Manufacturing Public Enterprises in Ethiopia

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While Ethiopia already had important public enterprises before 1974, after the revolution it amassed a much larger number and variety of public undertakings. The administrative structure which would oversee and control this sudden boom was created essentially from scratch. In this paper we first consider some of the legal aspects of public enterprise. Then we examine the structure of controls on state enterprises, including accounting and auditing practices. Finally we examine the performance of a set of manufacturing firms. We relate negative trends in their behaviour to weaknesses in the administrative mechanisms which govern them.

The paper analyzes the financial statement of several manufacturing public enterprises. The firms exhibit very heavy borrowing, declining liquidity, sluggish inventory turnover, modest profitability, and a short term orientation. On almost every indicator and for every firm, there is a strong negative trend. Possible explanations are suggested which relate the firms' regarding finance and operations to the regulatory and ownership framework within which they function.

1. History and Legal Aspects of Public Enterprise in Ethiopia

Public enterprises began in Ethiopia during the rule of Emperor Menelik II, around 1908. They were used in strategic sectors such as posts and telegraph, armaments and publishing, and helped the large expansion and consolidation of centralized administration which occurred during his rule. The Italians created more enterprises, for similar purposes.

The first modern comprehensive law regulating trade and business organizations was the Commercial Code of 1960. Many share companies, including publicly owned ones, started up immediately after its passage. They included Ethiopia Airlines, Ethiopian Shipping Lines and the Commercial Bank of Ethiopia.

Public enterprises multiplied in unprecedented numbers in the period following the popular Revolution of Ethiopia, from September, 1974 onwards. Three proclamations especially accelerated the proliferation of public enterprises:

(1) the Government Ownership of the Means of Production and Distribution, Proclamation No. 26/1975;

(2) the Public Ownership of Rural Lands, Proclamation No. 31/1975; and

(3) the Government Ownership of Urban Lands and Extra Houses, Proclamation No 47/1975.

The first proclamation specified that some business activities (construction, transport & publishing) were to be undertaken exclusively by government. Others would be undertaken in joint ventures between government and foreign capital, while yet others (especially

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commerce and trade) would be the domain of the private sector. Private investment was limited by ceilings on capital investments, with differential ceilings between commerce and industry as well as between individuals, cooperatives and business organizations.

The immediate effect of this law was that all business in sectors designated for government were immediately nationalized. Only government could set up new business in those sectors. It was necessary to establish government institutions to manage the now public firms in the newly monopolized field. Under the nationalization decree of 1975, the Revolutionary Government took direct control of 72 private firms, and became principal shareholder in 20 other companies. By 1984, there were 198 public establishments in the manufacturing sector alone.[1] At present there exist 416 industrial establishments with 10 or more workers. Of these, 187 are state-owned and account for 90 percent of the overall output and 80 percent of employment in the organized sector.

The second proclamation also resulted in the creation of several public enterprises. Private large scale farms were abolished. State farms filled the vacuum, under enterprises such as the Upper Awash Valley Agricultural Development Corporation., Houses nationalized under the third proclamation were organized under a new public enterprise created to manage them.

Before the revolution, some public enterprises were created under the commercial code. After the revolution, all public enterprises have been created by statute. Pre-existing companies were changed into statutory public enterprises by proclamation and legal notices. There exist, however, enterprises which have *de factor* existence only. They are not departments of ministries. They have not been established by any statute, nor registered in accordance with the law which governs private business organizations. However, they borrow money from banks; they employ workers; they sue and are sued; thus they show the characteristics of legal "personality". Most of the enterprises under the Ministry of State Farms Development have this murky legal status.

The phrase "public enterprise" appeared first in Ethiopian law in 1975, and was defined in the "Public Enterprises Proclamation No. 20/1975". The Minister of Natural Resources Development (MNTD) was given the power "to establish public enterprises to engage in agricultural; industrial; commercial; public service; hotel; tourist service and mining activities; confer juridical personality on and define the objectives and functions of such enterprises". Other laws have followed this one, including the Public Enterprises Regulation No 5/1975 and the Regulation and Coordination of Public Financial Operations Proclamation No 163/1979.

Under the various laws which govern public enterprises, there is ambiguity regarding the nomenclature and hence the governance of sate enterprise. Under the Public Enterprises Proclamation only those undertakings established by regulations issued pursuant to it are said to be public enterprises. However, according to the Regulation and Coordination of the Public Financial Operations Proclamation No. 163/1979, a public enterprise is any state owned business undertaking which is "designated as such", by the Minister of Finance. This implies that plants; factories or farms which are branches of what the Public Enterprises Proclamation calls "public enterprises" could themselves be designated as "public enterprises".

The nationalized enterprises were at first all put under the aegis of a newly established Ministry of National Resource and Development. Prior to the revolution, this organization was known as the National Resources Development Agency, the first development corporation established. During its life as a development agency, it did not accomplish much. Neither did its successor, the MNRD.

The MNRD, in its attempt to administer the enterprises under its supervision and rationalize their operation, tried to establish new organizational structures. It formulated various *ad hoc* accounting polices and procedures, prescribed uniform authority and responsibility for all enterprise managers, department heads, accountants, and purchasers. It tried to introduce "workers' councils" to replace governing executive boards of enterprises in line with the new thinking of "the rule of the proletariat", to make the enterprises belong to the workers. However, this was not carried through because workers showed more concern with issues of securing their rights and benefits rather than management of the enterprise. There were occasions when workers not only overruled managers' decisions, but took action against managers by imprisoning them in the plant and sanctioned them by either fining them or cutting their salaries. This intimidation of managers seriously compromised their capacity to manage the enterprises.

The MNRD was too constraining for enterprise management and caused lower productivity. There were too many hierarchies of rules and regulations. The Ministry itself became too big, having under its command enterprises from every sector of the economy. It was too bureaucratic; its head office tried to control the field activity of plants, with little or no understanding of operations at the plant level. The MNRD ran into problems and conflicts with other ministries. Its rule and functions became cumbersome and controversial.

The MNRD was soon dissolved, and each enterprise was assigned to a parent ministry or supervising authority which has direct sectoral concerns. In 1976 the Ministry of Industry was established to control and manage the nationalized industrial firms which it took over from MNRD, as well as other industrial enterprises which were established subsequently. Other ministries like the Ministry of Domestic Trade, the Ministry of Foreign Trade, and the Ministry of Health took over the supervision and control of enterprises in their sectors.

The sectoral organization of the enterprises led to at least three hierarchical levels of management. The office of the National Committee for Central Planning (ONCCP) gives policies and directives to ministries. Each corporation reports to a ministry or a supervising authority, which in turn reports to the ONCCP. Enterprises (or plants) report to corporations. Some enterprises (plants) report directly to a ministry or supervising authority, instead of corporation.

Within this pyramidal structure, however, there is confusion between the accounting entity, the legal entity responsible for taxation, and the economic entity responsible for planning. The level of the financial accounting unit and the economic decision unit may not necessarily be the same as the level of the legal tax-paying unit. It is not clear whether the corporation or the enterprise is the legal entity. Initially, the corporation was recognized as the legal and

tax-paying unit, but later the enterprise became the operating entity and the tax-paying unit. This ensured maximum return of surplus from enterprises, thus exerting more stringent budgetary pressure on public enterprises. The effect of this has been progressive deterioration in the financial condition of the industrial sector. During the period 1980-87, surpluses totaling Birr 585 million were payable to government, although losses exceeded retained earnings by Birr 315,000.

For accounting purposes, it is important whether the corporation and the enterprise relationship is to be seen as out of a parent or of a subsidiary, a holding company, or head office to a branch. Some nationalized companies' legal status was not certain until the corporations to which they belong were established. It was not until August, 1979, for example, that various nationalized insurance corporations were declared branches of one National Insurance Corporation thus making it one tax paying entity

Guidance and Control of State Enterprises

Enterprises are subject to several different kinds of controls. They participate in planning. The prices which public enterprises can charge for their products are heavily influenced by government. They receive many directives and guidelines on accounting procedures.

Planning

Since the establishment of the Central Planning Supreme Council, later on the NCCP, public enterprises are supposed to prepare and submit their plans and annual budgets for approval. Until the early eighties corporations were left to prepare their plans and budgets on what they thought was their capacity profile. These budgets were prepared in varied manner depending on past (pre-nationalization) experience of the enterprises and available manpower. With the issuance of Proclamation 163/1979, attempts were made to introduce better discipline in planning and budget preparation with much more uniform procedures and formats in the form of production plans, purchase and manpower requirements interpreted into a financial plan, and a budget. Successful implementation of such discipline was not easy in the face of shortages of manpower and expertise. It was also believed that corporations routinely underestimated their capacity in planning.

At present corporations negotiate annual plans and budgets with ONCCP. The ONCCP sends to corporations physical production targets based on this macro plan. In turn corporations using bottom-up techniques to come with adjusted achievable targets which they consider more or less as their competence profile. The targets are negotiated with ONCCP in meetings similar to budget hearings, and approved. Announcements are made internally and quotas distributed to plants to be adhered to and achieved with "a socialist competition emulation". Agitation campaigns are undertaken to overfulfill these quotas. Thus production becomes a fetish without much regard for cost or machine and equipment life and safety and long run befits. Annual prizes are awarded to plants and corporations which overfulfil their quota. Enterprises are supposed to submit quarterly reports on the fulfilment of their plants to the ONCCP through the corporations.

Finance and Disposition of surplus

There are two main sources of finance available for any enterprise, debt and equity. In Ethiopia the distinction between debt and equity is blurred, because of the use of "capital charges". According to Article 10 of proclamation 163/1979, capital charges are to be computed at the rate of 5 percent of the state capital plus the general reserves balance of the previous fiscal year and are payable to the government within seven months following the end of the fiscal year. Capital charges are due irrespective of enterprise performance, and some enterprises actually borrow funds from banks to meet these obligations. Capital charges are deductible for tax purposes.

Equity can be increased by new investment or via internally generated funds, but the latter is usually not available to public enterprises in Ethiopia. The surplus of public enterprises is siphoned away, first in the form of capital charges. Next corporate income taxes are due: they are payable by enterprises, not by corporations, so losses by one unit cannot be used to reduce taxes payable by other subsidiaries of the corporation. If an enterprise has any surplus after capital charges and taxes, it may retain 10 percent of it towards reserves, but only until general reserves reach a ceiling of 30 percent of state capital. Any remaining surplus must be paid to the government within 7 months of the end of the fiscal year. Legally, reserves retained can be utilized only for certain purposes: increasing working capital, amortizing debt, better utilization of existing facilities, and covering losses.

In view of the above, any new equity capital must then come from the government budget, if it comes at all. Such new equity funds, however, have not been readily available, because the government budget has been too constrained to fund all those projects deemed desirable. Thus the easiest way for public enterprises to meet their need for funds is through debt, short or long term. Banks do not subject public enterprises to as strict scrutiny and screening as do private enterprises, since they are part of the state. Borrowing by public corporations carried an implicit guarantee, in as much as the banking system is entirely state owned. Furthermore, the public corporations are usually the major depositors of the bank. Nominally the Minister of Industry has authority to approve borrowing, but lately the ministry seems only to be involved in large long-term loans.

Pricing

There is no central price control agency, although there is some talk of establishing one. This does not mean that enterprises or corporations set their own prices. The price at which corporations are expected to sell is subject to final approval by the ONCCP and eventually by the council of Ministers, and is usually dealt with in conjunction with the approval of the annual budget of the corporations, or at extraordinary sessions. The ONCCP has been opposed to any price changes in general. Most of the corporations transfer their products to the Ethiopian Domestic Distribution Corporation, or to some other state agency. This is perhaps the reason why some enterprises find it futile to determine their cost. They consider it their role to produce, and the government's role to subsidize the cost.

Keeping prices constant or with little change in spite of rising production costs, especially in terms of inputs that require foreign exchange, has not been without its consequences. On the one hand it has meant the government has to subsidize these costs. This has led the government to put a ban on all imports except on essential materials of production for factories, which has led to harsh foreign exchange allocation and control. Extensive production difficulties are witnessed in manufacturing enterprises with aging or non-functioning plant and equipment, resulting in poor quality products. The effect has also been visible in shortages of various products which are available only under or behind the counter at prices higher than the official ones. This has led to prosecution of many offenders, but to no avail. The long queue of customers visible in government stores for Ethiopian manufactured goods and the involvement of a number of enterprise workers in selling goods to private retailers for substantially higher prices are the resultant effects. The official rate of inflation given by the Central Statistics Office for the Retail Price Index is 10 percent, but this is obviously an underestimate.

Accounting Practices

The state of accounting practices and procedures varies considerably between enterprises. There is no central authority to issue uniform accounting standards, control procedures, and reporting guidelines. Instead, many organizations have direct or indirect responsibility for the control of finance operations of the state enterprises. These are:

(a) The Office of the National Committee for Central Planning (ONCCP)
(b) The Ministry of Finance-through the Budget, Treasury, Inland Revenue
(c) The Auditor General
(d) The Working People's Control Committee
(e) The Supervising Authority
(f) The Audit Services Corporation

However, the extent to which the various guidelines have been implemented is very doubtful. Some firms say in their mandatory report to the ONCCP on annual plan accomplishments that they are implementing them gradually and are now putting into practice 50-60 percent of the guidelines. Some are still using the pre-nationalization manuals with some amendments. Others are revising their post-revolutionary guidelines and manuals for the second and third time. There are still some who do not have well prepared financial guidelines.

Each ministry or supervising authority issues its own accounting guidelines. Enterprises often find difficulties in implementing them, so they develop their own guidelines instead. There is too much emphasis on authorization procedures. The guidelines do not ensure that information needed for decision making is available. The information provided is not amenable to protection and control of fixed assets, not for analyzing efficiency and profitability.

Accounting definitions are not uniform between enterprises, which makes their accounts non-comparable. For example, in some firms fixed assets are defined as those with a life of over one year. In other firms, they are defined as assets whose value exceeds a fixed amount, and the amount varies between firms. In some firms the amount is fixed as low as Birr 50 (about US$ 25), which leads to an overstatement of assets and an understatement of periodic expenses. Given the limitations of depreciation policies in Ethiopia, this leads to serious overstatement of profit in some enterprises.

Various anomalies in accounting practices persist, and distort the use of the financial information which is available. For example, guidelines regarding loss on foreign exchange, bad debt, inventory valuation, and extraordinary items are all unclear. Different forms treat them differently, not necessarily disclosing the exact practice followed. The result is that profit is measured differently be different firms.

Net profit is disposed of through capital charges, taxes, reserves and residual surplus, whose treatment as expenses, or as return on equity is unclear. Proclamation 163/1979 permits capital charges to be tax-deductible expenses. Some organizations treat it as payable on the balance sheet, while others do not. Reductions in property taxes, and waivers and exemptions of capital charges, lead organizations to teat them as part of surplus (reserves) or part of equity and not as liability at times.

Straightline depreciation is almost always used, with fixed by legal notice. However, some enterprises have assets not covered by the rules, so they introduce their own rates adopted from international guidelines. The different rates are used not only for internal purposes, but also for tax purposes. Few enterprises in Ethiopia distinguish between accounting methods used for financial reporting or tax reporting purposes.

A survey of public enterprises was not possible because of bureaucratic and administrative hurdles and the desire to keep activity of public enterprises a state secret. Instead, in depth case studies of 5 corporations were made, and various state enterprise reports were used to arrive at the present findings on accounting practices.

Most accounting manpower is devoted to processing primary source documents such as receipts, invoices, purchase orders, vouchers, etc. Little manpower remains for posting, closing, adjusting,and summarization of accounts. In some organizations, recording to books of final entry is done while the customer is waiting. For example, in one enterprise, recording of receipts slips into the subsidiary ledger cards is done from the customer's copy while the customer is waiting. One can imagine the plight of the customer as he is asked to go from window to window before he obtains his receipt, so that bookkeeping clerks do their recording, analysis and posting, including post referencing. Besides inconveniencing customers, such procedures thwart the purpose of internal accounting control-seperation of cash receiving from bookkeeping.

Accounting staff are not highly trained, only 19 percent having gone beyond high school. Auditing staff are more highly trained, with 44 percent having training beyond high school. Qualifications of accounting and auditing staff are shown in Table 1

Table 1: Accounting and Auditing Staff Profile in Five State Corporations

Corporation	Accounting Staff: BA or Diploma	Accounting Staff: High School	Accounting Staff: Total Number	Auditing Staff: BA or Diploma	Auditing Staff: High School	Auditing Staff: Total Number
A	35	108	143	15	7	22
B	8	86	94	4	4	8
C	79	297	376	37	35	72
D	7	25	32	3	24	27
E	10	66	76	2	8	10
	139	582	721	61	78	139
	19%	81%	44%		56%	

External auditing is the responsibility of the Audit Services Corporation, itself a state enterprise. However, that corporation doens't have enough staff to keep up with demand. Much of the auditing work is contracted to private auditing firms, and even so there is a long backlog for auditing. Audits usually occur several years after the corporation closes its books, as shown in Table 2.

Table 2 Closing Dates of Books and Audits for Five Enterprises

Fiscal Year	Books and Accounts Closed: A	B	C	D	E	Financial Audit Completed: A	B	C	D	E
1980	NA	81	82	83	NA	85	82	83	83	NA
1981	NA	81	83	83	NA	85	82	84	83	N
1982	NA	82	83	84	85	86	83	84	85	85
1983	NA	83	84	85	87	86	84	85	85	87
1984	NA	84	85	86	87	86	84	86	NA	87

Audits are purely financial; there are no efficiency audits. Program and efficiency auditing is the responsibility of the Auditor General's Office, as provided for by Proclamation 13/1987. The implementation of efficiency audits in Ethiopia has not, however, been carried out in practice. There is a conspicuous absence of one body responsible for the overall monitoring of the performance of public enterprises and for developing financial and economic indices for measuring their activities.

Financial Statement Analysis

In the following pages we attempt to analyse the financial performance of the manufacturing public enterprises in Ethiopia. We use their financial reports and information from the Ministry of Industry. The manufacturing enterprises are grouped into corporations, for which consolidated financial statements are available.

The analysis would be more meaningful if there were compiled ratios of public enterprises in developing countries with which to compare. However, little such data is available. Therefore, we use the ratios reported by Dubb & Bradstreet for 72 linens of business in manufacturing. The relevance of the Dunn & Bradstreet ratios is, of course, an open question, since they apply to private firms in an industrialized country.

Net Worth to Total Assets Ratio

The ratio of net worth to total assets shows the proportion of owners' equity in the total finance employed in the enterprise, the balance coming from borrowed funds. The lower the ratio, the larger is the portion of total assets financed by borrowing. High borrowing means high obligations to creditors and a high financial burden, especially if the rate of profitability is low. Therefore, it indicates high risk.

As shown in Table 3, the ratio of net worth to total assets in the manufacturing public enterprises in Ethiopia has had an overall average of 0.41. It decreased from 0.57 to 0.27 for the period examined (1976-81), and declined in all corporations. This means assets of enterprises have been increasing not from an increase in equity funds, but rather from an increase in borrowing. In every sector except sugar the ratio was much lower than for similar linens of business in the D & B sample, as can be seen in Table 4.

Table 3: Dun & Bradstreet, Median Ratios in Selected Manufacturing Lines of Business, 1977.

Line Business	1976/77	1977/78	1978/79	1979/80	1980/81	Average
Beverages	0.69	0.57	0.33	0.29	0.29	0.43
Building materials	0.72	0.58	0.42	0.29	0.17	0.44
Chemicals	0.62	0.61	0.39	0.34	0.28	0.45
Fibers	0.51	0.370.	32	0.21	0.16	0.31
Food	0.46	0.44	0.25	0.19	0.18	0.30
Leather and Shoes	0.28	0.21	0.12	0.05	0.002	0.13
Metal works	0.49	0.33	0.25	0.23	0.26	0.31
Printing	0.52	0.45	0.29	0.30	0.31	0.37
Sugar	0.83	0.85	0.71	0.75	0.51	0.73
Textiles	0.54	0.50	0.37	0.38	0.38	0.43
Tobacco and Matches	0.77	0.720.71	0.51	0.49	0.64	
Wood works	0.43	0.380.39	0.43	0.24	0.37	
Average	0.57	0.500.38	0.38	0.27	0.41	

Source: Prepared from the Ministry of Industry, in "Ethiopia Recent Economic Developments and Future Prospects", World Bank, May31, 1984. Volume II pp. 149-154.

The current assets of these corporations have generally increased by about 100 percent from 1976/77-1989/81 for all except two corporations whose increase was less than 50 percent (see table 5). The fixed assets have increased at a slower pace, with half the corporations reporting decreases. Current liabilities have changed rapidly, while increases in longterm liabilities have been slight or even negative. Equity amounts have been decreasing overall.

The enterprises are, then, heavily indebted and have a narrow equity base with 60-8- percent of their assets financed by debt. There may be nothing wrong in using debt finance. If the profitability rate in the enterprise can more than justify the interest and the financial charge requirements on the borrowed funds it is positive leverage.

Table 4: Dun & Bradstreet, Inc., Median Ratios in Selected Manufacturing Lines of Business, 1977

Lines of Business	(1) nw/ta	(2) ca/cl	(3) in/ca	(4) fa/ca	(5) si/ta	(6) s/in	(7) np/ta
Cotton, Woven Facrics	61	2.83	.405	.38	2.14	6.70	.05
Commercial Printing	.51	2.63		.35	2.28		.07
Concrete, Gypsum & Plastic Products	.58	2.41	.315	.49	1.74	11.50	.08
Confectionery & Related Products	.63	2.67	.525	.27	3.00	7.30	.8
Fabricated Structural Metal Products	.48	2.23	.424	.26	2.09	6.60	.09
Footwear	.50	2.43	.499	.14	2.69	5.70	.05
Grain Mill Products	.50	2.01	.456	.32	3.17	14.20	.06
Industrial Chemicals	.54	2.42	.362	.40	1.56	7.60	.09
Iron & Steel Foundries	.57	2.87	.257	.46	2.04	12.40	.10
Malt Liquos	.63	1.90	.375	.58	2.27	12.50	.08
Metal Stamping	.50	2.14	.370	.38	2.26	9.00	.09
Paints and Varnishes & Lacquers	.55	2.77	.465	.23	2.34	6.70	.06
Bottled & Canned Soft Drinks	.51	2.58	.381	.43	2.10	14.70	.14
Wood Household Furniture	.54	2.88	.507	.22	2.12	6.90	.05

col. 1 - net worth/total assets
col. 2 - current assets/current liabilities
col. 3 - inventories/current assets
col. 4 - fixed assets/total assets
col. 5 - sales/total assets
col. 6 - sales/inventories
col. 7 - net profit, total assets

When we encounter 60 percent or more of the total debt in these enterprises as current liabilities, there is cause for worry. Firms may be using short term loans to finance fixed assets. In the long-run, such financing puts an increasing burden of risk on the creditors.

There is a question whether the Dun & Bradstreet reference is relevant for public enterprises in a developing country. It could be argued that public enterprises can afford to assume heavy debt, since their borrowing comes out of the other idea of the government pocket—the bank. Some would even ask, is it material whether a public enterprise obtains its funds from borrowing or from the state treasury directly as government investment? Is it not like obtaining it from two sides of the same pocket, or from two pockets of the same owner — the state? In such a case, the criteria and measurement of enterprise efficiency then becomes elusive, and the concept of a return on investment become blurred.

Table 5 Manufacturing Public Enterprises in Ethiopia—Profile ofBalanceSheet Changes, 1976/77-1980/81 (in millions of Birr)

Corporation	Current Assets	Fixed Assets	Total Assets	Current Liabilities	Long-term Liabilities	Net Worth
Beverages	64.1	38.0	102.1	78.0	25.1	-1.0
Building materials	7.0	-1.0	6.6	19.6	3.9	-16.9
Chemicals	42.0	5.9	47.9	41.9	0.0	6.0
Fibers	27.5	-2.8	24.7	29.4	1.1	-5.8
Food	89.0	13.0	102.0	94.0	6.0	2.0
Leather and shoes	52.4	-6.4	45.4	61.3	5.7	-21.6
Metal works	49.5	-1.6	47.9	49.3	-0.4	-1.0
Printing	15.7	-1.8	17.0	16.1	0.2	0.7
Sugar	90.0	31.8	121.9	96.7	17.2	8.0
Textiles	44.9	21.6	66.5	57.1	20.5	-11.1
Tobacco and matches	31.4	3.8	35.2	32.0	-0.1	3.3
Wood works	9.3	-1.1	8.2	9.0	-0.2	-0.6

A main reason for the extensive reliance on debt finance must be the unavailability of equity funds, as mentioned earlier. Post hoc treatment of this heavy debt blurs the distinction between debt and equity. With rules for the forgiveness of debt and conversion of debt into subsidy which is written off, the capital structure of a public enterprise becomes impossible to subject to proper financial discipline.

Current Ratio

This is the ratio of current assets to current liabilities. It shows the ability to meet current obligations with current assets, those assets which are liquid or easily convertible.

The current ratio observed in Ethiopian manufacturing public enterprises shows an overall average of 1.6, which is not unfavourable, because it is above 1 (see Table 6). A ratio of one or above would indicate just barely covering current obligations without elbow room for any delays in current asset conversion. The current ratio in these enterprises has been decreasing in all the corporations. The decrease in the current ratio seems to come as a result of the increase in current liabilities, or because of the increase in the current liabilities to meet working capital needs. The trend indicates liquidity problems. Compared with Dunn & Bardstreet's current ratio in similar lines of business, the Ethiopian ratio is much lower. The average current ratio for similar lines of business in D & B is above 2 or close to 3.00, while the Ethiopian one less than 2.00, and decreasing, though not to less than one.

The favourableness of the current ratio depends on the composition of the current assets. Overall 50 percent or more of the current assets is in inventory, followed by receivables (see table 7). This is higher than that reported in D & B. The liquidity of current assets depends on how easily saleable the inventory is, and how quickly collectible the receivables are. If

the inventory value is overstated, if inventory is composed of obsolete stick, or letters of credit in transit of supplies for consumption, then the inventory is far from liquid. The same concern also applies in the quality of receivables. If current receivables include items whose terms of collection are uncertain, then current assets will be overvalued and the current ratio misleadingly overstated. The liquidity position, then is much more risky. As financial data for 1976-81 were prepared before the 1987 review of the Ministry of Industry's accounting procedures manual, the reliability of the data may be questionable.

Table 6: Ratio of Current Assets to Current Liabilities of ManufacturingPublic Enterprises in Ethiopia

Lime Business	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82
Beverages	1.43	1.30	1.10	1.09	1.06	1.20
Building materials	2.40	1.71	1.35	1.14	1.03	1.53
Chemicals	2.09	1.99	1.41	1.28	1.18	1.59
Fibers	1.34	1.39	1.22	1.10	1.06	1.20
Food	1.43	1.32	1.10	1.09	1.11	1.21
Leather and shoes	1.83	1.60	1.28	1.13	1.13	1.39
Metal works	1.90	1.43	1.35	1.27	1.31	1.45
Printing	1.74	1.61	1.74	1.17	1.25	1.50
Sugar	4.37	4.89	2.27	3.00	1.47	3.20
Textiles	1.70	1.70	1.41	1.38	1.36	1.51
Tobacco and matches	3.36	2.90	2.90	1.69	1.62	2.49
Wood works	1.26	1.13	1.30	1.46	1.15	1.27
Average	2.07	1.91	1.53	1.40	1.22	1.63

Source: Prepared from the Ministry of Industry in "Ethiopia Recent Economic Developments and Future Prospects", World Bank, May 31,1984. Volume II, pp. 149-154.

Table 7 Ratio of Inventory to Current Assets of Manufacturing Public Enterprises in Ethiopia

Line Business	1976/77	1977/78	1978/79	1979/80	1980/81	Average
Beverages	0.48	0.54	0.55	0.64	0.72	0.59
Building materials	0.65	0.69	0.60	0.58	0.51	0.61
Chemicals	0.67	0.65	0.49	0.56	0.51	0.58
Fibers	0.74	0.80	0.63	0.57	0.51	0.65
Food	0.35	0.26	0.23	0.25	0.23	0.26
Leather and shoes	0.77	0.80	0.77	0.78	0.70	0.76
Metal works	0.68	0.54	0.64	0.71	0.72	0.66
Printing	0.51	0.57	0.54	0.52	0.49	0.53
Sugar	0.49	0.34	0.40	0.32	0.39	0.39
Textiles	0.57	0.67	0.68	0.56	0.63	0.62
Tobacco and matches	0.52	0.48	0.55	0.39	0.52	0.49
Wood works	0.53	0.52	0.56	0.58	0.49	0.54
Average	0.58	0.57	0.55	0.53	0.5	0.56

Source: Prepared from the Ministry of Industry in "Ethiopia Recent Economic Developments and Future Prospects", World Bank, May 31, 1984. Volume II pp. 149-154.

Fixed Assets to Total Assets

This ratio indicates the portion of investment tied up in fixed assets. The optimal ratio depends on the firm's line of business. Normally, in a heavy industry, such as metal and steel, a high ratio of fixed assets to total assets would be expected. In light industries the opposite would be true. In Ethiopian manufacturing enterprises, the percentage of fixed assets in total assets is 20-30 percent overall, ranging from as low as 9 percent (see table 8).D & B's ratio for similar lines of business is on average closer to 35 percent. The Ethiopian ratio also exhibits a decreasing trend throughout the period, both overall and in most corporations. The trend indicates that increases in total assets have not resulted in fixed asset increases, but rather in current assets activity.

Table 8: Ratio of fixed Assets to Total Assets o Manufacturing Public Enterprises in Ethiopia

Line of Business	1976/77	1977/78	1978/79	1979/80	1980/81	Average
Beverages	0.32	0.34	0.37	0.32	0.35	0.34
Building materials	0.33	0.30	0.27	0.25	0.25	0.28
Chemicals	0.20	0.23	0.15	0.15	0.15	0.18
Fibers	0.34	0.26	0.25	0.17	0.13	0.23
Food	0.27	0.30	0.24	0.17	0.18	0.23
Leather and shoes	0.42	0.36	0.32	0.25	0.22	0.31
Metal works	0.14	0.12	0.07	0.06	0.06	0.09
Printing	0.20	0.16	0.12	0.17	0.16	0.16
Sugar	0.53	0.49	0.39	0.32	0.41	0.43
Textiles	0.26	0.23	0.25	0.24	0.27	0.25
Tobacco and matches	0.21	0.18	0.15	0.18	0.17	0.19
Wood works	0.30	0.26	0.23	0.17	0.14	0.22
Average	0.29	0.27	0.23	0.20	0.20	0.24

Source: Prepared from the Ministry of Industry in "Ethiopia Recent Economic Developments and Future Prospects", World Bank, May 31, 1984, Volume II, pp. 149-154.

Overall the portion of investment in fixed assets seems to be low. More is being spent on current assets than on long-term investment, especially in inventory build-up. This indicates a short-term orientation, as was shown in Table 5. Current production may be increased at the expense of the long-term value of fixed assets.

Sales to Total Assets (Asset Turnover)

Asset turnover is the ratio of sales to total assets. It indicates the volume of sales generated by each Birr of assets invested. The greater the turnover, the higher is the efficiency of asset utilization. In the Ethiopian manufacturing enterprises examined, on the average the turnover is less than 1.00 or close to 1.00 (see table 9). It is not what would be considered efficient utilization of investment. For the volume of investment, sales generated are small,

although it varies from industry to industry, and from period to period. Similar ratios from D & B for comparison show higher turnover, 100-200 percent higher, depending on the industry.

Sales to Inventory Turnover

This relationship expresses the number of times the inventory has turned over. The larger the turnover, the faster moving the inventory the more liquid is the quality of inventory held. The turnover also indicates the extent to which the capital tied up in inventory. Thus, the smaller the turnover, the more capital is tied up slow-moving inventory. Naturally, the rate of turnover will vary, depending on the type of activity and the type of industry the enterprise is in.

Inventory turnover for Ethiopia manufacturing is on the average 2.2 times, with a decreasing trend (see table 10). D & B's average inventory turnover for private enterprises in similar lines of business is about 5 minimum.

It can be inferred that low turnover occurs as a result of sales not increasing as fast as inventory holdings. Why inventory holdings have increased faster requires further inquiry. It may be to hedge against expected shortages, to meet expected increases in demand, or to meet a production target. It is also possible that inventory may be overstated as supplies and other consumable items are included. Note, for example, that in D & B's printers (job) line of business ratio computation (see table 4), there is no inventory turnover, as there are no inventories in the sense of goods held for sale. They carry only supplies and those are not included under inventories and entered in turnover calculation. Such a distinction in inventory definition and classification is not yet in practice in Ethiopian public enterprises. Turnover may also appear to be depressed because sales prices are held low in the face of rising costs of inventory and production.

Table 9 Ratio of Sales to Total Assets of Manufacturing Public Enterprises in Ethiopia

Line of Business	1976/77	1977/78	1978/79	1979/80	1980/81	Average
Building materials	0.66	0.61	0.60	0.67	0.69	0.65
Chemicals	1.26	0.84	1.27	1.05	0.99	1.08
Food and beverages	1.43	1.24	1.20	1.25	1.25	1.22
Leather and shoes	0.72	0.62	0.90	1.05	0.98	0.86
Metal works	0.97	1.37	1.11	1.46	2.30	1.44
Printing	0.85	0.86	0.86	0.88	0.89	0.87
Sugar	0.38	0.30	0.53	0.49	0.43	0.43
Textiles and fibers	0.90	0.71	0.84	0.99	0.98	0.88
Tobacco and matches	1.07	1.04	1.09	0.93	0.95	1.02
Wood works	0.93	0.87	1.10	1.01	1.07	0.99
Average	0.91	0.85	0.95	0.97	1.05	0.95

Source: Prepared fro the Ministry of Industry, in "Ethiopia Recent Economic Developments and Future Prospects, "World Bank, May 31,1984. Volume II, pp. 149-154.

Net Surplus to Total Assets

This ratio measures the rate of return on total assets invested. The net rate of return on assets in Ethiopian manufacturing public enterprises is about 2 percent. Some, like the Chemicals and tobacco and Matches corporations have exhibited average returns of 12 percent. There are also three or four corporations that have shown losses (see Table II). The average rate of return is not high, given that D & B's rate of return on total assets is in the neighborhood of 6 or 7 percent. The minimum rate of return on bank saving in Ethiopia is 6 percent, which can be taken as the floor for a comparison of any rate of return on investment. However, considering that capital charges (cost of equity capital) of 5 percent have been levied already on equity, the rate of return in the Ethiopian public enterprises could be higher than exhibited by the above ratio. This would lead to the conclusion that Ethiopian manufacturing public enterprises have actually been performing well.

Table 10: Ratio of Sales to Inventory of Manufacturing Public Enterprises in Ethiopia

Line of Business	1976/7	1977/78	1978/79	1979/80	1980/81	Average
Building materials	1.5	1.3	1.4	1.5	1.8	1.5
Chemicals	2.4	1.7	3.1	2.2	2.3	2.3
Food and beverages	4.8	4.5	4.4	3.9	3.6	4.2
Leather and shoes	1.7	1.3	1.7	1.8	1.8	1.7
Metal works	1.7	2.9	1.8	2.2	1.5	2.0
Printing	2.1	1.9	1.9	2.0	2.1	2.0
Sugar	1.7	1.7	2.1	2.2	1.9	1.9
Textiles and fibers	2.1	1.3	1.6	2.3	2.1	1.9
Tobacco and matches	2.6	2.6	2.3	2.9	2.2	2.5
Wood works	2.5	2.3	2.5	2.1	2.5	2.4
Average	2.3	2.1	2.3	2.3	2.2	2.2

Source: Prepared from the Ministry of Industry, in "Ethiopia Recent Economic Developments and Future Prospects. " world Bank, May 31, 1984. Volume II pp. 149-154.

We must be aware that annual capital charges are also subject to many waivers, exceptions and changes, which do not result in deductions from surplus, nor from regular payments.

Table 11: Ratio of Net surplus to Total Assets of Manufacturing Public Enterprises in Ethiopia

Line of Business	1976/77	1977/78	1978/79	1979/80	1981/82	Average
Building materials	-0.01	-0.10	0.04	-0.07	-0.23	-0.09
Chemicals	0.11	0.005	0.12	0.08	0.06	0.07
Food and beverages	-0.10	0.05	0.05	0.04	0.02	0.05
Leather and shoes	0.03	-0.04	0.01	0.02	-0.02	-0.00
Metal works	0.06	0.06	0.05	0.08	0.09	0.07
Printing	0.08	0.79	-0.10	0.13	0.12	-0.11
Sugar	-0.04	0.02	0.07	0.09	0.05	0.04
Textiles and Fibers	0.06	-0.003	-0.15	0.05	0.04	0.00
Tobacco and matches	0.16	0.16	0.11	0.12	0.03	0.12
Wood works	0.07	-0.01	0.04	0.04	0.05	0.04
Average	0.06	-0.06	0.02	0.06	0.02	0.02

Source: Prepared from the Ministry of Industry in "Ethiopia Recent Economic Developments and Future Prospects", World Bank, May 31, 1984. Volume II, pp. 149-154.

4. Conclusion

During the early period after the nationalization of private enterprises, heavy emphasis was given to the legal aspects of the enterprises. Public ownership was ensured by a series of proclamations, formulating the legal entity of the enterprises.

This trend is seen in the number of proclamations and decrees establishing new public enterprises. Sufficient consideration was not given to whether and when public enterprises are to be established and how and by whom they are to be monitored. As a result, there were many ad-hoc decisions made to combine, consolidate, merge, fold and/or amalgamate, contract, expand and rename state enterprises as and when events dictated. Only the legal instrument was relied upon to effect changes. Although it could be said that this was much more glaringly observed during the formative years, today there is no national yardstick for consideration of the matter.

With time, the need for more attention to financial management was felt. Steps were taken to provide state enterprises not only with organizational structures, but also with financial management guidelines to instil better financial control. This was done first in the form of "financial administrative and internal control guidelines" (Yefinance Astedader Ina Yewist Kuttitiier Memeria) prepared by an *ad-hoc* committee established either by a corporation, or ministry or enterprise, and later in the form of various accounting and auditing manuals in different institutions.

The guidelines and manuals emphasized the process of receiving and payment of cash transactions and approval procedures. They required long and involved paper work which uses excessive manhours, overburdening the system, preventing the preparation of reliable data necessary for timely decision making.

A tremendous number of manhours were put into the preparation of these guidelines and manuals; they have undoubtedly been useful in the day-to-day operations, providing a rudimentary foundation for financial information flow and processing. However, the adequacy of these guidelines for promoting operational efficiency, serving planning needs, assuring protection of assets, and ensuring reliability of data needed by the enterprises, is highly doubtful.

These guidelines and manuals were prepared at various levels, such as the supervising authority, the corporation, or the enterprise. They are not coordinated in content and objective, and times, they conflict. Many audit reports reflect this conflict in their "qualified audit reports" as they disclose the different methods and practices followed.

Financial reports and statements prepared on this basis do not provide for comparability of financial data. Efficiency cannot be measured, nor can a realistic judgement of enterprise operation be obtained from such information.

A ratio analysis of the financial information available (1976-81) for the 12 manufacturing enterprises under the Ministry of Industry seems to indicate that:

(a) the public enterprises under study seem to be under-capitalized, as they manifest heavy indebtedness,
(b) the increase in the total assets (investment) through the period seems to be the result of an increase in current assets and not fixed or long-term assets,
(c) the increase in current assets emanates mostly from a buildup in inventory.
(d) the inventory is relatively slow-moving,
(e) the current ratio is low, indicating an increase in current liabilities at a much faster rate than current assets, leading to a liquidity problem. There is an increasing use of current debt, visible in the form of unpaid bills and other pending suspense accounts (sundry creditors).

The study depicts varying and inconsistent accounting policies,, procedures, practices and reporting formats. There is a need to coordinate, harmonize and refine these accounting policies and practices.

There is a conspicuous absence of one coherent centralized body responsible for issuance of financial procedures and guidelines. There is no "agent of supervision" to monitor the firms' viability and efficiency.

The study depicts the emphasis on the legal aspects of the enterprises and the effect of the government budgetary control procedures on the public enterprise 'financial management.

Overall one may say that the performance of these public enterprises may not be regarded negatively and as has been said, "they have been holding on steadily", considering that the government has been skimming off profits (surplus) in the form of capital charges, taxes, and residual surplus, and given that the enterprises have not been permitted to set their own prices. However, the financial indices show a poor equity base. Most are undercapitalized, operating at the top part of the balance sheet, which seems to emphasize short-sighted policies, and practices. The financial ratios show deterioration. Continuous decline in financial ratios is symptomatic of "enterprise sickness", incipient, if not definitely "sic

The enterprises are faced by constraining accounting policies originating from procedures and poor accounting practices which result in inadequate financial information for qualitative performance evaluation to permit identification of "sick" ones from "dead" ones or to distinguish viable from non-viable operations.

Stringent laws and rules framed with a view to exercising public control and ownership as expressed in the party slogan of "we shall control our wealth (and enterprises) through government and people's control" have not led to efficient enterprise management.

Recent attempts to introduce central planning are only in the formative stage. The planning policy and practice so far have been oriented towards achievement of production targets and central control of information through various progress reporting mechanisms of achievement of targets. This has not led to cost conscious optimising management operations. Rather, management has been directed to meeting production targets and keeping the enterprise running at all costs, which again has led management to operate only on the top part of the balance sheet, without looking at the long run state of health of the enterprise.

The corporations examined include several enterprises under them. Some of these enterprises could be operating more efficiency than others or could be more financially viable than others. The consolidated information provided does not permit looking into these sub-units' operations and performance. Some of these corporation also suffer from accumulated losses carried forward, which may lead to difficulties or impending difficulties, for which the performance of the whole sector may be blamed.

In conclusion, there are many long-term financial and managerial and accounting policies that need improvement to permit public enterprises to operate and be managed more independently and in a business-like manner, especially in terms of improving their financial health through the use of proper accounting tools.

Beyond this we cannot say they are performing well and therefore the old cliche that public enterprises are bad performers and thus should be privatized is wrong. Nor do we want to say they are doing bad and therefore should be privatized. We are of the opinion, however, that in Ethiopia public enterprises management has been oriented towards making sure of the 'publicness" of the enterprises; that they are public property belonging to the worker; that they are the centre of political cells and the embryo for political ideology; that the workers have been made to have more say or influence the operation and management more that the manager. The manager has been intimidated not to do anything that angers labour, so that profitability and productivity are slogans left to workers' initiative, and not something to be achieved by management strategy. As such the financial and accounting considerations have been relegated to legal procedures designed to achieve stringent control of information, resources and management by the party on behalf of the proletariat. We are therefore saying that the enterprise management environment could be made to operate more independently so that more appropriate financial and accounting discipline could be introduced in the management of these enterprises in order for them to perform better.

Endnotes

1. Wold Bank, Recent Economic Developments and Future Prospects, volume II, May 31,1984.