

Jimma University
Faculty of Business
Department of Management

Research on the topic:

Assessment of operating and financial
performance of privatized firms in Ethiopia
A case study on Dill Edible Oil Factory.

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Assessment of operating and financial performance of privatized
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A case study on Dill edible oil factory.

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Abstract

The study describes the financial and operating performance of Dill Edible Oil Factory by making a comparison of its performance before and after privatization.

The study sought to determine whether privatization is truly desirable in Ethiopia and whether the performance of privatized firms lives up to the expectation of government and development agencies. In particular, it tried to determine whether privatized firms increased their profitability, their operating efficiency, their capital expenditure, and their out put. It also examined the effect of privatization on employment, capital structure and dividend policy. To this end, the study compared the performance indicators of Dill Edible Oil Factory for the three years before privatization and the three years after privatization. The study used documentary and unstructured interviews for data collection.

Acknowledgment

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CHAPTER 1

1 Introduction

1.1 Overview of the organization

Dill Edible Oil Factory was established in 1968 and privatized in 1991 by transferring the previous enterprise fully owned by the government.

The firm is located in Addis Ababa. The company was established as a private enterprise in 1968 but nationalized after a year and has been engaged in the production and sales of refined edible oil and by products. The firm has bought new additional equipment at the end of 1991. The equipment can yield good processing rates with a good quality output. Currently the factory has 130 employees who are either permanent or contract.

1.2 Background of the study

Privatization of state-owned enterprises has become an important phenomenon in both industrial and developing countries. Privatization have been occurring at an increasing rate over the past decade, particularly in developing countries, whose share in global privatization revenues rose from 17 percent in 1990 to 22 percent in 1996 (the Economist, 1997).

Most empirical studies of privatization have focused on the industrial countries, with the notable exceptions of Galal and

others (1994) and Megginson, Nash, and Van Randenborgh(1994; henceforth MNR) who assessed the welfare gains or losses resulting from the privatization of twelve companies. The authors reported net welfare gains in eleven of the twelve cases and found no cases in which workers showed an overall loss from privatization. As their sample was small and unrepresentative of the universe of privatized firms, their findings should not be generalized.

The MNR study covered a much larger sample. The authors presented strong evidence that after privatization the sample firms became more profitable, increased their real sale and investment spending, and improved their operating efficiency. The companies also significantly reduced their debt levels and increased dividend payments.

Over the years the World Bank, has noted that rates of return on equity invested on industrial or commercial public enterprises are often about a third of those in the country's industrial private sector. The overall contention is that there are two spectra of performance from good bad one for public enterprise one for private firms. There is a fair degree of overlap between the two but the private sector performance extends some what to the right of the public enterprises performance spectrum and mean performance for private enterprises is also somewhat to the right (the World Bank, 1995).

Some studies have also looked at firms before and after privatization. These recent studies show generally, and impressively, improved performance after sale (A journal of finance article²; by MNR the performance of sixty-one companies from eighteen countries in thirty-two industrial sectors). The study shows strong post sale performance increased real sales, greater profitability and most surprising an increase in work forces.

A second study focused on the welfare consequences of selling public enterprises. The study looked at pre and post sale performance in profitability and productivity in twelve firms in four countries. It went on to construct an elaborate fictitious argument against known facts on privatization. The authors were then able to say " private firms have shown a significant increase in operating and financial performance more than they had before privatization."(Boycko, Maxim, Andrei Shleifer, and Robert W. Vishny, 1996).

Based on the reasoning and evidence, it is clear that ownership matters and that it is a significant determinant of the profitability and productivity of an enterprise.

1.3 Objective of the study

The main objective of the study is to analyze the operational and financial performance of Dill Edible Oil Factory using financial information in order to make recommendation on the privatization process of Ethiopia.

1.4 Methodology

The study was conducted on Dill Edible Oil Factory, which is found in Addis Ababa and privatized at the beginning 1991 e.c.

1.4.1 Important data and performance indicators of the study

Important data for the study were performance indicator of the three years before privatization and three years after privatization of the firm. These were:

- ❖ Profitability

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- ❖ Efficiency
- ❖ Investment
- ❖ Output
- ❖ Leverage and dividend

The following were important data that are used to evaluate the performance of the firm

1. real sales
2. number of employees
3. capital investment
4. total debt and total asset

The study used documentary data and unstructured interviews with the general manager and marketing manager.

1.4.2 Methods of Data analysis

Data analysis carried out as follows using financial ratios

Profitability

It is measured on the return on sales

Operating and net income efficiency

The study has measured operating efficiency on the basis of the sales efficiency ratio (real sales per employee) and net income efficiency ratio (net income per employee). That is

Operating efficiency = real sale / no of employee

Net income efficiency = net income / no of employee

If the ratio is interpreted as higher that it was before privatization we can say that the firm uses its resources efficiently. A lower ratio will result in the opposite.

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Investment

Privatized firms are expected to increase their capital expenditures because they have greater access to private debt and equity markets and more incentives to invest. To estimate capital investment, the study used the ratio of capital expenditure to sales.

Capital investment = capital expenditure/sales

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CHAPTER 2

2. pre and post privatization performance of the firm

2.1 profitability

→ As firms move from public to private ownership their profitability should increase (kikeri, Sunita and Jhon Nellis 1992). In response to shareholder's wish to maximize profits, the managers of newly privatized firms, can be expected to place greater emphasis on profit goals. And privatization typically transfers both control rights and cash flows rights to the managers, who then show a greater interests in profits and efficiency than in pleasing the government with higher out put per employment. The study's result showed significant improvements in profitability after divestiture. As measured by the return on sales, profitability rose on average from 2.66* percent before privatization to 10.15* Percent after privatization.

The study's result showed a significant improvement in profitability after divestiture, as it is measured by return on sales ratio. The fig. below shows the improvement in profitability after it has been privatized.

fig. 1 profitability

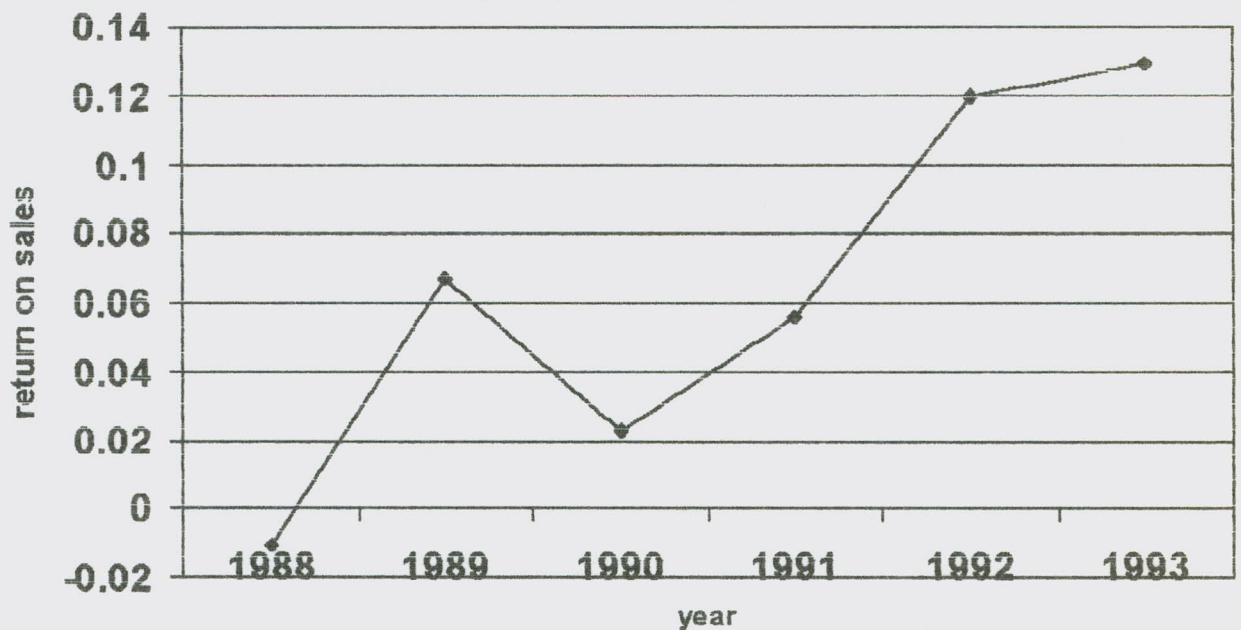


Table 1:profitablity Raito

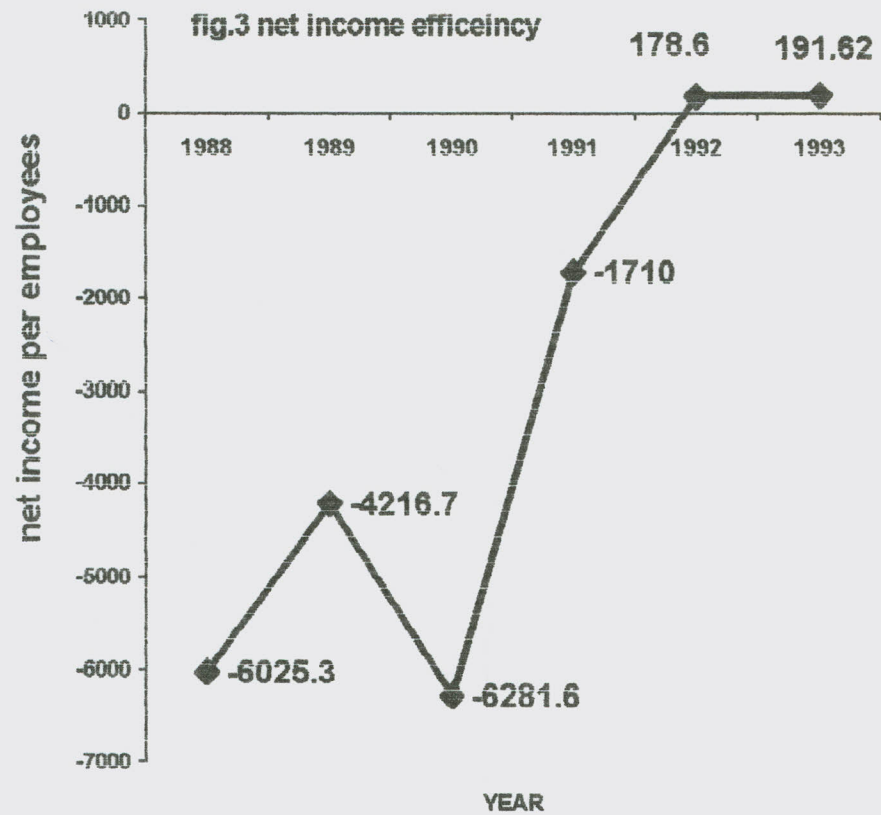
Year	1988	1989	1990	1991	1992	1993
Return on sales	(.0104)	.0674	.0229	.0556	.1199	.1291

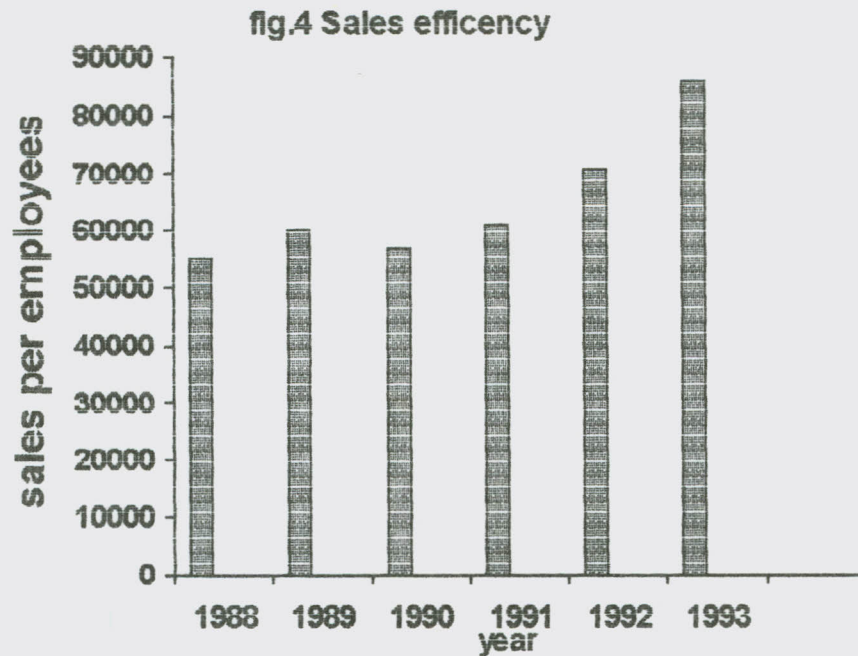
In 1988 the Profitability ratio as it is shown in the graph was (0.0104) and in 1991 it rose to 0.0556 ofcourses it is less than that of the year 1989(before privatized) when we observe the next two years after it has been privatized, the profitability ratio showed an increment. This is because as the firms become privatized the owner wishes to have higher profit and the manager of the newly privatized firms place a greater emphasis on profit goals(assessing new market and sales promotion).

2.2 operating and net income efficiency ✓

The greater emphasis on profit and the cuts in government subsidies following privatization can be expected to lead firms to use their human, financial, and technological resource more efficiently (The World Bank 1995). The study measured operating efficiency on the base of the sales efficiency ratio (real sale per employees) and net income efficiency ratio. Both ratios showed a significant increase following privatization with the sales efficiency ratio 54^a Percent on average. The increase in sales efficiency was significant in Dill Edible Oil Factory; the result is similar to that of the previous studies in different countries (The World Bank 1995).

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These graphs show the increment in terms of both sales and net income efficiency after the firm has been privatized as measured by sales efficiency ratio and net income efficiency ratio.

As firms move from public to private ownership their objective also changes from serving the public with little or no profit to maximize profit (MNR, 1994). Firms could increase profit by increasing sales or/and minimizing its operating and administrative cost, in addition to using the organizational resources effectively and efficiently.

As shown in the graphs the firm's operating and net income efficiency has shown a significant increment. This is because the

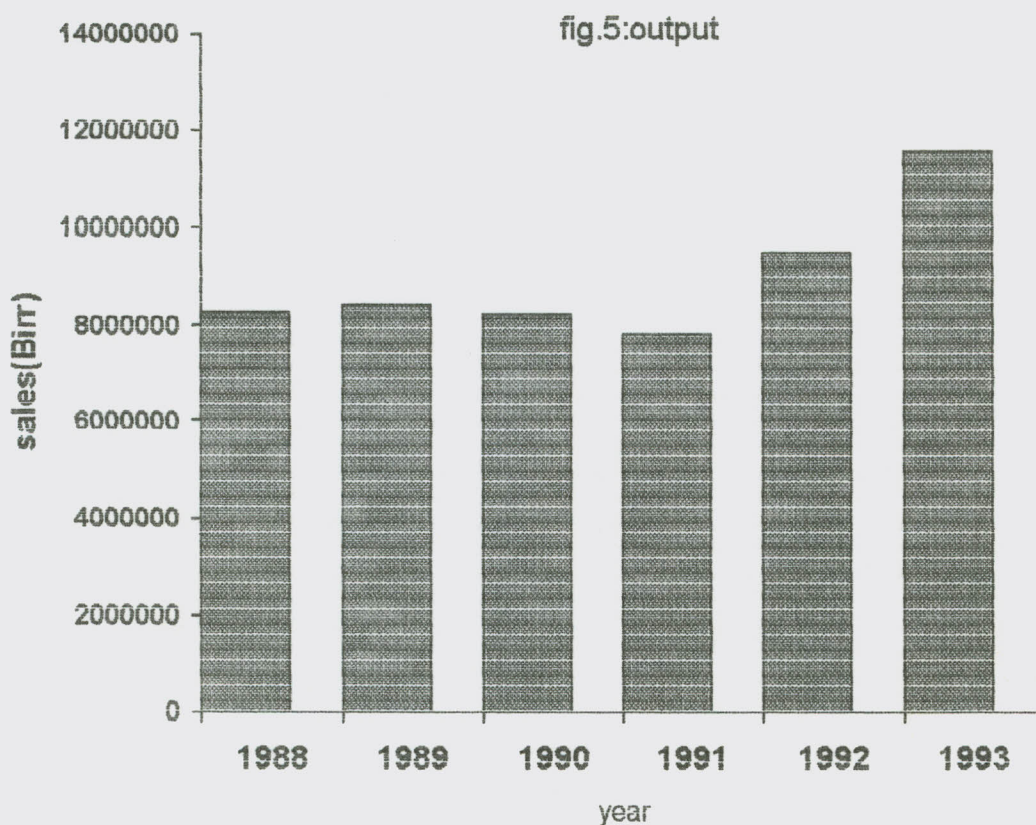
sales amount was increased after it has been privatized. For example, the sales amount in the year 1988 was Birr 8,267,296 and in 1991, sales amount was 7,811,586.58 which is less than that of the 1988, but when we see the 1992 and the 1993 sales amount has been increased. As a result the operating efficiency(sales divided by employees) has shown a significant improvement. This is because of the improvement in resource management after it has been privatized.

2.3 Investment

Government expects that a greater emphasis on efficiency will lead newly privatized firms to increase their capital investment spending. Privatized firms can also be expected to increase their capital expenditure because they have greater access to private debt and equity markets and more incentive to invest. This also true in Dill Edible Oil Factory. It increased its investment by investing some of its money in banks. These results confirm the importance of privatization as an incentive to improve efficiency and increase investment.

2.4 Output

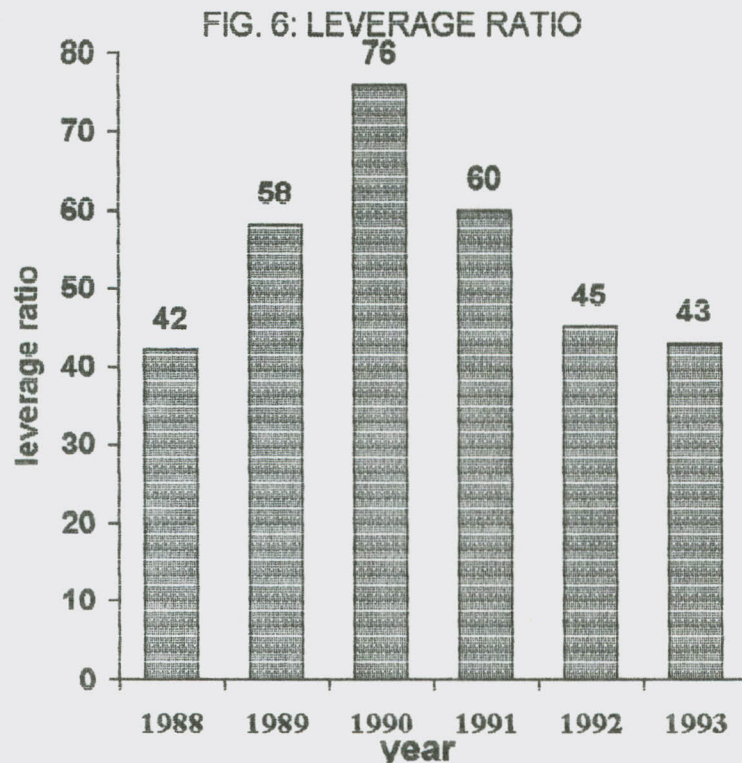
Correctly conceived and implemented, privatization can be expected to foster efficiency and investments and thus stimulate new growth and employment. The study's results confirm these expectations. Real sales rose from an average of .15 percent before privatization to 22 Percent after privatization. This increase in output reflects the increased productivity of the privatized firms.



2.5 leverage and dividend

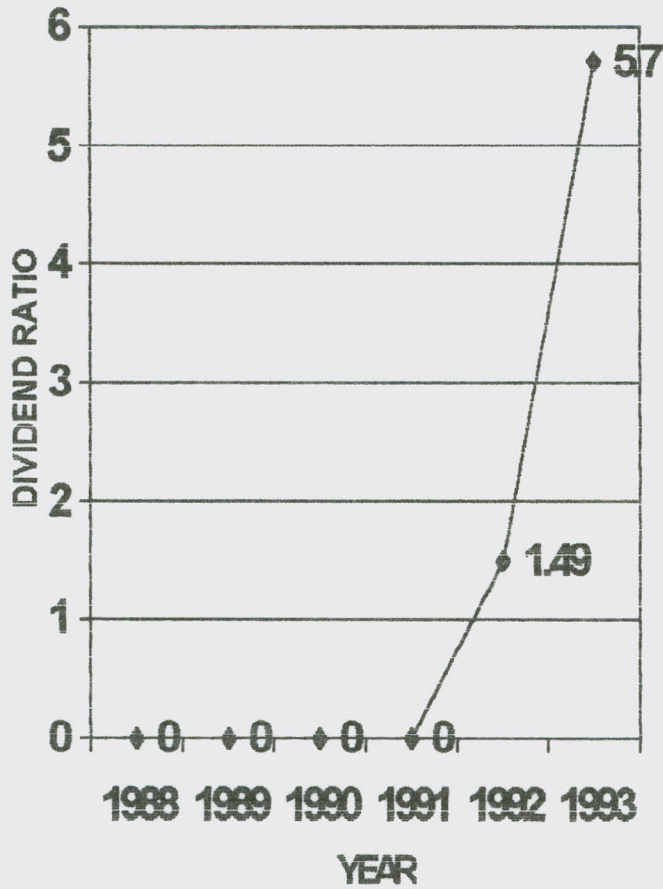
The switch from public to private ownership can be expected to lead to reduce leverage, since the government removal of debt guarantees will increase firms' cost of borrowing and the firms will gain increased access to public equity markets. As predicted, the study's results show that leverage, as measured by the ratio of total debt to total assets decreased significantly down 14 percent on average.

Dividend payment can be expected to increase, since private investors unlike governments, generally demand dividends. As predicted the dividend payment ratio (dividends divided by net income) and the ratio of dividends to sales showed significant increase. This evidence suggests that newly privatized companies increase their dividend payments markedly.



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FIG7 DIVIDEND PAYMENT RATIO



CHAPTER 3

3 Conclusion and recommendation

The study examined the financial and operating performance of Dill Edible Oil Factory, which privatized recently. The study showed significant increase in profitability, operating efficiency, capital investment spending, output, and decline in no employees and leverage and an increase in dividends.

Thus ownership seems to matter as privatization brings with it private owners who place greater emphasis on profit goals and carry out new investments that increase out put and employment. Efficiency improves as a result and profitability follows.

As a matter of fact, it is not only Dill Edible Oil Factory that has become successful after privatization. Although not all enterprises, which are privatized recently, are able to increase their operating and financial performance in contrast to the public bureaucracies, which lag behind modern in management system, they are trying to establish a better one. As this is true the privatization agency of Ethiopia should facilitate the privatization process

Evidence suggests that the more efficient the allocation of investment the higher the over all national productivity, output, income and economic growth.

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It is common that the process of privatization in all developing countries goes at a slow pace. It is said that privatization has some political, economic and cultural bounds with governments. Some investors are pessimistic about the third world political leadership. That is why foreign investors are discouraged in investing in the privatization program of in most third world countries. So the Ethiopian privatization agency should eliminate the perception of a lack of transparency in the program held by various domestic constituencies by means of disseminating information regularly. That the public should know will ensure that foreign investors and Ethiopian expatriates living abroad are not discouraged in investing in the privatization program.

In the privatization program a problem of wide gap of value estimation between that of the agency and entrepreneurs was witnessed which should be resolved in a round table negotiations.

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Appendix 1

1 profitability

$$\text{Return on sales} = \frac{\text{sales} - \text{cost of goods sold}}{\text{Sales}}$$

$$= \frac{\text{Gross profit}}{\text{Sales}}$$

1988	$\frac{(88,277.33)}{8,267,296.02}$	= (0.0104)
1989	$\frac{566,229.15}{8,407,071.09}$	= 0.0674
1990	$\frac{188,941.69}{8,226,415.82}$	= $\frac{0.0229}{0.0799}$
1991	$\frac{434,028.42}{7,811,586.58}$	= 0.0556
1992	$\frac{1,282,227.36}{9,519,197.96}$	= 0.1199
1993	$\frac{1,145,420.90}{11,566,384.27}$	= $\frac{0.1291}{0.3046}$

The average growth rate of profitability before privatization was $\frac{0.0799 \times 100}{3} = 2.66$ per year

The average growth rate of profitability per year after privatization = $\frac{0.3046 \times 100}{3} = 10.15$ /year

Appendix 2

2. Efficiency

2.1 Sales efficiency

It is measured on the sales efficiency ratio (sales per employees)

Year	Sales	No employees	Sales per employees
1988	8267296.021	150	55115.30
1989	8407071.09	140	60050.50
1990	8226415.82	136	60488
1991	7811586.58	130	60089.12
1992	9519197.96	135	70512.50
1993	11566364.27	135	85676.7

2.2 net income efficiency

Year	net income	No employees	net income per employees
1988	(903791.83)	150	(6025.3)
1989	(590335.22)	140	(4216.7)
1990	(854297.66)	136	(6281.6)
1991	(229311.39)	130	(1710.0)
1992	24112.86	135	178.6
1993	25870.099	135	191.62

- Net income efficiency is measured on ratio of net income per employees

Appendix 3

3 Leverage and Dividend

3.1 leverage = $\frac{\text{Total debt}}{\text{Total asset}}$

Year	total debt	total asset	ratio(percentage)
1988	2641288.77	6356216.33	.42 = 42%
1989	3017280.59	5157402.78	58%
1990	3281870.12	4308218	76%
1991	3150040.36	5198958.29	60%
1992	1534293.52	3358287.45	45%
1993	2995867.28	966069.96	43%

3.2 dividend payment ratio the dividend ratio for the year 1992 and 1993 was as follow

Dividend - $\frac{\text{dividend}}{\text{Net income}}$

1992 $\frac{36,015.7}{24,112.86} = \underline{1.49}$

1993 $\frac{150,019}{25,870.099} = \underline{5.7}$

Appendix 4

4. Number of Employees

<u>Year</u>	<u>No</u>
1988	150
1989	140
1990	136
1991	130
1992	135
1993	135
1994	130

DILL EDIBLE OIL FACTORY
TRADING & LOSS ACCOUNTS
FOR THE PERIOD ENDED SENE 30th 1988

	1988	
Sales(net)	8267296.02	
Cost of Good Sold	8353573.35	
Gross operating surplus (loss)		(86277.33)
Other Income		247218.34
		16941.01
Expense:		
Distribution	181792.37	
Administration	625213.51	
Interest	213955.26	
Capital charge	-	
Audit fee	20,000	
Board fee	23771.70	1064732.84
Net surplus & loss before taxation		(903791.83)
Provision for taxation		
Net surplus/loss after taxation		-
Transfer to General reserve		-
Transfer to residual surplus		-

DILL EDIBLE OIL FACTORY
TRADING & LOSS ACCOUNTS
FOR THE PERIOD ENDED SENE 30th 1989

	1989	
Salcs(nct)	8,407,071.09	
Cost of Good Sold	7,840,841.94	
Gross operating surplus (loss)		(566,229.15)
Other Income		64,151.85
		630,381.00
Expense:		
Distribution	127,776.15	
Administration	595,225.43	
Interest	449,223.34	
Capital charge	-	
Audit fee	20,000.-	
Board fee	28,491.30	1,220,716.22
Net surplus & loss before taxation		(590,335.22)
Provision for taxation		
Net surplus/loss after taxation		-
Transfer to General reserve		-
Transfer to residual surplus		-

DILL EDIBLE OIL FACTORY
TRADING & LOSS ACCOUNTS
FOR THE PERIOD ENDED SENE 30th 1990

	1990	
Sales(net)	8226415.82	
Cost of Good Sold	8037474.13	
Gross operating surplus (loss)		188941.69
Other Income		30013.17
		228954.86
Expense:		
Distribution	170364.92	
Administration	517306.69	
Interest	314163.71	
Capital charge	-	
Audit fee	20,000.-	
Board fee	24417.20	1073252.52
Net surplus & loss before taxation		(854297.66)
Provision for taxation		
Net surplus/loss after taxation		-
Transfer to General reserve		-
Transfer to residual surplus		-

DILL EDIBLE OIL FACTORY
TRADING & LOSS ACCOUNTS
FOR THE PERIOD ENDED SENE 30th 1991

	1991	
Sales(net)	7811586.58	
Cost of Good Sold	7377558.16	
Gross operating surplus (loss)		434028.42
Other Income		114593.18
		548621.60
Expense:		
Distribution	100354.44	
Administration	316215.57	
Interest	312140.56	
Capital charge	-	
Audit fee	20,000	
Board fee	22222.42	770932.99
Net surplus & loss before taxation		(222311.39)
Provision for taxation		
Net surplus/loss after taxation		-
Transfer to General reserve		-
Transfer to residual surplus		-

DILL EDIBLE OIL FACTORY
TRADING & LOSS ACCOUNTS
FOR THE PERIOD ENDED SENE 30th 1992

	1992	
Sales(net)	9519197.96	
Cost of Good Sold	8376970.60	
Gross operating surplus (loss)		1142227.36
Other Income		49176.17
		1191403.53
Expense:		
Distribution	116324.75	
Administration	584254.91	
Interest	355037.13	
Capital charge	-	
Audit fee	20,000	
Board fee	23281.27	1098898.06
Net surplus & loss before taxation		92505.42
Provision for taxation		32376.91
Net surplus/loss after taxation		60128.56
Share holder dividend		36015.70
Net profit		24112.86

DILL EDIBLE OIL FACTORY
BALANCE SHEET
FOR THE PERIOD ENDED SENE 30/1988

Fixed Assets		3391,416.31	1987 birr 3,822,238
<u>CURRENT ASSETS</u>			
Stoke	2,629,307.73		2,483,600.-
Debtors	257,617.60		871,498.-
Associated Enterprise	51,363.37		
Cash & Bank Balance	26,511.32		9,100.00
	2,964,800.02		3,364,198.-
Total asset		6,356,216.33	
<u>CURRENT LIABILITIES</u>			
Creditors	1,419,460.27		3,794,511
Associated Enterprise	2,209,792.64		
Provision for profit taxation	181,198.60		231,199.-
Capital charge payable	(28,649.96)		(28,650.-)
Residual surplus payable	(5,982.13)		(5,982.-)
Bank loan	1,196,078.55		1,108,585.-
Bank Over Draft	1,445,210.22		1,988,344.-
	7,188,108.16	4,223,308.14	7,088,007.-
		831,891.83	(3,723,809)
			98,429
<u>FINANCED BY</u>			
Capital		2,321,000.00.-	2,321,000
Former share holder		387,768.30	387,768
Accumulated Deficit		(3,540,660.13)	(2,610,339.-)
		831,891.83	98,429.-

DILL EDIBLE OIL FACTORY
BALANCE SHEET
FOR THE PERIOD ENDED SENE 30/1989

	Note	Birr	Birr	1988Birr
	2		3,029,736.99	3,392,230.-
Fixed Assets				
Current Assets	3	1,974,900.66		2,620,581.-
Stoke	4	92,373.82		644,224.-
Debtors	5	52,030.71		
Cash & Bank Balance	6	8,360.60		39,855.-
		2,127,665.79		3,304,660.-
		Total Asset	5,157,402.78	
Current Liabilities				
Creditors	7	1,186,299.21		3,88,110.-
Associated Enterprise	8	2,514,078.25		
Bank loan	9	1,164,176.49		1,818,031
Bank Over draft		1,853,104.10		1,789,864.-
Provision for profit tax	10	171,198.60		181,198.-
Capital charge payable		(28,649.96)		(28,650.-)
Residual surplus payable		(5,982016)		(5,982)
		6,851,221.53	(1,726,558.71)	7,612,553.-
			1,696,821.75	4,337,893
Finance by				945,663.-
Capital		2,321,000.-		2,321,000.-
Former share holder		378,768.30		387,768.-
Accumulated Deficit	11	(4,405,590.05)		3,654,431.-
			1,696,821.75	945,663.-

DILL EDIBLE OIL FACTORY
BALANCE SHEET
FOR THE PERIOD ENDED SENE 30/1990

	Note	Birr	Birr	1989 Birr
Fixed Assets	2		2,577,913.49	3,024,372
Current Assets				
Stoke	3	1,444,189.93		1,866,770.-
Debtors	4	76,296.08		817,060.-
Cash & Bank Balance	5	60,447.84		
	6	149,371.27		8,439.-
		1730,305.12		2,692.269.-
		Total Asset	4,308,218.61	
Current Liabilities				
Creditors	7	998,649.33		4,209,865.-
Associated Enterprise	8	2,519,722.05		
Bank loan	9	1,285,692.69		1,159,147.-
Bank Over draft		1,996,177.43		1,853,310.-
Provision for profit tax	10	106,198.60		717.199.-
Capital charge payable		(28,649.96)		(28,650.-)
Residual surplus payable		(5,982.16)		(5,982.-)
		6,871,807.98		7,350,888
			(5,141,502.86)	(4,666,620.-)
			(2,563,589.37)	(1,642,248.-)
Finance by		2,321,000.-		2,321,000.-
Capital		378,768.30		378,768.30
Former share holder	11	5,272,357.67		(4,351,016.-)
Accumulated Deficit			(2,563,589.37)	(1,642,248.-)

DILL EDIBLE OIL FACTORY
BALANCE SHEET
FOR THE PERIOD ENDED SENE 30/1991

	Note		1990Birr
Fixed Assets	2		2,584,394.-
Current Assets		2,225,540.59	
Stoke	3	2,366,451.38	-
Debtors	4	415,936.90	1,423,161.-
Associated Enterprise	5	61,890.60	707,418.-
Cash & Bank Balance	6	(130,021.82)	-
		2,973,417.70	149,362.-
		2,714,257.60	2,279,941.-
		5,198,958.29	
Current Liabilities			
Creditors	7	2,373,527.87	4,007,737.-
Associated Enterprise	8	2,516,409.36	
Bank loan	9	1,173,663.87	1,285,693.-
Bank Over draft		1,976,376.49	1,996,177.-
Provision for profit tax	10	61,198.60	106,199.-
Capital charge payable		(28,649.96)	28,650.-
Residual surplus payable		(5,982.16)	5,982.-
		8,265,704.71	(5,151,233.-)
		8,006,544.07	(2,566,839.-)
Finance by			
Capital		2,321,000.-	
Former shar holder		2,387,768.30	
Cumulated Deficit	11	5,775,514.72	(3,006,746.42)
			(2,566,839.-)

DILL EDIBLE OIL FACTORY
BALANCE SHEET
FOR THE PERIOD ENDED SENE 30/1992

		1991 Birr
Fixed Assets		
Current Assets	1,908,147.90	2,225,540.59
		-
Stoke	1,291,632.39	2,422,131.29
Debtors	80,811.33	(728,500.14)
Cash & Bank Balance	776,958.3	173,009.75
	145,013,955	1,866,640.90
	Total Asset	
	3,358,287.45	
	116,012,798	1,504,420.09
	246,309,136	2,463,044.93
Current Liabilities	119,456,145	1,173,663.87
Associated Enter prise	339,732,07	1,976,376.49
Bank loan	61,198,60	61,198.60
Bank Over draft	(286,499,6)	(28,649.96)
Provision for profit tax	(59,821,6)	(5,982.16)
Capital charge payable	618,407,934	7,144,071.86
Residual surplus payable	618,407,934	(5,277,430.96)
	(4,733,939.79)	(3,051,890.37)
	(2,825,791.89)	
Finance by	2,321,000.00	2,321,000.
Capital	387,768.30	387,768.30
Former shar holder	(553,456,019)	5,760,658.67
Accamateted Deficit	2,825,791.89	35,051,890.37

DILL EDIBLE OIL FACTORY
BALANCE SHEET
FOR THE PERIOD ENDED SENE 30/1993

			1992 Birr
Fixed Assets			190814790
Current Assets		350154526	
Stoke	231638486		129163239
Debtors	173046875		8081133
Cash & Bank Balance	58232894		7769383
	Total Asset	69660699	145013953
Current Liabilities	205166475		116012798
Creditors			246309136
Associated Enter prise	245526319		119456145
Bank loan	26486628		133973207
Bank Over draft	25001		6119860
Provision for profit tax	24096190		(2864996)
Capital charge payable	(2864996)		(598216)
Residual surplus payable	(598216)	(591922382)	618407934
	938374849	(431767856)	473393979
Finance by		(282579189)	
Capital	232100000		232100000
Former shar holder	38776830		38776830
Accamateted Deficit	(702644686)		(553456019)
	(431767856)		(282579189)



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