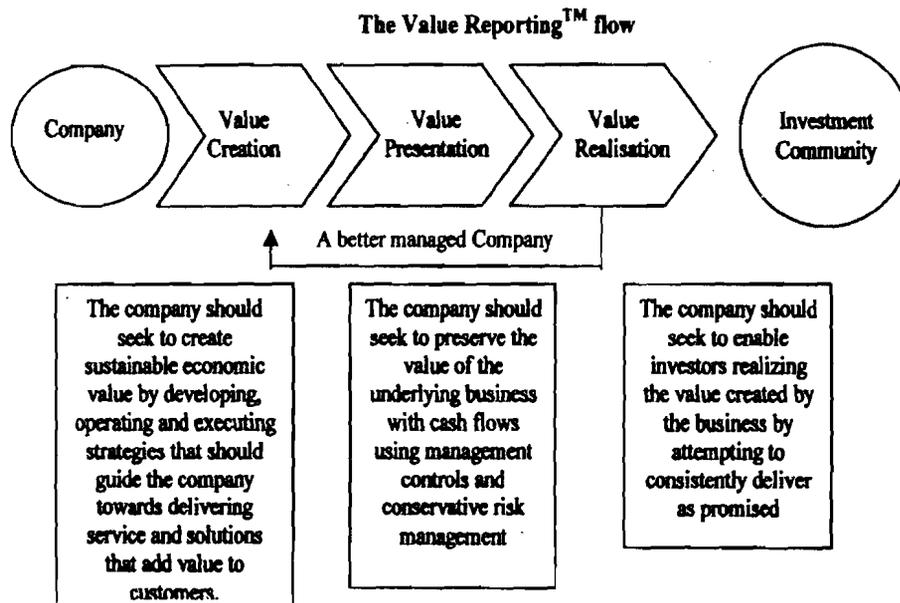
[Source: Freeman, R.E. (1984), Strategic Management: A Stakeholder Approach, Ballinger Publishing Co., Boston, p.179.]

Tobin's Q

It is the ratio of the firm's market value to the replacement cost of its physical assets. Tobin's Q is high when the firm has valuable intangible assets in addition to physical capital, such as monopoly power, goodwill, a stock of patents, presence of efficient management etc.. It is a very effective device to exhibit cross-sectional relationship like relationship between ownership and value.

Value Reporting™

Value Reporting™ comprises a comprehensive set of financial and non-fi-



[Source: Annual Report, 2003-2004 of Infosys Technologies, p.130.]

financial performance, measures and processes, tailored to a company's business, which provides both historical and predictive indicators of shareholder value. Value Reporting™ also provides a methodology to improve transparency and provide capital markets with information needed to accurately assess future value. This innovative technique of corporate performance was first developed by Robert Eccles, Robert Herz, Mary Keegan and David Phillips, associated with the accounting firm Pricewaterhouse Coopers, USA. A flowchart of value Reporting™ is shown below:

Financial statements indicate historic performance and may not always fully exhibit performance on matters critical to creating long-term shareholder value. To overcome this anomaly, a range of non-financial parameters were recommended by this model which are described below:

● The Value Reporting™ Disclosure model			
● <u>External market overview</u>	● <u>Internal value strategy</u>	● <u>Managing for value</u>	● <u>Value Platform</u>
● Competitive environment	● Goals	● Financial performance	● Innovation
● Regulatory environment	● Objectives	● Financial position	● Brands
● Macro-economic environment	● Governance	● Risk management	● Customers
	● Organization	● Segment performance	● Supply chain
			● People
			● Social reputation

End note

Among the number of available measures and techniques of corporate performance, an enterprise sometimes uses more than one measure or technique simultaneously. But, any one measure or technique cannot be identified as self-sufficient. Actually, these are not mutually exclusive. Generally the inclination of the companies for measuring corporate performance is towards traditional measures over the non-traditional ones. However, a growing trend of the companies towards adopting non-traditional or innovative measures of corporate performance like EVA™, MVA™ and Value Reporting™ etc. is recently observed. These disclosures will give more options towards satisfying all the stakeholders' needs and promote greater transparency and accountability for the company itself. In fine, it can be concluded in the

words of Kaplan and Norton (2001) that measurement creates focus for the future and communicates important messages to all the organizational units and employees. To take full advantage of this power companies should integrate their new measures into a management system.

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AN ANALYSIS OF THE HR PERSPECTIVE OF CORPORATE GOVERNANCE

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*P. K. Tripathy***

Abstract

The process of Corporate Governance is formulated and implemented by the people involved in the process. But conventional treatment of Corporate Governance tends to de-emphasize this aspect that is essential for a comprehensive discussion on the issue. In this perspective the present paper tries to highlight some of the drawbacks of the conventional treatment of Corporate Governance. The paper then makes an attempt to analyse the importance and different aspects of the HR perspective vis-à-vis Corporate Governance and the issue of codetermination. Ultimately an effort has been taken to develop an alternative model of Corporate Governance based on the HR perspective.

A Prologue

The issue of Corporate Governance has caught the imagination of all segments of the corporate and the academic world today. The separation of ownership from control in organizations has led to some interesting issues (Berle and Means, 1932; Zahra and Pearce, 1989) of which Corporate Governance is an important one. It is generally observed that an agency problem occurs when managers serve their own interest at the expense of the shareholders (Williamson, 1984; Fama and Jensen, 1983). In this situation, an important task pertains to chalking out ways and means to get rid of this problem and it is, in this context, that the role of Corporate Governance has generally been highlighted. Although the issue of Corporate Governance has received a lot of attention, there is considerable difference in the conceptual definitions that have resulted in variations in the usage of the term. The 'Report on the financial aspects on Corporate Governance' defines it as 'the system by which

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companies are directed and controlled' (Cadbury, 1992).

In a broad sense, Corporate Governance deals with all the factors and forces, both internal and external to the organization, that work to harmonize the interests of managers and shareholders (Baysinger and Hoskisson, 1990). It has also been defined as "...the process whereby people in power direct, monitor and lead corporations, thereby create, modify or destroy the structures and systems under which they operate..."(McGregor, 2000). The process of Corporate Governance is formulated and implemented by the people involved in the process. But conventional discussions on Corporate Governance tend to de-emphasize this aspect, which is essential for a comprehensive discussion on the issue. Conventional discussions on Corporate Governance talk about an organization's primary goal of maximizing shareholder's wealth in a legal and ethical manner involving three main players namely the shareholders, management and the board of directors. The shareholders have trusted the company and invested their capital, the management runs the company, which is accountable to the directors, and the directors in turn are answerable to the shareholders.

Various factors such as changing structure, size and nature of business organizations, increasing need to protect the investors' interests in the emerging markets. series of corporate failures both in the public and private sectors etc. are responsible for accelerating the relevance of Corporate Governance. In this backdrop, several Corporate Governance codes and principles have been formulated in different countries and in our country as well.

Corporate Governance Practices in India and Abroad

In the international perspective, several Corporate Governance codes and principles have been formulated to lay down guidelines for organizations. In Great Britain, the Committee on the Financial Aspect of Corporate Governance (popularly known as the Cadbury Committee) was set up in 1991 due to some corporate failures. The committee recommended the separation of the posts of chair of the board and chief executive, an increase in the independence of the non-executive directors and strengthening the role of remuneration and audit committees. The committee developed a Code of Best Practices. The Greenbury Committee was set up in reply to public concern over executive pay and the committee recommended about the disclosure of director's pay, pay setting process and contract. The Committee on

Corporate Governance, known as the Hampel committee was formed following the recommendations of the earlier committees to review the implementation of such recommendations. In the US, the detection of corporate scandals in organizations such as Enron, WorldCom etc. impelled the government to concentrate on the issue of Corporate Governance. The Sarbanes-Oxley Act (SOX) Act was passed to protect the investors from fraudulent accounting practices. In South Africa, the King Committee Report suggested guidelines relating to the functioning and appointment of non-executive directors, disclosure norms, audit committee, etc.. The OECD Investors' Principles of Corporate Governance recommended about 'Fairness', 'Accountability' and 'Responsibility' in the context of Corporate Governance. In India, the Confederation of Indian Industries (CII) formulated Code on Corporate Governance which recommended about the composition of the board, appointment of non-executive directors, information to be placed before the board, disclosure, etc.. SEBI appointed the Birla Committee which recommended guidelines relating to the composition of the board, nominee directors, remuneration committee, audit committee, disclosure norms, declaration of financial performance etc.. The Naresh Chandra Committee Report suggested recommendations on various aspects, such as, role, remuneration and training of the independent directors, audit committees, the auditors and their relationship with the company. The Narayana Murthy Committee focussed on the role of the audit committee and the board composition, mainly the independent directors.

An analysis of the Corporate Governance codes and principles would highlight one common thing, i.e., they are generally related to the financial and accounting aspects only. But effective governance practices should be able to address issues larger than those of finance, law, compliance and stock exchanges. The principles should try to address issues that prescribe recommendations that would make the organization more effective. If we try to look at the definitions stated at the beginning of this paper, we can easily see that there is considerable difference between the popular definitions and the popular codes and principles. It would be prudent to term the popular codes and principles as "Financial Aspects of Corporate Governance" (as mentioned in the Cadbury committee report) rather than Corporate Governance since in this term 'corporate' includes important aspects other than financial governance. This treatment has restricted the issue of Corporate Governance within the financial domain. The popular codes and principles are not holistic in the sense that

only the interest of the shareholders has been highlighted in these code and principles. An organization is a coalition of various groups where, apart from the shareholders, board and top management, there are others who are equally important in governing the corporation. Thus, any guideline on good governance should try to take into consideration the interest of all the stakeholders in an organization instead of a particular stakeholder. This is an important aspect that seems to be missing, in general, in all the popular codes and principles. There are issues relating to the human aspect of governance. A holistic analysis of Corporate Governance should try to incorporate the Human Resources (HR) aspects of governance. Moreover, the conventional treatment of Corporate Governance talks about the exclusive right of the investors and thus labour is considered as 'outsider'. This is a wrong proposition because undermining this vital aspect in an organization would render the practice as partial and incomplete. Employees are important stakeholders in modern organizations but the popular codes and principles tend to de-emphasize the role employees can play in Corporate Governance. The fact that labour should be given adequate attention in any discussion on Corporate Governance has been thoroughly discussed in the later sections of this paper. But, at the same time, these are issues that do not perhaps fall under the purview of finance alone. It is here that the role of HR comes into the fore. Only then the issue of Corporate Governance will not be limited within the restricted purview of Accounting and Finance.

An Analysis of the Importance of HR Perspective through an Integrated Approach

It has already been mentioned earlier that conventional treatment of Corporate Governance tends to over-emphasize the financial aspects of governance. Even if we consider that Corporate Governance is about the functioning of the Board, Non-Executive directors, Management, etc., that would not make the story complete. People are involved whether in the functioning of the Board, or in the functioning of Non-Executive directors and Management. It has been felt that the sources and types of finance, the objectives of the shareholders and the intervention rights related to various forms of finance provide a set of constraints as well as opportunities that influence managerial choice of labour (Gospel and Peddleton, 2003). So, the 'people' aspect needs to be given adequate attention and coverage.

The HR perspective assumes a significant place in any discussion on Corpo-

rate Governance due to the process of laying higher emphasis in the context of aligning HR practices with business strategies of organizations. Several studies have been carried out to analyse this linkage between HR and business strategy of organizations and the impact of HRM practices on the business performance of organizations (Schuster, 1986; Arthur, 1984; Pfeffer, 1994; Huselid, 1995; Ostroff, 1995). Some studies have revealed that HRM practices develop a match between certain strategic or organizational conditions and certain specified aspects of human resource processes and skills (Leontiades, 1982; Migliore, 1982; Sweet, 1982; Harvey, 1983; Gerstein and Reisman, 1993). Other studies have revealed the linkage between business strategy and compensation system of organizations (Chakravarthy and Zajac, 1984; Carroll, 1987; Balkan and Gomez-Mejia, 1990; Armstrong and Murlis, 1991). Some other works have highlighted the other aspects of the linkage between business strategy and HRM practices (Davis, 1981; Miles and Snow, 1984; Linkow, 1985; Buller, 1988; Beatty and Schneier, 1988; Sonnenfield and Peiperl, 1988; Costa, 1993; Waterman, 1994; Peck, 1994). In analyzing the linkage between business strategy and HRM practices, several set of HR practices have been highlighted by researchers (Delaney et al., 1989; Becker et al., 1997). Some studies have considered multiple HR practices in terms of High Performance Work Practices (HPWP) (Huselid, 1995, Purcell, 1999) and HR practice configuration (Delery and Doty, 1996; Lepak and Snell, 1999). These aspects are significant in the context of Corporate Governance because Corporate Governance is related to the strategic affairs of an organization, which brings the business strategies of organizations at the centre of attention. Unfortunately research suggests that few board members are aware of the fact that good people management is related to positive organizational outcome (Higginbottom, 2002).

According to Pound (1995), for effective governance what is required is truly a 'governed corporation' rather than a 'managed corporation'. He has specified some guidelines regarding Boardroom Paradigm and Practices in the context of a governed corporation, where the board's role is to foster effective decisions and reverse failed policies rather than just review past performance, monitor and replace management. According to Pound (1995), the Board Characteristics and Policies of a governed corporation should be as follows:

Board Characteristics:

- Expertise sufficient to allow the board to add value to the decision-making process.
- Incentives to ensure that the board is committed to create corporate values.
- Procedures that foster open debate and keep board members informed and attuned to the shareholders' concerns.

Policies:

- Required areas of expertise that must be represented on the board
- Minimum time commitment of 25 days
- Large option package for directors
- Designated critic to question new policy proposals
- Regular meeting with large shareholders
- Board members' freeness to request for information from employees.

Source: Pound, J. (1995), "The Promise of a Governed Corporation", *Harvard Business Review*, July-August, pp. 79-103.

A closer look at these issues would make it quite clear that if the above characteristics and policies are to be properly handled, HR has a prime role to play. Without the role of HR, Corporate Governance would only remain as codes and principles sans people. Analysing the behavioural aspects of the people involved in the process of Corporate Governance would be an important exercise under the HR perspective of Corporate Governance. This is so because, when people govern an organization, they use their talent and perceptions, ways of decision-making, wisdom, understanding and creativity. They also live either deliberately or otherwise according to their values and beliefs about themselves and their perceptions (McGregor, 2000). Value signifies "a specific mode of conduct or end state of existence which is personally or socially preferable to an opposite or converse mode of conduct or end state of existence" (Rokeach, 1973). Values would therefore help us to understand the attitude and behaviour of the people involved in Corporate Governance. The nature of value of the Top Management Team (TMT) will give us an understanding about the way in which an organization will be governed and the

ethical behaviour of the people involved in governance process.

Another issue that is important in the HR perspective is the issue of decision-making process. Effective Corporate Governance requires a system where management and the board collaborate on decisions and both regularly seek inputs from workers and shareholders. Corporate Governance should try to aim at ensuring that effective decisions are made. Effectively utilizing the talent and intellects of all individuals involved in a decision-making process can result in effective decision making since the process brings together a pool of skills, experience and outlook. Here an important factor is the extent of trust that group members have on one another (McGregor, 2000). TMT as decision-makers functioning as a group is influenced by nested problems and search for the viable solution, timing, choice situation etc. vis-à-vis Corporate Governance. This brings into the forefront the vital aspect of strategic decision-making in the perspective of Corporate Governance where involvement of TMT and analytic-rational, intuitive-emotional and politico-behavioural components of decision-making (Jauch and Glueck, 1989) assume greater importance.

Leadership also plays a vital role in the way the process of Corporate Governance is carried out in an organization. Factors such as values, beliefs and attitude of the leader, personality of the leader, style of leadership and the nature of leadership that the situation demands are important in this context. A leader should possess the ability in managing emotion in oneself and of others that is essential for effective governance. Information sharing on issues such as financial performance, strategy etc. communicates to the employee that he is trusted by the leader (Pfeffer, 1998). An important issue that needs to be addressed here is that why Board needs HR? HR has a definite role to play in the selection of board members. According to Klinvex, *et al.* (1999), board can make many mistakes if the members are selected without HR's help and HR can effectively contribute in the process of the selection of board members. This would also fulfil to a certain extent the shareholders' demand of higher accountability and effective governance since effective selection of board members with HR's help facilitates the selection of the best members suited for the job.

The compensation philosophy of an organization envisaged through Corporate Governance must reinforce and reflect the organization's culture, external environment and business strategy (Cummins, 1984). This would ultimately result in attracting, retaining and motivating employees thereby resulting in reduction of cost

and equitable salaries for employees.

The HR perspective of Corporate Governance assumes greater significance because of the fact that there is an increasing pressure on the individual employee to have a general understanding of the tasks and processes of the organizations (Goldstein and Gilliam, 1990). At the same time, there are different degrees to which employment relations have changed and union, management and employees have been forced to come to terms with several changes in the perspective of employment relations (Hartley and Stephenson, 2000). It is argued that employees' involvement in Corporate Governance is essential because they are subject to the authority of the organization and so they should be given the right for democratic participation in the decision-making of the organization (Parkinson, 2003). It is also justified to state that an organization should have a separate reporting on the employment relations aspects under Corporate Governance. Others argue that employees should have a proper say and should be consulted on issues relating to the structure, situation and probable development of employment and any anticipatory measures that could threaten employment (Williamson, 2003). To summarize, employee involvement in Corporate Governance would be beneficial in the following ways:

- Strengthening the system of human resource management within an organization
- Increasing employee motivation
- Enhancing legitimacy and authority of decision-making
- Developing the organizational culture
- Making positive contribution to economic growth and social stability

Do we see any reflection of the above dimensions in the treatment of Corporate Governance? The answer would probably be in the negative. Thus we should get rid of the complacency in the name of so-called 'Best Practice of Corporate Governance'. Usage of the term 'Corporate' in the perspective of governing organizations should be such that the treatment becomes unified, all-inclusive and integrated.

Co-determination in the HR Perspective of Corporate Governance

The issue of co-determination assumes a significant place in any discussion on Corporate Governance more so, if the discussion happens to on the HR perspective of Corporate Governance. Co-determination is a parallel form of representation

available to employees in addition to labour unions where employees are allowed to elect representatives to the supervisory board of the company. Since 1970s, co-determination has been acting as a 'guiding principle' of European Corporate Governance (Gerum and Wagner 1998). Legal provisions relating to co-determination for employees in supervisory and management boards have been enacted in a number of European countries. Even in Great Britain, the Bullock Committee of Inquiry and Industrial Democracy Report (1977) recommended co-determination in companies. Co-determination is generally concerned with industrial democracy though its economic efficiency has also been recognized (Gerum and Wagner 1998). It is generally argued that co-determination makes a significant contribution to an organization in different ways that are relevant in the context of Corporate Governance. The process helps to improve the supply of information to workers' representatives thereby restricting the chance of 'post-contractual opportunism' from the employer's side. Works Council is another aspect of co-determination especially in Germany; where employees have the right to elect such a council, which enjoys the right to participate in specific business decisions. In addition to this, the works council is consulted on vital decisions relating to economic health of the organization, hiring managerial employees, introduction of new technology, work organization, etc.. Co-determination is also an appropriate method for enhancing efficiency by reducing the creation of 'expectation errors' (Furubotn and Wiggins, 1984). Freeman and Lazear (1995) have argued that an organization's total earnings would increase by the introduction of co-determination due to reasons such as reduction in the economic inefficiencies, support for new solutions to the problems, greater consciousness in workplace on the part of the worker etc.. There has however been criticism against the approach of co-determination as well. For example, Emmons and Schmid (2001) argue that co-determined firms tend to be overstaffed that ultimately results in loss of efficiency. It is therefore felt that strict minority representation on corporate boards in respect of Corporate Governance would be helpful in controlling efficiency and restricting possible loss of steering.

It would be interesting to relate the issue of co-determination with the Indian perspective. In India, there have been several experiments in the context of Workers' Participation in Management. There have been experiments on Works Committee (1947) to smoothen the relationship between the workmen and the management in the day-to-day work. Joint Management Councils (1958) talked about setting up of

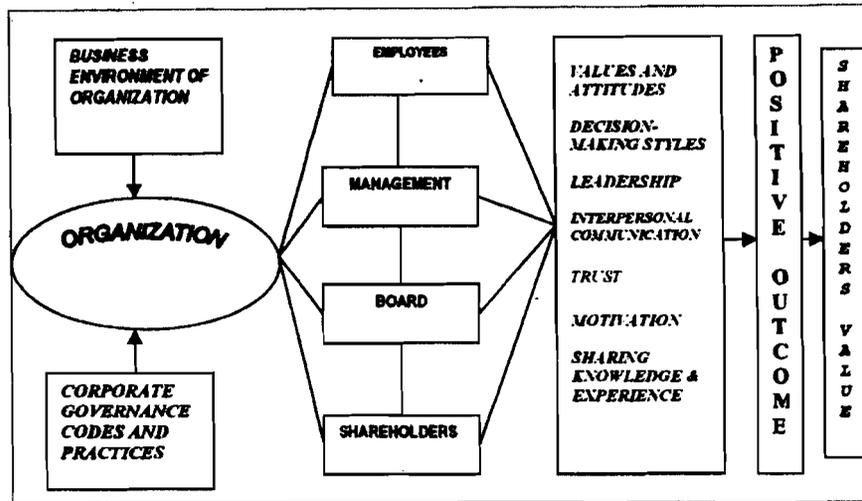
councils where workers are given rights to receive information and to be consulted on different issues such as method of production, general economic condition etc.. There have been experiences with Worker Director (1970), Worker Participation Schemes (1975, 1983), Employee Share Ownership etc.. These experiments have not been able to show the kind of results expected and there was lack of interest shown by the employers in general. Moreover the experiments have been in the operative and administrative decision areas rather than the strategic decision areas, which is relevant in the context of Corporate Governance. Therefore, the role has to be played by the Government/ Regulatory Bodies by making necessary legal provisions in the issue of co-determination. This is so because no single organization in India would have an incentive to start co-determination. It is only when all organizations (in general or industry-wise) introduce co-determination, there will be a perceived opportunity for enhancing earnings through this form of institutional innovation. It is also imperative to argue that the issue of involvement of workers in strategic decision-making process assumes special importance mainly due to the process of changes in labour laws initiated in our country. This would give workers the right to have a say on the strategic affairs of their organizations that would be beneficial for their existence.

A model on the HR Perspective of Corporate Governance and Conclusion

It would be prudent to relate the above discussion in the form of a model that considers Corporate Governance in a holistic framework and the one that does not overemphasize the role of accounting, finance, compliance, norms etc.. Considering these as essential elements of Corporate Governance, a 'Stakeholder's Model of Corporate Governance' (Parkinson, 2003) would be most appropriate. According to this model, various groups that are affected by the organization should be treated as 'ends and not means' (Evans and Freeman, 1988) and the interest of all the employees and other stakeholders should be given equal importance (Williamson, 2003). The model incorporates the proposition of the Preamble to the OECD Principles on Corporate Governance "...Employees and other stakeholders play an important role in contributing to the long-term success and performance of the corporation, while governments establish the overall institutional and legal framework for corporate governance". Accordingly, a holistic model has been developed as shown in the

Figure 1. In this model, business environment of an organization has been considered to influence an organization since there is a strong relationship between an organization and its business environment. This, coupled with Corporate Governance Codes and Principles, has a 'dyad' effect on an organization. Accordingly, an organization is required to respond according to the changes in its business environment and the prescriptions of the popular code and principles on Corporate Governance, which will ultimately provide a direction to the organizational action. The organizational effectiveness can be improved by considering those (both within and outside the organization) who have a significant stake of interest in the organization. In the perspective of this model, the issue of Corporate Governance could be analysed. An organization can achieve long-term improvement in shareholder value if it gives importance to the interests of all important stakeholders as shown in the model. This

FIGURE 1: A MODEL ON THE HR PERSPECTIVE OF CORPORATE GOVERNANCE



In conclusion, it can be said that there have been considerable changes in the business environment of organizations that have influenced all stakeholders of business organizations. Though the issue of Corporate Governance has been confined within the purview of accounting and finance, it has got equal relevance in the per-

spective of employment relations. Since the issue of Corporate Governance is in a nascent stage especially in a developing country like India, its relevance will increase, as time will progress. In future, the issue is going to play a vital role in the all aspects of an organization including the aspects of HR. This will, in turn, depend on the role played by the employers, government and regulatory bodies. Further research and in-depth studies in this direction are necessary for a comprehensive understanding of the issue.

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DISINVESTMENT OF PUBLIC SECTOR ENTERPRISES: ISSUES AND CONCERNS

*Goutam Bhowmik**

Abstract

The terms privatization and disinvestment have become popular in recent time. Conceptually, there exists some differences between the two terms but practically they are used interchangeably. In India the disinvestment process has been started since the early 1990's with two fold objectives. First, to mitigate the fiscal deficit both at the Central and State Level. Second, to improve the efficiency of Public Sector Enterprises (PSEs). The decade long disinvestment performance, however, reveals that the Govt. has failed miserably to mitigate the fiscal deficit. On the other hand no precise relationship can be established between privatization and improvement of efficiency. Another concern relating to the disinvestment process is the undervaluation of public assets. The paper touches these issues in a brief manner.

1. Introduction

There seems to be high degree of unanimity among economists and policy makers about the basic objective(s) of our economy. All want an accelerated economic growth and at the same time, want to see that benefits of growth are equitably shared. In a word, they want economic growth with social justice. There are, however, conflicting opinions regarding the methodology to be adopted to achieve the objective(s). During the last four decades since independence state participation in economic activities primarily in the form of investment in Public Sector Enterprises (PSEs) had been perceived as the best way to achieve the basic goals. The result was the emergence of a gigantic public sector as a symbol of socialistic design of India. Massive investments have been made over the past four decades to build this enormous public sector, which played a crucial role in the country's industrialization and extending social infrastructure.

But not all have been going well in this sector. When we make introspection about the efficiency and effectiveness of these enterprises we have to content our-

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selves with the realisation that they have failed to work up to expectations. Specially in the matter of economic viability and efficiency, their performance has been so dismal that they have increasingly become a subject of public debate and criticism. For this it has been acknowledged that the PSEs are required to be reformed and restructured. And finally, the Government of India came out with a new economic policy in July 1991, which marked the beginning of new approach towards PSEs known as 'economic reform'. Reform of PSEs in one way or another is intimately related with the process of 'disinvestment' although the former includes many other measures. In this paper some issues relating to the disinvestment of PSEs and more specifically central PSEs have been examined.

Before going into deep, the conceptual difference between the terms 'disinvestment' and 'privatization' should be made clear. Section two pinpoints the differences that exist between these two terms. In section three the objectives of disinvestment and how far these objectives have been fulfilled during the past one decade of economic reform have been discussed. The important issue of valuation of PSEs and for that matter of fact undervaluation of PSEs is covered in section four. Section five contains concluding remarks.

2. Disinvestment vs. Privatization

The word privatization means act of making private, specially to change from public or government ownership to private control or ownership. It implies change in ownership resulting in a change in the management. The privatization of PSE occurs only when the government sells more than 50% of its ownership to private entrepreneurs. Disinvestment, on the other hand, is a broad term having wider connotation as it could either involve dilution of government stake to a level that results in transfer of management or could also be limited to such a level as would permit government to retain control over the organisation. Disinvestment of government stake beyond 50% effectively implies privatization. Further, privatization also means allowing private players to participate in a particular sector of business by the government which was earlier restricted to the former. Thus, privatization can take place in the two stated ways.

Another important distinction is that privatization inevitably relates to the selling of government stake whereas disinvestment may relate to selling of government stake or may not. It may indicate the selling of stake of any person and/or institution. Though the meaning of these two terms is conceptually different, yet throughout the paper these two will be interchangeably used.

3. Objectives of Disinvestment: A critique

Broadly speaking, there are two objectives of disinvestment of PSEs: first, to reduce or mitigate the fiscal deficit of the government and second, to improve the efficiency of PSEs.

The argument put forward in favour of the first objective is that government needs additional resource to retire past debt leading to the reduction in interest burden and to invest in those areas which are much higher in social priority viz., infrastructure, education, health care etc.. The advocates of disinvestment believe that it would be better to meet this financial need from the sale of PSEs rather than by creating fiscal deficit. But some questions may be raised in this regard. Suppose all PSEs are sold. In that case, whether the fund released will be sufficient to pay off the public debt? If yes, whether there remains some fund for investment in so-called areas of social priority? If remains, whether we make such investment for only one time knowing fully well that we need incremental investment in those areas over time so as to get a desirable growth in national income? Will it be reasonable to expect that in future our budget can generate enough surpluses so that the incremental financial need can be fulfilled? If not, what course of action we will take? Will we raise public debt from domestic market or from World Bank? Only time can provide the answers.

However, if past one decade of disinvestment performance is any standard then we can say that the government has failed to fulfill its basic objective of meeting fiscal deficit from the disinvestment proceeds. As shown in Table-1, the disinvestment proceed as a percentage of fiscal deficit varies between 0.6% to 8.8% over the last twelve years and on an average it is just 3.17%.

Table -1**(Rs. in Crores)**

Years	Amount realised from disinvestment	Fiscal deficit	Disinvestment receipt as a % of fiscal deficit
1991-92	3038	36325	8.36%
1992-93	1961	40173	4.88%
1993-94	1866	60257	3.1%
1994-95	5078	57703	8.8%
1995-96	357	60243	0.6%
1996-97	455	66733	0.7%
1997-98	902	83937	1%
1998-99	5371	113349	4.7%
1999-2000	1892	108898	1.7%
2000-2001	2600	111275	2.3%
2001-2002	5632	140955	4%
2002-2003	3336	145466	2.29%
Average	2707	85443	3.17%

Source: Computed from Annual survey of Public Enterprises, 2001-02 and RBI Bulletin, September 2000

Some believe that in future disinvestment process will gain momentum and will be able to meet a significant portion of fiscal deficit. But with the recent Supreme Court judgment asking for prior revision of legislative status before going for disinvestment of HPCL and BPCL, the government is expected to face more hurdle in fulfilling disinvestment targets and for that matter the target of curbing fiscal deficit in coming years. The government now, is considering the option of selling shares of HPCL, BPCL, ONGC, IOC, SCI etc. in small bits to meet the target. However, it would be of no use if privatization is done in such fractional way because that will pull down the price that the shares would otherwise fetch if sold in large chunks. Regarding revision of legislative status, a strong will on the part of the government and support from all major political parties are required. Due to the lack of the former and the unhealthy relationship among the major political parties, it is unlikely that disinvestment process will get an expeditious turn in coming years and as a result the objective of curbing fiscal deficit from disinvestment proceeds looks very distant possibility. After the recent change-over in central government new idea named "Dis-

investment with Human Face” comes to the forefront. The implications of such concept are to be seen in near future.

Secondly, the issue of disinvestment of PSEs steams out primarily from the question of efficiency or rather the lack of it in much of this sector. The advisors of the government have the conviction that state ownership is the principal impediment on the way of improvement in efficiency. The underlying belief is: induction of private ownership/participation can have a salutary effect on the economic efficiency by increasing the accountability of management and imparting greater autonomy. Contrary to this, some critics argue that there is no positive relationship between ownership and efficiency and, therefore, according to them, the belief that privatization, by itself, leads to improvement in efficiency is questionable. As suggested by them apart from privatization there may be two alternatives available to improve the efficiency of PSEs. These are:

- (a) granting greater financial and operational autonomy to the management of PSEs; and
- (b) creating competitive market structure and opening up of new areas for competition between public and private sector.

The implementation of ‘Memorandum of Understanding (MOU)’ by the government of India since 1988 substantiated the belief that granting greater financial and operational autonomy to PSEs and at the same time making them accountable for achievement of their objectives would lead to increase in efficiency. An introspection of Table 2, which summarises the result of performance evaluation of MOU-signed PSEs, reveals that MOU exercise brought about positive improvement over the years. In 2000-2001, the aggregate gross margin of MOU signing PSEs was 15.5% higher than that of 1999-2000 and 12.8% higher than the target set for them (Mishra & Puri, 2002).

Table - 2

Year-wise evaluation of PSEs under MOU

Year	No. of PSEs signed MOU	PSEs Evaluated	Excellent	very Good	Good	Fair	Poor
1991-92	71	59	21	25	10	3	-
1992-93	98	67	28	22	10	7	-
1993-94	101	97	46	29	12	10	-
1994-95	106	67	39	26	-	-	2
1995-96	104	103	51	31	7	12	2
1996-97	110	110	46	27	19	11	7
1997-98	108	108	45	25	13	21	4
1998-99	109	108	42	30	13	21	2
2000-2001	107	107	49	26	12	12	7

Source: Indian Economy since Independence edited by Uma Kapila

Another way out is to create competitive market structure by making public sector more productive and efficient through competitive pressure and exploring new areas for public investment. According to Pranab Bardhan and John E. Roemer (1992), competitive markets are necessary to achieve an efficient and vigorous economy, but that full-scale private ownership is not necessary for the successful operation of competition. In this regard, the experience of China, which initiated economic reforms in 1978, can be cited as eye-opener. During 1978-1992, China's GNP grew at an annual rate of 8.8% while industrial sector grew at a rate exceeding 10% p.a. As a result, its GNP trebled over the 15-year period. According to Bardhan and Remer this remarkable growth has been achieved not as a result of privatization but by marketization and opening of new areas for competition between public sector and private sector, as very few PSEs have been privatized during this period and largest contribution of industrial growth has come from PSEs. As the private sector has grown, PSEs have responded to the increased competitive pressure by becoming more productive (I.J. Singh, G. Jefferson and Thomas Rawski, 1994.).

The experience of China shows that to improve efficiency, it is necessary to

create competitive market structure. It is competitive environment that matters rather than ownership so far as bringing improvement in efficiency is concerned. The experience of China is more relevant because both China and India have same demographic pattern and have confronted with similar sort of problems.

4. The issue of undervaluation of PSEs

During the past decade of disinvestment, the Govt. faced widespread criticism from various sections of the society for massive undervaluation of PSE shares offered for sale. Some of these are enumerated below:

- Report No. 14 of CAG 1993 reveals that the extent of loss suffered by the Govt. in percentage term during first two rounds of disinvestment varied from 127% in case of HPCL (its shares having been sold for Rs. 243 against the market price of Rs. 550) to as high as 616% in case of NLC (share sold for Rs. 11 as against a market price of Rs. 82). (Mishra & Puri, 2002)
- During Congress rule, two coal mines in Madhya Pradesh were sold for about Rs. 11 crore, whose total valuation was more than Rs. 1000 crore. (Uma Kapila, 2001)
- In the 7th round of disinvestment carried out in 1994-95 a small fraction of ownership (less than 10%) in high profile companies like ONGC, SAIL, IOC and SCI fetched Rs. 4843 crore against the target of Rs. 4000 crore. However, it has been estimated that given the then profitability and future prospect of these companies, the shares offered for sale could easily be worth Rs. 8000 crore. (Mishra & Puri, 2002)
- BALCO that was sold to Sterlite Group in March 2001 for just Rs. 551.20 crore has been a profit generating and dividend paying company apart from contribution of around Rs. 300 crore to the Govt. by way of taxes and duties. Reserve and surplus of the company at the time of disinvestment stood at Rs. 460 crore and its Korba plant was worth more than Rs. 1100 crore. (Mishra & Puri, 2002)
- In case of disinvestment of VSNL, the Govt. realised Rs. 202 per share against the market price of Rs. 168 on the day of sale. This was highlighted by the Govt. as a great achievement. However, the fact is that even one month before the declaration of VSNL privatization, it had a share price of Rs. 221. (Chanakya, September, 2002)
- The Govt. has recently sold some ITDC hotels to different private companies for throwaway price of Rs. 2-6 crore. Considering the prime area they occupy in the city, they could have valued many times more. For example, one hotel in Kerala

belonging to ITDC was sold for Rs. 9 crore when the value of its land alone was worth more than Rs. 130 crore (Chanakya, September, 2002). In another case one hotel in New Delhi was sold for Rs. 70 crore. After one month the private owner of the abovementioned hotel sold a very small portion of the hotel for commercial complex for Rs.70 crore. (G. L. Dave, 2004)

- Jessop, one of the best known heavy engineering plant in India was sold for Rs.18.18 crore (sale could not be completed due to a stay order issued by Kolkata High Court) whereas its current market valuation at that time was more than Rs.130 crore. (Mishra & Puri, 2002)

Coming to the reasons behind such gross undervaluation of PSEs for the purpose of disinvestment C.P. Chandrasekhar and Jayati Ghosh (2002) opined that the basic problem of all privatization of public assets is that they tend to be associated ultimately with losses to the state exchequer. According to them, if the government sells the asset that provides income or profit equal to or more than the government securities, the government would lose future income by selling it. On the other hand, from the private sector point of view, it makes no sense to purchase an asset unless it provides at least a rate of return equal to the rate of return on government securities, because that is where private investors could otherwise put the money without any risk. This implies that for such sales to occur either:

(a) the private investors must believe that it is capable of generating more profit than the public sector. But that is essentially a management issue and there is no point as to why the public sector cannot also employ professional managers to achieve this; or

(b) the asset must be undervalued so that actual return for private buyer turns out to be higher, which really means that state exchequer has lost the money.

Apart from this generalised theory there are some other reasons for such undervaluation. These are discussed below.

(i) Method of valuing PSEs

In valuing PSEs four valuation methods are recognised by the Ministry of Disinvestment. These are – Net Asset Value Method, Transaction Multiple Method, Replacement Cost Method and Discounted Cash Flow (DCF) Method. Out of these methods, DCF method is considered to be the best method of valuing a going concern. According to this method the firm's value is calculated by aggregating the

present value of cash flows that the firm will generate in future and the market value of non-operating or idle assets. But in valuing PSEs, the government does not consider market value of land, property and any idle facility because of the restrictions on sale or alternative use of these assets imposed through shareholders' agreement. Thus the buyer or strategic partner receives those assets without any consideration. This exclusion of market price of idle assets is the main reason behind such gross undervaluation. This was what actually happened with Jessop, ITDC hotels and collieries.

(ii) Non consideration of synergic effects and change in market structure

Valuation of PSEs for disinvestment should consider the benefits to be accrued to the buyer from synergy of operation and change in market structure. Synergy of operation may result in reduction of overlapping activities, economy from operation at a higher scale, cost reduction due to avoidance of duplication of internal services. Better control over the capacity of industry, input supply and product market arising out of acquisition of PSE lead to the change in market structure. All these are very much significant to the potential buyer and therefore he should be willing to pay a premium over and above the control premium. In practice these benefits are not properly weighted and considered while fixing 'reserve price' for a PSE disinvestment. A case in point is disinvestment of Balco. Prior to disinvestment of the company there were only four players in the market – Balco and Nalco in public sector, Hindalco and Sterlite in private sector. The acquisition of Balco helped Sterlite group to achieve dominant position in the market. It is not clear whether the government had considered this in valuing Balco and consequently in deciding its reserve price.

(iii) Collusion among bidders

In order to maximize revenue from sale of PSEs, the government has gone for sealed bid auction. But collusion among bidders to keep the bid at low level may jeopardise the objective. In India it is very much possible because there are only a few business groups which have the ability to bid for large PSEs. It cannot be ruled out that they might have tacitly entered into an agreement to share PSEs under sale and thereby acquire control over large PSEs at prices cheaper than full value price.

iv) Corruption

The gross undervaluation of PSEs reveals the prevalence of widespread corruption on the one hand, and foul play between sections of the government and particular business group close to the government on the other hand. In the words of Mr. Dipak Basu (2002) “ Strategic sale, is what in plain English means selling the public sector to some favourable business group at a massive discount.” This is not only undesirable but unethical as well.

There is no denying the fact that the government has not come clean regarding valuation of PSEs. Many areas of valuation require further investigation and revision. In valuing PSEs, the government does not consider replacement cost knowing well that the buyer does take into his account the cost of creating similar facility. The government should realise that fixation of reserve price is a commercial decision and there should not be any bar to applying commercial prudence. The government policy, not to include market price of idle assets on the ground that there are some restrictions for three to four years, is not justified specially because after the expiry of the stipulated period, the buyer gets the absolute right over these assets. A more sensible approach would be to consider the value of these idle assets and removing the restrictions. That will provide the buyer enough flexibility to respond to changes in business environment. The government should subsequently resist any unwarranted disposal of such assets by exercising its right as a substantial shareholder.

5. Conclusion

This paper has discussed some fundamental issues concerning disinvestment of PSEs which require in-depth thinking on the part of the government. Government policies and their implementation during the last one decade suggest that public sector is entirely a place of inefficiency and the best remedy available to cure it is to privatize these organisations irrespective of the fact whether such transformation creates private monopoly or concentration of business power among a handful group of businessmen. India's experience shows that private companies are not a paragon of virtue. Calcutta Electric Supply Corporation, for example, is a private company but has failed to pay about Rs.960 crore for the electricity it has purchased from the West Bengal State Electricity Board. Recently the government has handed out Rs.3500 crore to the private sector steel plants. One of the interesting facts is that

the losses incurred by loss-making PSEs are, to a considerable extent due to the takeover of sick units from the private sector. For example, in 1991-92, 40% of total loss-making PSEs were of this nature.

If a public sector company is suffering loss and if that loss is not due to theft, corruption or militant trade unionism, that loss should be considered as subsidy for the rest of the economy because normally PSEs are in the core sector of the economy and are forced to charge less, sometimes even less than their cost of production, to subsidise other upstream industries both in public and private sector. Thus this loss of PSEs is not the index of inefficiency but the degree of support they provide for the rest of the economy. Though loss-making PSEs have been the prime concern of government, interesting fact is that very few loss-making PSEs have been privatized. The government does not find bidders for those PSEs that are not at all profitable. Shares of those PSEs, which have been showing competitive rate of return, are easily disinvested. This results in a situation where we privatise the profit and nationalise the losses.

Coming to the fiscal correction it can be said that creation of fiscal deficit is not as bad as it is often aired. When there is a possibility that investment in infrastructure and other areas of social priority will lead to growth in national income, as the underlying assumption of use of disinvestment proceeds to finance such investment suggests, raising credit from RBI may be a viable option. Then why is government reluctant to do so? The reason seems to be the Govt. commitment to WTO to move toward market economy and to open the economy for import as part of the liberalised trade policy by removing the public sector.

Last but not the least, there is no denying the fact that our economy is characterised by waves. During first four decades since independence economic policies were driven by nationalisation wave. This is evident from the fact that at the end of third five year plan there were 73 central PSEs and by 1980 the number reached 179. In the 1980s about 80 another PSEs were added to the tally. Since 1990, privatization mantra has been gaining momentum to make correct the damage done by nationalisation wave. If mass nationalization were bad we are not entirely right by adopting the policy of indiscriminate privatization. The best approach would be not to go with the wave but to adopt policies, which are compatible with the inherent characteristics of our economy. We should follow disinvestment strategy but that surely for our best interest and not for the interest of other developed countries.

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THE IMPACT OF TECHNOLOGICAL PROGRESS ON THE PERFORMANCE OF BANKS IN INDIA

*Amitesh Chowdhury**

Abstract

This paper infers that increase in IT investment makes a positive impact on the performance of Banks without any doubt. It is also concluded that in recent years PSBs and OPBs have enhanced their IT investment to improve efficiency and cut down costs though foreign banks are well head in this regard from the beginning.

Globalisation is a process whereby the integration of world into single market is taking place. It is a process that brings the together : industry, investment, information technology and individual customer. The integration of these four components results in competition, customer focus and cost control. The environment is changing and the structure of every socio-economic entity should change its structure in order to adapt to the changing environment.

Indian banking system is passing through a transitional stage to acclimatize itself with global banking scenario. There are already 34 Private Sector Banks in India as compared to 27 in Public Sector and 44 Foreign Banks. Public Sector Banks have a major share of 81 percent of total banking assets, Private Sector Banks account for 10.93% and the foreign banks account for 8.06%. Mutual Funds also have come into this scenario. The strategy of Niche marketing is also introduced in the banking field.

The objectives of this article is to show the usefulness and impact of Information Technologies (IT) on the performance of banks in India.

This paper is divided into following sections. The first section presents a brief history of technological development in the banking sector in India. The second section discusses the areas where major technological upgradation has taken

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place. The third section deals with the methodology of the study and the major findings of the study. The fourth section contains the suggestions for improvement in productivity and conclusions.

Section 1

Technology is the sum total of different techniques by which man changes his environment. Information technology is the outcome of three C's—Computer, Communication and Customers. Technology in the banking sector particularly means computerisation or mechanisation. Since 1996 there have been several rounds of discussions between IBA and the various trade unions on the prospect of computerization of the banking system, though the trade unions insisted on the issues like workers' retrenchment and displacement of workers though need for such a change was felt in the developed countries as back as 1958 and many banks implemented policies directed towards implementation of new technologies. But due to nationalisation nothing tangible could be achieved. The need for first technology implementation was felt in 1980's when the banking sectors in the post-nationalisation period proved to be inefficient with respect to their profitability, collection of loans and advances to unproductive sectors, State of NPAs, Collection of deposits and borrowings and liquidity and financial management.

Several attempts have been made and a number of Committees have been formed in India to go into details of technology upgradation in the banks. In 1980 computer policy and Planning Department (CPPD) was set up to train the officers and executives in computer application programmes. Dighe Committee in 1981 suggested the use of computer in functional areas. A first blue print for computerisation and mechanisation in banking industry was drawn up in 1983-84 by Dr. Rangarajan Committee. The report was published in 1989 drawing up a perspective plan for computerisation. Later Vasudevan Committee was formed to suggest procedures for technological upgradation in the banking sector. Narasimham Committee (I & II) was formed for reforms in the banking sector. The Goporia Committee was formed to look into methods of improving Customer Service in banks and Central Vigilance Commission was set up of to look into the progress of computerisation in the banking sector.

Section 2

The purpose of computerisation for banking operation is four fold, viz.,

- i) Improving Customer Service;
- ii) Improving house keeping;
- iii) Improving decision making and
- iv) Improving Productivity and profitability of banks.

In order to satisfy and attract the customers and run the banking functions steadily and quickly the banks have introduced different technological tools. Such as Electronic Fund Transfer (EFT) Electronic Payment System (MICR technique), Indian Financial Network (INFINET), Electronic Clearing Service (ECS), Automated Teller Machines (ATMS), Plastic Money (ATM Card, Debit Card, Charge Card, Debt Card, Cash Card, Corporate Card, Prepaid Card, Gold Card, International Credit Card etc.), Swift (Society for world wide Inter-bank Financial Telecommunication) Swadhan (shared payment network system), Advanced Ledger Posting Machines (ALPM), CFMS, SFMS, LAN, WAN, PC etc.

Section 3

Increase in IT investment is one of the contributing factors for improved performance of the banks in India. The other contributing factors are higher labour productivity, general economic environment, managerial skills, better recovery etc. It would be very difficult to separate the contribution of IT from the contributions of other factors. However, it is possible to explore the linkages between IT investments and financial performance by studying trends and peer group comparisons. For this purpose total Indian banking system is categorised into four—Public Sector Banks (PSBs), Old Private Banks (OPBs), New Private banks (NPBs) and Foreign Banks (FBs).

Regarding usage of IT in banks the study divides banking organisation into Branch Automation and Business Automation. Branch Automation is related to Networked Branches, Fully Computerised Branches, ATM Branches, ALPM Branches, Internet Banking and Computer Literacy in Banks. Business Automation is related to automation of specialised Branches and a automation of functional areas at controlling offices.

Regarding the impact of computerisation the study has taken business vis-à-vis staff strength, business per employee (BPE), staff expenses as a percentage of total income, IT expenses as a percentage of other operating expenses and IT investment as a percentage of operating profit.

Usage of IT in banks: The business which is mostly affected by the use of IT is the banking business. The progress of IT usage in banks is reflected in the following Tables. The source of the Tables is Reserve Bank of India Bulletin (Board of Banking Supervision's Report).

(a) Branch Automation:

Networked Branches : As on March 31, 2000, all NPBs and FBs have gone for total networking of branches, the PSBs and OPBs are far behind and it is less than one percent in case of PSBs and OPBs.

ATM Branches : It is seen that NPBs and FBs have installed many ATM branches while PSBs and OPBs have been very slow in setting up the ATMs and thereby failing to serve high net worth customer and losing their profit margin. One thing should be noted that in the year 2000, FBs had highest percentages of branches with ATMs (Table 1).

Table 1 : ATM as percentage of Total Branches.

Bank Groups	1996	1997	1998	1999	2000
1	2	3	4	5	6
PSBS	0.11	0.24	0.38	0.49	0.80
OPBS	0.00	0.11	0.15	0.29	0.39
NPBS	89.19	87.67	91.53	89.01	95.90
FBS	14.74	55.10	72.28	90.91	113.83
All banks	0.21	0.49	0.76	1.00	1.54

Source :- RBI Bulletin Dec,2002, Report of the Department of Banking Supervision.

Fully Computerised Branches (FCs) : In respect of FC branches, FBs and NPBs are well ahead of the PSBs and OPBs, but during last five years the number is progressively increasing (Table 2).

Table 2 : Fully computerised branches as a % of total branches

Bank Groups	1996	1997	1998	1999	2000
1	2	3	4	5	6
PSBs	3.14	5.26	7.84	10.31	13.79
OPBs	8.38	12.01	16.60	23.78	30.74
NPBs	100.00	100.00	100.00	100.00	100.00
FBs	97.89	97.96	98.02	97.73	97.87
All banks	3.73	6.01	8.79	11.62	15.46

Source :- RBI Bulletin Dec,2002, Report of the Department of Banking Supervision.

Table 3 : ALPM branches as percentage total branches

Bank Groups	1996	1997	1998	1999	2000
1	2	3	4	5	6
PSBs	6.44	8.78	9.70	10.50	12.21
OPBs	8.77	10.03	10.57	10.35	12.48
FBs & NPBs	100	100	100	100	100
PSBs & OPBs	6.58	8.86	9.75	10.49	12.22

Source :- RBI Bulletin Dec,2002, Report of the Department of Banking Supervision.

- * **Advanced Ledger Posting Machines Branches (ALPM):** In this case also FBS and NPBS have well reached to the 100% destination while OPBs and PSBs are not sufficiently progressive (Table 3).
- * **Internet Banking :** This is a new business opportunity, which requires extensive use of secure technology. The enabling legal and regulatory environment is being created. At present only NPBs are active in this segment.
- * **Computer Literacy :** From the Tables 4 & 5 it is clearly seen that though PSBs and OPBs have gradually increased the number of computer literates employed during last five years, they are lying far behind FBs and NPBs. IT specialists also are employed in those banks for better remuneration.

Table 4 : Computer Literate Employees as percentage to total staff

Bank Groups	1996	1997	1998	1999	2000
1	2	3	4	5	6
PSBs	7.92	10.64	14.02	20.01	21.51
OPBs	11.62	16.14	21.37	28.63	34.03
NPBs	100.00	100.00	100.00	100.00	100.00
FBs	84.33	85.37	87.42	87.82	88.58
All banks	8.41	11.31	14.86	20.95	23.00

Source:- RBI Bulletin Dec,2002, Report of the Department of Banking Supervision.

Table 5 : IT specialists as percentage to total staff

Bank Groups	1996	1997	1998	1999	2000
1	2	3	4	5	6
PSBs	0.19	0.24	0.33	0.39	0.47
OPBs	0.52	0.55	0.81	1.20	1.50
NPBs	4.95	4.52	4.83	4.49	3.87
FBs	3.28	3.52	2.88	3.02	2.70
All banks	.22	0.27	0.37	0.45	0.55

Source :- RBI Bulletin Dec,2002, Report of the Department of Banking Supervision.

(b) Business Automation: Regarding business automation, none of the PSBs and OPBs have fully computerised their operations, whereas out of the 22 FBs covered, only six banks have not achieved full computerisation level as yet.

Impact of Computerisation : Before going into the study of impact of computerisation we should know about the areas where computerisation is being implemented. These areas are branch offices, service branches, regional/zonal offices and head offices. Computerisation of service operation has certainly contributed to the reduction in the reconciliation problems in the clearing operations. Similarly, the use of information technology at regional offices and head office levels has

sharpened, inter-alia, the MIS capability of banks thus contributing to overall efficiency in decision making mechanism. Computerisation of branches which directly interact with customers has contributed to higher customer satisfaction besides handling higher volume of business and reducing transaction costs. Thus, while it is very difficult to pinpoint as to how much of this improvement in financial performances is directly attributable to computerisation, it is possible to derive indirect linkages by assuring computerisation as one of the factors for improvement in efficiency.

Table 6 : Business (advance + deposits) vis-à-vis staff strength (per cent)

Bank Groups	1997	1998	1999	2000	2001	2002
1	2	3	4	5	6	7
PSBs	11.82 (-0.18)	18.06 (-0.27)	22.52 (-1.06)	16.93 (-1.38)	14.45 (-8.57)	12.22 (-4.98)
OPBs	21.61 (1.69)	21.85 (2.21)	23.05 (2.74)	18.53 (-0.97)	13.05 (-4.99)	11.29 (-2.60)
NPBs	98.45 (66.10)	92.61 (43.95)	17.79 (34.62)	52.65 (27.15)	31.04 (72.28)	23.80 (9.49)
FBs	17.82 (0.59)	3.68 (5.16)	13.56 (3.37)	7.34 (-8.73)	22.96 (0.31)	8.72 (-6.19)
All Banks	14.04 (0.06)	18.84 (0.09)	21.75 (-0.61)	17.68 (-1.30)	15.62 (-7.60)	12.53 (-4.64)

Source :- RBI Bulletin Dec,2002, Report of the Department of Banking Supervision.
(Figures in parentheses indicate percentage change in staff strength)

Business here means advances plus deposits. It is seen that the growth of the business has been decreased for all the banks comparing 1997 with 2002 except PSBs with certain variations in between 1997 and 2002. In case of NPBs the fall in business growth is noteworthy. All banks have decreased their staff strength except NPBs and with the exception of certain years from 1997 to 1999 for OPBs and FBs. The benefits of computerisation will certainly be the ability to generate high volume of business with low number of people. In this respect PSBs are showing the best performances.

Table 7 : Business per Employee

(Rs. in lakhs)

Bank Groups	1996	1997	1998	1999	2000	2001	2002	*CAGR (percent)
PSBs	65.66	73.30	86.26	101.92	120.17	158.12	180.74	19.03
OPBs	82.89	92.27	113.12	131.25	159.49	190.57	230.35	17.11
NPBs	499.53	834.23	901.36	761.91	893.90	642.45	720.86	6.49
FBs	492.22	337.88	437.10	464.81	519.82	714.93	880.24	9.24
All Banks	70.44	77.54	92.28	108.57	129.37	175.90	207.33	13.76

Source :- RBI Bulletin Dec,2002, Report of the Department of Banking Supervision.

*CAGR means Compounded Annual Growth Rate taking logs for different years.

Business per employee is simply derived dividing (Advances + Deposits) by the No. of employees. Table 7 represents that all banks have increased BPE with higher level of automation in different years. But in case of NPBs and FBs the rate is very high. From CAGR it is clear that PSBs and OPBs are well ahead in this direction.

Table 8 : Staff Expenses as a percentage of Total Income

Bank Group	1996	1997	1998	1999	2000	2001	2002
1	2	3	4	5	6	7	8
PSBs	20.76	19.06	18.62	18.90	18.00	20.30	16.43
OPBs	14.37	11.56	11.93	12.50	12.40	11.50	10.82
NPBs	7.20	2.56	2.58	2.90	3.00	3.30	4.40
FBs	9.91	10.86	7.69	9.40	8.40	8.30	8.73
All banks	19.83	17.94	17.28	18.90	18.00	20.30	14.53

Source :- RBI Bulletin Dec,2002, Report of the Department of Banking Supervision.

THE IMPACT OF TECHNOLOGICAL PROGRESS

From Table 8, it is seen that to maintain the same level of efficiency the banks have to reduce their staff strength in order to introduce higher level of computerisation. The ratio is declined for all bank groups but the decline is higher in case of PSBs and OPBs, because in case of FBs and NPBs the level of automation is already higher.

Table 9 : IT Expenses as percentage of other operating expenses

Bank Group	1996	1997	1998	1999	2000
1	2	3	4	5	6
PSBs	3.97	4.17	5.10	5.53	6.60
OPBs	4.23	4.01	2.52	3.93	5.13
NPBs	6.15	5.89	7.74	8.25	7.42
FBs	9.66	7.69	12.25	6.62	7.46

Source :- RBI Bulletin Dec,2002, Report of the Department of Banking Supervision.

From Table 9, it is represented that in terms of responses as percentage of other operating expenses all banks excepting the PSBs have maintained almost steady level of the ratio whereas in case of PSBs it has increased of considerably. IT expenses means depreciation on IT investment.

Table 10 : IT Investment as a percentage of Operating Profit

Bank Group	1995	1996	1997	1998	1999	CAGR in IT investments (percent)
1	1	3	4	5	6	7
PSBs	3.41	4.72	5.34	6.32	8.02	41.10
OPBs	4.59	5.91	4.10	3.92	6.99	18.44
NPBs	58.68	41.84	21.35	16.24	22.87	41.24
FBs	3.88	7.41	14.81	10.24	7.02	60.40
All Banks	3.84	5.39	6.23	6.92	8.35	41.40

Source:- RBI Bulletin Dec,2002, Report of the Department of Banking Supervision.

IT investment will be depended upon the amount of operating profit earned i.e. upon the operating cash flow. From Table 10, it is represented that PSBs and OPBs have increased IT investment during this period while, with respect to CAGR the progress of OPBs is very low in relation to others. So the reliance on IT by cutting down the employee strength is increasing.

Major findings:

- (i) On account of increased computerisation banking business is continuously increasing coupled with a reduction in staff since 1997 by handling higher volume of business and cutting down transaction cost.
- (ii) Considerable increase in business (Deposits + Advances) per employee for all bank groups has taken place with high growth rate for PSBs and OPBs than others though the formers are far behind in ranking.
- (iii) Reduction in staff expenses is directly related with the automation level of banks. This has been shown by the direct impact on PSBs in 2002 after introduction of VRS scheme for reducing one lakh employees during 2001.
- (iv) Banks have increased their IT investments substantially over a five year period. While they still spend less than 10% of the operating profit on it.

Section 4

Suggestion for improvement in productivity and for better comparison :

- (i) The PSBs are lagging from the viewpoint of clear cut goals of computerisation and there should be a definite time frame for implementation of computerisation in this banks .
- (ii) Since there is a time lag between IT investment and increase in efficiency/ productivity, PSBs and OPBs should go for increased connectivity with the banks.
- (iii) Other than direct IT-enabled-services the bank should look for the business like personal loans, housing loans, car loans etc. linking such services with computerisation to increase profitability.
- (iv) The banks should go for total branch automation (TBA) instead of going for partial automation.
- (v) PSBs and OPBs should improve computer literacy level by recruiting fresh blood and should go for outsourcing of IT where necessary. The excess staff not needed

immediately will have to be adjusted for another non-specialised functions or retained to be adjusted after death or retirement of existing staff through proper human resource management.

(vi) Small scale industry branches and agricultural finance should be given priority for automation to serve the customers of these sector in a better way.

(vii) Effective risk management system should be provided, security for computerisation and IT should be ensured, audit function should be effective and after all automation in the field of MIS and credit system should be ensured.

(viii) For better intersectoral comparison accomplishment of social objectives particularly in priority sector lending and mass banking should be given special weightage.

(ix) Environmental differences make the differences in productivity. FBs and NPBs are specially situated in the urban or metro areas where PSBs and OPBs have to cover both urban/metro and rural areas. So the methodologies for measuring productivity should efficiently be segmented; for example, foreign banks which are operating in metro/urban areas are to be compared only with metro/urban operations of other bank groups with similar technologies.

(x) There are two types of business: fund and non-fund. Business. Productivity in fund business makes no considerable difference among different banking sectors. But non-fund business productivity makes the differences in their performance.

Conclusions :

There is no-doubt that increase in IT investment makes a positive impact on the performance of banks. In recent years, PSBs and OPBs have enhanced their IT investment to improve efficiency and cut down costs. Many international studies show that there is a few years time lag between the time of automation and improvement in the financial performance.

For measuring productivity of banking operation, the conventional methods of funds business generated per rupee of establishment cost or per employee business volume cannot be relied upon, since the approach ignores the non-fund business generated by banking operations. It is not correct to base productivity comparison, or change thereof, on manpower alone. Business are generated by manpower used in

conjunction with materials including computers and premises etc. Hence the total operating cost should be the basis for productivity measurements and comparison. Last of all, the minimum amount of investment in IT that is Break Even Investment is a must to get the full benefit of computersation. Otherwise, the investment will be in vein.

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NETWORKS OF PROGRESS – TOWARDS A NEW INDIA

*Debashis Kundu **

Abstract

India is currently setting up a network of transport-systems that will criss-cross the country and carry a wide variety of items like freight, passengers, natural gas, electricity, voice, data, ships and even water. The transport-systems are expected to uniformly distribute all types of animate and inanimate resources all through the country in a cost and time-efficient manner. This efficiency is expected to translate into bigger outputs, greater productivity and optimal utilisation of resources leading to a substantial and sustainable economic growth for the country. An average GDP growth of 8% for the next fifteen years can eventually help India to join the developed country club by 2020.

1. Foreword

By the early 2002, the economic pundits were getting worried. The first and second generation economic reforms were not showing their expected results. The GDP (Gross Domestic Product) growth rate slowed considerably from the heady days of 1994-97 when GDP grew by around seven percent plus annually. India seemed to have lost her magic potential. When almost all hope was lost regarding India ever catching up with China, things began to change from late 2002 onwards. The quarterly growth rate started to take flight. All the sectors of the economy woke up simultaneously and pushed India's GDP figures close to that of China's. The accompanying table will highlight the fact better.

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TABLE 1
Growth in India's Real GDP (1995 to 2004) (in percentage)

Average	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
1996-2004										
5.9	7.6	7.5	5.0	5.8	6.7	5.4	3.9	5.0	7.0	8.5

[Source: Report on Currency and Finance 2003-04 and Past Issues, Reserve Bank of India; www.indiastat.com]

A lot of explanations have been given ever since on what is causing this economic rejuvenation and whether this trend will be sustainable or not. This paper seeks to add a new angle – the network-system angle - to India's growth story and argue the case for India becoming an economic superpower by the year 2020; as envisioned by our visionary president Dr. A.P.J. Abdul Kalam.

1.a The Question

The moot question that this article attempts to answer is – What is causing this Indian economic rejuvenation and will she be able to sustain this rejuvenation?

1.b The Answer

The fundamental reason that seems responsible for this economic growth is not the millions of dollars being put in by FIIs (Foreign Institutional Investors) or the thaw in India-Pakistan relations or even the strong agricultural growth seen in 2003-04. The real reason lies elsewhere. India, for the first time since the days of Sher Shah Suri, is starting to build upon its huge resource base – material resource, human resource and intellectual resource. And to extract the maximum mileage out of these resources she is building a network of channels that would link up the sources of raw materials and centers of production/processing with that of the market, located both inside and outside the country. This would at once serve two purposes – optimize the utilization of resources and propel the national economy towards greater prosperity. This has happened with the 'tiger' economies of South-East Asian countries during the eighties and nineties and is happening now in the case of China. The result is for everyone to see. So a proper, well-developed infrastructure helps a country to record sustainable economic growth.

The vast network of transport-systems that India proposes to build would cover the entire length and breadth of the country. This will help the country to tap resources located in any part of the country and bring them to areas where they can be processed and then consumed locally or exported. Also, resources not found in the country or are in short supply can be imported from outside and quickly distributed to the areas of production/consumption through these very networks.

2. Transport-Systems

The networks being put in place are the following:-

1. Road Network – Golden Quadrilateral project and the East West-North South Corridor → To provide point-to-point connection to any part of the country for low-volume goods and citizens.
2. Rail Network - Golden Quadrilateral project for the Railways → To move bulky and high-volume goods and a large number of passengers from one part of the country to another.
3. Natural Gas Network – “Blue Sky’ project by GAIL (Gas Authority of India Limited) To supply clean and efficient natural gas both to retail consumers and to industrial users.
4. Telecommunication Network – Projects of various government and private companies → To harness the intellectual capacity of Indians to export services and provide cheap voice and data communication to all Indians.
5. Electricity Network – Being set up by Powergrid Corporation → To maintain steady power supply to all parts of the country both during peak and off-peak hours.
6. Port Network – Project Sagarmala → To develop and grow international trade through the maritime route.
7. River Network (in planning stage) → To drain out excess water from one part of the country and channel it to the drier parts (especially during the monsoons).

2.1 Road Network

The most prominent of these various network-systems is the road-networking project. Roads are the only viable option to provide point-to-point connection to any part of the country. They help to bring in and take out goods and passengers from any location – be it in the plains, the mountains, the deserts, a village or a city.

It has been observed that almost 70% of India's domestic and foreign trade moves on these roads. If India grows at a rate of 7.5 % annually (in GDP terms), that would mean an increase in freight traffic exceeding 9 % annually. But lack of road-surface and the poor condition of the roads creates an artificial bottleneck in the road-transportation sector. The average productivity of a truck is 200 kms. a day as against 350-400 kms. that could be made possible through reduction of congestion.¹ The country as a result loses thousands of crores of rupees every year through lost opportunities.

India currently has around 3.3 million km. of roadways but only 65,569 km. of these are National Highways. The following table will show the break-up of various types of roads in India.

TABLE 2
Indian Road Network

Types	Length (In Km)
National Highways	65,569*
State Highways	1,31,899
Major District Roads	4,67,763
Village and Other Roads	26,50,000
Total Length	33 Lakh Kms(Approx)

[*National Highways are less than 2 % of network but carry 40% of total traffic]

[Source: National Highway Authorities of India (NHAI), 2004]

The country is now setting up two separate road networks – The Golden Quadrilateral (GQ) project and the East-West-North-South Corridor (EWNSC). The GQ project will link all the four metros and important cities and ports located close to them and cover a distance of 5,846 km. The EWNS Corridor, covering 7,300 km., will crisscross the country along its entire length and breadth and connect all the remaining Indian towns. The EWNS Corridor will connect Srinagar with Kanyakumari and Ahmedabad with Kohima. The total length of the roads will be more than 35,000 kms. The estimated cost of the project is Rs. 54,000 crores and is being implemented by National Highway Authorities of India (NHAI). The expected time required is 6 years i.e. till 2007. The requisite finances are being sourced as follows:-

Financial Sources for National Highway Development Project

Possible Sources	Rs.Cr. (On 1999 prices)	US\$ Billions (On 1999 prices)
Total Cost	Rs.54,000 Crores	US\$ 13.2 Billion
Cess on Petrol and Diesel	20,000	4.90
External assistance	20,000	4.90
Market borrowings	10,000	2.40
Private Sector Participation	4,000	1.00

[Source: National Highway Authorities of India, 2003]

The investments will be recovered through toll-tax. The roads are being built on a Built-Own-Operate-Transfer (BOOT) basis with an investment-recovery period of 30 years. Most of the roads thus being built are not brand new ones. They are just modifications and extensions of existing two-lane National Highways into four/six/eight-lane superhighways.

The government is contemplating the upgradation of an additional 34,000 km of national highways, as part of the existing National Highway Development Programme (NHDP). At present 20 percent of the national highways consist of one-lane roads. According to one estimate, the cost of converting two-lane highways into four-laned roads works out to around Rs. 4 crores/km while turning them into double-carriage roads is estimated to cost a little over Rs. 2 crores/km. The upgradation is expected to be taken up in two phases of 17,000 km each. While 14,000 km of highways are to be upgraded to four or six lanes under phase 1 and 2 of the NHDP, another 10,000 km will be upgraded under phase 3, better known as the Pradhan Mantri Bharat Jodo Pariyojana (name now changed). The phase 3 projects will be identified on the basis of traffic density and connectivity to centres of economic and tourist importance. The entire NHDP is to be executed by the NHAI.²

The ongoing projects will not only develop India's competitiveness in international trade by reducing the cost per unit of a product and thus save money, but will serve the country for the next twenty years or so taking into account the future traffic projections. The GQ project is expected to save over Rs. 8,000 crores solely on fuel and vehicle wear and tear costs. The benefits of speedy, safe movement of passengers and goods are additional. Also, it is expected to generate employment for over 5 lakh people everyday.

2.2 Rail Network

Indian Railways, starting its journey in 1853, is today one of the largest rail networks in the world under a single management. It is also the largest civilian employer in the whole world – employing over 16 lakh people. At present it is the world's fifth largest rail network, with route length of 63,518 km (2002) and carries more than 11 million passengers everyday. It has 300 storage and maintenance yards, 2,300 warehouses, 700 repair shops, 8,300 locomotives, 39,000 passenger coaches and about 350,000 freight wagons.³ In fact the Railways is the only proper network that India inherited from the British at the time of Independence in 1947. The British were able to rule the country and exploit its resources for their own benefit by using the Railways' speed and reach. The following table will give a sneak preview of the present rail network.

Table 4
Multi-gauge system of Indian Railways

Track	Broad Gauge (1676 mm)	Metre Gauge (1000 mm)	Narrow Gauge (762 / 610 mm)	Total
Kilometres	86,526	18,529	3,651	108,706
Route	Electrified	Total		
Kilometres	16,001	63,028		

[Source: <http://www.indianrail.gov.in/>]

At the present moment there is not much need to lay new lines but to develop the existing tracks to world-standards in terms of speed, safety and passenger-comfort. A project started by the Railways over the last few years to electrify the tracks, improve the safety system and to have a uniform broad gauge system. In fact India is the only country in the world having the largest network of broad-gauge track-system i.e. having a uniform track width of 1.67 metres. The project is called the Golden Quadrilateral Project for the Railways. Indian Railways has also planned to install 'anti-collision devices' on all trains by 2005 to prevent and reduce rail accidents.

Once completed, the project is expected to reduce the cost and time required

to travel, both for passengers and goods, and thus help to improve the efficiency of the national economy.

2.3 Natural Gas Network

India is the world's fastest growing economy after China. Her energy demand is huge. But except for a small percentage, she has to import the rest. Natural Gas is one such fuel. It is becoming the most preferred fuel the world over because it is cheap, eco-friendly and is found in sufficient quantities in many regions of the world. India currently produces around 67 million standard cubic meters of natural gas per day as against the demand potential of 151 million standard cubic meters per day (mmscmd). And the demand is likely to rise to 145 mmscmd by 2006-07 and to 225 mmscmd by 2011-12. Domestic production on the other hand is likely to increase only to 85 mmscmd by 2006-07 and 120 mmscmd by 2011-12. So India would need to import 60 mmscmd of gas from 2006-07 to meet its future demand.⁴

India has recently discovered substantial gas reserves off her eastern coast near Andhra Pradesh. But all this gas – imported or local – should be transported safely and cheaply to the user industries like power-generation, fertilizers, chemical companies apart from the households. So India requires a Gas Grid. India already has a network of pipelines. Gas Authority of India Limited (GAIL) owns and operates about 5,400 km of gas pipelines, while oil refining and retailing firms operate 6,600 km of pipelines to carry refined products and 4,000 km for crude oil.⁵ But in comparison to requirement, this is insufficient. So GAIL has formulated the Natural Gas Grid Development Plan (NGGDP) to lay 7,900 km. long pipeline network by 2007-08 at a cost of Rs. 12,000 crores, while state-run oil refining firms have planned to build 8,700 km of pipelines. GAIL and Reliance Industries have already started work. GAIL's pipes will link various domestic and cross border sources to the demand centres across the country. Reliance is also planning to lay 2,600 km. of pipelines to solve the transport problems.⁶ Work has also been started on three Liquefied Natural Gas (LNG) terminals to import gas over the next twenty years from the Middle-East. The effort of ONGC Limited should also be mentioned in this context. Its foreign subsidiary, ONGC Videsh Limited (OVL) has bought equity stakes in foreign oil and gas fields located in far-flung countries like Vietnam, Eastern Russia, Sudan and Myanmar. India is also working on a project to extract methane gas from her coal-mines. This is known as coal-bed methane (CBM) and is a very clean source

of fuel. This gas will also be supplied through this upcoming gas network. If all goes according to plan, India is well on its way to become energy-surplus by the year 2007.

The easy availability of such a clean fuel is expected to provide a big boost to India's growth rate. Also the damage to environment will be minimized due to low pollution caused by burning of natural gas.

2.4 Telecommunication Network

The most striking and promising network that is being built up across India is the tele-communication network. More specifically it is the optical-fibre backbone being set up by a private firm called Reliance Infocomm Limited which is expected to connect 600 cities across the country. The Railways, Powergrid and GAIL are also setting up communication networks along their railway tracks, electricity lines and gas pipelines respectively. However, they can offer their services only to a select group of institutional clients.

These networks have the power to transform India into an Information Superpower in the near future. All along we were talking of networks that will help the country to exploit her inanimate resources for the maximum commercial benefit of her citizens. But this broadband network seeks to exploit the manpower resources of the country and help her to become the "back-office of the world". The cost of the Reliance project is over Rs. 18,000 crores and the company hopes to make operating profit in the very first year of its operations. This shows the huge latent demand that exist in the country for affordable voice and data connectivity. Reliance has rightly judged the potential before anyone else and is set to reap the benefits of an expanding customer base. This network will also help to tap the huge pool of English-speaking educated workforce of India and help service the clients of global companies located in foreign countries. This will not only earn for India valuable foreign exchange, but also help to tackle her big unemployment problem. Already a number of multinational companies like General Electric, Pricewaterhouse Coopers have set up their global contact-centres in India and the Business Process Outsourcing (BPO) business is booming.

A new development that needs to be mentioned in this context is the acquisition of international telecom companies by Indian telecommunication companies. In 2003, Reliance purchased FLAG Telecom for \$165 million, VSNL purchased

Tyco Global for \$130 million while Bharti Telecom has set up I2I (a 8-terabit capacity submarine optical fibre connection) between India and Singapore. Thus today Indian companies own and operate much more international bandwidth than their domestic capacities.

2.5 Electricity Network

Modern lifestyle cannot function without electricity. Every modern gadget, be it for entertainment or for housework or office-work needs electricity to run. Hence the state of advancement of an economy is reflected by its per capita electricity consumption. The draft *National Electricity Policy*⁷ prepared by the Ministry of Power aims to achieve the following objectives:

- Access to Electricity - Available for all households in next five years,
- Availability of Power - Demand to be fully met by 2012. Energy and peaking shortages to be overcome and spinning reserve to be available,
- Supply of Reliable and Quality Power of international standards at reasonable rates to be achieved by 2012,
- Per capita consumption of electricity to be increased to over 1000 units by 2012,
- Minimum lifeline consumption of 1 unit/household/day.
- Protection of consumers' interests.

India, in spite of a huge installed power generating capacity, remains a power-starved country. The 16th Electric Power Survey (2000) had projected a peak demand of 1,57,107 MW and energy requirement of 9,75,222 MU (million units) by the year 2012. India needs to have over 1,00,000 MW of capacity addition during the period 2002-12 to meet this projected demand. But the State Electricity Boards (SEB) are almost bankrupt. This is because of the low plant load factor (PLF) at their power plants and the high incidence of power theft. And this results from the fact that power is not needed where it is produced and there is no grid available to evacuate that power to a place where it is needed most. So Powergrid Corporation of India (PGCIL) has started setting up High Voltage Direct Current (HVDC) power transmission lines all over the country. The goal is to have a national-level power grid by the year 2012. The proposed grid will be available to transfer 30,000 MW of power from one region to another. The cost envisaged for the Project is approximately Rs. 71,000 crores. The first phase of the project was accomplished with the completion

of 500 MW line at Sasaram connecting Eastern and Northern regions. The second phase ended with the commissioning of the 2000 MW Talcher-Kolar line connecting the Eastern and Southern regions. Though the work is far from over, yet we can already see the effects. The power-surplus states of West Bengal and Orissa are now selling power to the power-deficit states of Andhra Pradesh, Delhi, Uttar Pradesh etc. and are able to earn a neat sum in return. This helps to reduce the wastage of power, improve the efficiency of power plants and helps the SEBs to earn some cash. The day is not far off when every Indian home and factory will have uninterrupted power supply at a reasonable cost.

2.6 Port Network

India has nearly 6000 km. of coastline and about 163 ports. Twelve of these are Major Ports which are under the regulatory authority of the Central Government. The remaining are other ports, commonly known as intermediate and minor ports, and come under the administrative control of the respective State Governments. In addition, 32 ports cater to the needs of the islands of Andaman and Lakshadweep. The following table will show the port-wise details of traffic handled in 2001-02 and also the projected traffic for the year 2006-07.

TABLE 5
Current Goods traffic and Projected Traffic handled by the major ports (in million tonnes)

Ports	Traffic Handled in 2001-02	Projected Traffic in 2006-07
Kolkata	30.40	54.80
Mumbai	26.43	30.40
JawaharLal Nehru	22.52	34.50
Chennai	36.12	40.00
Cochin	12.06	17.20
Vizag	44.34	60.00
Kandla	37.73	51.00
Mormugao	22.93	26.30
Paradip	21.13	28.90
New mangalore	17.51	32.70
Tuticorin	13.02	18.70
Ennore	3.40	20.50
Total	287.59	415.00

[Source: Lok Sabha Starred Question No. 311, dated 11.12.2002; www.indiastat.com]

The ports are facing severe congestion. The utilisation rate is over 100% as compared to international norms of 60% to 65% and this leads to long waiting time which actually discourages established shipping lines from coming to Indian ports.⁸ So developments of ports are required if India wants to boost up her international trade and handle 415 million tones of projected cargo by 2006-07. Hence the network-system envisaged by the NDA Government for ports in August 2003 was known as Project Sagarmala.⁹ However it has been renamed as National Maritime Development Programme (NMDP). As the name suggests, it is a network of major, medium and minor ports to be developed all along the coastline of India. A lot of these ports already exist, but what is needed now is to upgrade these facilities and capacities and provide connectivity with their respective hinterland. The project will also look at the development of inland and coastal shipping, shipbuilding and international shipping. The estimated cost for each aspect of the project is being given below: -¹⁰

	<u>Rs. in crores</u>
Port Sector	54,900
International Shipping	15,000
Shipbuilding and ship-repair	10,000
Inland water transport	16,000
Coastal shipping	10,000
Maritime training	2,000
Aids to navigation	<u>1,360</u>
	<u>109,260</u>

The project is expected to take ten years to complete. In its revised format, the project will be implemented in phases through private-public partnership programmes. The money will be raised through private investment, by a cess of 5 paise/kg of cargo handled at the existing ports and government grants. India sits at a vital position in the world maritime map. Her shipping routes link the Americas, the Far-East and South-East Asia with Africa, Middle-East and Europe. Hence the development of our own maritime interest will help us not only to participate effectively in this sector but also serve foreign companies doing business in the Indian Ocean Region.

2.7 River Network

India is a land blessed with rivers, mountains, plains, seas and oceans. Every year, the South-West monsoon dutifully arrives over the parched landscape and pours water generously. With so much water around, Indians should be literally drowning in water. Yet we hear recurrent news of drought, crop-failures and suicides by farmers. The root cause is uneven distribution of water. Parts of the country receive excessive rains which are then washed off to the ocean, while the other parts remain bone dry. In order to correct this anomaly, the government is toying with the idea of joining all the major rivers of the country and channel excess water from one part to the other. The project is slated to be completed by the year 2016. A task force working under the National Water Development Agency (NWDA) has already identified 30 major links distributed into two major components – the Himalayan component having 14 links and the Peninsular component having 16 links. The Indian Institute of Management, Ahmedabad has been assigned the task of evolving an organisational structure for the implementation of the project, considering the time-frame, quantum of works, execution and available best possible returns.

The project is audacious to say the least. The impact on India's ecology and geography is unknown. Then there are issues like that of technical feasibility, international water-sharing agreements, cooperation of state governments etc. to take care of. If it is proved beyond doubt that the project will be able to supply water to all of India's industries, cities and fields; India will have to do that in her supreme national interest. If and when the project starts, it will take at least fifteen years and more than Rs.1,00,000 crores to achieve the goal. A number of feasibility studies have been done and initial work may start in the near future. Like all the other networks, this river-network promises to enliven the future of India.

3. The Conclusion

India was one of the most advanced economies during the ancient and medieval periods. Our arts, culture, science and business were far too robust than that of the western civilizations. But modern age brought bad luck for the country. She was colonized and plundered for hundreds of years. But Independence in 1947 at last broke her shackles. And post 1991, she has embarked upon a new growth trajectory to make up for lost time. The work on various networks of road, rail, electricity, etc. will now attempt to harness her enormous resources and make her strong and pros-

perous. And by the words of our President Dr. A.P.J. Abdul Kalam, India is poised to join the league of developed nations by the year 2020. The construction of these network-systems is a step in that direction. So the day is not far off when the words of our national poet Rabindranath Tagore will come true; -

“Bharat Abar Jagat Sabhay Shrestha Asana Labey”

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Communication

ACCOUNTING STANDARD - AN INSIGHT

*Rudrajit Raychaudhuri**

The paradigm shift in the economic environment in India during last few years has led to increasing being devoted to Accounting Standard as a means towards ensuring potent and transparent financial reporting by Corporates. Accounting Standards sought to make uniform business language to protect the interest of international investors.

The world of finance is changing very fast. World has become a global village. Key forces responsible for changes are development of new technologies, innovation of financial instruments and the growth of financial linkages globally. Giant corporates are growingly allowed to take over corporates of other countries. Unless the accounts are prepared on same principles and policies investors cannot make critical analysis of financial statements and annual accounts of the corporates of other countries. Hence arises the need of introduction and imposition of Accounting Standards with the purpose of harmonization of accounts.

The objective of Accounting Standards is, therefore, to reduce the accounting alternatives in the preparation of financial statements within the bounds of rationality, thereby ensuring comparability of financial statements of different enterprises with a view to providing meaningful information to various users of financial statements to enable them to make informed economic decision.

The Companies Act, 1956, as well as many other statutes in India require that the financial statements of an enterprise should give a true and fair view of its financial position and working results. The requirement is implicit even in the absence of a specific statutory provision to that effect. The Accounting Standards are issued by the Institute of Chartered Accountants of India with a view to describing the accounting principles and the method of applying these principles in the preparation and presentation of financial statements so that they give a true and fair view. The Accounting Standards not only prescribe appropriate accounting treatment of

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complex business transactions but also foster greater transparency and market discipline. Accounting Standards also help the regulatory agencies in bench marking the accounting accuracy.

The cross-border transfer of Capital are becoming increasingly common that have forced the setting of AS. After the adoption of liberalisation and globalisation as the corner stones of Indian economic policies in early 90s and the growing concern about the need of effective corporate governance, of late, the Accounting Standards have increasingly assumed importance.

At present 42 Accounting Standards are in force issued by IASC on the basis of International Accounting Standards. So far, 28 India Accounting Standards have been issued; some of the most important ones are -

AS 1	...	Disclosure of Accounting Policies
AS 2	...	Valuation of Inventories
AS 3	...	Cash Flow Statement
AS 6	...	Depreciation Accounting
AS 9	...	Revenue Recognition
AS 13	...	Accounting for Investment
AS 14	...	Amalgamation
AS 15	...	Retirement Benefits to Employees

ICAI is responsible for making and issuance of AS. These have legal recognition through an amendment in the Companies Act, 1956 whereby every company is required to report whether the provisions of ASs have been complied with or not. Also, Insurance Regulatory & Development Authority is required to follow AS. Recently, SEBI has added a new clause that listed companies shall mandatory comply with AS.

Section 211 of the Companies Act, 1956 deals with form and contents of Balance Sheet and Profit & Loss Account. Amendment of the Act in 1999 has inserted new sub-section 3A, 3B & 3C to Sec. 211 with a view to ensuring that financial statement are prepared in accordance with AS.

Section 211 (3A) requires every Profit & Loss Account and Balance Sheet to comply with AS.

Section 211 (3B), the companies not following the ASs shall have to disclose in notes to Profit & Loss Account and Balance Sheet the following:

- (a) deviation from AS;

- (b) reasons for such deviation;
- (c) financial effect arising due to such deviation

National Advisor Committee in AS has been constituted u/s 210A to advise Central Government about formulation of AS.

BY sub-section 2AA of sec. 217, Board's Report should include Director's Statement as to AS.

But on the other side, the saddest part of the whole thing is: in spite of strict rule-based Accounting Standards in existence in USA for over a long time, serious impropriety happened in Enron, World.COM, Arthur Anderson, leading to demolition of one of the biggest audit firms. On the other part of the world, in India, Accounting standard is evolving and still things went wrong in UTI.

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