PUBLIC ENTERPRISES AND CORPORATE GOVERNANCE

MPA SEMESTER IV

PAPER : PUBLIC ENTERPRISES AND CORPORATE GOVERNANCE

UNIT IV

TOPIC COVERED : PRICING POLICY OF PUBLIC ENTERPRISES

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Pricing Policies of Public Enterprises

Pricing is a controversial and difficult subject. It is not possible to lay down a general prescription about the price policy of PEs. The nature of different enterprises vary greatly: some are industrial and trading, some are developmental and promotional, and some others are either basic or provide essential services. Much also depends upon the competitive environment, domestic and international, in which an enterprise. In monopoly or near monopoly conditions, and with a less exacting financial discipline, PEs may have higher cost which is passed on to the consumer.

Need and Importance of Pricing Policy

The need is to ensure that PES keep their cost of operations at the lowest. Surplus labour and low productivity is characteristic of our PEs.

Extra cost are often passed on to the consumer because of following :-

(i) amenities over and above those prescribed by the law,

(ii) excessive inventories,

(iii) neglected and unsystematic maintenance,

(iv) under-utilisation of capacity, and

(v) low level of overall managerial efficiency

It should be ensured that PEs prices do not contain an unnecessarily large element of inefficient use of resources. Similar control should, of course, be applied on private enterprises which claim immunity on the facile and doubtful assumption of competition taking care of this aspect. It is stated that an ideal price policy should help in promoting a rational allocation of resources and thus accelerate balanced growth of the economy.

Difference between Price Determination in Public and Private Enterprises

1. Public Control
2. Market Condition
3. Effected by the Business Objectives
4. Tax Element in Prices

Characteristics of Public Enterprises Price Policy

Characteristics of Price Policies of Public Enterprises are as follows:

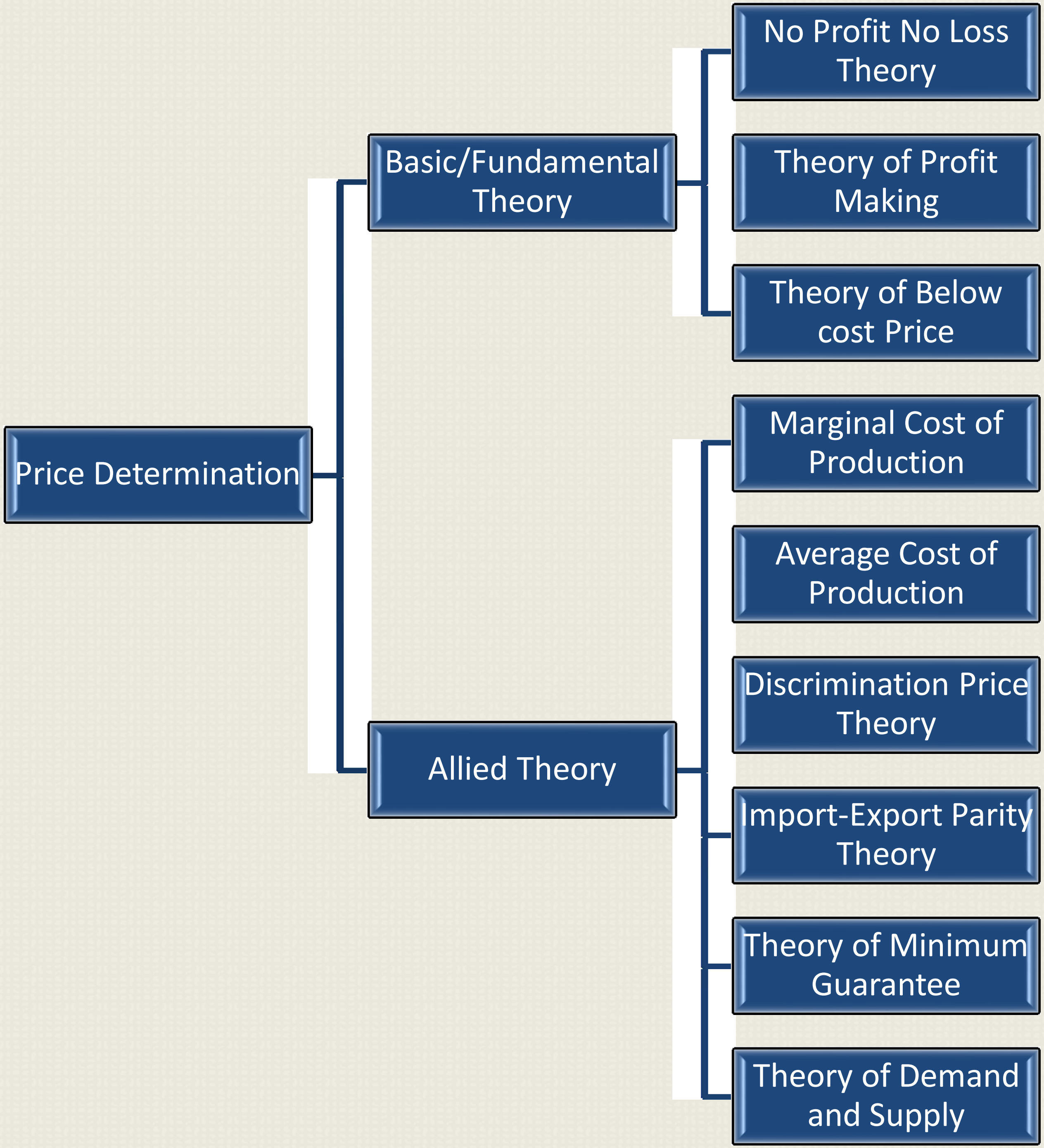
1. Objective of Public Enterprises
2. Monopolistic Position of Public Enterprises
3. Ownership
4. Nationalisation of Industries
5. Relationship with National Budget
6. Public Interest

Theories of Price Determination in Public Enterprise

Price Policy of Public Enterprises are directly linked with the welfare of consumer hence Price Policies should be very well thought. For the same many economist have suggested various principles of the Price Determination.

These principles are classified in two broad categories:

1. **Basic Theory of Price Determination**
2. **Allied Theory of Price Determination**


Price Determination
Basic/Fundamental Theory
No Profit No Loss Theory
Theory of Profit Making
Theory of Below cost Price
Allied Theory
Marginal Cost of Production
Average Cost of Production
Discrimination Price Theory
Import-Export Parity Theory
Theory of Minimum Guarantee
Theory of Demand and Supply

Basic Theories

a) No Profit No Loss Theory

According to many economists in long term Public enterprise should try to equate its expenditure and income. For this the PEs should follow two rules:

i. After meeting its capital expenditure PEs should not earn any profit or loss
ii. The entire price it charges for different should correspond to relative cost.

It will help in achieving two different aspects:

i. Above mention rules are helpful in checking Inflation as well as deflation.
ii. It also prevents unwanted expansion of PEs.

Basic Theories…

b) Theory of Profit Making

Theory of Profit Making is always a controversial for determining the price of goods and service produced by the PEs. But in developing country like India, a country of mixed economy, if we follow the no profit no loss concept then we are unable to lay down the measure of performance of PEs and if we follow the no profit no loss concept it will hamper the mixed economy in the socialistic society.

c) Theory of Below cost Price

In order to serve the public interest it is essential to operate few PEs for the economic development of the Nation. It is expected from these type of PEs that they should charge less then the relative cost of the goods and service produced by them for fixed tenure. The main objective is to promote the utilization of the goods and services in that fixed tenure. Example of such PEs is Water Supply Service, Electricity Production and Irrigation projects.

Allied Theories…

a) Marginal Cost of Production

This principle was first used by the Prof. Hotelling. According to him for price determination PEs should consider the marginal cost of the goods and services produced by that particular PEs this will help in promoting the maximum utilization the goods and service produced. This principle is not considered as useful for the price determination of the Indians PEs.

i. In India different kind of goods and services are produced by the PEs and hence determination of marginal cost is not feasible.
ii. PEs where a large no of goods and services are the produced, the marginal cost automatically tends to zero. Hence in this case determining marginal cost become irrelevant.
iii. In this principle marginal cost is not calculated at fixed price.
iv. All those places where means of production cannot be differentiated the principle of marginal cost is inapplicable.

Allied Theories…

b) Average Cost of Production

S. S. Khera, had propounded the principle of Average Cost of Production. According to him the concept of price being equal to average cost is more valid as a price theory for developing country like India. But it is very difficult to implement as it is very difficult to determine the average cost and element of time is also plays a very important role in price determination. Hence price should be fixed according to current price cost and capital cost.

c) Discrimination Price Theory

According to this principle the price is charged to consumers and different sector for the same goods and services. By this discrimination government promote the appropriation and demote the consumption of the particular goods and service. Eg. Coal, mineral oil, electricity and rail fair of different coaches.

Allied Theories…

d) Import-Export Parity Theory

According to theory of imported parity the price of the goods and service produced by the PEs should be equal to a price if we import the same goods and service. This principle is used in such sectors where competitiveness is important. Challenges in applying this principle

- How to decide the base price if we import the same goods/ services from more than one country.
- International Exchange rate also not stagnant.
- Imported item includes cost of import, transportation and insurance which makes it calculation very complex.

Allied Theories…

e) Theory of Minimum Guarantee

For determination of cost PEs follows Theory of Minimum Guarantee or Theory of Two Party Tariff. According to this theory up to a certain level for a goods and services the minimum price is determined and after the certain level price will be determine per unit basis. This type of price policy ensure the minimum revenue for the PEs. Eg. Telephone Sector, Electricity, Water Supply ect.

f) Theory of Demand and Supply

This theory can also be used for goods and services produced by the PEs. In this government decide the price to ensure the balance between the demand and supply of the goods and services. This can be done by following methods:-

- Price Control
- Tax Element in Price

Conclusion

The conditions under which PEs operate and the tasks assigned to them are so varied that no single rule of price setting could be applicable to them. There must inevitably be a variety of methods of price fixation commensurate with the need and requirement of each PEN or a homogeneous group of PEs.

It is also necessary to have a clear enunciation of policy to provide adequate guidance to PEs in price fixation. With the increasing emphasis on market economy, price regulation is gradually becoming out of date. The government policy is also against subsidised price of any product or service. Even for monopoly items, the emphasis is on international competitiveness.

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