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EARC II/Report No. 2

GOVERNMENT AND PUBLIC ENTERPRISES : THE TOP MANAGEMENT AND THE BOARDS

CONFIDENTIAL

D.O. No : EARC-II/1/6/83-Adm.

आर्थिक प्रशासन सुधार आयोग
ECONOMIC ADMINISTRATION REFORMS COMMISSION
10, Janpath,

New Delhi, November 28, 1983

L.K. Jha,
CHAIRMAN

My dear Prime Minister,

In the course of our study of the procedures governing the grant of various approvals for which Industries have to apply to Government, we noticed that public sector enterprises were in many respects subjected to a tighter control than the private sector. While there are understandable reasons why Government should keep a closer and more detailed watch on the performance of enterprises set up by it, care has to be taken to ensure that in the process their efficiency, productivity and profitability do not suffer. We therefore decided to submit separate reports dealing with the special problems which arise in the relationship between public sector enterprises and the Ministries under which they are located as well as the government machinery as a whole.

Accordingly, more than a year ago we initiated discussions with the Chief Executives of public sector enterprises, collectively and individually, as well as with Secretaries dealing with them. However, on account of our pre-occupation with the speedy finalisation of our recommendations regarding reforms in the sphere of direct taxation, it is only now that we are in a position to submit our reports in respect of the public sector.

One of the things which struck us at the very outset was the fact that while the top management of the public sector consisted by and large of capable, dedicated men, their moral was often low, largely because the relationship between them, the Board of Directors over which they presided and the Government was fraught with uncertainties and doubts. Since the whole framework of accountability and autonomy rests on the quality of the top management and the Boards, our first report on public enterprises which I forward herewith is entitled : "Government and Public Enterprises : The Top Management & the Boards". Other reports covering different aspects of the relationship between Government policies and procedures and the functioning of the public enterprises will follow.

Copies of this letter and the report are also being sent to the Finance Minister (as the Bureau of Public Enterprises comes under his purview), the Ministers in charge of Industry, Steel & Mines, Energy & Petroleum, Chemicals & Fertilizers, and Commerce as all these Ministries are concerned with important public enterprises, and the Cabinet Secretary.

Yours sincerely,

Sd/-

(L. K. Jha)

Shrimati Indira Gandhi,
Prime Minister of India,
South Block,
New Delhi-110011.

Encl : Two copies of the Report.

L. K. Jha,
CHAIRMAN

CONFIDENTIAL

D.O. No : EARC-II/1/6/83-Adm.

आर्थिक प्रशासन सुधार आयोग

ECONOMIC ADMINISTRATION REFORMS COMMISSION

10, Janpath,

New Delhi, 28th November, 1983

My dear

I have great pleasure in enclosing for your information a copy of my letter to the Prime Minister together with a copy of our Report on "Government and Public Enterprises : The Top Management and the Boards".

Yours sincerely,

Sd/-

(L. K. Jha)

1. Shri Pranab Mukherjee, Minister of Finance.
2. Shri Narayan Datt Tiwari, Minister of Industry.
3. Shri N.K.P. Salve, Minister for Steel & Mines.
4. Shri Vasant Sathe, Minister of Chemicals & Fertilizers.
5. Shri P. Shiv Shankar, Minister of Energy & Petroleum.
6. Shri Vishwanath Pratap Singh, Minister of Commerce.

Copy with a copy of the report to :—

Shri C.R. Krishnaswamy Rao Sahib,
Cabinet Secretary,
Rashtrapathi Bhavan,
New Delhi.

Sd/-

(L. K. Jha)

GOVERNMENT AND PUBLIC ENTERPRISES : THE TOP MANAGEMENT AND THE BOARDS

I. Introductory

Area of study.

1.1 The performance of public enterprises has attracted a good deal of attention—and criticism—over the years. In the recent past there has been growing concern over the low returns on the huge investments made in the public sector. There have been studies by Committees and Commissions, discussions in seminars and conferences, Audit Reports by the Comptroller and Auditor General of India and reports by Parliamentary Committees, dealing with different aspects of the performance of public enterprises. The present Commission does not intend to cover the same ground as the previous studies. Our focus instead will be essentially on the impact of the government machinery on public enterprises. Government rules, policies and procedures which apply to the public sector, over and above those which apply to the private sector as well, and the need to obtain governmental clearance (formally or informally) prior to the implementation of decisions taken by public sector enterprises, have a profound effect on the efficiency and profitability of these enterprises. Our attempt, therefore, is to examine what changes in governmental approvals, procedures and regulations would be most helpful to the fulfilment of the goals and targets of public enterprises. We propose to submit our views and recommendations in separate reports on different topics.

The organization and style envisaged by the IPR 1956.

1.2 Barring departmental enterprises like the Railways, Posts and Telegraphs and ordnance factories, almost all public enterprises have a corporate framework, either as companies governed by the provisions of Company Law or as statutory corporations governed by the terms of the Statute incorporating them. They are thus separate entities, not a part of the Ministry or Department under whose administrative control they operate. This organisational framework is not an accident. It reflects the approach spelt out in the Industrial Policy Resolution of 30th April, 1956, which stated : "With the growing participation of the State in industry and trade, the manner in which these activities should be conducted and managed assumes considerable importance. Speedy decisions and a willingness to assume responsibility are essential if these enterprises are to succeed. For this wherever possible, there should be decentralisation of authority and their management should be along business lines. It is to be expected that public enterprises will augment the revenues of the State and provide resources for further development in fresh fields. But such enterprises may sometimes incur losses. Public enterprises have to be judged by their total results and in their working they should have the largest possible measure of freedom." There are two crucial ideas here, viz., that the management of public enterprises should be along business lines and that in their working they should have the largest possible measure of freedom.

Subsequent trends.

1.3 The prime responsibility for running public enterprises along business lines was vested in the Board of Directors and it was the Board which was expected to have the largest possible measure of freedom. While in purely organisational terms this pattern persists, in operational terms there has been a strong trend towards running the enterprises on departmental lines and circumventing their freedom by regulations and traditions which leave them little freedom to take any major decisions; and even for minor ones they often have to seek the formal or informal approval of the Government department under which they are placed, and which may, in practice, mean the approval of the Cabinet, the Minister-in-charge or a junior official of the Ministry.

Subject of present report.

1.4 We are not unconscious of the reasons for this change. The autonomy of enterprises seemed to run counter to their accountability. Audit reports, questions in Parliament, criticism in the press and many other factors have led to this change. In her Address to the heads of enterprises at the meeting of the Chief Executives of Public Enterprises held on 5th April, 1983*, the Prime Minister stressed both accountability and managerial autonomy equally. While we propose to examine the issues pertaining to accountability separately and subsequently, in the present report we are addressing ourselves to the questions of appointments of the top executives and the composition of the Board of Directors, because it is on their quality and calibre that the quality of the management depends and also the degree of the autonomy that can be conferred on them. We should add that we have dealt with these questions only in relation to those public enterprises which are engaged in industrial, commercial or allied activities and not in relation to public sector banks or financial institutions.

Discussions held.

1.5 We have had a free and frank exchange of ideas with a large number of Chief Executives and Directors of public enterprises, as also with a number of Secretaries to the Government of India; and the subject also came up for consideration in the course of our meetings with Management Institutions and some of the State Governments, as well as with the Comptroller and Auditor General of India. These discussions have helped to clarify issues and highlight areas of importance and were of invaluable assistance in our own consideration of the matter in all its aspects. We have also kept in view the observations of the Prime Minister in her aforesaid address to the heads of enterprises.

*Reproduced in Lok Udyog, April '83.

II. Top posts : Appointments and terminations

PESB procedures.

2.1 For appointments to top posts in the public sector, whether they be posts of Managing Director or Chairman and Managing Director or posts of functional Directors, or even posts at the third level, namely, General Managers and equivalent, there are well-understood producers in force. The Public Enterprises Selection Board is now an established institution. During the course of our meetings with the Chief Executives, some of them did express some sense of dissatisfaction with the PESB's processes of selection. We are sure that the PESB is aware of the importance of designing its methodology and procedures of selection to ensure that the best possible people are recruited for the top posts in the public sector. We would leave it to them to consider the suggestions, if any, that the experienced public sector executives may wish to make in this regard, perhaps through the medium of the Standing Conference of Public Enterprises (SCOPE).

Need for adequate remuneration.

2.2 We would add that the best men cannot be selected by stinting on salaries. In this context it would be wrong to be unduly concerned with the relationship between the salaries of the top executives in public enterprises and those of senior officials in Government. When we try to select top managers for public enterprises we are in fact competing for talent with the private sector. It may not be possible for the public sector to match the total remuneration package including perquisites of all kinds which private sector employers are able to provide to their top managers, but *the level of remuneration and service conditions in public enterprises should be determined with greater attention to conditions in the private sector than those in Government service.* As things are, pay-scales in force in public enterprises, while they are somewhat more generous than Government pay-scales (though this is offset by some of the facilities that Government is able to provide to its employees, e.g., a good health insurance scheme and subsidized housing), are nowhere near the kind of emoluments that private sector executives enjoy. Under these conditions, it is extremely difficult to recruit the best available talent in the country for top posts in public enterprises. This matter deserves the careful and urgent attention of the Government. *In particular, even more than salaries, the ability to hire appropriate housing is of the utmost importance. The kind of house rent ceilings that are in force in public enterprises do far more to discourage good talent from coming into the public sector than even the pay-scales in force.*

Some complaints against probation.

2.3 During our discussions with the Chief Executives, we were struck by the near-unanimous concern regarding the sense of insecurity that prevailed, and the general feeling of being under the constant threat of termination of service for reasons and considerations which were not readily intelligible. There was in particular acute dissatisfaction with the fact that the appointment of a Chief Executive was for one year in the first instance, and that he was, as it were, formally or informally on probation. Further, even after the one-year period he was not always given a five-year contract but a contract for a limited period of say, two years or so, with an uncertainty as to further continuance. This made it difficult for him to function effectively and show results. This kind of uncertainty also tended to undermine the confidence and autonomy of the Chief Executive. It was pointed out that people selected to the top posts in the public sector were not young men being newly recruited for service but men with years of experience in the industry whether in the public sector or in the private sector; that the procedures of selection should be rigorous, but that once selected they should be forthwith given a five-year contract. In any case their services were terminable at any time on three month's notice. It was therefore, hardly necessary for them to be put on probation, which only meant that at the end of one year the Government had the option of getting rid of them without giving them any notice. This was relatively a small advantage from the Government's point of view, but a major disability and a source of humiliation from the point of view of the appointee. It was also argued that the termination of an appointment was too drastic a step; that persons in the age-group of forties or fifties could not readily find alternative employment; that such a step should not be lightly taken or appear to be arbitrary; and that it should be governed by some appropriate procedures and possibilities of alternative assignments should also be borne in mind.

.....short contracts.....

.....and arbitrary terminations.

2.4 We also elicited the views of a number of Secretaries to the Government on this matter (particularly those who have had a good deal to do with public enterprises) during the course of our discussions with them. We found a general consensus in favour of doing away with the concept of probation, granting a reasonable length of time to the top executives so as to enable them to show results, and maintaining a degree of stability in regard to their appointments.

Our views.

2.5 We have considered this matter carefully. We do not believe that public enterprise executives should enjoy the same kind of security as civil servants, as this would nullify the very purpose of establishing public enterprises as companies or corporations. We are sure that the executives themselves would agree with this view. We are also opposed to the constitution of a common Public Sector Service or the formation of any kind of a management pool as that would

contribute to the bureaucratization of the public sector. However, we do find merit in many of the points referred to above. *We recommend that once a person has been selected for a top post in a public enterprise by virtue of his background and experience there should be no need to place him on probation or keep him on a short leash by granting him a term of one or two years at a time. All top executives—whether Managing Directors or functional Directors—should on appointment be forthwith be given a five-year contract.* Five years should be a reasonable period in which to watch a person's performance and evaluate the results. *At the end of the five-year period, if the executive has done well, he should be forthwith given a ten-year contract or a contract upto his superannuation, whichever is earlier.* This does not give him excessive security, as there is always a provision for the termination of his service on three month's notice.

No need for probation.

Five-year contract.....

.....followed by contract upto superannuation.

2.6 *We further recommend that the termination of the appointment should not be casually done.* At present, if a Chief Executive displeases a Minister or a Secretary he runs the risk of being sacked. A slightly less arbitrary procedure seems necessary. We do not propose that the Government's freedom of 'hiring and firing' should be hamstrung by elaborate procedures of show-cause notices; nor would we recommend a consultation with the PESB. All that we suggest is that *as the appointment is made with the approval of the ACC, the termination of the appointment should also have the approval of the ACC* rather than depend on the decision of one Minister. We would add that it should be recognized that the executives of public enterprises, like civil servants, do not hold political office, and that *a change of Government or even of the Minister in administrative charge of the undertaking should not be an occasion for disturbing the existing incumbents.*

Termination : ACC approval desirable.

2.7 In this context we should like to refer to the problem of "topless public enterprises" which is the subject of frequent criticism in the Press and in Parliament. This seems to us to be a wholly avoidable problem. The solution is obvious : *the replacement for a Chief executive who is due to retire should be found well in advance and the selected person should be inducted into the organization as an understudy with an overlap of, say, six months with the existing incumbent.* This is not a novel idea but is in fact a fairly elementary principle of good management. All that we suggest is that this should be invariably done. We would further suggest that *if for any reason the successor is not in position on the date on which the existing incumbent is due to demit Office, there should be an automatic extension of the term of the latter until a successor is in fact able to take over from him. On no account should a top post be left vacant.* The damage done by vacancies at the top far exceeds any possible harm that extensions of tenure might do, unless the existing incumbent has been judged to be unworthy of the office he holds.

Need to avoid vacancies at the top.

2.8 An important question which remains to be considered in relation to the appointment of Chief Executives is whether there should be a full-time Managing Director and a part-time Chairman of the Board, or whether the two positions should be combined in the post of Chairman and Managing Director. As a rule Government have been appointing a single Chairman-cum-Managing Director, which meets the need for unified command and the avoidance of conflicts at the top level. However, part-time Chairman have also been appointed in some instances. During the course of our discussions, the public-enterprise Chief Executives were unanimously of the view that the appointment of a part-time Chairman in addition to a full-time Managing Director would be fraught with the potential of conflict and difficulty. This view was also shared by all the Secretaries with whom we have discussed the matter. *We feel that the general policy in force is a sound one and should be allowed to continue.*

CMD or MD + part-time Chairman ?

III. Composition of the Boards of Directors

3.1 In general, the Boards of Directors of public sector enterprises consist of some full-time functional Directors, some so-called Government Directors who belong to different Ministries and some other part-time Directors—usually non-officials—appointed on a year-to-year basis. Within this broad pattern, there seems to be no uniformity of practice or principles determining the composition of individual Boards. Obviously there cannot be the same kind of composition for all Boards. However, there is need for evolving some broad concepts which should be followed in setting up the Boards.

Need for some broad concepts.

3.2 Clearly, we cannot have a Board consisting only of full-time "functional" Directors, as such a body will not be a Board at all but only an internal Committee of Management. It is also common ground that there should not be too many Government officials on the Board as this would tend to inhibit the functioning of the enterprise on autonomous businesslike lines and to bureaucratize its style. What then should be the other elements in the Board ?

The kind of Board we envisage.

3.3 Our public enterprises Boards are executive bodies. Their functioning has to be managerial rather than deliberative. So in selecting part-time Directors, the criterion should be to induct such people from outside as would be directly helpful in the attainment of the goals of the enterprises. These may include persons with appropriate commercial or industrial or operational experience, expertise in the relevant disciplines drawn from academic or research institutions as well as those trained in the skills of management. In particular cases, some special interests and concerns may have to be taken note of in addition.

3.4 *Thus we envisage a composite body which will include a certain number of full-time functional Directors; one or two persons with experience in the relevant industry or business; academics or research men in the related disciplines; a management man or two; and of course the 'representative' Directors, their numbers being kept to the minimum.* These matters are discussed in greater detail in the ensuing Sections.

IV. Functional Directors

Need for a general pattern.

4.1 In many public enterprises, there is a Finance Director in addition to the Managing Director, but in some of the smaller ones there is only a Financial Controller or Adviser or a General Manager (Finance) and not a Finance Director. (It is in fact rather strange that in one of the largest of central public enterprises, namely, the Food Corporation of India, there is no Finance Director!). In different public enterprises there are full-time Directors for diverse functions such as Personnel, Marketing, Production, 'Technical', 'Projects', etc.

4.2 These variations do not seem to be the result of a conscious attempt to evolve a pattern or adopt meaningful criteria for such appointments. The practice seems to be that the Ministry concerned argues the case for a Directorship for, say, the Marketing or Personnel function in a certain enterprise; this is then examined by the BPE and the PESB and is then put up to the Finance Minister for approval to the creation of the post. The treatment of such proposals in a manner akin to the processing of the creation of Governmental posts seems hardly appropriate. In fact it should not be necessary to deal with this matter on a case-by-case basis at all.

Minimum of three functional Directorships.

4.3 In this context it is somewhat of fallacious to adopt the principle that the 'smaller' public enterprises do not really need full-time Directors other than the Chief Executive. Even the smaller public enterprise is not really very small in comparison with units in the private sector and in any case not too small for a sound corporate organization. Any organization which has been given in independent corporate existence should have a proper Board. It may be 'small' in comparison with a large public enterprise, but internally its relative 'smallness' is of little significance from the point of view of a proper management pattern and organization. *We would say that there should be a minimum of three functional Directorships in a public enterprise Board regardless of the size of the organization; there would of course have to be a larger number (say five or six or an even larger number) in the bigger public enterprises.*

Functions to be covered.

4.4 As to the functions to be covered, some are self-evident. Apart from the Chief Executive there should of course be a Director (Finance). Other functions which need to be looked after by full-time Directors would include Personnel or Industrial Relations, Marketing and Research and Development. If an operating public enterprise takes on a new project, then it may need a Director in charge of that project. Whether there should be a Director (Production) or Director (Technical) would depend on the nature of the operations; but in general, production, being the central function of any manufacturing enterprise, should be the responsibility of the Chief Executive, to be discharged with the assistance of his staff and line officers; similarly, for the 'technical' function too, the Chief Executive could derive assistance from a staff officer without his necessarily being elevated to the Board level. Precisely which of these functions should be provided for at the Board level in each case is a matter to be worked out; but *what is needed is a one-time exercise by, say, the PESB in consultation with the administrative Ministry concerned to determine the number of functional Directorships and the functions to be covered in each of the Central public enterprises.* It should be possible to complete such an exercise within a few months. *On the basis of the pattern so determined the necessary posts of Functional Directors should be created.* Thereafter, there could be periodical (say biennial or triennial) reviews of the matter.

V. Government Directors

Criticism of Government Directors.

5.1 The role of 'Government Directors' has been the subject of a good deal of comment in the reports of committees, newspaper articles and elsewhere. The criticisms which are made can be summed up as follows : there is excessive Government representation on the Boards of public enterprises; the presence of too many officials on the Board undermines the autonomy of the enter-

prise; Government Directors tend to throw their weight about and are treated as if they are more important than other Directors; they tend to reserve their views on important issues, or to take one view on the Board and another in the Ministry; and one official is frequently on too many Boards to be able to do adequate justice to the work arising out of the Directorships.

Possibility of dispensing with Government Directors ?

5.2 One possibility which has been suggested in this connection by the Fazal Committee, for instance, is that there should not be any Government Directors on the Boards at all. This has been advocated by some as the only means of ensuring that the public enterprise Managements are able to play their management role without excessive bureaucratic influence, and of fulfilling the objective of bringing about an arm's-length relationship between the Government and public enterprises; but the question is far from simple. The Board cannot be merely a body consisting of the full-time functional Directors, as such a body would be (as pointed out earlier) not really a Board but only an internal Committee of Management presided over by the Managing Director, with the other Directors (being his subordinates) probably unable in most cases to play the role of Directors effectively. But if the Board is to include persons other than the full-time functional Directors, why should Government officials as such be ruled out, even when they are in a position to play a useful role on the Board by virtue of their background and experience ? Public enterprises are bound to the Government by so many strands of control, approval, funding, accountability, policy guidelines, and so on, that the association of Government officials with the Board can be of some advantage; it provides for a liaison role and a channel of communication between the public enterprises and the Government. Government officials moreover usually have knowledge of Government policies and developments in other sectors of the economy which may be helpful to the enterprise. In the course of our discussions with a large number of Chief Executives of public enterprises we found that while there were indeed some complaints of Government Directors tending to throw their weight about and being regarded (or expecting to be regarded) as more important than other Directors—these defects can and should be corrected—the general view was that on the whole Government Directors played a positive rather than a negative role; that the real difficulties of public enterprises were with the bureaucratic machinery in the Ministeries; and that in dealing with that machinery Government Directors often played a useful mediating role.

'Excessive Government representation'—some clarifications.

5.3 From this point of view we have to consider the two questions of : (a) excessive Government representation on the public enterprise Boards, and (b) the proper role of the Government Directors. In considering the first question, a distinction needs to be drawn between the truly 'representative' Directors and other Directors. Usually, the administrative Ministry is represented on the Board of a public enterprise by the Joint Secretary concerned and by the Financial Adviser who incidentally also represents the Ministry of Finance. These two officers can be truly said to be the 'Government Directors' on the Board in the strict sense of the term as they do represent the interests and concerns of Government as the owner of the enterprise. In addition, there may be other Government officials on the Board for special reasons. For instance, the Board of a public sector fertilizer company may include not merely the representatives of the Ministry of Chemicals and Fertilizers but also a senior official from the Ministry of Agriculture, for the purpose of reflecting the point of view of the users of fertilizers. Similarly, on the Board of a public sector drugs and pharmaceuticals company, in addition to the officers from the Ministry of Chemicals and Fertilizers there may also be a representative of the Health Ministry which is concerned with public health and with the interests of the general public which uses drugs and pharmaceuticals. There are also instances in which representatives or agencies which provide important infrastructural facilities, such as the Port authorities, the Railways, the State Government, etc., are included. Sometimes efforts also are made to put on the Board persons who could bring to bear on the proceedings some relevant professional, technical or industrial experience or specialised expertise. Given the enormous range of Government activities in this country, a good deal of this experience or expertise is also often found within the Government fold. For instance, officers of the DGTD or the Department of Science and Technology may be put on the Boards of certain public enterprises to which their respective specializations have some relevance. Having regard to all this, it may well happen that the Board of a particular enterprise includes quite a few Directors drawn from Government sources. Out of these, however, only the two representing the administrative Ministry and the Finance Ministry can be said to be 'Government Directors' in the sense of playing a representative role on behalf of the owner.

5.4 It follows from the above that general observations of a sweeping nature against excessive Government representation on the public enterprise Board can be misleading, and that the matter needs to be looked at with reference to the facts and circumstances of each case. Nevertheless, there is something to be said for keeping down the total number of Government officials on a public enterprise Board, even if only two of them are 'representative' Directors.

Need various special concerns and interests be represented ?

5.5 This leads to the question whether all special concerns or interests need always be represented on the Board. Consumers' or end-users' interests, infrastructural concerns such as the problems of railway movement or of port facilities, and so on are undoubtedly important; but they can be

taken care of through suitable coordinating or consultative machinery. The induction of such interests or concerns into Board meetings through Directorships tends to cause conflicts of interest and is not conducive to the smooth and harmonious functioning of the Board; it certainly does not facilitate the functioning of the Board as an executive and decision-making body. For instance, the representative of the Agriculture Ministry on a public sector fertilizer company, the representative of the Ministry of Shipping and Transport on a public sector iron-ore mining company, and the representative of the Health Ministry on a public sector drugs and pharmaceuticals company, are bound to be pre-occupied with their special concerns and interests; they cannot really be expected to participate keenly in and commit themselves wholeheartedly to the management of the affairs of the public enterprise in question. The concerns and interests that they represent are indeed very important but there should be other channels of consultation and communication for them; Board Directorships are perhaps not the most appropriate means of ensuring attention to such points of view. Their role to the extent that they are on the Board should be to identify themselves with the objectives of the enterprise, contributing their knowledge, expertise and judgement to its success rather than to further the interests of some other group.

Need to keep down the number of Government officials on the Board.

5.6 *We should therefore recommend that the number of Directorships reflecting special concerns or interests should in fact be reviewed and minimised if not eliminated. To the extent that some of them are felt to be necessary we would suggest that consideration should be given to the possibility of drawing the necessary persons from non-government sources. By and large, the aim should be to confine the number of Government officials on the public enterprise Board to two, namely the Joint Secretary concerned from the administrative Ministry and the Financial Adviser, who could then be regarded as 'Government Directors' in the strict sense of the term of being representatives of the owner. The number of other Government officials on the Board, if found necessary, should be kept down to no more than one or two.*

5.7 *None of this, however, applies to the presence, on the Boards of Public enterprises, of executives or experts drawn from other public enterprises.* Indeed, there is a great deal to be said for such a transfer of experience. Later in this Report we recommend the inclusion of part-time Directors who can provide useful inputs of relevant industrial or commercial or technological or operational expertise and experience. There is every reason why such expertise and experience should preferably be drawn from other public enterprises. *We would strongly advocate such a course.*

The role of Government Directors.

5.8 In paragraph 5.1 above we referred to some of the points made in criticism of the role of Government Directors on the Boards of public sector enterprises; and in paragraph 5.2 we referred to the view held by some that there should be no Government Directors at all on such Boards, but saw no reason to support such an extreme view. However, it is essential to have clarity about the role that the Directors are expected to play. Here too, there are two totally divergent views possible. One can be that the Director should regard himself as just a Director exactly like the others and become a part of the corporate management, forgetting in the process that he may belong to a Ministry which on a number of issues may have a final deciding or overriding voice in regard to what the enterprise may or may not do. The other extreme view could be that the Government Director functions and behaves as the representative of a higher agency and considers his role to be that of ensuring that the Board as a whole and the Chief Executive do conform to the policies, principles and procedures in respect of which he is, so to speak, a watchdog.

5.9 In our judgement, neither of the two extreme views can or should be followed in practice, whatever their attractiveness in purely theoretical terms. The correct approach in our view can only be evolved if there is a proper understanding and a clear enunciation of the areas in which the Board is the deciding authority and those in respect of which the Board's views are essential in the nature of a recommendation to the Government. In respect of the former, the Government Directors must identify themselves with the objectives and goals of the enterprise and engage in joint thinking on equal terms with their fellow-Directors. They will no doubt be able to contribute to the decision-making process by virtue of the knowledge and experience they possess their awareness of trends and developments in the economy outside the parameters of the operation of the enterprise itself, and in other similar ways. In doing so, the Government Director should be particularly careful not to try to put himself on a higher pedestal than his colleagues on the Board or to appear to speak from a position of authority. On the other hand, in regard to matters which will require Government's clearance following a different and more detailed examination than the Board itself can undertake, he cannot obviously be expected to commit the Government in any way or even to pledge his support to whatever proposal the Board may adopt. He should certainly help the Board in shaping its proposals or recommendations in a manner which would take care of the concerns which Government will bear in mind when considering them. In doing so, again, he should not give the impression of seeking to exercise any kind of veto. The rest of the Board should instead be made to feel that his suggestions are constructive and help-

ful, and are aimed at pointing out ways in which the objectives of the Board and the concerns of the Government can be reconciled in the formulation of the Board's proposals. He should therefore be looked upon by the Board as a helpful colleague and not as someone who tries to boss over his colleagues.

5.10 However, it is not merely a question of the Government Director's own attitude. The role he actually plays on the Board is also influenced by the expectations in this regard on the part of the Government. There are numerous instructions imposing diverse responsibilities on the Government Director. This is understandable, considering that he is nominated by the Government as its representative on the Board. Unfortunately, the accent is often very heavily on the watchdog role, excessive emphasis on which tends to create an adversary relationship between him and the other Directors and to make the harmonious functioning of the Board difficult. From time to time, suggestions have also been put forward that arrangements for the briefing of Government Directors by the Government before Board meetings and their reporting to the Government after the meetings should be strengthened. Instant response and some degree of flexibility and accommodation are very necessary at any Board meeting, and this is hardly possible if the role of the Government Director is excessively formalised and reduced to a merely representative one. Occasions may arise when a matter which comes before the Board is so important and has such implications that the Government Director may himself consider it necessary to have consultations in the Ministry in advance, or to make a formal report to the Secretary or to the Minister after the meeting; but this should be left to his discretion and judgement. Again, frequent recourse to notes of dissent or to formal requests for items to be placed on the agenda is also likely to distort the functioning of the Board. Differences and disagreements may indeed occur at Board meetings, but the effort should be to resolve them through discussions. There could certainly be occasions when agreement is not reached, and the matter seems important enough for a Director—whether a Government Director or any other—to insist that his view should be recorded in the minutes, but such instances should be the exception rather than the rule.

5.11 As regards the question whether the Government Director should reserve his position on a matter coming up before the Board, or alternatively whether he can go along with the proposition at the Board meeting and then take a different view of the matter while examining it in the Government, we feel that the dilemma posed can be avoided if there is a proper understanding of the dual role played by the Government Director on the part of all concerned, i.e., the Government Director himself, the other Directors on the Board and the Government. As already indicated, the Government Director is both a Director of the Company like other Directors, and a representative of the Government; and corporate and Governmental points of view may not always be identical. It is not objectionable for different opinions being arrived at by the same person on the same matter if he has to look at it from different points of view on different occasions. However, this should not necessitate a formal reservation of his position at the Board meeting by the Government Director. Board decisions are taken as a rule by consensus, and we would not favour the Government Director formally reserving his position on any matter which falls entirely within the corporate competence. Nor need he do so on issues on which the corporate point of view has to be referred to the Government. At the same time, we would expect the other Directors to understand that in respect of matters which require to be referred to Government, the Government Director, while participating in the deliberations of the Board and even joining in its consensus, does not and cannot in any way commit the Government. There should be a general convention to this effect. In the subsequent examination of the matter in the Government, his freedom to look at the proposal critically from the governmental point of view should not be held to have been abridged or prejudiced by his involvement in the earlier consideration of the matter by the Board. The other Members of the Board should not at that stage construe this as a case of resiling from a view held by him earlier at the Board meeting; nor should the Government expect him to refrain from joining in the Board consensus on a proposal merely because it requires a reference to the Government, and might on subsequent examination in the Government prove unacceptable to Government for one reason or another.

5.12 In fact, the question of the Government Director taking one view at the Board and another in the Ministry should not really arise, because his role in the Ministry would really be one of commenting and explaining rather than that of taking a final view; if a decision on the matter were entirely within his competence in the Ministry, he could very well have arrived at his final view and expressed it at the Board meeting itself. Matters requiring a reference to the Government are and should be those on which a final decision has to be taken at a level higher than that of the Government Director in his official capacity (say, at the level of the Secretary or the Minister), or needs a consultation with another Ministry or agency (e.g., the Ministry of Finance, the BPE, etc.). In such a case, on receipt in the Ministry of a reference from the public enterprise, the role of the Government Director in his capacity as, say, a Joint Secretary in the Ministry should mainly be to explain the thinking behind and the rationale of the proposal approved by the Board, and not to sit in judgement over the decisions of the Board of which he is a member.

5.13 *Summing up the above discussion, we recommend that the dual role of the Government Directors should be clearly recognised both by the public enterprise Managements and by the Government. There should be a clear charter for the role of the Government Director which should recognise that he would function equally as a Director of the company and as a representative of the Government. With such a charter, and with a knowledge of the Government's policies and guidelines, the Government Director should be allowed to function freely and use his own judgement on matters coming up before the Board, without any formalised system of briefing by the Ministry before the meeting or of reporting to the Ministry after the meeting. It should be left to his judgement and discretion whether to seek a briefing or make a report. No adversary relationship should be created between the Government Director and the other Directors by an excessive emphasis on the former's representative or watchdog role. The emphasis should be on the smooth and harmonious functioning of the Board. The Government Director for his part should identify himself with the objectives and goals of the enterprise, engage in joint thinking on equal terms with his fellow Directors and not assume a superior status. While playing partly a representative role on behalf of the Government on the Board, he should not reserve his position on the matters before the Board but should try to join the Board consensus; however, the others on the Board should not expect him to commit the Government in respect of matters which require to be referred to the Government. In the subsequent examination of Board-approved proposals in the Government his role should be mainly elucidatory, and he should not sit in judgement on the decisions of the Board.*

Need for clarity about the spheres of the Board and of the Government.

5.14 *Essential to the success of the proposals outlined above is clarity about the powers of decision-making which pertain to the Board and those which are reserved for the Government.* While on paper and in the Articles of the Company, such clarity exists, in a very large number of cases, informal advice amounting virtually to a directive percolates from the administrative Ministry to the public sector enterprises under it. In consequence, the Government Directors on Boards also tend to be used or considered to be acting as channels of informal control by the Ministry. We feel this is not a happy trend. The functional autonomy of these enterprises is essential for their good performance. However, whether the measure of autonomy is large or small, there should be no vagueness about the areas in which the Board can take decisions and those in which it must seek prior governmental approval. It is only when the spheres of responsibility are clearly defined that accountability will become meaningful.

Government Directors to be focal points for references and to play a liaison and coordinating role.

5.15 While most of the Chief Executives whom we met had really no serious complaint against the Government Directors as such, they did express impatience with the obfuscations of the Secretariat, the need to chase papers from desk to desk, the ill-informed queries from middle and lower levels which had to be answered, the incomprehension which had to be grappled with, and the enormous delays which had to be accepted as inevitable. This is where the Government Director can help. One of the advantages of having the officers of the Ministry on the Board is that they can play a liaison role and improve the level of understanding and the adequacy of response on the part of the Ministry. *We would suggest that references to the Ministry for approval, sanction, clearance, etc., should be addressed to the officer who functions as the Government's representative on the Board,* i.e., the administrative Joint Secretary concerned with the public enterprise in the Ministry, (or the Financial Adviser, depending on the subject of the reference). *It should be his responsibility to process the matter and obtain the necessary Government approval promptly.* (Incidentally we envisage only an elucidatory role for him in this context as indicated in paragraph 5.12 above). If necessary he may seek assistance from his subordinates and get details checked or calculations made; but there should be no need for a reference from a public enterprise to start at the bottom of the hierarchy in the Ministry and move slowly upwards with notes being written at multiple levels by people-ill-qualified to deal with the matter. Nor is there any reason why the public enterprise executives should have to go from section to section and officer to officer in the Ministry explaining their problems and trying to expedite the movement of papers.

One officer on too many Boards ?

5.16 Lastly, we turn to the point that some of the Government Directors sit on too many Boards and are therefore unable to do justice to the work generated by these Directorships in addition to their work in the Ministry. There is some force in this, but the point tends to be exaggerated or mis-stated. Undoubtedly there is a limit to the capacity of any individual and it is bound to be reached at some time or the other; but it does not follow that an officer who sits on, say, six Boards, would necessarily find himself unable to do justice to the work. His membership of the Boards improves the depth of his understanding of the sectoral problems and the detailed working of the enterprise in question, and makes his tasks in the Ministry somewhat easier. The work generated by the Board meetings is not necessarily an addition to the work in the Ministry; it is in fact part of the latter. In the case of Ministries which function largely through public enterprises, Board Directorships are an essential part of the senior official's work. There would no doubt be some additional load of work arising out of the Board membership, but on the whole, the work at the Board level and the work in the Ministry complement each other. A membership of some six or seven Boards would certainly cast a burden on the officer,

but this is only one more instance of the incidence of over-work at the senior levels in the Government. *The answer to this problem does not lie in distributing the Directorships in such a manner that officers who sit on the Board of a particular public enterprise are not directly concerned with the organization in their work in the Ministry. The proper course is to spread the work-load more evenly so that each senior officer is required to handle only a manageable number of public enterprises. [We would add that in Ministries which have a large number of public enterprises to look after, a restructuring to reduce the number of Under Secretaries and perhaps even Deputy Secretaries and provide for an additional Joint Secretary or two may add to efficiency and lead to economy.] In addition, the number of public sector Directorships held by each Joint Secretary could also be kept down by putting Directors and Deputy Secretaries on the Boards of the smaller public enterprises*

Need to spread work-load more evenly.

5.17 A possibility which has been mentioned in this connection is to appoint one officer in each Ministry for the exclusive purpose of sitting on the Boards of all the public enterprises under the Ministry; his sole business would be to function as the 'Government Director' on behalf of the Ministry. However, this kind of centralization of Directorships could sever the link between the officers dealing with the public enterprise in the Ministry and the Board of the enterprise. Communication between the Government and the public enterprise in such a case would be at one remove, i.e., through the Government Director. We do not see much advantage in this. We feel that the function of two-way communication and liaison between the Government and the public enterprise is best performed by the officer actively concerned with the public enterprise in the Ministry doubling also as a Director of the Company.

VI. Other part-time Directors

How many part-time Directors ?

6.1 Having provided for an adequate number of Functional Directors and a minimum number of Government Directors we have to consider how many other part-time Directors there should be, what areas of expertise and experience they should cover, and from what sources they should be drawn. *In determining numbers, some regard should be had for the overall balance of the Board.* For a medium-size public enterprise we would consider a Board consisting of three to four full-time Functional Directors (including the Chief Executive), two Government Directors, and say, three or four other part-time Directors, to be a fairly balanced one. But, of course, there can be no pre-determined numbers; much would depend on the areas which need to be covered.

What kinds of part-time Directors ?

6.2 Our main concern in considering the question of the *kind* of part-time Directors, (other than the Government Directors) to be provided for, is to ensure that the functioning of the Board is professional, managerial and decisive. Directors should be people who can contribute with their knowledge or experience to the efficient management of the enterprise. It is therefore necessary to identify what kinds of talent or expertise apart from those provided for by the full-time Directors and the Government Directors should be supplied by the part-time Directors. This would, of course, vary from enterprise to enterprise, *but parallel to the determination of a pattern of full-time Directorships for each enterprise (as recommended in paragraph 4.4 above), there should also be a determination of the number and types of part-time Directorships needed on the Board of each enterprise. Once this has been determined there should be some degree of stability in the structure of the Board.]* For instance, in the Board of a public enterprise concerned with organic chemicals there should always be one or two chemists/chemical technologists from an appropriate university or national laboratory; on a public enterprise concerned with non-ferrous metals, there should always be experts connected with the related mining and metallurgical activities; and in addition, on all these Boards there should also be a mangement expert. In the kind of professional Board that we envisage there is no place for merely eminent or decorative persons or persons appointed for the purpose of patronage, as such persons would not be in a position to contribute anything to the efficient management of the enterprise.

Need for a stable pattern for each enterprise.

Requirements and sources.

6.3 While the structure of the Board including the part-time Directorships would have to be determined specifically for each public enterprise, *certain general observations can be made regarding requirements and sources. Experts in management and accountancy would certainly be helpful for most enterprises.* From the Institutes of Management, the reputable management faculties of certain Universities or Institutes of Technology, as well as from professional bodies such as the Institutes of Chartered Accountants and or Cost and Works Accountants or other similar institutions the necessary names could be selected. *Those engaged in research in relevant fields* can help the development of R&D activities of the enterprise; these *can be picked up from the appropriate research institutions in the country as well as from professional institutions* such as those of Chemical Technologists, Metallurgists, Engineers, etc. *Industrial and operational*

experience in allied fields of activity can also be of considerable help; for this purpose *persons who are whole-time Directors in one public enterprise or another can very usefully function as part-time Directors on one or two other enterprises in allied fields.* Such cross-fertilisation of ideas and experience will strengthen mutual cooperation among public enterprises. While it may be possible to find relevant experience and expertise in the private sector, there are difficulties in drawing part-time Directors for public enterprises from the private sector, as there are possibilities of conflicts of interests; this is on the whole better avoided. *Economists* may have a very useful role to play on the Boards of some (though not all) public enterprises. They could make useful contributions to the proceedings of the Boards of organisations which are engaged in international trade or in carrying out buffer-stocking operations within the country, such as the STC or the MMTC. The Boards of public enterprises engaged in the manufacture of items of considerable importance to the economy such as steel or fertilizers may also benefit from the inclusion of economists. The selection of economists for public enterprise Boards could be made by looking at the lists of economists invited for consultation from time to time by the Planning Commission or the Finance Ministry.

Maintenance of ready lists or panels.

6.4 It is, of course, necessary to choose the best available men and also to ensure that they have an adequate understanding of their responsibilities. The process of selection should not be *ad hoc.* It should not be necessary for the Ministry to commence a search for an appropriate person as and when a particular vacancy arises. *There should be available readymade lists or panels of persons already screened and included as suitable for public enterprise Directorships in given areas. These lists should be compiled and kept updated from time to time by the various Ministries, in consultation with the Chief Executives of the public enterprises concerned where appropriate, and should be drawn upon as and when the need arises.*

6.5 It may also be necessary to make a provision for the inclusion of workers' representatives in some or all the Boards. We do not propose to expatiate on this, as workers' participation in management is already an accepted policy of the Government, and the Labour Ministry are seized of its implementation. There have also been some instances of the inclusion of a workers' representative in the Board of Directors. Government will doubtless carry this process further in the light of the experience gained.

VII. Duration of the Boards

Delays in the constitution of the Boards.

7.1 One of the factors which tend to limit the effectiveness of the Boards of public enterprises is their limited life and the discontinuity that this leads to. In most cases the Board is fully in existence only for a part of the year. Each year after the Annual General Meeting, the Board has to be constituted afresh. Some months are lost in this process, and by the time the full Board is assembled half the year is over, so that the new Board has barely a few months in which to function before the next AGM. This means that for several months after each AGM there is only a truncated Board consisting of the Chief Executive, the full-time functional Directors (if any) and a few Government Directors. Such a Board can hardly play the role of the supreme body charged with the direction and control of the affairs of a public enterprise and the repository of all powers. Moreover, with a truncated Board of this kind, the importance and influence of the Government Directors and of officials of the administrative Ministry get accentuated, and the public enterprise becomes virtually a subordinate office of the Ministry. Steps need to be taken to ensure that the full Board of Directors is in a position to function immediately after the AGM.

Need to give part-time Directors a reasonable term.

7.2 Towards this end, the practice of appointing part-time Directors only for the year in question (which is already partly over), which means that a part-time Director has little time even to acquaint himself with the affairs of the enterprise before this Directorship expires, should be given up. The careful selection of part-time Directors which we have urged in the previous section would be rendered pointless, if the persons so selected are able to serve only for a limited period. Part-time Directors should be appointed for a sufficiently long period, say three years at a time. As all the part-time Directors, if appointed at the same time, could also retire together, leading to discontinuity, the system of rotational retirement of the Directors (other than the ex-officio ones) should be adopted, which the company law provides for, but which is not being generally done in the public sector.

Rotational retirement.

7.3 *We would therefore, recommend that the practice of all part-time non-official Directors retiring at the end of each AGM should be discontinued; that part-time non-official Directors should be given a spell of three years at a time; and that by means of rotational retirement a degree of continuity in the Board should be maintained.*

VIII. Summary of conclusions and recommendations

The following is a summary of the main conclusions and recommendations contained in this Report :—

8.1 We propose to submit a number of separate reports on different topics relating to the impact of the Governmental machinery on public enterprises, keeping in mind the approach to the management of public enterprises outlined in the Industrial Policy Resolution 1956 and the stress recently laid by the Prime Minister on their accountability and autonomy. The present report is concerned with the questions of appointments of the top executives and the composition of the Boards of Directors.

(Paragraphs 1.1—1.5)

8.2 (a) In regard to the methodology and procedures of selection of top personnel, the PESB may consider the possibility of inviting suggestions from experienced public sector executives, perhaps through the medium of the Standing Conference of Public Enterprises (SCOPE).

(Paragraph 2.1)

(b) To ensure the selection of the best men, the level of remuneration in public enterprises should be determined with greater attention to conditions in the private sector than those in Government service. In particular, realistic house-rent ceilings are of the utmost importance.

(Paragraph 2.2)

(c) Once a person has been selected for a top most in a public enterprise by virtue of his background and experience, he should not be placed on probation or given a short-term appointment. A top executive should, on appointment, be forthwith given a five-year contract. At the end of the five-year period, if he has done well, he should be given a ten-year contract or a contract upto his superannuation whichever is earlier.

(Paragraphs 2.3—2.5)

(d) The termination of the appointment of a top executive in a public enterprise should not be casually done. As the appointment is made with the approval of the ACC, the termination of the appointment should also have the approval of ACC. A change of Government or even of the Minister in administrative charge of the undertaking should not be an occasion for disturbing the existing incumbents.

(Paragraph 2.6)

(e) The replacement for a Chief Executive who is due to retire should be found well in advance and the selected person should be inducted into the organisation as an understudy with an overlap of, say, six months with the existing incumbent. If for any reason the successor is not in position on the date on which the existing incumbent is due to demit office, there should be an automatic extension of the term of the existing incumbent until his successor is in fact able to take over from him. On no account should a top post be left vacant, unless the existing incumbent has been held to be unworthy of the office he holds.

(Paragraph 2.7)

(f) The general policy in force of appointing a single Chairman-cum-Managing Director rather than a full-time Managing Director and a part-time Chairman of the Board is a sound one and should be allowed to continue.

(Paragraph 2.8)

8.3 There is need for evolving some broad concepts in regard to the structure of public enterprises Boards. These Boards are executive bodies and their functioning has to be managerial rather than deliberative. We envisage the Board as a composite body which will include a certain number of full-time functional Directors; one or two persons with experience in the relevant industry or business; academic or research men in the related disciplines; a management man or two; and the 'representative' Directors, their number being kept to the minimum.

(Paragraphs 3.1—3.4)

8.4 (a) The creation of Functional Directorships should not be done on a case-by-case basis but on the basis of a pattern consciously evolved.

(Paragraphs 4.1—4.2)

(b) There should be a minimum of three Functional Directorships in a public enterprise Board regardless of the size of the organization.

(Paragraph 4.3)

(c) There should be a one-time exercise by (say) the PESB in consultation with the administrative Ministry concerned to determine the number of Functional Directorships and the functions to be covered in each of the Central public enterprises. On the basis of the pattern so determined the necessary posts of Functional Director should be created.

(Paragraph 4.4)

8.5 (a) While we have taken note of some of the criticisms often directed against 'Government Directors' we do not favour the view that there should not be any Government Directors on the Boards at all. The association of Government officials with the Board can be of some advantage, as this provides for a liaison role and a channel of communication between the Government and public enterprises. The real difficulties of public enterprises are with the bureaucratic machinery in the Ministries, and in dealing with that machinery Government Directors often play a useful mediating role.

(Paragraphs 5.1—5.2)

(b) In considering the question of excessive Government representation on the Board, a distinction needs to be drawn between the truly 'representative' Directors and other Directors included for various special purposes; only the former are 'Government Directors' in the strict sense. Nevertheless, there is something to be said for keeping down the total number of Government officials on a public enterprise Board. The number of Directorships reflecting special concerns or interests should be reviewed and minimised if not eliminated, as these do not facilitate the harmonious functioning of the Board as an executive and decision-making body. To the extent that some of them are felt to be necessary, consideration should be given to the possibility of drawing the necessary persons from non-Government sources.

(Paragraphs 5.3—5.6)

(c) However, this does not apply to the presence on the Board of executives or experts drawn from other public enterprises, which we would strongly advocate.

(Paragraph 5.7)

(d) The dual role of the Government Directors should be clearly recognised both by the public enterprise Managements and by the Government. There should be a clear charter for the role of the Government Director, which should recognise that he would function equally as a Director of the company and as a representative of the Government. With such a charter, and with a knowledge of the Government's sectoral policies and guidelines, the Government Director should be allowed to function freely and use his own judgement on matters coming up before the Board, without any formalised system of briefing by the Ministry before a Board meeting or of reporting to the Ministry after the meeting. It should be left to his judgement and discretion whether to seek a briefing or make a report. No adversary relationship should be created between the Government Director and the other Directors by an excessive emphasis on the former's representative or watchdog role. The emphasis should be on the smooth and harmonious functioning of the Board. The Government Director for his part should identify himself with the objectives and goals of the enterprise, engage in joint thinking on equal terms with his fellow Directors and not assume a superior status. While playing partly a representative role on behalf of the Government on the Board, he should not reserve his position on the matters before the Board, but should try to join in the Board consensus; however, the others on the Board should not expect him to commit the Government in respect of matters which require to be referred to the Government. In the subsequent examination of Board-approved proposals in the Government his role should be mainly elucidatory, and he should not sit in judgement on the decisions of the Board.

(Paragraphs 5.8—5.13)

(e) Essential to the success of the proposals outlined above is clarity about the powers of decision-making which pertain to the Board and those which are reserved for the Government.

(Paragraph 5.14)

(f) References to the Ministry for approval, sanction, clearance, etc., should be addressed to the officer who functions as the Government representative on the Board. It should be his responsibility to process the matter and obtain the necessary Government approval promptly. (His role will, of course, be mainly elucidatory as already indicated in (d) above.)

(Paragraph 5.15)

(g) The answer to the problem of one officer having to function as a Director on the Boards of too many public enterprises is to spread the workload more evenly in the Ministry, so that each senior officer is required to handle only a manageable number of public enterprises. In Ministries which have a large number of public enterprises to look after, a restructuring to reduce the number of Under Secretaries and perhaps even Deputy Secretaries and provide for an additional Joint Secretary or two may add to efficiency and lead to economy. In addition, the number of public sector Directorships held by each Joint Secretary could also be kept down by putting Directors and Deputy Secretaries on the Boards of the smaller public enterprises.

(Paragraph 5.16)

8.6 (a) The functioning of the Board should be professional, managerial and decisive, and the part-time Directors should be people who can contribute with their knowledge and experience to the efficient management of the enterprise. There should be a reasonable balance between the numbers of full-time Directors and Government Directors on the one hand and non-official part-time Directors on the other. Parallel to the determination of a pattern of full-time Directorships for each enterprise, there should also be a determination of the number and types of part-time Directorships needed on the Board of each enterprise. Once this has been determined there should be some degree of stability in the structure of the Board.

(Paragraphs 6.1—6.2)

(b) Experts in management and accoutancy, those engaged in research in relevant fields, persons with the relevant industrial or operational experience, economists, etc., would be among the kinds of persons who should be appointed as part-time Directors. They can be selected from Institutes of Management, Universities, Institutes of Technology, Institutes of Chartered Accountants and of Cost & Works Accountants, research and professional institutions, etc. Persons who are whole-time Directors in one public enterprise can very usefully function as part-time Directors in another. Drawing part-time Directors for public enterprises from the private sector is on the whole better avoided. Economists could be selected from the lists of economists invited for consultation from time to time by the Planning Commission and by the Finance Ministry.

(Paragraph 6.3)

(c) The Ministries should (in consultation with the Chief Executives where appropriate) compile and keep updated lists or panels of persons screened and included as suitable for public enterprise Directorships for various areas, and names should be drawn from these lists as and when the need arises. It may also be necessary to make a provision for the inclusion of workers' representatives in some or all the Boards in the light of the past experience in this direction.

(Paragraphs 6.4—6.5)

8.7. The practice of part-time non-official Directors retiring at the end of each AGM should be discontinued; they should be given a spell of three years at a time; and by means of rotational retirement a degree of continuity in the Board should be maintained.

(Paragraphs 7.1—7.3)

EARC-II/Report No. 4

GOVERNMENT AND PUBLIC ENTERPRISES : AUTONOMY AND ACCOUNTABILITY

CONFIDENTIAL

L.K. Jha,
CHAIRMAN

No. EARC-II/1/8/83-Adm.
आर्थिक प्रशासन सुधार आयोग
ECONOMIC ADMINISTRATION REFORMS COMMISSION
10, Janpath
New Delhi, the 4th January, 1984

My dear Prime Minister,

In our first report on public enterprises we had dealt with their "Top Management and the Boards." I am now forwarding our second report on public enterprises entitled "Government and Public Enterprises : Autonomy & Accountability". It has been our endeavour in this report to argue that the objective of accountability would be better served by giving greater autonomy to the enterprises. We have emphasised in this context the desirability of some re-orientation of the various instruments of control by Government, by the Auditor General and by Parliament, to which the enterprises are subject.

Our next report which should shortly be in your hands, will deal with the question of simplifying and streamlining governmental procedures which hamper the efficient functioning of the public sector and undermine its profitability.

Copies of the report and this letter are being sent to the Ministers concerned with major public enterprises as also to the Cabinet Secretary.

Yours sincerely,
Sd/-
(L. K. Jha)

Shrimati Indira Gandhi,
Prime Minister of India,
NEW DELHI.

ENCL : as above. (Two copies)

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D.O. No. EARC-II/1/8/83—Adm.
आर्थिक प्रशासन सुधार आयोग
ECONOMIC ADMINISTRATION REFORMS COMMISSION

L.K. Jha,
CHAIRMAN

10, Janpath,
New Delhi, the 4th January, 1984

My dear,

I have great Pleasure in enclosing for your information a copy of my letter to the Prime Minister together with a copy of our Report on "Government and Public Enterprises : Autonomy and Accountabilitv".

Yours sincerely,
Sd/-
(L. K. Jha)

1. Shri Pranab Mukherjee, Minister of Finance
2. Shri Narayan Datt Tiwari, Minister of Industry
3. Shri N.K.P. Salve, Minister for Steel & Mines
4. Shri Vasant Sathe, Minister of Chemicals and Fertilizers.
5. Shri P. Shiv Shankar, Minister of Energy and Petroleum, New Delhi.
6. Shri Vishwanath Pratap Singh, Minister of Commerce, N. Delhi.

Copy with a copy of the report to :

Shri C.R. Krishnaswamy Rao Sahib,
Cabinet Secretary,
Rashtrapathi Bhavan,
New Delhi.

Sd/-
(L. K. Jha)

ECONOMIC ADMINISTRATION REFORMS COMMISSION

EARC-II/Report No. 4

GOVERNMENT AND PUBLIC ENTERPRISES: AUTONOMY AND ACCOUNTABILITY

I. Introductory

1.1 In our earlier Report on public enterprises (EARC-II/Report No. 2) we had made a number of recommendations aimed at ensuring the selection and retention of good top executives and the careful constitution of professional Boards of Directors for public enterprises, as it was to these that the much-desired autonomy would be entrusted. In the present Report we spell out the case for autonomy, and also question the validity of the argument or assumption that the accountability of the enterprises to the Government, and the answerability of the Government to Parliament, necessitate the kind of erosion of the autonomy of public enterprises which seems to have taken place over the years.

1.2 In this Report we shall be essentially concerned with the broad concepts and systems affecting the autonomy of public enterprises or relating to their accountability. We propose to deal with the governmental approvals and clearances of different kinds needed by public enterprises, and the lines on which procedural simplifications can be effected and the processing of proposals expedited, in a separate report.

II. The inter-relationship of autonomy and accountability

2.1 *It was with a view to enabling public enterprises to be run efficiently and autonomously by competent managers and technicians that the tradition (coming on from British days) of undertakings in the public sector being run departmentally was discarded and corporate entities were set up for the purpose.* This was brought out in the Industrial Policy Resolution 1956 which stressed the importance of the enterprises being run on business lines and given freedom of management; some observations from that document were cited in our earlier Report. It may also be recalled that when Parliament took strong exception to the purchase of certain shares belonging to Mundra by the LIC, its criticism of the Ministry was partly on the ground that it had given certain directions of a nature which interfered with the autonomy and judgement of the LIC Board. Subsequently, the Report of the Krishna Menon Committee reiterated and spelt out more fully the importance of the autonomy of public enterprises. These healthy trends and concepts have suffered a setback in later years.

2.2 *It is sometimes assumed that there is a conflict between autonomy and accountability. That is not so. Indeed, the two go together and what conflicts with both is control.* The more detailed and extensive a system of control over the actions and decisions of the Management, the less accountable the Management becomes. An agency which merely complies with directions or regulations cannot be answerable for shortfalls in achievement but only for procedural lapses. An inverse relationship between control and accountability holds good even in the case of Government Departments but it has still greater validity in the case of the corporate public enterprise. Unfortunately, in the name of public accountability numerous checks and controls are introduced at every stage, which hinder executive action, concentrate decision-making powers in the Ministry and in fact dilute the accountability of the Management. In effect there is too much of fussy overseeing of public enterprises but too little of real monitoring; too much of control but not enough of accountability in the real sense. If all major decisions and even minor ones are taken by the Management of an enterprise with the prior approval or advice or guidance or concurrence of the Government, the Management cannot be accountable for the results but only for having complied with the wishes of the Government. *The kind of control exercised by the Ministries thus not only erodes autonomy but in the process destroys the basis of accountability.*

2.3 Increasing concern is rightly being voiced over the low profitability of public enterprises which is often contrasted with the high earnings in the public sector. Obviously this cannot be attributed to the fact that the share-holding and financing of the former is with the State whereas for the latter the finance comes from the financial institutions set up by the State, an anonymous mass of shareholders and (upto a point) from the promoters or enterpreneurs concerned. It will be fallacious to identify the differences in profitability with the differences in the pattern of ownership and financing. The real difference lies much more, though not wholly, in the attitudes of those who provide the finance. In the private sector the owners leave the management free to do what it likes in its own good judgement—except when it needs more finance from the shareholders—and ask them questions about their performance in terms of the results achieved once a year at the Annual General

Meeting at which the Auditor's Report as well as the Report of the Board of Directors is presented to the shareholders. In contrast, public enterprises are virtually managed and run by those who are supposed to speak on behalf of the shareholder, viz., the President of India. These include a large body of administrators not too knowledgeable about the nature of the problems confronting the enterprises and devoting only occasional and partial attention to them, usually from a sectoral point of view. The decisions and directions, formal and informal, which are handed down to the enterprises, do not pay adequate attention to their impact on productivity and profitability but are often influenced by concerns which cannot but the described as extraneous to the working of the enterprises.

2.4 It is understandable that public enterprises should need governmental approval for all the major project decisions for which the Government has to provide the necessary funds by way of equity and loans; what is involved in such cases is really a governmental investment decision. It is also clear that in the area of industrial approvals and economic management, the governmental controls, clearances and reporting requirements which apply to the private sector must equally apply to public enterprises. For the rest, it would be natural to expect that the public sector, being the Government's own creation, would have a much easier time procedurally speaking than the private sector; but usually the public sector has to pursue an even more tortuous course through the bureaucratic maze than the private sector. One of the consequences of this is a slowing down of the decision-making process which affects production, delays the completion of projects, generally raises costs and undermines efficiency. *While public enterprises, like units in the private sector, must be subject to such statutory controls as exist, we believe that ideally they should be subject to no other constraints on their autonomy, though of course when they seek additional finance from the Government they must justify it fully. Here again, once the investment decision has been approved and the necessary funding provided for, the Management should be allowed to go ahead without seeking any further clearances except those which apply to all undertakings (whether in the public or in the private sector) such as those relating to industrial licencing, foreign exchange releases etc.* Such an approach will not undermine accountability but will in fact enable the Government to take the Management of the enterprise to task, and even to change it if satisfactory results are not achieved.

2.5 Apart from the inter-relationship between autonomy and accountability, it is necessary to be clear regarding the concept of accountability itself. In a Report entitled 'Accountability' (EARC Report No. 29) which dealt with the accountability of officials in the Ministries/Departments and other Government offices, we had drawn a distinction between accountability in the narrow sense of responsibility for the correctness and propriety of individual actions or decisions or of conformity to rules and procedures, and accountability in the wider sense of answerability for the performance of tasks and the achievement of results; and we had laid stress on the latter. This applies with even greater force to public enterprises. Unfortunately, there is not much evidence of a widespread appreciation of this distinction.

2.6 *In brief, we are persuaded that the concepts and instrumentalities relating to the accountability of public enterprises, which have come to prevail over the years are in need of a careful re-construction with a view to ensuring (a) that they do not erode the autonomy of public enterprises and thus hamper the very objectives and purposes for which the enterprises have been set up and given corporate shape and for which they ought to be accountable; and (b) that what is sought to be secured is accountability in the true sense indicated in the preceding paragraph.*

III. Monitoring by the administrative Ministries

3.1 The instrumentalities through which the accountability of public enterprises is enforced are monitoring by the Government, audit procedures, Parliament Questions and examination by Parliamentary Committees, and 'vigilance' arrangements. Let us consider first the monitoring of public enterprises by the Ministries.

3.2 The monitoring takes diverse forms. Once a year, detailed material is called for the preparation of the Budget and the Annual Plan for the ensuring year (as also the Revised Estimates for the current year), and the material so received is studied and discussed in a number of meetings in the administrative Ministry, the Finance Ministry and the Planning Commission. This provides an occasion for reviews of production, profitability, cash flows and the generation of resources, project implementation, problems (if any), and so on. Apart from this, Quarterly Performance Review (QPR) meetings are held with reference to a number of prescribed reports, returns and statements forming part of what is known as the Management Information System, which has been developed to different degrees of refinement in different Ministries.

3.3 But that is not all. Throughout the year there is an enormous inflow of reports, returns, statements, and so on, from the public enterprises into the Ministries. Some of these statements are annual, some half-yearly, some quarterly, some monthly and some of still greater frequency

(e.g., fortnightly or weekly); there are even instances of daily telex messages giving production information, and we are told that there are cases in which information is received in the Ministry twice a day ! Apart from these, there are *ad hoc* requests for information from time to time for diverse purposes. Some of these, once introduced, tend to become regular returns. The burden all this casts on the public enterprises can be well imagined. Another problem is that details of a similar or only slightly different nature are called for by different agencies in Government in different forms. It is not as if all this enormous inflow of information is fully utilised for policy formulation or for decision making purposes in Government. A good deal of the information merely gets buried in files.

3.4 Not only is there a constant and continuous review (or, shall we say, the *appearance* of it) of production, financial results, projects, etc., but there is also an endless stream of queries and requests for information regarding specific actions or decisions of the public enterprise Managements relating to contracts, dealerships, agencies etc., or regarding alleged irregularities and malpractices. Reports are sometimes called for with reference to Parliament Questions and sometimes in response to complaints, allegations, representations or recommendations received in the Ministry from various sources.

3.5 As regards meetings, these are not confined to periodical review meeting; there is an enormous number of meetings for diverse purposes, and many of the senior executives of public enterprises have to attend meetings in the Ministries several times a week and sometimes even daily. The position is particularly bad in the case of public enterprises which are located in Delhi, but the Ministries do not hesitate to summon even the senior executives of public enterprises located outside Delhi for frequent meetings and consultations. The Chief Executive of practically every public enterprise, wherever located, has to make more than one visit to Delhi every month; they are virtually treated as officers of the Ministries. Lastly, there are queries, instructions and informal suggestions through frequent telephone calls to public enterprises.

3.6 *It will not be an exaggeration to say that the Ministries have tended to integrate and absorb the public enterprises and convert them into mere extensions of themselves. This is aided by our concepts of 'administrative Ministry' and 'administrative control'*, which merit some attention.

3.7 It is significant that each public enterprise is said to be *under* a particular Ministry. We tend to take this for granted but this is by no means self-evident or the only kind of arrangement possible. Public enterprises are business ventures of the Government. The Government contributes their equity capital to begin with and thus plays the role of investor and owner; it also provides long-term loans for the public sector projects and thus assumes the role of a development banker; and occasionally, it even provides a part of the working capital funds. None of this necessarily leads to the conclusion that a public enterprise should be 'under' a Ministry. Private sector companies to which the financial institutions provide term loans and equity are not held to be 'under' the financial institutions. Undoubtedly the shareholders as the ultimate owners of a company have a certain role to play through the Annual or Extraordinary or Special General Meetings, have to pass certain Resolutions, elect the Directors, and so on; but the shareholders do not play a managerial role. The Government also plays the role of economic planner and regulator, but this role is played in relation to the economy as a whole including both the private sector and the public sector; this by itself does not call for a relationship between Government and public enterprises which is different from the relationship between the Government and the private sector units in the economy. Nor can the relationship between the administrative Ministry and the public enterprise with which it is concerned be usefully explained by the analogy of the holding company and its subsidiaries; a holding company performs a role of broad policy guidance, surveillance and coordination, whereas the role of the administrative Ministry *vis-a-vis* the public enterprise goes much further. If there has been a tendency for the relationship of master and subordinate to develop between an administrative Ministry and the public enterprises with which it is concerned—and it is such a relationship which is implied when it is stated that a public enterprise is 'under the administrative control' of a particular Ministry—this is because of several circumstances and factors.

3.8 Firstly, the Ministry has to present the Demands for Grants relating to the enterprise to Parliament, release the funds so voted to the enterprise, answer questions in Parliament relating to the enterprise, and thus function as the channel of communication through which the accountability of the enterprise to Parliament is discharged. Secondly, the Ministry appoints the Board of Directors and the top management, and holds over the top Management the power of termination of appointments. (About this we have had something to say in our earlier Report). Thirdly, when the Government first undertook commercial, manufacturing, or other business ventures, this was done through departmental undertakings; and some elements of the relationship between a Ministry and its departmentally run undertakings continue to subsist in the relationship

between the Government and public enterprises, despite the corporate form given to the latter. Lastly, the Ministry has to reckon with the expectations on the part of the general public and the Press regarding the level of knowledgeability and responsibility which it has to maintain in relation to the public enterprises within its purview. *Thus, in its relationship with a public enterprise, the Ministry's inherent tendency to slip into the kind of role with which it is familiar* vis-a-vis *departmentally run undertakings is strengthened and reinforced partly by its having to function as the conduit through which the accountability of the public enterprise to the Parliament is discharged, and partly by the general and widespread assumption that it ought to be fully knowledgeable about and responsible for every detail of what happens in public enterprise.*

3.9 The last is an important point. On the one hand, there is a general expression of concern for the autonomy of public enterprises and a depreciation of bureaucratic interference; on the other hand, when some specific instance of alleged inefficiency or irregularity or impropriety in a public enterprise comes to notice, there is a general presumption that the administrative Ministry must be aware of and is answerable for such things. This kind of ambivalence and inconsistency needs to be explicity recognised and resolved; left tacit, it tends to complicate the relationship between the Ministry and the public enterprise.

3.10 Undoubtedly, administrative Ministries should monitor the performance of public enterprises, review their production plans, keep an eye on the progress of their projects, watch the availability to the economy of the items which the public enterprises are to produce, see that the cash flows and the generation of resources in the public enterprises are upto the expectations, and so on; but all this does not call for daily, weekly or even monthly reports or excessively frequent meetings and consultations. Quarterly performance reviews ought to be adequate; and of course the once-a-year budgetary exercise is inescapable. Even quarterly reviews cannot be satisfactorily programmed if there is too large a number of public enterprises within the purview of one Ministry, in which case the meetings might have to be half-yearly. There is certainly need for information but to the extent possible the information requirements of different agencies in Government should be integrated and met through one set of reports and returns. *There is urgent need to review and drastically reduce the enormous number of reports, returns and statements flowing into Ministries from the public enterprises, limit them to the inescapable minimum, and ensure that there is a machinery in the Ministry for the effective review of the information through QPR meetings with which all the agencies concerned in Government are associated.* Such an exercise has been attempted in one or two Departments (e.g., Chemicals and Fertilizers), but this needs be carried out in a systematic manner in all the Ministries.

3.11 A thought which may be interjected at this juncture is that *it would be better to refer to this as the 'Monitoring and Information System' of the Ministry rather than the 'Management Information System'.* What is meant by the latter is of course that the economic Ministries such as Steel and Mines, Chemicals and Fertilizers, Energy and Petroleum, Industry, etc., have all a management role to perform in relation to the sectors of the economy with which they are concerned; and that their information system should be designed to meet the requirements of such economic management. However, the expression might tend to convey the misleading suggestion that these are Management Information Systems in relation to the public enterprises with which the Ministries are concerned, or in other words, that the ultimate management of the public enterprises vests in the administrative Ministries. This is an impression which ought to be avoided. *In so far as a public enterprise is concerned, its Management Information System should stop with its Board of Directors. The role of the Ministries is to review and monitor and not to manage the public enterprises.* This may seem a mere semantic point but the nomenclature has the potentiality to influence attitudes.

3.12 Outside of the QPR meetings which should be an integral part of the monitoring system, there should be no need for other reports, returns or meetings. The tendency to institute a new return or report whenever a new problem, difficulty or requirement comes to notice, and the tendency to convene meetings at the least provocation, need to be severely curbed. *It may not be possible to lay down the rigid rule that there should be no meetings whatsoever outside of the QPR meetings, but there should be a conscious effort to minimise meetings and to resist the temptation to summon the Chief Executives and Directors of public enterprises to attend meetings in the Ministries, particularly when they are located outside Delhi.* We are of course not referring to the meetings which might have to be convened to consider specific proposals such as proposals for sanctions to projects, which are received from the public enterprises themselves; or to the meetings of working Groups in connection with the formulation of the Five Year Plan or special policy review groups which might be set up, and in which the Chief Executives or senior officials of public enterprises might be included as members. What we are seeking to minimise is meetings for performance reviews or for operational matters connected with public enterprises or for dealing with problems which ought to be left to the public enterprises to deal with.

3.13 *As regards* ad hoc *requests for information, telephone calls, etc., there should be an effort to curb these.* If an information system has been laid down with care to cover all the requirements, it should not be necessary to call for further information from time to time. *Once the information system has been reviewed and streamlined, there should be a definite embargo on the addition of more reports and returns from time to time except with clearance at a level not lower than that of the Secretary of the Ministry.*

3.14 It is also customary for Ministries to receive copies of the agenda and proceedings of the meetings of the Board of Directors of the public enterprises, for record in the Ministry. It can be useful to have these on record but the temptation to examine them with a view to asking supplementary questions or issuing instructions to the public enterprises should be resisted.] *The relationship between the Ministry and the Boards of public enterprises should be essentially through the Government Directors, and as we have already observed in our earlier Report there should be no excessive formalization of the role of the Directors.* (EARC II/Report No. 2, paragraph 5.10).

3.15 Apart from the reports and returns which form the subject matter of QPR meetings in the Ministries (with which the Bureau of Public Enterprise is also associated) the Bureau tends to ask for separate information direct from the public enterprises for its own purposes. In so far as this is merely in the form of requests for financial and statistical information for the purpose of the compilation of the Annual Surveys that the Bureau brings out, there need be no objection, as this material is readymade and is to be provided after the completion of the financial year, and there is no extra burden on the public enterprise Managements. However, the Bureau also asks for information for the purpose of certain reports which it submits to the Government, such as 'quick' profitability reports from time to time, detailed information for a Half-Yearly Report to the Government on major public sector investments, etc. The provision of information for such purposes is also a part of the accountability of public enterprises to the Government. Whether this accountability should be discharged through the administrative Ministry concerned or through the Bureau of Public Enterprises is a matter which needs consideration. However, we shall deal with this in a separate report on the role of the Bureau of Public Enterprises.

3.16 *Summing up the above discussion, we would make the following recommendations :*

(i) *There should be a radical re-examination of the nature of the Government's relationship with public enterprises. The concept of 'administrative control' should be throughly reconsidered with a view to restoring to the public enterprises the freedom of management which the IPR* 1956 *envisaged. Public enterprises should be distanced from the Ministries and the latter confined to periodical reviews of over-all performance with reference to overall objectives. The constant stream of instructions, questions, requests for information, summonses to meetings, telephone calls, etc., should be drastically curtailed. The detailed supervision of operational matters should be stopped. Determined efforts should be made to get away from the tendency on the part of the administrative Ministries to treat public enterprises as subordinate offices.*

(ii) *All Ministries concerned with public enterprises should undertake a thorough review of their existing information systems, reduce the very large number of incoming reports and returns significantly, and ensure that the requirements of diverse agencies are met through one integrated set of forms, and that the incoming information is processed and reviewed effectively through joint meetings at periodical intervals, not oftener than once in a quarter. It should be recognised that in relation to public enterprises the role of the Ministry is one of monitoring and not management.*

(iii) *Once the information system has been reviewed and streamlined, there should be a definite embargo on the addition of more reports and returns from time to time except with clearance at a level not below that of the Secretary of the Ministry.*

IV. The audit of public enterprises

4.1 An important instrumentality for the enforcement of the accountability of public enterprises is audit. Indeed it is audit which comes to mind first when a reference is made to accountability. It is therefore necessary to consider the auditing system in relation to public enterprises very carefully.

4.2 Public enterprises are subject to a double audit. There is first an audit by a firm of chartered accountants who are the statutory auditors of the enterprise in question; this is then followed by a supplementary and super-imposed audit by the Commercial Audit wing of the Comptroller and Auditor-General's organisation, in terms of Section 619 of the Companies Act. The CAG's audit in turn has several facets. and its results appear in multiple forms: comments on the accounts (or, in the alternative, a statement to the effect that there are no comments) to be published along with

the Balance-Sheet and Profit and Loss Accounts; 'audit paragraphs' on particular executive actions, decisions, transactions, etc., published in one of the parts of the CAG's Commercial Audit Report; and comprehensive reviews or appraisal reports on entire organizations or some aspects or activities thereof. (The CAG's comments on the accounts of all public enterprises are also collected together and published in a separate part of the CAG's Commercial Audit Report, entitled "Resume of the Company Auditors' Reports and Comments on Accounts of Government Companies").

4.3 Many senior executives of public enterprises, as also some students of public administration and of the management of public enterprises, have been critical of what looks like a hypertrophy of audit control over public enterprises in this country. Our attention has also been drawn to the fact that there are other countries, for instance the U.K., in which public enterprises are not under the audit of the Comptroller and Auditor General. However, in India there is a well-established tradition of scrutiny by the CAG, and considering the massive investment of Government funds in public enterprises, we believe this is right and sound. At the same time, we have to ensure that this exercise places the minimum strain on the Managements of public enterprises and becomes as instrument for guiding them and not, as has been represented to us, something which inhibits initiative and encourages greater attention to procedure than to results.

4.4 Taking first the audit of the accounts in terms of Section 619 of the Companies Act, it has been persuasively represented to us that this imposes severe strains on the public enterprises. A public enterprise has first to get its accounts audited by its statutory auditors and then get them passed by the Board and certified by those auditors; it is only thereafter that the supplementary audit by the CAG can formally begin, even though it is in fact commenced earlier on an informal basis. Thereafter, on the completion of the second audit the observations of the Director of Commercial Audit have to be placed before the Board once again together with the replies of the Management, and these have to be printed alongside of the accounts; or alternatively, the necessary corrections and modifications to the accounts have to be carried out in the light of the observations, so as to obtain a declaration that the CAG has no comments on the accounts. Such corrections and modifications to the accounts, even if they are few and minor, (in fact, even if there is only the addition of a Note below the accounts), necessitate a second passing of the accounts by the Board and a fresh certification by the Company's statutory auditors. This is a cumbersome system, and public enterprises have to strain every nerve to complete the entire process and submit the accounts to the Annual General Meeting within the deadline prescribed under the Company Law. In the process, the Management does not always have adequate time to hold discussions with the Director of Commercial Audit, provide suitable explanations and persuade him to see its point of view on at least some of the points raised. Such a system seems *prima facie* to be in need of a review.

4.5 The system also places public enterprises at a disadvantage vis-a-vis the private sector. The publication of the accounts of public enterprises, not merely with the usual auditor's report but also with a number of comments by the CAG (or with a large number of 'Notes below the Accounts', of varying degrees of significance, added as a result of the CAG's audit), may tend to give the impression to the general public that the public sector is more inefficient and less business like in its book-keeping and gets a less clean bill of health from the auditors, than the private sector. Such an impression may gain further strength from a perusal of the separate report by the CAG in which comments on the accounts of all public enterprises are brought together in one volume. While in the audit reports on individual organizations such comments can at least be seen in perspective against a total picture of the general state of accounts in that organization, the assemblage of such comments relating to a large number of public enterprises in one volume—and audit comments by their nature relate only to defects and deficiencies—could give the misleading impression of warranting general adverse conclusions regarding the state of accounts in the public sector as a whole. And yet, if enterprises in the private sector were similarly subjected to a double audit and the defects and deficiencies in individual units brought together in one volume entitled "Comments on the accounts of private sector companies", the picture presented might be no better and might be even worse. But such a system applies only to public enterprises, and general and unfavourable conclusions regarding their comparative efficiency are bound to be drawn, however unwarranted. In any case, public enterprises have too many critics, some of them motivated ones; it appears to us that the audit arrangements for them need not be such as unwittingly to provide hostile critics with further material for unfair comments, adversely affecting the reputation of public enterprises and the morale of their executives.

4.6 Further, the system could also give rise to differences of opinion between the chartered accountants and the CAG's organization on questions of classification, accounting principle or policy, disclosure requirements, etc. Such differences between two teams of professionals, each acting conscientiously, are inevitable on occasion; and the Managements of public enterprises could find themselves in a vary difficult position in such a situation.

4.7 On the whole we feel that the CAG's audit need not be a duplication of the kind of audit which the chartered accountants do. The functions envisaged in Section 619 of the Companies Act are essentially a part of the cycle of completion of the annual accounts for submission to the AGM. It seems to us that the CAG need not be involved in this process. We hasten to add that this argument is not proceeding in the direction of suggesting the removal of public enterprises from the purview of a scrutiny by the CAG; we have already expressed ourselves against such a suggestion. The possibility that we are urging for consideration is that the Indian Audit Department should divest itself of the burden of the regular audit of the accounts, and play instead a wider, higher and more positive role by undertaking periodical overall appraisals of the performance of public enterprises. This would of course require appropriate amendments to the Companies Act. Naturally the Comptroller and Auditor General will have to be consulted before any such changes are made.

4.8 It may be argued that the CAG's audit does in fact result in a number of comments or Notes below the Accounts, and that this itself proves that such a double audit is necessary. However, the accounting of accruals and liabilities is at best an approximation and perfection in this matter can never be reached. However carefully the accounts are audited by one auditor, it is always possible for another to find that certain accruals and liabilities have not been fully reflected or certain contingent liabilities not disclosed in the accounts, or that certain deficiencies exist in the records. Indeed, if the accounts, after an audit by the chartered accountants and a supplementary audit by the CAG's organization, were to be subjected to a further audit by yet another agency, this too could result in additional comments. At no stage would we be able to say that finality has been reached. There may indeed be a few instances in which the comments arising from the second audit result in a significant modification of the picture presented by the company and its statutory auditors, but we doubt if this warrants a standing system of double audit for the whole of the corporate public sector.

4.9 We must clarify that with the change that we envisage, the possibility of an examination of the accounts of a public enterprise by the CAG is not ruled out. An overall appraisal of the performance of an organization could include a review of its accounts, and appropriate comments on the state of accounts could certainly be included in the appraisal report. (Such a review would also enable the CAG to form an opinion on the quality of audit conducted by the chartered accountants; this would enable the CAG to review and revise the panels of chartered accountants maintained by him for the purpose of nomination of auditors for Government Companies). But all this need not be done as a part of the cycle of completion of accounts and their submission to the AGM. For the latter purpose, public enterprises might well be allowed to follow the same procedures and be subject to the same formalities as the private sector.

4.10 We turn now to the question of overall appraisal. Every investment decision is taken with reference to certain objectives: a principal objective, perhaps of (profitable) production or of trading, and a number of subsidiary objectives, social, economic or other. It is clearly necessary to see in due course what relationship the actual achievements and costs bear to the projections made at the time of the investment decision. It is of course possible to entrust the appraisal to a specialized agency such as a Management Institute or a consultancy organization or even a professional group within the Government such as the Project Appraisal Division of the Planning Commission. However, the Audit Department in India has in fact been undertaking such appraisals, and we would support this. What is important is to recognize that this activity has to go beyond audit in the usual sense, and must involve several other techniques and skills in addition to those of auditors; in fact the orientation of such overall appraisals has to b different from that of the normal audit function. For instance, the purpose of audit is essentially fault-finding, whereas an appraisal attempts to compare results with objectives and come to a finding, favourable or unfavourable. An audit paragraph implies an adverse comment; the process of audit is essentially a search for points on which adverse comments can be formulated. If no such points are found, no audit comment appears. If a development bank were to undertake an appraisal of a project financed by it and finds that all the objectives have been realised at reasonable cost, its appraisal report will express satisfaction; whereas in such an instance, an auditor would either refrain from publishing any report or mention only those instances in which there was some shortfall or deficiency. We feel that appraisal reports on public enterprises, even if carried out by the Audit Department, should be guided by the kind of approach and orientation that a development bank or a Management consultancy organization would bring to the task.

4.11 A point of some importance in this context is that a proper appraisal or evaluation would require a multi-disciplinary team. Some technical experts or specialists or eminent persons with relevant experience are doubtless associated with the sittings of the Audit Board, but that is too late a stage for such association, as the Board can only consider a draft report which has already been compiled by a body of auditors. It is necessary to constitute a multi-disciplinary appraisal team right from the start. The team should consist of technologists, engineers, economists, project evaluators, financial analysts and accountants; and the leader of the team should be an experienced project evaluator and not an auditor.

4.12 As such appraisals would involve a considerable amount of work on the part of both the Audit department and the Managements of public enterprises, they would impose too heavy a burden if attempted annually. Besides, it is also necessary to allow a reasonable period of time for a study of the appraisal report and the taking of appropriate remedial action in the light of such study; this will not be feasible if immediately after the completion of one report, work on the next report begins. We would therefore suggest that such an appraisal report should be taken up in respect of each enterprise only once in three years. In the case of very large organizations where even a comprehensive appraisal report once in three years would be an enormous task, it may be better to take up particular units or aspects or operations for appraisal reports; but here too the intervals between reports should be such as to allow a reasonable period for study and action. We would also suggest that the appraisal report should be completed within a reasonable period of time and should be susceptible of fairly quick study, as a prolonged lapse of time in the completion of the appraisal report or in its examination by those concerned would result in the report becoming out of date and having to be updated from time to time; such updating exercises could add to the delays and become a never-ending process.

4.13 Needless to say such overall appraisals of the performance of public enterprises should extend not merely to what the Management has done or not done but also to decisions, directives, guidelines, etc., provided by the Government which may have a bearing on production, profitability and the general performance of the enterprise. If delays in governmental clearances, directives in regard to pricing which are not part of any statutory price control, the incidence of taxation and other similar factors are hampering the fulfilment of the basic objectives for which an enterprise was set up, this needs to be brought out in the appraisal report.

4.14 Lastly, as mentioned earlier, the CAG's audit also results in a series of audit paragraphs on particular actions or transactions or decisions or contracts. In the case of Governmental operations, there can be no appraisal of the functioning of Government as a whole, and audit has to be directed towards the regularity and/or propriety of particular expenditure or transactions. There could be some reviews of departmental schemes or programmes, but by and large audit as applied to Governmental expenditure has necessarily to be directed towards the individual case, the specific expenditure or the particular decision. The extension of this approach to public enterprises is based on a misconception and is fraught with danger. In the course of implemeniation of a project, and in the course of current operations in a project which has gone into production, the public enterprise managers have to take a series of decisions on various matters, such as purchases, contracts, etc; decisions have also to be taken in response to technological problems or constraints, market changes, and so on. Some of these decisions may be wrong, some may be right, and some may be positively brilliant, but none of these is an end in itself; they all contribute to an overall level of performance which is what matters in the end. Further, an adverse comment on an individual case is equivalent to a statement that in a given situation an alternative view or decision or action was possible; but this amounts merely to the substitution of the auditor's judgement for that of the authority charged with the responsibility for executive action. The most serious consequence of such *ex post facto* questioning of the exercise of judgement or discretion or of the making of decisions, is that it tends to undermine the confidence and initiative of the executive who has to function under the pressure of actual circumstances and usually under a time-constraint, and to promote the evasion of responsibility. The questioning of the exercise of delegated authority, or the 'second guessing' of the considered decisions or actions of competent authorities, is a matter not to be lightly undertaken even in the audit of Governmental expenditures and transactions, much less in the case of an autonomous business organization. This kind of micro-audit of isolated judgements, actions, decisions, etc., seems to us to go counter to the *raison 'd etre* of the corporate form given to public enterprises, and to be not in conformity with the spirit of the Industial Policy Resolution of 1956 to which we had made a reference earlier in this Report. Any references to individual cases or actions should in our view be exceptional and should be only for the purpose of illustrating the overall style and efficiency of the organization, as part of the appraisal report envisaged in the preceding paragraphs.

4.15 In the light of the above we would recommend :

(i) *that in consultation with the CAG, and through appropriate amendments to the Companies Act, the disability of a double audit in the case of public enterprises (which places them in a disadvantageous position vis-a-vis the private sector) should be removed, and they should be allowed to complete their accounts, get them audited and submit them to the Annual General Meeting in accordance with the same procedures and subject to the same formalities as the private sector;*

(ii) *that instead of duplicating the kind of audit which the chartered accountants do the CAG should play a wider, higher and more positive role of periodical overall appraisals in relation to public enterprises;*

(iii) *that such appraisals should go beyond audit in the usual sense and must involve several other techniques and skills in addition to those of auditors, and should be guided by the kind of approach and orientation that a development bank or a management consultancy organization would bring to the task; that they should not be confined to fault-finding and commenting on deficiencies but should also bring out achievements: they should compare results with objectives and come to a finding favourable or unfavourable;*

(iv) *that such appraisals should be carried out under the auspices of the CAG by multi-disciplinary teams consisting of technologists, engineers, economists, project evaluators, financial analysts and accountants and led by an experienced project evaluator;*

(v) *that such appraisals should cover not merely the actions or omissions of the Management but also governmental decisions, directives, delays, etc., which have had a bearing on the performance of the enterprise in question;*

(vi) *that such an appraisal of each enterprise should be attempted not annually but once in three years or so, and should be completed within a reasonable period of time and should be susceptible of quick study, so as to obviate the need for repeated updating exercises; and*

(vii) *that the 'audit paragraph' approach, which consists in a micro-audit of isolated actions, decisions, judgements, etc., should be avoided as this undermines the confidence and initiative of the executive and promotes the evasion of responsibility; and reference to individual cases or actions should be exceptional and should be for illustrative purposes only, as a part of the overall appraisal report.*

V. Accountability of public enterprises to Parliament and its Committees

5.1 The kind of attitudinal changes on the part of the Government and the reorientation of the audit system that we have called for need acceptance and understanding on the part of Parliament and its Committees. A drastic overhaul of the relationship between the Government and public enterprises is hardly possible without the blessing and support of Parliament. This would call for some reappraisal by Parliament of the kind of control it wishes Government to maintain over public enterprises. The nature and extent of coverage of Parliament Questions and of the scope of investigations by Parliamentary Committees are matters which Parliament and its Committees have themselves to consider; they have to draw their own boundaries for their questioning and investigations. However, we trust we may without impropriety take the liberty of putting forward a couple of points for consideration in this connection.

5.2 Firstly, so far as we know, Parliamentary Committees are anxious that the operational freedom of public enterprises should not be eroded by excessive bureaucrative interference. But when Members of Parliament ask questions about the details of day-to-day administration or executive action, such as appointments, transfers, the awarding of contracts, purchase decisions, the institution or termination of dealership agencies, etc., or when Parliamentary Committees go into such matters, the necessary information has to be provided by the Ministry; the Ministry has therefore in turn to address questions on these matters to the public enterprise Managements. Once they get into the habit of asking the Managements questions relating to such administrative and executive matters, they tend to continue to do so even without the justification of Parliament Questions. [The erosion of the operational autonomy of public enterprises by the bureaucracy thus gets unwitting assistance, though this is far from Parliament's intention.]

5.3 Secondly, sometime in 1978 the Standing Committee on Public Enterprises (SCOPE) submitted a memorandum setting forth in muted language the dismay and demoralisation which the public enterprise executives (rightly or wrongly) felt at the series of reports issued in 1977-78 by the Parliamentary Committee on Public Undertakings under the Chairmanship of the late Shri Jyotirmoy Basu on such matters of day-to-day administration or housekeeping as guest houses or staff cars, or such operational matters as entertainment, foreign travel, publicity, etc.; and at certain general and highly derogatory observations about the managers of public enterprises contained in these and other Reports of the Committee. We are drawing attention to this Memorandum not because of the points made in it in answer to some of the criticisms but because it shows how a Parliamentary Committee's criticisms of minor lapses or general adverse remarks about public enterprise executives can have a demoralising effect on those executives, particularly as such criticisms get picked up by the Press or by motivated critics of public enterprises, and give the executives a feeling of hurt and humiliation.

5.4 Obviously there cannot be any limitation on the freedom of Parliamentary committees to comment on the performance of public enterprises and their executives, except such as they

choose to impose upon themselves. Since the development of the public sector has been proceeding with full Parliamentary support, we have no doubt that toning up the morale of public sector executives would have as much importance in the eyes of Parliament as drawing attention to such shortcomings and lapses as come to their notice. The question which needs consideration is how the apparently conflicting objectives can be reconciled.

5.5 We have already made one suggestion which should help in this direction: we have recommended that the reports of the Comptroller and Auditor General on the performance of public enterprises should have their focus not so much on procedural lapses or individual actions or decisions as on overall performance, and should dwell not only on shortcomings but also on achievements. Such a widening and re-orientation of the scope of the CAG's Reports would enable Parliament to have a better perspective on the performance of public enterprises; and while poor performance will continue to be criticised, approbation could be given to cases of excellence in performance.

5.6 We have a further suggestion to make. In view of the concern which has recently been voiced by Government at the highest levels about the importance of improving the performance of public enterprises and the keenness of Parliamentary interest in the subject which is evident from reports of Parliamentary Committees as well as debates on the floor of the House, it seems to us that *it might be useful*, particularly if Government accept our views about the need for greater autonomy and less departmental control over public enterprises, *to have a debate in Parliament based on a White Paper or a Policy Statement or a Resolution which seeks to define the basis and modalities of a new arm's-length relationship with public enterprises. Such a debate could provide an occasion for an examination by Parliament of the need for the establishment of conventions regarding the scope of Parliament Questions and of examination by Parliamentary Committees.*

VI. 'Vigilance' arrangements

6.1 One more instrument of accountability—and a serious inhibitor of executive action and decision-making in public enterprises—is the 'Vigilance' machinery and procedures. Undoubtedly, standards of probity, integrity and regularity have to be maintained and there has to be a machinery to watch this, but the externality of this machinery (consisting of the CBI and the Vigilance Organization), the lack of adequate knowledge and appreciation of the circumstances, urgencies and compulsions of executive action, the protracted quasi-judicial procedures which are followed and the general tendency (if we may put it paradoxically) to presume guilt until innocence is proved, all these together have an intimidating effect on the public enterprise executives.

6.2 For instance, in matter such as purchases or contracts, there is provision in theory for the acceptance of an offer other than the lowest, recourse to limited, single or negotiated tenders, the cutting short of procedures and formalities in an emergent situation, etc.; but in practice, the adoption of any route other than open tenders followed by the acceptance of the lowest offer is fraught with the danger of allegations of corruption by parties which fail to secure the order or the contract or even by disgruntled employees within the organization. This sets in motion CBI enquiries or the institution of formal departmental proceedings under the Vigilance Organization's auspices. This risk is present to a lesser extent even in the taking of decisions on establishment and house-keeping matters: employees with a sense of grievance can always start off enquiries or proceedings by making unfounded allegations.

6.3 Further, even if consultations take place with the Ministry concerned before proceedings are instituted, and the Ministry vouches strongly for the integrity and the unblemished record of the officer against whom allegations have been made and the respect in which he is generally held, nevertheless, the attitude of the Vigilance Organization and the CBI generally is that any one against whom an allegation has been made is a suspect officer and that it is up to him to prove his innocence in formal proceedings. This is what we meant by referring earlier to the tendency to presume guilt until innocence is proved. In due course an innocent officer may indeed be able to establish his innocence, but in the process some years pass and by the time he is exonerated, he is usually a broken man. He would already have suffered irreparable damage to his career and reputation; and even if efforts are made at that stage to restore his position in the organization, pay him the arrears of his pay and allowances, etc., things will never be the same again. Nor would he on any future occasion be able to take decisive action. Under the circumstances, the general tendency to play safe is understandable, but it inflicts a grievous cost on public enterprises in terms of delays in decision-making and consequent delays in projec implementation, as also the tendency to go in for a safe rather than a necessarily sound decision

6.4 An instance which was brought to our notice related to a proposal put forward by the Management of a public enterprise to end some protracted arbitration proceedings by accepting a compounded payment of a fairly handsome sum offered by the other party. Most Directors are said to have agreed that the sum offered was good and that a settlement would save an enormous amount of executive time and trouble, not to mention the avoidance of the costs involved in arbitration proceedings and the uncertainty of the outcome; but some are said to have pointed out that even if the arbitration lasted long and eventually produced a negative result no one would question the acceptance of the arbitration award, whereas a negotiated settlement, however sensible, was liable to be questioned on the ground that the payment obtained could have been larger, and allegations of collusion could not be ruled out. In the end, we are told that the Board settled for the 'safe' course of allowing the arbitration proceedings to continue.

6.5 A suggestion made to us by the Chief Executives of public enterprises in this connection seems worthy of consideration. They felt that if necessary the Chief Executives and the Directors of the organization could be within the purview of the Chief Vigilance Commissioner, and that the rest of the organization should be overseen only by the Board which ought to function as the vigilance Body for the entire organization. *In respect of all officers and employees below the Board level, the decision whether to launch departmental proceedings or authorise prosecution should rest with the Board, and there should be no need to consult either the administrative Ministry or the Chief Vigilance Organization in this regard.*

6.6 *Even in respect of categories which will still remain within the purview of the external Vigilance organization or may come within the purview of CBI investigations, there is a need for some attitudinal changes as well as institutional arrangements.* During the course of discussions on related issues in the context of the earlier EARC Report on Accountability in Government offices it was agreed that there was need to ensure that no case was taken up for investigation by the CBI or other Vigilance agencies without a proper screening at a senior level, that *before an officer was made to face proceedings or investigation his actions should have been reviewed by a group of his peers who had the necessary technical knowledge and familiarity with the milieu of his work, and who would view things in their proper perspective, that within the investigating agencies themseleves there would have to be a change in attitudes in viewing the actions of public servants; and that for this purpose persons of knowledge and understanding and with the ability to take a proper view would have to be inducted into those agencies. All this would apply equally to vigilance proceedings or investigations in the case of executives of public enterprises.*

VII. Accountability—for what ?

7.1 We have repreatedly stressed that public enterprises should be held accountable for overall performance and achievement of results rather than for individual actions or decisions. Towards this end there must be a clear statement of the objectives and purposes envisaged and the results expected, which can be a basis for the enforcement of accountability. As there are some purposes and objectives which are common to all public, entrprises and other which are specific to individual enterprises, this has to be a two-tier exercise. *In the first place, there has to be a statement of the Government's conception of the goals of the corporate public sector in the planned development of the economy.* This could perhaps be spelt out in the White Paper or policy Statement or Resolution we have recommended earlier (paragraph 5.6 above).

7.2 *Following such a general declaration and in line with it specific charters can and should be prepared for individual enterprises.* We are aware that with reference to the recommendations of Parliamentary Committees, Ministries have in fact been asking each public enterprise to prepare a statement of organisational goals. However, this is not a matter in which the initiative can be left to the enterprises. Since it is the Government which invests in public enterprises for certain purposes and objectives, it is for the Government to lay down what those objectives and purposes are, both as a general statement for public enterprises as a whole and as specific charters for individual enterprises.

7.3 Profitability will of course be one of the primary objectives in most cases. There could be a few instances in which an organisation is clearly not expected to make a profit (e.g. the Food Corporation of India) but these must be exceptions. In the past, there was some uncertainty as to whether public enterprises should make profits, but happily that situation has changed; increasigly, profit-earning has been receiving greater attention and stress is laid on the importance of public enterprises generating resources which could be ploughed back into the planned development of the country. The social responsibility and the fulfilment of other goals with which public enterprises may be entrusted shuold be met out of the resources generated by them and not by making an indirect draft on the exchequer by incurring losses. (This of course does not rule out the possibility of direct and specific compentation by the Government to public

enterprises for specific non-commercial responsibilities cast on them by governmental directive). However, the profits and losses of public enterprises need careful interpretation for a variety of reasons. The profitability of public enterprises is a complex subject which we propose to deal with in a separate report.

7.4 The objectives could be laid down not merely in financial terms but in physical terms as well, such as the levels of capacity utilisation and production. However, production by itself would not serve a useful purpose if what is produced merely gets added to the stock-holding of an organization; what is important is disposable production, which meets the needs of consuming industries or individuals. Again, public enterprises should not seek high profits by merely pushing up prices; cost reduction to raise profits should be an important objective. Technological upgradation and adequate research and development efforts which help lower costs and give better products to consumers could be other objectives. In the case of state-trading organizations or organizations which are in a monopolistic position, an important objective could be the ensuring of the availability of certain commodities or products in the economy at reasonable prices. There could also be certain other ancillary socio-economic objectives in each case. This is merely by way of illustration; the actual objectives in each case would need to be carefully spelt out.

7.5 We would caution that there should not be a multiplicity of objectives. There could be a primary objective and one or two subsidiary objectives; but if public enterprises were burdened with a large number of objectives, this would result in a lack of a clear sense of direction and lead to a diffusion of energy and effort. Moreover, the larger the number of objectives the greater the possibility of conflicts *inter se;* a multiplicity of objectives would also render the assessment of performance difficult. It too many tasks with equal weightage were assigned to public enterprises, then there is a danger of some blurring of responsibility and accountability. In this context we must draw attention to the problems created by the very large number of 'guidelines' issued by the Bureau of Public Enterprises from time to time. These are described as guidelines but are virtually treated as Government orders, and tend to become mini-objectives on a very large number of matters over and above the basic objectives of production, profitability, etc. They also tend to be treated by the Ministry, Audit and Parliamentary Committees as rules or orders to which public enterprises must conform, even slight deviations being treated as 'irregularties' for which the Management has to answer. Far from furthering accountability, such a proliferation of guidelines and instructions results in a serious erosion of autonomy and consequently of accountability as well.

7.6 *Within the framework of a charter for each enterprise laid down by the Government, the Managements of individual enterprises should formulate their own statements of corporate goals, targets and phased programmes with definite deadlines.* The annual or multi-year document so framed by each corporate Management should then constitute its commitment to the Ministry for the achievement of the projected results, and the Managements should be accountable for their fulfilment.

7.7 If it is agreed in principle that there should be (a) a specific charter laid down by the Government for each enterprise and (b) a corporate statement of goals, targets and programme within the frame work of such a charter, then *suitable groups can be set up to work out the scope and contents of each of these documents in detail and with care and precision. It should be possible to complete this task within a few months for the existing projects. As regards new projects to be sanctioned or new enterprises to be established hereafter, the objectives and purposes of the investment decision should be clearly set forth in the notes which are submitted to the Public Investment Board or to the Cabinet and should be reproduced in the body of the governmental approval which is issued or in an annexure to that document. This should be followed by the formulation of a corporate statement (in the case of a new organization) or additions to or modifications of the corporate statement (in the case of an existing organization).*

7.8 At present public enterprises, like their counterparts in the private sector, follow the practice of publishing a Director's Report along with their annual accounts as part of their Annual Report. This has largely become a ritual which does not serve much practical purpose. *We would suggest that the Annual Report should be made the occasion for a self-appraisal by the enterprise with reference to the goals, targets and objectives set forth in the Government's charter for it and the corporate statement to which it stands committed.* This self-appraisal should be carried out by a competent group of professionals within the organization, or if necessary outside help can be sought for this purpose. Naturally, this cannot be certified by the auditors, but it would nevertheless represent a claim by the Management of what they have been able to ahieve with reference to the objectives for which the organization was set up. This claim could then be examined at the time of the ex-post facto appraisal either by a Governmental agency or by the CAG's organization.

VIII. Summary of conclusions & Recommendations

Scope of report.

8.1 In this report we have been concerned with the broad concepts and systems relating to the autonomy and accountability of public enterprises, leaving the detailed procedures for governmental clearances and approvals to be dealt with in a later report.

(Paragraphs 1.1 & 1.2)

General approach : inter-relation-ship of autonomy and accountability.

8.2 (i) It was with a view to enabling public enterprises to be run efficiently and autonomously that they were set up as corporate entities. There is no conflict between autonomy and accountability; the two go together, and what conflict with both is control. A detailed and extensive system of control over the actions and decisions of the Management not only erodes autonomy but also in the process destroys the basis of accountability.

(ii) While public enterprises, like units in the private sector, must be subject to such statutory controls as exists, ideally they should be subject to no other constraints on their autonomy, though of course when they seek finance from the Government they must justify it fully. Here again, once the investment decision has been approved and the necessary funding provided for, the Management should be allowed to go ahead without seeking any further clearances except those which apply to all undertakings (whether in the public or in the private sector) such as those relating to industrial licensing, foreign exchange releases, etc.

(iii) The accountability concepts and instrumentalities which have come to prevail over the years are in need of careful reconsideration with a view to ensuring: (a) that they do not erode the autonomy of public enterprises and thus hamper the very objectives and purposes for which the enterprises have been set up and given corporate shape, and for which they ought to be accountable; and (b) that what is sought to be secured is accountability in the wider sense of answerability for the performance of tasks and the achievement of results, rather than in the narrow sense of responsibility for the correctness and propriety of individual actions or decisions or conformity to rules and procedures.

(Paragraphs 2.1—2.6)

Monitoring by Ministries.

8.3 (i) There should be a radical re-examination of the nature of the Government's relationship with public enterprises. The concept of 'administrative control' should be thoroughly reconsidered with a view to restoring to public enterprises the freedom of management which the Industrial Policy Resolution of 1956 envisaged. Public enterprises should be distanced from the Ministries and the constant stream of instructions, questions, requests for information, summonses to meetings, telephone calls, etc., should be drastically curtailed. The detailed supervision of operational matters should be stopped. Determined efforts should be made to get away from the tendency on the part of the administrative Ministries to treat public enterprises as subordinate offices.

(ii) All Ministries concerned with public enterprises should undertake a thorough review of their existing information systems, reduce the very large number of incoming reports and returns significantly, and ensure that the requirements of diverse agencies are met through one integrated set of forms, and that the incoming information is processed and reviewed effectively through joint meetings at periodical intervals not oftener than once in a quarter. It should be recognised that in relation to public enterprises the role of the Ministries is one of monitoring and not of management.

(iii) Once the information system has been streamlined there should be a definite embargo on the addition of more reports and returns from time to time except with clearance at a level not below that of the Secretary of the Ministry.

(Paragraphs 3.1—3.16)

Audit.

3.4 (i) In consultation with the CAG, and through appropriate amendments to the Companies Act, the disability of a double audit in the case of public enterprises (which places them in a disadvantageous position vis-a-vis the private sector) should be removed, and they should be allowed to complete their accounts, get them audited, and submit them to the Annual General Meeting, in accordance with the same procedures and subject to the same formalities as the private sector.

(ii) Instead of duplicating the kind of audit which the chartered accountants do, we feel that the CAG should play a wider, higher and more positive role of periodical overall appraisals in relation to public enterprises.

(iii) Such appraisals should go beyond the audit in the usual sense and must involve several other techniques and skills in addition to those of auditors, and should be guided by the kind of approach and orientation that a development bank or a management consultancy organization would bring to the task. They should not be confined to fault-finding and commenting on deficiencies but should also bring out achievements; they should compare results with objectives and come to a finding, favourable or unfavourable.

(iv) Such appraisals should be carried out under the auspices of the CAG by multi-disciplinary teams consisting of technologists, engineers, economists, project evaluators, financial analysts and accountants, and led by an experienced project evaluator.

(v) The appraisals should cover not merely the actions or omissions of the Management but also governmental decisions, directives, delays, etc., which have had a bearing on the performance of the enterprise in question.

(vi) Such an appraisal of each enterprise should be attempted not annually but once in three years or so, and should be completed within a reasonable period of time and should be susceptible of quick study, so as to obviate the need for repeated updating exercises.

(vii) The 'audit paragraph' approach which consists of a micro-audit of isolated actions, decisions, judgements, etc., should be avoided, as this undermines the confidence and initiative of the executive and promotes the evasion of responsibility; any reference to individual cases or actions should be exceptional and should be for illustrative purposes only, as a part of the overall appraisal report.

(paragraphs 4.1—4.15)

Accountability to Parliament.

8.5 (i) A drastic overhaul of the relationship between the Government and the public enterprises is not possible without the blessing and support of Parliament.

(ii) Parliamentary Committees' criticisms of minor lapses or general adverse remarks about public enterprise executives can have a demoralising effect on these executives, particularly as such criticisms get picked up by the press or by motivated critics of the public sector, and gives the public enterprise executives a feeling of hurt and humiliation. We have no doubt that doning up the morale of public enterprise executives would have as much importance in the eyes of Parliament as drawing attention to such shortcomings and lapses as come to their notice.

(iii) It would be useful to have a debate in Parliament based on a White Paper or a Policy Statement or a Resolution by the Government, which seeks to define the basis and modalities of a new arm's-length relationship with public enterprises. Such a debate could provide an occasion for an examination by Parliament of the need for the establishment of conventions relating to the scope of Parliament Questions and examination by Parliamentary Committees.

(Paragraphs 5.1—5.6)

'Vigilance' arrangements.

8.6 (i) The 'vigilance' machinery and procedures act as serious inhibitors of executive action and decision-making. The lack of adequate knowledge and appreciation of the circumstances, urgencies and compulsions of executive action, and the protracted procedures which are followed, tend to have an intimidating effect on the public enterprise executives.

(ii) In respect of officers and employees below the Board level, the decision whether to launch departmental proceedings or authorise prosecution should rest with the Board, and there should be no need to consult either the administrative Ministry or the Chief Vigilance Organization in this regard.

(iii) Even in respect of categories which will still remain within the purview of the external vigilance organization or may come within the purview of CBI investigations, there is a need for some attitudinal changes as well as institutional arrangements:

(a) Before an officer is made to face proceedings or investigation, his actions should have been reviewed by a group of peers who have the necessary technical knowledge and familiarity with the milieu of his rok, and who can view things in the proper perspective.

(b) Within the investigating agencies themselves there would have to be a change in attitudes in viewing the actions of the public enterprise executives. For this purpose, persons of knowledge and understanding and having the ability to take a proper view should be inducted into those agencies.

(Paragraphs 6.1—6.6)

8.7 (i) For the enforcement of accountability, there must be a clear statement of the objectives and purposes envisaged and the results expected.

Enforcement of accountability Governmental and Corporate statement of objectives.

(ii) In the first place, there should be a statement of Government's conceptions of the goals of the corporate public sector in the planned development of the economy.

(iii) Following such a general declaration and in line with it, specific charters should be prepared for individual enterprises. There should not be a multiplicity of objectives for a given organization; there should be a primary objective and perhaps one or two subsidiary objectives. An excessive number of objectives or a very large number of governmental 'guidelines' could lead to a diffusion of effort and energy and a blurring of responsibility and accountability, and could render the assessment of performance difficult.

(iv) Within the framework of the charter for each enterprise laid down by the Government, the Managements of individual enterprises should formulate their own statements of corporate goals, targets and phased programmes with definite deadlines. This document should then constitute the commitment of the organization to the Ministry for the achievement of the projected results, and the Management should be accountable for their fulfilment.

(v) Suitable groups should be set up to work out the scope and contents of each of the aforesaid documents with care and precision. It should be possible to complete this task within a few months for the existing projects and undertakings. For new projects or new enterprises, the objectives and purposes should be clearly set forth in the notes which are submitted to the Public Investment Board and the Cabinet, and should be reproduced in the governmental approval to the project or to the establishment of the enterprise; this should be followed by the corporate statement.

(vi) The Annual Report of each enterprise should be the occasion for a self-appraisal by the enterprise with reference to the goals, targets and objectives set forth in the Government's charter for it and the corporate statement to which it stands committed.

(Paragraphs 7.1—7.8)

EARC II /Report No. 6

GOVERNMENT AND PUBLIC ENTERPRISES : GOVERNMENTAL CLEARANCES AND APPROVALS

L. K. Jha
CHAIRMAN

CONFIDENTIAL

D. O. No. EARC-II/1/10/84-Adm.

आर्थिक प्रशासन सुधार आयोग

ECONOMIC ADMINISTRATION REFORMS COMMISSION

10, Janpath

New Delhi, March 13, 1984

My dear Prime Minister,

Normally one would expect that governmental procedures in relation to the Public Sector would be smoother, simpler and quicker than those which apply to the private sector. Unfortunately, this is not so. The multiplicity of approvals which the public sector has to obtain and the time taken in granting them are among the factors which hamper the efficiency of public enterprises. I now forward our third report on public enterprises entitled 'Government and Public Enterprises : Governmental Clearances and Approvals' which puts forward some recommendations to improve the situation.

2. As in the case of our earlier reports, copies of this letter and the report are being sent to the Ministers concerned with major public enterprises and to the Cabinet Secretary.

Yours sincerely,
Sd/-
(L. K. Jha)

Smt. Indira Gandhi,
Prime Minister of India,
NEW DELHI.

ENCL : Two copies of the Report.

CONFIDENTIAL

D. O. NO. EARC-II/1/10/84-Adm.

आर्थिक प्रशासन सुधार आयोग
ECONOMIC ADMINISTRATION REFORMS COMMISSION

10, Janpath

New Delhi, 13th March, 1984.

L. K. Jha,
CHAIRMAN

My dear,

I have great pleasure in enclosing for your information a copy of my letter to the Prime Minister together with a copy of our report 'Government and Public Enterprises : Governmental Clearances and Approvals'.

Your sincerely,
Sd/-
(L. K. Jha)

1. Shri Pranab Mukherjee, Finance Minister.
2. Shri N. D. Tiwari, Minister of Industry.
3. Shri N. K. P. Salve, Minister for Steel & Mines.
4. Shri Vasant Sathe, Minister for Chemicals and Fertilizers.
5. Shri P. Shiv Shankar, Minister of Energy and Petroleum.
6. Shri V. P. Singh, Minister of Commerce.

COPY WITH A copy of the report to
Shri C. R. Krishnaswamy Rao Sahib,
Cabinet Secretary, New Delhi.

Sd/-
(L. K. Jha)

56 Fin./84—7.

ECONOMIC ADMINISTRATION REFORMS COMMISSION

EARC-II/Report No. 6

GOVERNMENT AND PUBLIC ENTERPRISES : GOVERNMENTAL CLEARANCES AND APPROVALS

I. Introductory

1.1 In our Report entitled "Government and Public Enterprises : Autonomy and Accountability" (EARC II/Report No. 4), we had gone into the broad concepts and systems affecting the autonomy of public enterprises or relating to their accountability, and had indicated that the governmental approvals and clearances of different kinds needed by public enterprises, and the lines on which procedural simplifications could be effected and the processing of proposals expedited, would be dealt with in a separate report. The present Report is in pursuance of that indication.

1.2 The theme of our earlier Report was the need for operational autonomy to enable public enterprises to be run on business lines, this being the *raison d'etre* of the corporate form given to them. In this Report we are concentrating on the procedural hurdles which come in the way of the efficiency and success of public enterprises. It is obvious that companies/industries, whether in the public sector or in the private sector, are subject to certain common regulations, controls and procedural requirements; and generally speaking, public enterprises cannot claim or get any preferential treatment or waivers in this regard. However, our concern is with the fact that in the matter of getting governmental clearances there seems to be a measure of (perhaps unintended) discrimination against public enterprises. They usually have to comply with more tortuous procedures and in many instances they are required to seek the specific approval of the Government in matters where the private sector Management is free to act in its own judgement and discretion. This has the unfortunate effect of delaying action, which slows down the implementation of projects and raises their costs; it also causes interruptions and shortfalls in the production of running enterprises.

1.3 We recognise of course that the private sector is up to a point (and up to a point only) dealing with shareholders' funds whereas public enterprises draw upon the resources of the Exchequer; and that Government may therefore have to exercise a closer scrutiny over the investment proposals of public enterprises or their expenditure on the emoluments and amenities of their staff. However, it is our judgement, as explained more fully in subsequent paragraphs, that many of the clearances which public enterprises have to seek can either be dispensed with or granted through procedures which could be much speedier and more economical in terms of time and manpower than those which are followed at present. If unnecessary clearances are dispensed with, and if procedures for those which must continue are streamlined, there would be not only an improvement in the performance of public enterprises but also a measure of economy in administration, because all too often Ministries try to duplicate processes of examination which have already been gone through in the enterprises themselves by persons with greater knowledge and expertise than those in the Secretariat can be expected to possess.

II. Industrial approvals

2. We take industrial approvals first. A unit in either the public or the private sector may need an Industrial Licence for a new project, and the procedures followed are similar; public enterprises have no special problem in this regard. Similarly, so far as we know, both public and private sector proposals relating to foreign collaboration approvals follow the same route; public enterprises seem to suffer no special disability in this regard. As regards procedures for capital goods clearances, public enterprises do suffer a disability inasmuch as most of their proposals for capital goods imports are dealt with through inter-departmental consultations on files in the usual Secretariat manner, leading to considerable delays. *We have already dealt with this problem and made certain recommendations in relation to capital goods clearances for public enterprises in our Report on 'Industrial Approvals : Capital Goods Clearances' (EARC Report No. 14, submitted to the Government in October,* 1982). We need not repeat those recommendations here. However, extracts from that Report will be found in the Annexure to this Report.

III. Foreign exchange releases

General.

3.1 From such examination as we have been able to make of the matter, it seems to us that public enterprises suffer greater delays than the private sector in securing foreign exchange releases. There might be need for greater scrutiny in cases involving public funds than in those involving the use of private funds, but all releases of foreign exchange, whether for the private sector

or for public enterprises, are made from the same reserves or the same credits; we see no reason why releases of foreign exchange for public enterprises should be subject to more prolonged scrutiny or more protracted procedures than those which apply to private sector proposals. Further, any consideration at the governmental level should be limited to those aspects where greater knowledge and expertise are available within the Ministries than in the enterprises themselves.

Foreign exchange releases for projects.

3.2 Thus it is entirely appropriate that applications for import licences whether from the public sector or the private sector should be scrutinized by Government to see whether the equipment in question can be supplied from indigenous sources or must be imported, because Governmental agencies like DGTD do have much more information on this subject than enterprises applying for import licences. On the other hand when the need for import is accepted, it would be safe to assume that the technical judgement about the suitability of any particular equipment over another is better exercised by the experts within the enterprises than by the technical officers whose advice is available to Ministries. Similar freedom in regard to the choice of country of supply should also be given to the enterprise concerned except where on account of the availability of credits from particular sources, it is necessary on foreign exchange considerations to prefer supplies from one country rather than another. In the case of projects in the private sector, the Capital Goods Committee merely exercises a judgement on the order of magnitude of the foreign exchange required and the source from which it can be met, and leaves the actual decisions in regard to the selection of suppliers, contractors, etc., to the Management; there is no reason why the same attitude should not be adopted in respect of the public sector. If there is a superimposition of governmental judgement on such matters, Government takes away a part of the responsibility and consequently a part of the accountability of the public enterprise Management for the successful implementation of the project within the sanctioned time and cost. Further, examination of such matters on file by the administrative Ministry, its FA and the Department of Economic Affairs leads to avoidable delays, and casts an unnecessary burden on the Secretariat. As it is, the Secretariat is over-worked and, despite the steady increase in its manpower, cannot give prompt responses to the queries and communications that it has to deal with. Eliminating unnecessary work in the Secretariat which it is not even well-equipped to perform would not only be helpful to public enterprises but could lead to improved efficiency and economy in administration.

3.3 In cases where the foreign exchange needs of a project are being financed from a particular aid source, a part of the problem arises from the requirements of aid-giving agencies. Even after a project is accepted for foreign-exchange financing from a particular aid source, the conditions of such aid sometimes require the approval of the larger contracts by the aid-giving authorities; and as the documents are forwarded through the Government of India; the latter's approval also becomes necessary. This, however, is a problem common to both public and private sector projects, and the governmental involvement should be the same in both cases, that is, it should be confined to seeing that proper methods and procedures have been followed in the selection of consultants/contractors/ suppliers and that considered decisions have been taken by the Management or by the Board of the organization. In the case of the projects of public enterprises, there is a tendency for the Government to go beyond this and to undertake a *de novo* examination of the entire matter, treating the material submitted merely as evidence on the basis of which it has to arrive at its own judgement. This in our view is neither necessary nor desirable.

3.4 When the foreign exchange needs of a project are being financed not through one or two large project loans but through a package of minor aid allocations and/or free foreign exchange, and no special procedures have to be complied with to satisfy any external agency, the procedures for the release of foreign exchange should be much simpler so that the completion of the project could be expeditious. Unfortunately, even when a package of foreign exchange is worked out after a project is approved, this is not forthwith placed at the disposal of the project authorities; the foreign exchange is released from time to time on request as and when the project authorities negotiate particular purchases or contracts. Their applications are dealt with by the administrative Ministry and then recommended to the Department of Economuc Affairs through the F.A. of the Ministry. At each stage, the proposal is subject to a scrutiny to assess its essentiality, to see whether proper procedures have been followed, whether the best value is being obtained for the money, etc. This is a process which entails a lot of additional work in the Ministries and results in delays. Even when in some cases, as a result of such time-consuming scrutiny, some savings appear to have been achieved by making a few cuts here and there, all too often they are more than off-set by the delay in the production getting started and the increase in cost because of interest charges and price escalation. If (as in the case of the Kudremukh project) the foreign exchange release for a project is made annually instead of in driblets throughout the year, and adequate freedom is given to the enterprise to place orders, the project can get completed without overruns of time or costs.

3.5 In those cases in which the foreign exchange requirements are covered through one or two major project aid allocations or project loans, it is relatively easy to place the foreign exchange at the disposal of the project authorities soon after the investment decision; but even in other cases in which a foreign exchange package consisting of a number of relatively minor aid allocations and some free foreign exchange has to be worked out, this should be done at a fairly early date after the sanctioning of the project, and the releases should be done annually, at the beginning of each year and not in bits and pieces throughout the year on specific requests and proposals. In regard to purchases against such foreign exchange releases, public enterprises should enjoy the same degree of freedom and autonomy as the private sector does, and as they themselves do for indigenous purchases and contracts. [The objective of Government keeping an eye over them can be better achieved by the Government Directors on the Board than by involving two Ministries in the examination of each proposal after it has been approved by the Board of Directors of the enterprise.]

Maintenance imports.

3.6 Turning now to maintenance imports, i.e., imports of raw materials or other inputs or operating supplies needed for current production, there is a relaxed and liberalised regime of import control in operation. There are certain import policies in force in this regard. Items are either on OGL or are covered by 'Actual User', etc., policies, and there are systems of 'automatic' and 'supplementary' licensing. The objective is to ensure that the import requirements for current production are speedily met. Private sector units apply to the licensing authorities for their requirements. In theory, the same policies and procedures apply to public enterprises also; but on occasion, such proposals from public enterprises are dealt with on files by the administrative Ministry, referred to the Financial Adviser and then on to the Ministry of Industrial Development and the Department of Economic Affairs for the release of foreign exchange; this inevitably entails delays. Such file-processing occurs particularly if the automatic licensing is inadequate and supplementary licensing is found necessary for additional or unforeseen imports. Under such circumstances, private sector units apply to the licensing authorities through the sponsoring authority, which in most cases is the DGTD; and there is no reason why public enterprises should not follow the same route. The processing of their proposals on files in the usual Secretariat manner may be based on the mistaken assumption that public enterprises are helped by the assistance of the Ministry in this matter; in fact, however, routing through the Ministry often causes only delays. The policies and procedures in respect of imports for the purpose of current production ought to be exactly the same for both public enterprises and private sector units.

Submission of foreign exchange releases to Ministers.

3.7 There is a procedural rule of the Finance Ministry in terms of which foreign exchange releases of Rs. 2 crores and above have to be submitted to the Minister in charge of the Administrative Ministry as well as the Finance Minister, whereas in the case of the private sector the Chief Controller of Imports and Exports is empowered to issue licences worth crores of rupees in accordance with the policies in force, without seeking the orders of any higher authority. The release of foreign exchange involves a clearance of an import of goods or services under the prevailing import policy and a clearance of the quantum and kind of foreign exchange involved. Once the appropriate authorities have accepted the functional need for the goods or services in question, their indigenous non-availability, the need for import, the choice of the source of import, and the quantum of foreign exchange involved, the release of foreign exchange becomes inevitable. It is not quite clear why this kind of operational matter should be submitted to the Ministers. However, even if this is considered necessary as a discipline in the larger cases, this could at best apply to cases of isolated release of foreign exchange. Once a project has been examined in detail by the appraisal agencies, cleared by the PIB and approved by the Cabinet, and a sanction has been issued for the investment decision involved including an indication of the quantum of foreign exchange component, Government is clearly committed to providing that foreign exchange in some suitable form. This may be done at one go through a single project-aid allocation or a direct project-specific loan from an aid-giving agency, or the foreign exchange (aid allocations or free foreign exchange) may be released from time to time in the light of need. In either case, this is merely a logical consequence of the investment decision. It is not clear why in respect of a project sanctioned by the Government each individual release of foreign exchange should be repeatedly submitted to the administrative Minister and the Finance Minister. This casts an unnecessary burden on the Ministers and entails avoidable delays. This procedure seems even more unnecessary in the case of maintenance imports where the operational requirements have necessarily to be left to the Management and the question of import can easily be dealt with in terms of the prevailing import policy.

3.8 Summing up the above discussion on foreign exchange releases, we would recommend as follows :

(i) *Releases of foreign exchange for public enterprises should not be subject to more protracted procedures than those which apply to private sector proposals.*

(ii) *As in the case of private sector proposals which are considered by the Capital Goods Committee, the governmental judgement in considering the foreign exchange requirements*

of a project of a public enterprise should be confined to the order of magnitude of the foreign exchange required and the sources from which it can be met. Decisions in regard to the selection of suppliers, contractors, etc., should be left to the Managements. A super-imposition of governmental judgement on such matters diminishes the responsibility and accountability of the Management, leads to delays in project implementation and casts a responsibility on the Secretariat which it is ill-equipped to discharge.

(*iii*) *In those cases in which the total requirements of foreign exchange are covered through one or two major project loans, it should be easy to place the foreign exchange at the disposal of the project authorities at an early date after the investment decision. In other cases, where a combination of a number of relatively minor aid allocations and some free foreign exchange has to be worked out, this too should be done at a very early date after the sanctioning of the project; and the releases of foreign exchange should be made annually at the beginning of each year and not in a piecemeal manner throughout the year on specific requests and proposals.*

(*iv*) *The policies and procedures in respect of imports for the purpose of current production ought to be exactly the same for both public enterprises and private sector units, and there should be no need for the proposals of public enterprises to be dealt with on files in the normal Secretariat manner.*

(*v*) *The procedural requirement of the submission of foreign exchange releases over Rs. 2 crores to the administrative Minister and the Finance Minister should not apply to releases from time to time to meet the foreign exchange requirements of projects sanctioned by the Government. The sanctioning of a project implies a commitment to find the necessary foreign exchange, and the actual release of foreign exchange in each case is an operational matter to be dealt with by the appropriate authorities in terms of the import policies in force and the foreign exchange availability from different sources. Maintenance imports too have to be dealt with in terms of current policies and should not require a submission to the Ministers.*

IV. Indigenous purchases, contracts, etc.

4. We have so far been considering cases involving foreign exchange releases. Where there is no question of foreign exchange, public enterprises, in theory, have full freedom in contract/purchase decisions; but governmental intervention is not uncommon even in this area (e.g. pressures on behalf of other public sector organisations or in some cases even on behalf of private sector organizations within the country). Having set up large public sector organizations for certain purposes, e.g., HEC for supplying machinery for steel plants, MAMC for mining machinery, Hindustan Steelworks Construction Limited for civil construction and structural and equipment erection work for steel plants, etc., it is understandable that the Administrative Ministries concerned with these organizations should take up cudgels on their behalf in their efforts to secure contracts or orders. There are instances in which the Board or a Board Committee of a public enterprise has considered offers from diverse agencies, made a comparative evaluation of the offers, and chosen a particular party, but thereafter finds itself under pressure to place the order on or award the contract to a particular public enterprise which had lost out on the tender or failed to tender at all. *For meeting the needs of goods and services for the projects or the operations of public enterprises, there could be legitimately a preference for other public enterprises as suppliers, contractors, consultants, etc., within certain limits and subjects to certain conditions; but this has to be a matter of generalised policy and not one of* ad hoc *instructions in specific cases or of interventions in particular decisions.* Such instructions or interventions in particular cases should as far as possible be avoided, as they tend to impair the responsibility of the Managements of public enterprises for the completion of projects within the sanctioned cost and time, or for the efficient running of completed projects. *If in a particular case it becomes necessary for the Government to give instructions on a matter like this the instructions should be in writing.* This is because decisions in regard to the selection of suppliers, contractors and consultants are often subject to scrutiny by Audit and Parliamentary Committees at a later stage, and those who are called upon to defend the decisions should be able to find on record material on the basis of which they can be satisfactorily explained.

V. Releases of rupee funds for projects

5.1 One more constraint on the operational freedom and flexibility of public enterprises is the difficulty of getting rupee funds released from the Government. We are of course not suggesting that they should get money from the Government for the asking. A stringent scrutiny is certainly called for before a provision is made in the Government's Budget for investments in public enterprises by way of equity or loan towards the cost of sanctioned projects. During the Plan & Budget discussions, the requirements of the projects are (or should be) carefully considered with reference

to physical progress and the actual disbursement needs in the ensuing year; in view of the general constraint on resources, every effort is made both by the Ministry of Finance and by the Planning Commission to cut down the provisions to the inescapable minimum. Full account is also taken of the internal resources which the public enterprises could be expected to contribute towards the Plan outlay during the year, and efforts are made to minimise the draft on the Government's Budget. A second such scrutiny is made at the time of the Revised Estimates. It would therefore be reasonable to suppose that the funds so provided would be promptly made available to the public enterprises for implementing the sanctioned projects. However, this is not always the case.

5.2 The drill for obtaining funds from the Government's Budget for the sanctioned projects of public enterprises is that a quarterly projection has to be made of physical progress and disbursement needs; and in the light of this, the actual release of funds is made on a monthly basis. The intention is that the actual release of funds from the Government's Budget should be made no earlier than absolutely necessary. The result is that month after month the public enterprise executives have to keep making requests to the Ministry for the release of funds for disbursements on the projects under implementation. Inevitably, there are delays in the processing of such requests and the release of funds. In the last quarter, the Government's scrutiny becomes particularly stringent, and strenuous efforts are made to prevent the possibility of any significant carry-forward of unspent funds by public enterprises from one year to the next.

5.3 The result sometimes is that the funds required for current operations, *i.e.*, working capital funds, have to be used to make payments on projects, and then recouped on the receipt of project funds from the Government; and such recoupment can be delayed, leading to severe liquidity strains. Not only are the Managements obliged to use costly bank finance for making project payments, but there is also another undesirable consequence, namely, that they are sometimes obliged to delay payments to their consultants or contractors or suppliers because they have not yet received the release of funds for the month or for the quarter in question. This in turn could result in poor service from contractors and high prices for supplies. Large projects cannot be kept on a short leash in this manner.

5.4 *We would strongly urge that having once determined the provision to be made for a project in the Annual Plan and the Budget after a careful and detailed scrutiny of probable physical progress and disbursement needs (and of course with due regard to the resource constraint), there is no need for a detailed and protracted examination on the occasion of each release; in other words, the budgetary process should not continue throughout the year.*

5.5 *Ideally, the funds should be released in two instalments in April and October, but if necessary, the releases could be made quarterly in April, July, October and January. This release should be smooth and automatic; in the first three quarters, the funds should be released more or less for the asking. It is only in the last quarter that an effort should be made to regulate it with reference to the disbursement needs, so as to keep the carry-forward of unspent balances into the next year at a reasonable level. A drill should be laid down such that the funds needed for a given quarter would be in the hands of the project management before the commencement of the quarter.*

VI. Investment Approvals

6.1 In this section we are concerned not with questions of investment criteria or techniques of appraisal but with the machinery and procedures for governmental approvals to investment proposals from public enterprises.

Delegated authority of the Boards.

6.2 The powers of the Boards of public enterprises to sanction capital outlays have been fixed at different levels in different categories of enterprises in accordance with the size of the gross block. The delegated powers have been enhanced from time to time and they now stand at the following levels : Rs. 10 crores in the case of enterprises with a gross block of above Rs. 200 crores; Rs. 5 crores where the gross block is between Rs. 100 crores and Rs. 200 crores; and Rs. 2 crores where the gross block is below Rs. 100 crores.

Making the delegation real.

6.3 We have heard complaints that this delegation is not fully operative because of certain procedures and practices. The Plan takes into account the totality of the capital outlay of public enterprises including renewals, replacements and other minor and miscellaneous capital expenditures; *per contra*, on the resources side the Plan takes into account the internal resources of public enterprises, including the depreciation provision. This is merely for the purpose of enabling the Plan to reflect the total capital outlay in the public sector, and not with a view to whittling down the delegated authority of the public enterprises Managements; but such a consequence could and does follow occasionally. A condition for the exercise of the delegated power is that the capital outlay in question should stand included in the Annual Plan and the Budget; there is also a standard

requirement in the case of many public enterprises, in terms of their Articles of Association, that their Capital Budgets need the Government's approval. These two requirements taken together could be so understood as to reduce or nullify the delegated authority of the Boards of public enterprises to sanction capital expenditures. But this need not be so. What is needed is a reasonable aggregate provision in the Plan and the Government's Budget for renewals and replacements, balancing facilities and other minor and miscellaneous capital outlays. In support of such provision, some details may have to be given but this should be in the nature of a broad picture; every component need not be spelt out in detail. (Only the major projects which require governmental approval need to be specifically exhibited). *Once the Plan includes a broad aggregate provision for the purposes mentioned above, the delegated powers of the Board should be fully operative, and they should be able to sanction individual proposals for capital outlay without any need to seek the Government's approval except in those cases in which an individual item goes beyond their delegated limit. (Even this financial limit should apply only to new investments and not to renewals and replacements).*

Investment proposals needing governmental approval.

6.4 Let us now consider the processes of approval of these investment proposals which need governmental clearance. In regard to major new investments with direct allocation of funds from the Exchequer, there are certain aspects which the Government alone can examine, such as whether the proposed investment is in accordance with the priorities of the National Plan and whether the requisite resources can be found. The Government as investor and lender also plays a role partly akin to that of a financial institution when it examines an application for a term-loan. An appraisal of the investment by the Government is, therefore, inescapable. All that one can say is that the investment appraisal function should be carried out in a business-like manner and not in the traditional Secretariat style. Project appraisals cannot be dealt with through sequential notings by numerous officials and departments on a perambulatory file. It must be professional and should be completed within a reasonable time.

PIB Procedures.

6.5 These objectives led to the introduction of the Public Investment Board procedures in 1972. Undoubtedly, this was a great improvement on the earlier procedures and practices, but from what we heard during our meetings with the Chief Executives and Secretaries it appears that the actual operation of the procedures is not exactly on the lines envisaged. The time-limits prescribed are evidently not strictly observed; too many agencies continue to be involved in the Governmental scrutiny of major public sector investment proposals; and each appears to undertake an independent examination instead of functioning as part of a joint appraisal team. There seems also to be a queuing of projects for consideration by the PIB partly because of the load on its appraisal machinery.

Large projects arising out of the Plan : joint team for formulation and evaluation.

6.6 In this context we have to distinguish between two kinds of proposals for investment decisions. There are investment proposals, particularly those relating to large projects, which arise out of the processes of sectoral and national planning. During the deliberations of working groups set up in connection with the formulation of the Five Year plans and the discussions which take place in connection with the annual plans, the consideration of projections of demand and of likely capacities, as also of the country's endowment of natural resources, inevitably points to certain investments in new capacities or expansions of existing capacities; and broad indications of certain new projects emerge in this process. For instance, the discovery of large deposits of bauxite on the east coast led to the idea of two large projects for their exploitation; the discovery of Rampura-Agucha deposits led to a perception of the need for a new zinc smelter; the projections of demand/supply gaps indicated the need for certain new starts in the steel sector; the identification of large resources of natural gas (both free and associated) led to the projection of a large number of fertilizer projects. The examples can be multiplied, but the ones mentioned should be adequate to illustrate the point that certain projects or possibilities get tentatively identified during the course of the national planning processes. These are developed further, studied in detail and formulated into projects for investment decision through the agency of certain public enterprises. In such cases it is not necessary to adhere strictly to the formality of a two-stage examination, first within the enterprise and then in the Government. Such projects are not really corporate proposals submitted to the Government for approval, but nationally identified projects developed and formulated through the expertise available in public enterprises. In such cases, there is great deal to be said for the Government agencies concerned with project appraisal being associated with the Managements and expert groups in the public enterprises from the earliest stages of project preparation. Such a joint team for formulation/evaluation would not merely eliminate the delays involved in a two-stage processing, but would also ensure that all the relevant issues get raised at the earliest stages and that the appropriate analyses of alternatives, sensitivity studies, etc., get undertaken so that the resulting projects is as well-conceived and soundly structured as possible. This has in fact been done in respect of some large projects. There is a case for standardising the procedure.

Other projects : need to strengthen formulation/ evaluation skills in public enterprises.

6.7 However, the above applies only to the really major investment decisions in each sector, covering very large projects. Besides these, there are large numbers of investment proposals which get formulated within the public enterprises, arising out of their operational needs, or to realise the ideas of balancing, debottlenecking, diversification, expansion or backward/forward integration, which emerge out of the corporate long-range planning. In such cases, a formulation and evaluation at the enterprise level has necessarily to be followed by an examination at the governmental level with reference to broader issues and points of view. What needs to be done is to strengthen the project formulation and evaluation skills within the public enterprise so that projects get formulated, appraised and finalised in a thorough, competent and professional manner, and that what emerges from the organization is likely to be a able to withstand the processes of governmental scrutiny, provide answers to all the questions that can be raised, and minimise the need for the governmental authorities to refer the proposal back for supplementary information, modification or revision.

Multiplicity of appraisal agencies : need to reduce.

6.8. We referred earlier to the multiplicity of agencies which are involved in the governmental scrutiny of investment proposals from public enterprises. The 'appraisal agencies' include the Finance Division of the Ministry; the functional Division in the Ministry which is concerned with the public enterprise in question; the Plan Finance Division of the Finance Ministry; the Department of Economic Affairs; two Divisions of the Planning Commission, viz,. the functional Division concerned with the sector of development and the Project Appraisal Division; and three Divisions in the Bureau of Public Enterprises, i.e., the Production, Construction and Finance Divisions. In addition to these, the Ministries, agencies and organizations which are concerned with specific aspects or features of the project, such as the rail movement of equipment or inputs or output, the port facilities needed, the raw materials or utlities required, technological aspects, environmental considerations, etc., are associated with the meetings of the appraisal group. While such broad-based consultation is not merely useful but very necessary, the number of agencies which are actually involved in an examination of the viability of the project for an investment decision should not be unduly large. It seems to us that there is a need to review the number of agencies involved in the appraisal process and the reduce them to the extent possible.

Spirit of joint appraisal by a group.

6.9. It is also necessary to keep in mind the spirit of the PIB procedures which envisage a joint appraisal by all the agencies concerned. At present, though the form of joint appraisal is maintained and meetings are held by the F.A., the different agencies appear to be conducting separate examinations of their own, conveying their comments in writing and expecting separate replies in writing. We are also given to understand that the Managements of public enterprises have to conduct separate disucssions with diverse agencies, provide information or clarifications to queries raised and try to persuade each of the agencies concerned/separately of the viability of the proposal The meetings of the appraisal agencies seem to serve the purpose of coordination more than that of appraisal. This does not seem to us to accord with the spirit of the PIB procedures. Further, this process of appraisal could be reasonably expected to result in the submission of one self-contained note to the PIB. However, during our discussions with the Secretaries, we were informed that a number of agencies tended to submit their own separate notes to the PIB, so that there were sometimes five or six notes before the PIB on the same project. This is also not in the spirit of joint appraisal.

6.10. We would strongly urge that the joint appraisal envisaged in the PIB procedures should become a reality. The appraisal group should be regarded as a team which functions together as one unit and not as an inter-ministerial committee which consists of a number of individuals who represent different Ministries or organizations. The pattern to be adopted is that of the appraisal team or groups which are set up by the World Bank or the IDBI. The end result of the exercise should be a joint appraisal report, and this should be the only document to be placed before the PIB, with, if necessary, a brief forwarding memorandum from the Ministry.

PIB procedure should be made to work speedily.....

6.11. In any case, even with all the agencies involved, the PIB procedure by itself is not necessarily one which should cause delays, and there have been occasions when major projects involving investment decisions of large magnitude have been able to pass through the gamut of appraisal procedures and obtain the clearance of the PIB within a reasonably short period of time. We have been told that if a project has been well prepared in accordance with the Guidelines for the Preparation of Feasibility Reports issued by the Project Appraisal Division, and all the necessary information has been provided, there is no reason why the appraisal processes and clearances by the PIB cannot be completed within three months; and that there have been instances in which this has been done. We would merely stress that this should become the standard practice and not an exceptional feature in particular cases. We would also stress the need for strengthening and augmenting the professional manpower resources of the Project Appraisal Division, as it is that Division which has to submit a technical appraisal note to the PIB on all projects. The load on the appraisal machinery is sometimes said to result in delays in appraisal. With greater manpower resources, particularly of the kind which is trained and specialised in project appraisals,

not only can the quening of projects for consideration be minimised but the speed and quality of the appraisal can also be improved.

....but proper evaluation necessary.

6.12. Having said that, we must add that a certain minimum length of time must necessarily be taken in a proper evaluation and appraisal of a project. Project authorities sometimes express impatience at the questions which are asked, the supplementary information which is sought, and the exercises by way of sensitivity studies which are set for them at the appraisal meetings; but this is the very essence of a techno-economic appraisal of a project. However carefully the project is prepared at the company level, an examination by the agencies which assist the PIB and the PIB itself is necessary and inevitable; as already mentioned, this is akin to the examination undertaken by a financial institution when a private sector entrepreneur submits his project to them for the sanction of a loan or the under-writing of equity. To the extent that the work has been done well at the company level, the answers to all questions would be readily available, and the requirement of additional information would be minimised. Further, it must be remembered that even if the project is well prepared and seems extremely worthwhile from the corporate point of view, the gvernmental agencies bring to bear a different kind of scrutiny and judgement from the point of view of the national economy, or with reference to certain policies. However, it should be possible to complete the governmental examination and approval of the projects of public enterprises within six months from the date of submission at the most.

Supplementary questionnaire to be standardized.

6.13 One suggestion can be made in this context. If, in project after project, the appraisal agencies find it necessary to ask a large number of questions and request supplementary information on a number of aspects, this could be indicative of one of two things. One possibility is that the guidelines on the preparation of feasibility studies circulated by the PAD are not being properly followed by those who submit projects for consideration; if so, the guidelines have once again to be brought to the notice of everyone, and full compliance with them insisted on. But it is also possible that the guidelines themselves need revision, so as to incorporate all the requirements which have emerged in the course of examination of so many projects. We would suggest that the PAD and the other agencies between them should standardise a questionnaire and circulate it as a supplement to the guidelines on feasibility studies, so that the project authorities could then be requested as a matter of standard practice not only to submit a Feasibility Report, but also to supplement it with answers to the standard questionnaire.

The 'updating' problem.

6.14 Another complaint which is frequently made is that a good deal of time elapses from the initial formulation of a project to the stage when it comes to the Government, so that even at that stage the project cost estimates are a bit out of date and that they become more so by the time the appraisal procedures are over and the project is ready for submission to the PIB. Sometimes as much as a year and a half of even two years can pass between the initial formulation of a project and its reaching the PIB. In the circumstances, the appraisal agencies usually insist on an updating of the cost estimates. This process itself then takes a certain amount of time, and by the time the updated cost estimates are taken up by the appraisal agencies for examination, they are once again somewhat out of date, and become still more so by the time the project is taken up for consideration by the PIB; and the PIB at that stage sometimes calls for an updating of the estimates. This repeated updating of project cost estimates is time-consuming and is in a way a never-ending exercise, as each updating means more time. This does not seem to us to be an insuperable problem. In the first place, if the project is well prepared to start with, and if the appraisal procedures within the company and clearance by the top Management and the Board could be compressed into the minimum possible time, the estimates should not be significantly out of date when they reach the Ministry; and if, thereafter, the PIB time-table is adhered to, once again the estimates will be only slightly out of date by the time they reach the PIB. Secondly, even where the processes take a little longer, it should not be necessary to undertake a number of intermediate updating exercises each contributing its own dealy. We would suggest that there should be no attempt at a detailed revision of the cost estimates at various intermediate stages. The figures of the project report should be maintained from the time of submission to the Government right upto the time of consideration by the PIB and clearance by the Government. However, if in this process more than a year has elapsed, at the PIB meeting updated figures should be given. No elaborate updating exercise should be necessary for this purpose. A quick updating with reference to some relevant indices should be adequate. We would suggest that this practice should be standardised, so that there is no repetitive updating of a detailed item-wise kind on the basis of fresh inquiries and investigations.

Gist of discussion.

6.15 In the light of the above discussion the following conclusions follow:

(i) *The project formulation and evaluation skills in public enterprises should be substantially strengthened so that what comes to the Government is a well-prepared proposal on which the need for further information or clarifications would be minimal.*

(ii) *For the major investment decisions in each sector covering the really large projects about which there are no doubts in regard to need for priority or inclusion in the plan, the governmental agencies could be advantageously associated with the corporate processes of formulation and evaluation right from the earliest stages, so that examination within the corporate organization and examination by governmental agencies can run in parallel.*

(iii) *The number of agencies involved in the governmental process of appraisal should be reviewed and reduced.*

(iv) *The spirit of the PIB procedures which envisage a joint appraisal by all the agencies concerned should be observed, and an independent examination by each agency leading to separate discussions with public enterprise Managements should be avoided. The appraisal group should function on the lines of the appraisal teams of the World Bank or the IDBI and the end result should be an appraisal report by the group as a whole, which should be the only document placed before the PIB, with, if necessary, a brief forwarding memorandum by the Ministry.*

(v) *The PIB procedures need not cause delays; it should be posible to complete the governmental processing and approval within three months, through special efforts. The professional manpower resources of the Project Appraisal Division should be augmented and strengthened so as to minimise the queuing of projects for consideration and to improve the speed and quality of the appraisal. In any case, from the time that a project is received in Government to the time when a formal sanction is issued after Cabinet approval, there should not be a lapse of more than six months at the most.*

(vi) *A standard questionnaire or checklist should be prescribed indicating clearly to all public enterprises and Ministries the kind of information needed over and above the Feasibility Report and the deficiencies noticed in the course of the examination of a large numbers of projects in the past.*

(vii) *During the process of appraisal in Government, there should be no repeated and detailed item-wise updating of project cost estimates. The figures of the project report should be maintained from the time of submission to the Government right up to the time of consideration by the PIB and clearance by the Government; but if in the process of good deal of time has unavoidably elapsed, there should be a quick updating by the application of certain indices, without fresh enquiries or fact-finding.*

VII. Price Approvals

7.1 In this Section we shall be concerned with the governmental clearances and approvals needed for the pricing of the products of public enterprises. In cases where there are statutory price controls in force or an administered pricing system is in operation, it goes without saying that the public sector, like the private sector, must abide by any regulations which Government may lay down. The prime purpose of such regulation is to prevent the consumer from being exploited in conditions of scarcity or on account of the absence of competition. Normally one should expect public enterprises to behave with a due sense of responsibility in their pricing, and the occasions for Government to interfere in their pricing decisions to be rare. However, in practice, the system of administered pricing applies even to industries which are wholly in the public sector such as coal and oil; and even when no system of administered pricing is in vogue, public enterprises are often expected to consult the Government formally or informally before revising their prices upwards.

Pricing a management function.

7.2 Pricing is one of the important corporate management functions, which may make a tremendous difference to the profitability of the enterprises and to the returns which Government expects from investments in the public sector. If Government tells a public enterprise to sell its product at particular prices, it cannot very well ask the management to account for poor returns in fact this provides it with an alibi against charges of mis-management and inefficiency.

Case for Government guidelines.

7.3 However, it has to be recognised that public enterprises are established with certain policy objectives and some of these might fail to be achieved, if pricing is treated solely as a corporate function and left entirely to the Management. Some public enterprises, individually or collectively, occupy positions of such dominance that dangers of monopolistic pricing are inherent in the situation. It may, therefore, be necessary for the Government to lay down some guidelines on the principles which should govern the pricing of the goods or services produced by public enterprises under these circumstances.

Existing guidelines.

7.4 There are indeed some very general guidelines of this kind. These are contained in certain Office Memoranda* issued by the Bureau of Public Enterprises. Briefly, the principles which have been laid down are that in the case of enterprises which produce goods or services in competition with other domestic producers the normal market forces would operate; and that the pricing of the products of those enterprises which operate under monopolistic or semi-monopolistic conditions should be on the basis of the landed cost of comparable imported goods which should operate as a ceiling. The first guideline, if it were followed as a rule, would certainly give the requisite autonomy to the Management to make appropriate price decisions in response to changing market conditions. This excellent principle, however, is not always followed in practice. Quite frequently, even in cases in which a public enterprise is in a competitive situation, and there is no formal price control in operation, the Government tends to exercise an informal control over the pricing decisions of public enterprises. Without labouring the point further, we would merely say that the principle of leaving pricing decisions to the Managements of public enterprises where these are in a competitive situation and there is no price control in operation, is a sound one and must be scrupulouly adhered to.

(a) Competitive situation.

7.5 In this context it has to be borne in mind that a public enterprise could be in a competitive situation not only in those cases in which it has to compete with other domestic producers within the economy but also where it meets only a limited part of domestic demand, the rest of the demand being made by imports; in the latter kind of case the public enterprise has to compete with imports and has to take pricing decisions with reference to the availability and prices of imports. In such cases too the Managements of public enterprises should have the freedom to take pricing decisions and decisions regarding product mix and quantum of production in the light of market conditions. If the import policy is excessively liberal or if imports are available at very low prices it should have the right to make representations to Government as private industry has.

(b) Monopolistic situation : Landed cost of imports as ceiling— objections.

7.6 The above point is linked with and leads on to the second guideline mentioned above, namely, treating the landed cost of comparable imported goods as a ceiling for domestic prices. Although plausible at first sight, this principle pre-supposes a measure of competitiveness on the part of Indian industries *vis-a-vis* imports, and it assumes that the customs duty correctly measures the extent of protection which may be needed by domestic producers. In actual fact, many Indian industries have a high-cost structure because the scale of production is too low or because of duties (both customs and excise) paid on raw materials, components, capital goods, etc., or because the technology is outmoded, or because they were set up with a view to reducing reliance on imports regardless of cost and the customs duties now prevailing are mostly revenue duties whose rates have not been scientifically determined to measure the competitive disadvantage of Indian manufactures. Adherence to this guideline may in some cases affect the profitability of public enterprises adversely, while in others, where the duties are pitched high excess profits may accrue to them. Since the bulk of the public sector production is of essentials on which the duties are low, the formula would on the whole be unfavourable to public enterprises. Industries in the private sector are not, as a rule, required to sell their products at the landed cost of comperable imports. To require public enterprises to do so could place them in a position of disadvantage.

Need to evolve other guidelines.

7.7 We are not arguing against general guidelines to cover pricing decisions in public enterprises. Indeed, we believe that if total freedom to fix prices cannot in certain cases be delegated to the Management, the better course of action would be to lay down some clear guidelines insted of expecting each such decision to be taken either by Government or with Government approval. There are certain general guidelines issued by the Finance Ministry largely for the guidance of the pricing authorities in the Government such as the BICP, these guidelines could also perhaps have an application to the pricing decisions of public enterprises. There has also been some discussion by economists on the principles which should govern public sector pricing. However, we do not propose to enter into a discussion of pricing policies or principles, as the present Report is largely concerned with the procedural approvals and clearances needed by public enterprises.

Detailed pricing decisions to be left to the Managements.

7.8 Once the guidelies have been laid down, public enterprises should be left free to follow them, and the cases of price revision which require reference to the Government minimised. There are several disadvantages in an excessive governmental involvement in the pricing decisions of public enterprises. Firstly, if public enterprises have to refer their pricing decisions to Government and await their approval, such proposals will be inevitably dealt with and processed in the normal Secretariat manner; they will have to pass through multiple levels and perhaps be placed before the Minister in charge or even a Cabinet Committee. The process is not such as to yield a quick decision, and this means that public enterprises cannot possibly respond quickly to changing situatons. Secondly, Government will get associated with all such decisions and will have to bear the responsibility for them in the public eye. This may make them reluctant to agree to price increases even

*BPE/46/Adv(F) /68/25 dated 27-12-1968.
BPE No. 1(76)/ Adv. (F)/70 dated 18-6-1970.

where these are necessary and justified, thus delaying the inevitable and meanwhile depressing the profitability or increasing the losses of public centerprises. It is therefore desirable that the pricing decisions of public enterprises should as far as possible not come to Government for approval, but should be left to be taken by the Managements within a broad framework of guidelines laid down by the Government. As things are, even where there is a pricing formula worked out by the BICP and approved by the Government and this includes an escalation formula for varying prices with reference to input costs, there are instances in which a price adjustment by the application of the escalation formula has still to be referred to the Ministry and even goes up to the Cabinet. The lapse of time in this process means that by the time the approval is obtained, the proposed price revision is already out of date and a further revision has become necessary with reference to additional cost increases. Besides, the Government tends to resist a proposed price increase as long as possible as it is bound to be unpopular, with the result that when eventually the price adjustment does take place it is substantial in character and has a significant impact on the general price levels in the economy. On the other hand, if there is a delegation of authority to the Management to arrive at their own decisions by the application of governmental guidelines or a pricing formula, price revisions might be frequent but not too large on any single occasion; and small variations could sometimes be observed by the downstream industries and not necessarily passed on to the ultimate consumers.

Need for flexibility.

7.9 In this context it is necessary to draw attention to some of the dangers of making the price guidelines too rigid. Sometimes there may be an uptrend in the market price because demand is in excess of supply. For the public sector to sell its products at prices well below those prevailing in the market can lead to black marketing and profiteering by middlemen with no benefit to the consumer. This has happened, for example. In the case of products like steel on a number of occasions in the past. The guidelines should provide for such contingencies. Contrariwise there may be situations in which, at the prices determined in accordance with the guidelines, sales prove to be difficult and stocks begin to pile up, with the need to secure bank loans at high rates of interest to finance them. In such cases, a managerial decision has to be made to choose one of various options such as selling at a lower price in order to save interest charges or cutting down the production of the item in question or taking any other course of action. If the guidelines do not expressly provide for such flexibility, there is a danger that sound decisions taken by the Management may come in for criticism on the ground that there has been a departure from the guidelines.

7.10 Our basic preference is that except for items for which a price control, applicable both to the public sector and the private sector, is in force, the Management of a public enterprise should have the freedom to adjust prices with due regard to its own profitability and market condition. To the extent that for certain items, because of their critical importance to the economy or because of the monopolistic position of the public sector, a measure of regulation is considered to be essential, it should be done through guidelines, which, apart from laying down general principles, should also have due regard to the nature of the product. These guidelines should have a measure of flexibility to enable the enterprise to make appropriate adjustments from time to time without having to seek governmental approval on each occasion.

References to Government : need for quick decisions.

7.11 While the occasion for references to Government by public enterprises regarding pricing decisions should be minimised they cannot perhaps be wholly eliminated. We would merely say that such references should be few and far between, and that where they become necessary they should be handled with the maximum speed. A drill should be laid down such that a decision on the proposal should be given to the public enterprise in question within a limited period of time. Alternatively, it should be laid down that if there is no objection from the Government within a stated period (say a fortnight), the public enterprise should be free to go ahead with the proposed price change. Where the examination of such proposals by government is merely to see whether the proposal is in accordance with the general guidelines, or, where a formula has been laid down, whether it has been correctly applied, we would see some advantage in leaving this to an expert body like the BICP rather than subjecting the proposal to dilatory processing in the Secretariat and giving a chance for the decision to be politicized.

To be left to an expert body.

Governmental instructions- to be formal Directives....

7.12 In an exceptional case, where Government feels that certain considerations of public policy call for its intervention in the pricing of a particular item or commodity which is produced by a public enterprise, the intervention should take the shape of a Directive formally issued. In the subsequent evaluation of the performance of the public enterprise the consequences of this Directive should be explicitly recognised.

....issued in consultation with Finance.

7.13 It is important that such directives should be issued with the concurrence of the Finance Ministry so as to ensure that due account is taken of the financial implications of the directive, since any curb imposed on the selling price of a product of a public enterprise, which is not warranted by the market forces, means a loss of resources (direct or indirect) to the Exchequer. The concurrence of the Ministry of Finance in the imposition of such a restraint should be obligatory.

Unnecessary references to the Govt. not to be encouraged.

7.14 It must be added that at times the Managements of public enterprises themselves tend to make references to the Government for approvals of (or tacit acquiescence in) pricing decisions even where governmental approval is not called for by any statutory control or standing instructions. In some instances, such references may be the result of specific requests or informal advice by the Ministry in others they are made by the Managements on their own, sometimes ostensibly to keep the Ministries 'informed' but more often for securing protection in the event of subsequent criticism. This practice should be discouraged.

Summing up.

7.15 Summing up the above discussion we would observe as follows :

(*i*) *Among the existing guidelines on pricing by public enterprises, the one which lays down that where a public enterprise is in a competitive situation the pricing should be left to be determined by the market forces, enunciates a sound principle which should be scrupulously adhered to. The second guideline, namely, that in the case of public enterprises which are in a monopolistic or semi-monopolistic situation the landed cost of comparable imported goods should be treated as a ceiling for the domestic price, is based on some assumptions which may not be borne out by the facts, and could place public enterprises in a difficult position.*

(*ii*) *Except for items for which a price control applicable to both the public sector and the private sector is in force, the Management of a public enterprise should have the freedom to adjust prices with due regard to its own profitability and the market conditions.*

(*iii*) *To the extent that for certain items, because of their critical importance to the economy or because of the dominant position of the public sector. A measure of regulation is considered to be essential, this should be done through guidelines drawn up with due regard to the nature of the product in question.*

(*iv*) *Once the guidelines are laid down, actual pricing decisions should be left to be taken by the enterprises. Any requirement of governmental approval for each individual pricing decision would not merely mean a delayed response to changes in costs or in the market conditions, but may also make the decision more difficult and more controversial because it would get politicized. If there is a pricing formula with a provision for variations with reference to changes in certain elements, price adjustments on the basis of the formula should not need a reference to the Government but should be left to the enterprises, so that price revisions could take place smoothly and gradually from time to time, rather than at long intervals and in large jumps.*

(*v*) *The Management should be given a measure of flexibility and discretion in the application of the guidelines and not required to adhere to a rigid policy without regard to the environment in which it operates.*

(*vi*) *Where a reference to the Government does become necessary, it should be handled with the maximum speed. A drill should be laid down to ensure the communication of the decision within a stipulated period (say a fortnight), failing which the public enterprise should be free to go ahead with the proposed price change. The examination of such proposals should be preferably left to a professional body like the BICP rather than the subjected to dilatory processing in the Secretariat.*

(*vii*) *In an exceptional case where considerations of public policy call for governmental intervention in the pricing of a particular item or commodity which is produced by a public enterprise, this should take the shape of a directive formally issued with the concurrence of the Finance Ministry; and the consequences of this directive should be explicitly recognised in the subsequent evaluation of the performance of the public enterprise.*

(*viii*) *Where there is no requirement of Governmental approval, any tendency on the part of the Managements of public enterprises to refer their pricing decisions to the Government directly or indirectly for approval should be discouraged.*

VIII. The Role of the Bureau of Public Enterprises

Need for an interpreting/ coordinating agency.

8.1 Considering the number and diversity of public enterprises and the magnitude of Government's investment in them, an agency of some kind is needed for performing certain functions, such as effecting coordination among the public enterprises on important matters; providing for a transfer of experience from one public enterprise or sector of development to another; acting as a clearing house of ideas; assisting the Government in the formulation of policies applicable to public enterprises as a whole; interpreting the Government to the public enterprises and *vice versa*;

ensuring the continuity of experience over time; and functioning as a store-house of information. It was (we believe) with these objectives in view that the Bureau of Public Enterprises (BPE) was set up.

Regulatory functions overshadowing more positive concerns.

8.2 However, over time, the BPE has for a variety of reasons come to assume more of a regulatory rule than a promotional one, and its coordinating activities have, at times, as we explain below, tended to impose a somewhat excessive measure of uniformity in various fields. Such a trend is noticeable in many other areas of governmental activity in which a preoccupation with regulation tends to overshadow more positive concerns. One possible reason for this in the case of the BPE is that when Audit Reports or Parliament Questions have drawn attention to any failings or shortcomings in particular enterprises, it has been felt that by issuing general instructions on the subject, the recurrence of these can be avoided. There are also other occasions where Government feel that they should lay down general instructions for the guidance of public enterprises. All these are issued in the form of Office Memoranda or circulars by the BPE, and have come to be known as the BPE guidelines.

8.3 One consequence of this trend has been that the Chief Executives of public enterprises look upon the BPE not so much as a friend and a philosopher but as a guide and as a very strict one at that. We feel that the BPE should lay much more emphasis on its role in projecting the performance of the public sector in the proper perspective and in explaining the hurdles and difficulties which the public sector often has to face. The public sector seems to suffer because not many speak up for it except in very general terms and it is not easy for individual enterprises to shield themselves effectively from some of the motivated criticism levelled against them. Within Government, the BPE should project the problems and difficulties of the public sector and act as a prime mover in simplifying procedures and eliminating delays in decision-making. Of course, the BPE should continue to provide guidance to the enterprises, but in doing so—and this is the main point we are dealing with here—it should be ensured that the operational autonomy of public enterprises is not subjected to undue restraints and a plethora of approval requirements.

The BPE guidelines.

8.4 BPE guidelines cover a wide range of subjects and have to be reckoned with frequently in the process of corporate decision-making. We had referred to this subject briefly in our earlier Report on the autonomy and accountability of public enterprises (EARC II/Report No. 4, paragraph 7.5). The quality and dimensions of the control relationship between the Government and public enterprises is reflected in the number and extent of coverage of the detailed instructions from the former to the latter. Apart from the wide range of subjects covered, the status of the guidelines is also a matter for consideration. The word 'guidelines' is misleading inasmuch as they are virtually Government orders to which the enterprises are expected to conform. The Government Directors, and in particular the Financial Advisers, are expected to bring to the notice of the public enterprises the guidelines of the BPE on any matter which might be under consideration. Even a minor departure from the guidelins on any matter tends to be construed as an irregularity. Just as in the audit of Governmental transactions, the Audit Department bases itself on the Governmental codes, rules and manuals, and questions specific instances of executive action or decisions in the light of these rules and orders, so too in the case of public enterprises, the CAG's audit tends to cite the BPE's guidelines as if they were the codification of governmental rules and regulations *vis-a-vis* the public enterprises, and to question not merely instances of actions or decision at various managerial levels in the enterprises, but even the considered decisions of the Boards. Perhaps this was not the Government's intention; but this is the manner in which the BPE guidelines have come to operate.

Need to review and reduce number, scope & coverage of Government guidelines.

8.5 While we have neither attempted nor been called upon to undertake any review of individual BPE guidelines, their sheer multiplicity and volume make us feel that *the number, scope and coverage of the guidelines should be thoroughly reviewed and drastically reduced, and only those concerned with major policy objectives and/or performance parameters retained.* We are not of course ruling out the possibility of the BPE studying matters of general interest to all public enterprises such as cash management, working capital management, inventory control, marketing, personnel management, etc.; but such *studies should be in the nature of joint exercises with the public enterprise Managements through workshops, seminars, etc., and the results should be embodied in papers and proceedings rather than in the form of governmental instructions or guidelines.*

Distinction between binding orders and circulars for information.

8.6 The guidelines which remain after such a review should, as a rule, not be treated as mandatory Government orders. *Binding orders should be as few as possible, and should be described not as guidelines but as directives indicating their mandatory nature. Communications which are merely meant to keep the entire body of public enterprises informed of matters, developments, policies and decisions which may be helpful to them, should be circulated under a different categorization which does not have the mandatory overtones of the word 'guidelines'.* These, while they may be meant for the broad guidance of the top Managements and Boards, should not be regarded as abridging their final power of responsibility of decision-making.

Needed : coordinated approach & not uniformity.

8.7 In issuing such general circulars applicable to all public enterprises, whether in the form of orders or directives or in the form of communications meant for general information and broad guidance, *the difference between evolving a coordinated approach to matters of common interest and ensuring uniformity should be borne in mind.* Given the differences between industry and industry and locality and locality, and considering the enormous diversity in circumstances, scales of opeations and concerns even between one public enterprise and another within the same industry or in the same locality, it is hardly possible to fit all public enterprises into a strait-jacket of uniform instructions. *[Further, a crucial element in good management is the ability to innovate and experiment, and the freedom to do this is bound to be hindered by adherence to uniform guidelines.]* Lastly, such general circulars as the BPE issues should be such as to command respect by virtue of superior knowledge and judgement arising from an access to wider information and deeper comparative studies than is possible for individual enterprises, and not merely because they emanate from a governmental agency which is presumed to be an authority superior to the enterprise.

Specific matters.

8.8 We have so far dealt with generalities. There are two specific matters which came up repeatedly during our discussions with the Chief Executives of Public Enterprises as well as with the Secretaries. One relates to wage negotiations and the other to the provision of housing. These are dealt with in the following paragraphs.

(a) Wage negotiations.

8.9 Wage negotiations in public enterprises present some difficult issues. For the Management to be really effective in the negotiations, it must be in a position to enter into commitments, to concede or reject demands, in its own right. In actual fact, [Trade Unions feel, and not without justification, that decisions rest with the Government and that the focal point for the consideration of labour demands is the BPE. This tends to erode the effectiveness of the Management. The attempt which has been made to delegate some authority to the Managements by the issue of guidelines and the provision of negotiating briefs do not seem to have helped much. The instructions do not remain a secret. Whatever is within the Management's power to concede is taken for granted by the Unions, and their entire pressure is to get more.

8.10 The one reason why greater delegation of negotiating powers to the Management is not possible is the feeling that whatever is conceded in one public enterprise will automatically have to be conceded in all. In the private sector, when the same business group controls a large number of different industries, such apprehensions are not entertained; if in a fertilizer plant in the private sector wages are raised or some amenities are conceded, there are no repercussions on a textile unit or an engineering unit belonging to the same group. Is it possible that the very fact that in the public sector it is believed that there would be repercussions, results in whatever is conceded to labour in one public enterprise becoming the basis of an irresistible claim in others? *The question whether greater freedom to the Management in the matter of labour negotiations would be desirable is not one on which we are formulating any recommendations. But we do suggest that the question should be examined within Government, as it is more a matter of policy than of procedures. [Purely from the procedural angle, we would suggest that instead of the BPE giving any written guidance to the Managements of enterprises on the subject, to the extent that its involvement is considered to be necessary, this should be secured by its representatives sitting with the Management and presenting a joint front, making it clear that no further appeal to Government would be possible.] It is also worth considering whether governmental pronouncements should begin to emphasise that there can be no uniformity in these matters in the public sector as such, and that the nature of the industry, the location and the existing levels of wages would all be relevant considerations in determining the terms and conditions of employees in different enterprises.*

(b) House rent allowance rates and rental ceilings.

8.11 Turning now to the norms and guidelines governing the provision of housing, there is first the question of the house rent allowance rates and the rental ceilings in respect of hired or leased accommodation. Restraint on the rates and uniformity among all public enterprises in a given station are sought to be achieved by the BPE through guidelines which lay down these rates and ceilings. The top Managements and even the Boards of Directors have not much leeway in this regard; departures from the prescribed limits need a clearance from the BPE. Two issues arise here: whether this is a matter which ought to be regulated by the Government or whether the Boards of individual public enterprises should be left free to fix their own limits on house rent allowance and on rentals for hiring or leasing accommodation for their officers in the light of the prevailing conditions; and whether, if this is an area in which the imposition of uniformity and restraint through governmental guidelines is considered desirable, the present limits are reasonable in the prevailing circumstances of scarcity of accommodation and high rental levels, particularly in the metropolitan towns. *Having raised the issue already in our earlier Report on Government and Public Enterprises : The Top Management and the Boards (ARC-II Report No. 2, Paragraph 2.2) we shall confine ourselves in the present Report merely to inviting attention to this as a problem which needs consideration by the Government.* Part of the problem arises from the location of offices of public enterprises in metropolitan centres. There are a number of good

reasons why the headquarters of public enterprises should be nearer their centres of production or operation. So far as we know, it is the Government's policy to discourage the establishment of new offices in Delhi. However, *if the offices of some public enterprises do have to remain in places like Delhi, Bombay or Calcutta, and if the Government does not wish to give complete freedom to the Managements or even to the Boards of Directors of such public enterprises to regulate their house rent allowance rates or the rates on which they hire accommodation for their officers with reference to prevailing rental levels. then one solution might be for the enterprise in question to build or acquire residential accommodation for certain numbers of their officers and staff.*) Owning accommodation might prove cheaper than hiring it in the long run, and besides, properties owned in metropolitan centres are likely to appreciate rather than depreciate in value.

(c) Housing & township components of projects.

8.12 Secondly, there is the question of the housing and township construction components of projects. This is an area in which the concern for uniformity and standardization has perhaps been carried to unnecessary lengths. While economy is important and it is necessary to ensure that public enterprises do not begin to complete with one another in setting higher and higher standards of housing and township. *it should be adequate if control in this area is exercised through (a) restraints on the total financial provision for township and housing in a project estimate ; (b) the prescription of levels of housing satisfaction in given areas* (50%, 60%, 70%, *etc.*) *and (c) the laying down of a scale of plinth-area admissibility for different grades of employees (the number of grades being not too numerous). It should not be necessary to go beyond this and insist on laying down typedesigns, specifications, details of construction, construction materials, etc., and requiring the clearance of detailed plans and estimates by the Construction Division of the BPE.* This kind of detailed clearance by the Construction Division of the BPE results in an unnecessary uniformity not merely of the scale of housing but even of designs, specifications, styles of construction, fixtures and features, etc., in public-enterprise housing all over the country. It seems disproportionate that so much attention should be paid to and such tight control maintained over what in most cases is a very small part of the project estimates. It also seems very desirable that within the broad norms of total costs, level of satisfaction and plinth-area standards, much greater scope should be allowed for the ingenuity and imagination of individual enterprises so as to provide for a greater degree of architectural variety, harmony with the enrvironment, conformity to local conditions and response to the requirements of users.

IX. Summary of Conclusions and Recommendations

9.1 *Scope of Report* : The present Report deals with governmental clearances and approvals of different kinds needed by public enterprises and considers possibilities of dispensing with the unnecessary ones and streamlining those which must continue, with a view to facilitating an improvement in the performance of public enterprises and bringing about a measure of economy in administration.

(Paragraphs 1.1—1.2)

9.2 *Industrial approvals* : In the area of industrial approvals, attention is invited to the recommendations in relation to capital goods clearances for public enterprises made in our Report on 'Industrial Approvals : Capital Goods Clearances' (EARC Report No. 14) (submitted to the Government in October 1982).

(Paragraph 2)

9.3. *Foreign exchange releases* : (i) Releases of foreign exchange for public enterprises should not be subject to more protracted procedures than those which apply to private secter proposals.

(ii) As in the case of private sector proposals which are considered by the Capital Goods Committee, the governmental judgement in considering the foreign exchange requirements of a project of a public enterprise should be confined to the order of magnitude of the foreign exchange required and the sources from which it can be met. Decisions in regard to the selection of suppliers, contractors, etc., should be left to the Managemetns. A superimposition of governmental judgement on such matters diminishes the responsibility and accountability of the Management, leads to delay in project implementation and casts a responsibility on the Secretariat which it is ill-equipped to discharge.

(iii) In those cases in which the total requirements of foreign exchange are covered through one or two major project loans, it should be easy to place the foreign exchange at the disposal of the project authorities at an early date after the investment decision. In other cases, where a combination of a number of relatively minor aid allocations and some free foreign exchange has to be worked out, this too should be done at a very early date after the sanctioning of the project; and the releases of foreign exchange should be made annually at the beginning of each year and not in a piecemeal manner throughout the year on specific requests and proposals.

(iv) The policies and procedures in respect of imports for the purpose of current production ought to be exactly the same for both public enterprises and private sector units, and there should be no need for the proposals of public enterprises to be dealt with on files in the normal Secretariat manner.

(v) The procedural requirement of the submission of foreign exchange releases over Rs. 2 crores to the administrative Minister and the Finance Minister should not apply to release from time to time to meet the foreign exchange requirements of the projects sanctioned by the Government. The sanctioning of a project implies a commitment to find the necessary foreign exchange, and the actual release of foreign exchange in each case is an operational matter to be dealt with by the appropriate authorities in terms of the import policies in force and the foreign exchange availability from different sources. Maintenance imports too have to be dealt with in terms of current policies and should not require a submission to the Ministers.

(Paragraphs 3.1—3.8)

9.4. *Indigenous purchases, contracts, etc.* : For meeting the needs of goods and services for the projects or the operations of public enterprises, there could be legitimately a preference for other public enterprises as suppliers, contractors, consultants, etc., within certain limits and subject to certain conditions; but this has to be a matter of generalised policy and not one of *ad hoc* instructions in specific cases or of interventions in particular decisions. If in a particular case it becomes necessary for the Government to give instructions on a matter like this, the instructions should be in writing.

(Pargaraph 4)

9.5 *Release of rupee funds from the Government Budget* : (i) Having once determined the provision to be made for a project in the Annual Plan and the Budget after a careful and detailed scrutiny of probable physical progress and disbursement needs and with due regard to the resource constraint, there is no need for a detailed and protracted examination on the occasion of each release; in other words, the budgetary process should not continue throughout the year.

(ii) Ideally, the funds should be released in two instamelnts in April and October, but if necessary, the releases could be made quarterly in April, July, October and January. The release should be smooth and automatic; in the first three quarters, the funds should be released more or less for the asking. It is only in the last quarter that an effort should be made to regulate it with reference to the disbursement needs, so as to keep the carry-forward of unspent balances into the next year at a reasonable level. A drill should be laid down such that the funds needed for a given quarter would be in the hands of the project management before the commencement of the quarter.

(Paragraphs 5.1—5.5)

9.6. *Investment approvals* : (i) While major project and investment proposals which require governmental approval need to be specifically exhibited in the Plan, the delegated authority of the Boards of public enterprises for sanctioning capital outlays on renewals, replacements, balancing facilities and other minor miscellaneous proposals or schemes should not be nullified by such proposals having to be itemised in detail in the Annual Plan or coming under detailed consideration during discussions with governmental authorities. Within such reasonable aggregate provisions for above-mentioned purposes as can be accommodated within the Annual Plan, the delegated powers of the Boards should be fully operative.

(Paragraph 6.3)

(ii) (a) The project formulation and evaluation skills in public enterprises should be substantially strengthened so that what comes to the Government is a well-prepared proposal on which the need for further information or clarifications would be minimal.

(b) For major investment decisions in each sector covering really large projects about which there are no doubts in regard to the need for priority or inclusion in the Plan, the governmental agencies could be advantageously associated with the corporate processes of formulation and evaluation right from the earliest stages, so that examination within the corporate organisation and examination by governmental agencies can run in parallel.

(c) The number of agencies involved in the governmental process of appraisal should be reviewed and reduced.

(d) The spirit of the PIB procedures which envisage a joint appriasal by all the agencies concerned should be observed, and an independent examination by each agency leading to separate discussions with public enterprise. Managements should be avoided. The appraisal group should function on the lines of the appraisal teams of the World Bank or the IDBI and the end result should be an appriasal report by the group as a whole, which should be the only document placed before the PIB, with, if necessary, a brief forwarding memorandum by the Ministry.

(e) The PIB procedures need not cause delays; it should be possible to complete the governmental processing and approval within three months through special efforts. The professional manpower resources of the Project Appraisal Division should be augmented and strengthened so as to minimise the queuing of projects for consideration and improve the speed and quality of the appraisal. In any case, from the time that a project is received in Government to the time when a formal sanction is issued after Cabinet approval, there should not be a lapse of more than six months at the most.

(f) A standard questionnaire or check-list should be prescribed indicating clearly to all public enterprises and Ministries the kind of information needed over and above the Feasibility Report, and the deficiencies noticed in the course of the examination of a large number of projects in the past.

(g) During the processes of appraisal in Government, there should be no repeated and detailed item-wise updating of project cost estimates. The figures of the project report should be maintained from the time of submission to the Government right up to the time of consideration by the PIB and clearance by the Government, but if in the process a good of time has unavoidably elapsed, there should be a quick updating by the application of certain indices, without fresh enquiries or fact-finding.

(Paragraphs 6.4—6.15)

9.7. *Price Approvals*: (i) Among the existing guidelines on pricing by public enterprises, the one which lays down that where a public enterprise is in a competitive situation the pricing should be left to be determined by the market forces, enunciates a sound principle which should be scrupulously adhrered to. The second guideline, namely, that in the case of public enterprises which are in a monopolistic or semi-monopolistic situation the landed cost of comparable imported goods should be treated as a ceiling for the domestic, price, is based on some assumptions which may not be borne out by the facts, and could place public enterprises in a difficult position.

(ii) Except for items for which a price control applicable to both the public sector and the private sector is in force, the Management of a public enterprise should have the freedom to adjust prices with due regard to its own profitability and the market conditions.

(iii) To the extent that for certain items, because of their critical importance to the economy or because of the dominant position of the public sector, a measure of regulation is considered to be essential, this should be done through guidelines drawn up with due regard to the nature of the product in question.

(iv) Once the guidelines are laid down, actual pricing decisions should be left to be taken by the enterprises. Any requirement of governmental approval for each individual pricing decision would not merely mean a delayed response to changes in costs or in the market conditions, but may also make the decision more difficult and more controversial because it would get politicized. If there is a pricing formula with a provision for variations with reference to changes in certain elements, price adjustments on the basis of the formula should not need a reference to the Government but should be left to the enterprises, so that price revisions could take place smoothly and gradually from time to time, rather than at long intervals and in large jumps.

(v) The Management should be given a measure of flexibility and discretion in the application of the guidelines and not required to adhere to a rigid policy without regard to the environment in which it operates.

(vi) Where a reference to the Government does become necessary, it should be handled with the maximum speed. A drill should be laid down to ensure the communication of the decision within a stipulated period (say a fortnight), failing which the public enterprise should be free to go ahead with the proposed price change. The examination of such proposals should be preferably left to a professional body like the BICP rather than the subjected to dialatory processing in the secretariat.

(vii) In an exceptional case where considerations of public policy call for governmental intervention in the pricing of a particular item or commodity which is produced by a public enterprise, this should take the shape of a directive formally issued with the concurrence of the Finance Ministry; and the consequences of this directive should be explicitly recognised in the subsequent evaluation of the performance of the public enterprise.

(viii) Where there is no requirement of governmental approval, any tendency on the part of the Managements of public enterprises to refer their pricing decisions to the Government directly or indirectly for approval should be discouraged.

(Paragraphs 7.1—7.15)

9.8 *The Role of the BPE* : (i) There is need for an organization for effecting coordination among public enterrpises on important matters, facilitating the transfer of experience, assisting the Government in the formulation of policies applicable to public enterprises as a whole, interpreting the Government to the public enterprises and *vice versa;* etc. However, as in other areas of governmental function, a preoccupation with regulation and control has tended to overshadow the more positive concerns of the Bureau of Public Enterprises.

(Paragraphs 8.1—8.3)

(ii) The number, scope and coverage of the Governmental guidelines and instructions to public enterprises should be thoroughly reviewed and drastically reduced and only those concerned with major policy objectives and/or performance parameters retained.

(Paragraphs 8.4—8.5)

(iii) Binding orders to public enterprises should be as few as possible and should, be described not as guidelines but as directives indicating their binding nature. All other communications which are meant to keep the entire body of public enterprises informed of matters, developments, policies and decisions which may be helpful to them, should be circulated under a different catogorization which does not have the mandatory overtones of the word 'guidelines'. In issuing such general circulars applicable to all public enterprises whether in the form of orders or directives or in the form of communications meant for general information and broad guidance, the difference between evolving a coordinated approach to matters of common interest and ensuring uniformity should be borne in mind. Further, a crucial element in good management is the ability to innovate and experiment, and the freedom to do this is bound to be hindered by uniform guidelines.

(Paragraphs 8.6—8.7)

(iv) The question whether greater freedom to the Management in the matter of wage negotiations would be desirable is not one on which we are formulating any recommendations. But we do suggest that the questions should be examined within Government, as it is more a matter of policy than of procedures. Purely from the procedural angle, we would suggest that instead of the BPE giving any written guidance to the Management of enterprises on the subject, to the extent that its involvement is considered to be necessary this should be secured by a its representatives sitting with the Management and presenting joint front, making it clear that no further appeal to Government would be possible. It is also worth considering whether governmental pronouncements should begin to emphasise that there can be no uniformity in these matters in the public sector as such, and that the nature of the industry, the location and the existing levels of wages would all be relevant considerations in determining the terms and conditions of employees in different enterprises.

(Paragraphs 8.9—8.10)

(v) (a) House rent allowance rates and the rental ceilings in respect of hired or leased accommodations are matters which need consideration by the Government; attention is also invited to the observations in this regard in our earlier Report on Government and Public Enterprises: The Top Management and the Boards (EARC-II/Report No. 2, paragraph 2.2).

(Paragraph 8.11)

(b) If the offices of some public enterprises do have to remain in places like Delhi, Bombay or Calcutta, and if the Government does not wish to give complete freedom to the Managements or even to the Boards of Directors of such public enterprises to regulate their house rent allowance rates or the rates on which they hire accommodation for their officers with reference to prevaling rental levels, then one solution might be for the enterprises in question to build or acquire residential accommodation for certain numbers of their officers and staff. Owing accommodation might prove cheaper than hiring it in the long run, and besides, properties owned in metropolitan centres are likely to appreciate rather than depreciate in value.

(Paragraph 8.11)

(c) The housing and township construction component of project is a matter in respect of which concern for uniformity and standardization seems to have been carried to unnecessary length. It should be adequate if control in this area is exercised through(a) restraints on the total financial provision for this component in a project estimate; (b) the prescription of levels of housing-satisfaction in given areas (50%, 60%, 70%, etc.); and (c) the laying down of a scale of plinth-area admissibility for different grades of employees (the number of grades being not too numerous). It should not be necessary to go beyond this and insist on laying down type-designs, specifications, details of construction, construction materials, etc., and requiring the clearance or detailed plans and estimates by the Construction Division of the BPE.

(Paragraph 8.12)

Annexure to the EARC Report on 'Government and Public Enterprises : Governmental Clearances & Approvals'

(ref. : paragraph 2)

Extract from the EARC Report on Industrial Approvals : Capital Goods Clearances
(EARC Report No. 14)

Special procedures for Larger Public Sector Projects.

28. The other area of special procedures which needs to be streamlined relates to the clearance of the capital goods requirements of the public sector projects. As stated earlier, the clearance procedures for capital goods imports of the public sector projects with an investment of less than Rs. 5 crores are the same as those applicable to the private sector. For the public sector projects with an investment of Rs. 5 crores and above, there are no streamlined procedures laying down definite processes, time-schedules and different levels of clearance authorities. In this category, we find that a comprehensive consideration of the total import requirements of a project and a consolidated release of foreign exchange take place only in those cases in which the project as a whole is posed to, say, the World Bank or one or more aid-giving countries for project aid, or where an external financing package is worked out *ab initio*. In all other cases, the investment decision is taken with only an indication of the broad magnitude of the foreign exchange component. Subsequently, during the process of implementation of the project, import clearance and foreign exchange releases are obtained piecemeal throughout the life of the project, through exchanges of notes and correspondence within the administrative ministry and between the administrative ministry and the DGTD/Department of Heavy Industry/Department of Economic Affairs, etc. As a result, long delays in the clearance of capital goods requirements are quite common and the implementation of the larger public sector projects suffers considerably.

29. There are, however, instances where special procedures are agreed upon in specific public sector projects of importance. For the Kudremukh Iron Ore Project, an expeditious procedure for the clearance of capital goods was adopted as early as April, 1976. We are happy to note that similar procedures are being evolved in respect of the Visakhapatnam Steel Project and the National Aluminium Company Ltd. The salient features of the special procedures in regard to these projects are as follows:

(a) Separate lists are prepared indicating—

(i) equipment which is to be imported;

(ii) equipment which is prima facie available indigenously; and

(iii) equipment which can be either imported or obtained/developed indigenously.

The basis of preparation of such lists is either consultation with the DGTD. the public sector undertakings and the Ministries concerned or publication in the IESB and newspapers.

(b) These lists together with the estimated foreign exchange value ceilings are cleared by the DGTD and CG Committee or by a Special Committee of Secretaries constituted for the purpose.

(c) The project authority has the freedom to make variations in type specifications, value, etc., within the overall ceilings cleared by the competent authority.

(d) The advertisement procedure as prescribed in the Hand Book of Import and Export Procedures is waived.

(e) Where the project's foreign exchange requirements have not been tied up *ab initio* through aid allocations, foreign exchange is released on a yearly basis.

30. We had occasion to discuss this issue with the Chief Executives of a number of public sector undertakings. They stressed the need to streamline the procedures for capital goods clearances for public sector projects. They were unanimous in suggesting that special procedures like those evolved in regard to the Kudremukh Iron Ore Project should be generalised to the extent possible for all public sector projects of a sizeable magnitude.

31. It may not be possible or necessary to adopt all the features of such special procedures in every public sector project with an investment of Rs. 5 crores and above. However, some of the features of the special procedures can and should be adopted in regard to the public sector projects of sufficiently large magnitude and importance. For this purpose, the investment criterion of

Rs. 100 crores and above can be considered. For such projects, some or all of the following special features can be adopted as appropriate:

(a) Waiver of the advertisement procedures.

(b) Determination of items of equipment and machinery to be imported or obtained indigenously, with due regard to the difference in prices and delivery schedules; full-fledged consultations among all the parties concerned should form the basis of such determination. Such consultation should have some kind of objective yardstick to go by. In this context also, the preference for indigenous equipment should not be absolute, but should be guided, among other things, by the cost of import substitution. Here too, the degree of protection generally admissible to the indigenous industry under the global tender procedure could be used as a rough norm, though in many cases the preference might have to be of a higher order.

(c) The identification of the foreign exchange requirements and the sources and tying up the allocations and releases at the intital stage itself.

(d) Where free foreign exchange releases are involved, annual releases at the beginning of the year and not in bits and pieces throughout the year.

32. The ICB procedures under the Empowered Committee are at present open to the public sector projects also for the specified industries. This should continue even after the special procedures are adopted for the public sector projects of larger magnitude as suggested above. The special procedures need not preclude the extension of the Empowered Committee procedure to public sector capital goods imports, wherever applicable.

33. We have suggested special procedures for the public sector projects of large magnitude mainly because we have found that the public sector projects have suffered long delays in the clearance of their requirements of capital goods in the absence of streamlined procedures, and because their cases are subjected to routine exchanges of notes and protracted inter-departmental examination. Private sector projects of large as well as small magnitude are already covered by the streamlined procedures of the CG Committee or the Empowered Committee and do not face the procedural handicap faced by the public sector. The special procedures are intended to remove the specific handicaps being experienced by the public sector.

34. Here, we should like to urge that the CG requirements of all public sector projects other than those for which the special procedure would apply, (i.e. projects involving an investment of less than Rs. 100 crores) should be dealt with through the CG Committee/Empowered Committee procedures exactly as in the case of the private sector projects. There should be no category of public sector projects, the CG requirements of which would have to be dealt with through correspondence or exchanges of notes between Ministries on files.

EARC II/Report No. 7

GOVERNMENT AND PUBLIC ENTERPRISES: THE PROFITABILITY OF PUBLIC ENTERPRISES

CONFIDENTIAL

D.O. No. EARC-II/1/9/83—Adm.

आर्थिक प्रशासन सुधार आयोग

ECONOMIC ADMINISTRATION REFORMS COMMISSION

10, Janpath

New Delhi, June 27, 1984.

L.K. Jha,
CHAIRMAN

My dear Prime Minister,

In continuation of three earlier Reports on Government and Public Enterprises, I forward herewith the fourth and last in this particular series, namely, a Report entitled "Government and Public Enterprises : The Profitability of Public Enterprises" (EARC-II/Report No. 7)

2. The public sector has come in for a lot of adverse criticism lately because of its poor profitability. A deeper and more detailed analysis is called for in order to take remedial steps. Many public sector enterprises are making good profits. Others were never meant to be profit making institutions. Yet others are unprofitable not because of faulty management but because of other constraints, including those imposed by governmental decisions or policies. The analysis of their performance in aggregate terms and the highlighting of their shortcomings without publicity for their achievements, e.g. in Audit Reports and Reports of Parliamentary Committees, tend to demage the image of the public sector as a whole. In our report, we have tried to explore possible lines of action to bring about a significant improvement in their profitability and performance.

3. Copies of this Report are as usual being sent to the Ministers concerned with important public enterprises and to the Cabinet Secretary. However, it is my hope that this Report, as well as our earlier Reports on the public sector, would be shared with some of the top executives in the public sector. They should have a sense of participation in the formulation of policies which govern them and not merely be at the receiving end of decisions handed down by different Ministries or the Bureau of Public Enterprises. If this thought appeals to you, Cabinet Secretary could devise appropriate ways for such consultation.

Yours sincerely,

Sd/-

(L.K. Jha)

Smt. Indira Gandhi
Prime Minister of India
New Delhi.

Encl. Two copies of the Report.

56 Fin/84—10

CONFIDENTIAL

D.O.No. EARC-II/1/9/83—Adm.

आर्थिक प्रशासन सुधार आयोग

ECONOMIC ADMINISTRATION REFORMS COMMISSION

10-Janpath

New Delhi, June 27, 1984.

सत्यमेव जयते

L. K. Jha
CHAIRMAN

My dear

I have great pleasure in forwarding for your information a copy of my letter to the Prime Minister together with a copy of our Report entitled "Government and Public Enterprises : The Profitability of Public Enterprises" (EARC-II/Report No. 7).

Yours sincerely,
Sd/-
(L. K. Jha)

1. Shri Pranab Mukherjee, Minister of Finance.
2. Shri Narayan Datt Tiwari, Minister of Industry.
3. Shri N.K.P. Salve, Minister for Steel & Mines.
4. Shri Vasant Sathe, Minister of Chemicals & Fertilizers.
5. Shri P. Shiv Shankar, Minister of Energy & Petroleum.
6. Shri Vishwanath Pratap Singh, Minister of Commerce.

Copy With a copy of the enclosures to:
Shri C. R. Krishnaswamy Rao Sahib,
Cabinet Secretary,
Rashtrapati Bhawan,
New Delhi.

Sd/-
(L. K Jha)

ECONOMIC ADMINISTRATION REFORMS COMMISSION

EARC-II/Report No. 7

Government and Public Enterprises : The Profitability of Public Enterprises.

I

In an earlier Report we had indicated that we would be dealing with the profitability of public enterprises separately*. The present Report is in pursuance of that indication.

2. The profitability of public enterprises is a subject that has attracted a good deal of attention. The relatively low level of return from the massive investments in public enterprises has caused concern, and has become the subject of comment by the Press, students of public administration and management, and the general public. There are two kinds of commonly prevalent attitudes : one is to deplore the performance of the public sector, make unfavourable comparisons with the private sector and exhort the public sector Managements to do better; the other is to defend the public sector and to argue that financial profitability is not an adequate yardstick or indeed even the primary objective, that the public sector has to carry a heavy burden of social over-heads and has to fulfil multiple objectives, and so on. While there are elements of truth in both views, neither seems to us wholly correct.

3. We do believe that financial profitability is (except in a few cases) both relevant and important and ought to be (and could be) the primary yardstick of performance evaluation, provided certain distorting features are eliminated or moderated; and that while there could be a multiplicity of objectives and obligations cast on public enterprises, these are best discharged out of generated surpluses rather than by incurring losses and making a draft on the Exchequer (though we do envisage direct governmental compensation for specific non-commercial obligations cast on public enterprises).

4. Public enterprises have been given corporate form and have to publish Balance Sheets and Profit and Loss Accounts, and clearly the intention is not that they should show recurring losses year after year. There could be a few instances in which an organization is not expected to make a profit, e.g., the Food Corporation of India, but that is clearly an exceptional case. In general public enterprises *are* expected to make profits. In the past there was some uncertainty regarding the legitimacy of profitmaking on the part of public enterprises, but fortunately that situation has changed; increasingly, stress is being laid on the importance of public enterprises generating resources which could be ploughed back into the planned development of the country. Moreover, in most cases the investment decision on a new project or the establishment of a new enterprise is based on an appraisal which does project a positive profitability, and it is surely not unreasonable to expect that projection to be achieved.

5. Any consideration of the profitability of public enterprises is bound to lead to questions of public as distinguished from private profitability and economic as distinguished from purely financial profitability. We do not propose to go into such questions in this Report, which will be concerned essentially with financial profitability. We have argued elsewhere for an appraisal of the performance of a public enterprise with reference to the goals, targets and objectives set forth in the Government's charter for it and the corporate statement to which it is committed (Section VII entitled 'Accountability—for what?' in the Report on Autonomy and Accountability, EARC-II/Report No. 4). But as far as possible, it is desirable to ensure financial profitability, as this is a simple, definite and concrete measure of performance. An economic profitability (which is determined after making a number of assumptions and adjustments and attaching weights to certain factors and adopting shadow prices) may indeed indicate the true value of the performance of a particular public enterprise to the national economy, but this may still leave the enterprise with a financial loss in its books which needs to be underwritten by the Government. On the other hand, an organization which makes large profits in financial terms is at least likely to have excellent cash-flows, even if the profits do not necessarily indicate managerial competence but arise from adventitious circumstances. (It must, however, be added that though accounting profits and good cash-flows often go together, they are not identical and we can have the one without the other).

6. What the present Report seeks to do is first to indicate how the financial profitability of public enterprises is to be understood, and then to put forward some suggestions for the improvement of that profitability.

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*Paragraph 7.3 of the Report "Government and Public Enterprises : Autonomy and Accountability"—EARC-II/Report No. 4.

II

7. At the outset, it is necessary to dispose of a common and familiar fallacy, namely, the tendency to talk about the public *sector* rather than about public *enterprises*. The presentation of performance figures in aggregate terms for public enterprises as a whole is open to serious question. The aggregation covers an enormous range of activity : steel plants, heavy electricals, chemicals, fertilizers, drugs and pharmaceuticals, mining (coal, iron ore, non-ferrous metals), textile mills, heavy engineering, light engineering, instrumentation, photo-films, consultancy, teleprinters, electronics, hotels, bakeries, international trade in diverse commodities and so on. What have all these in common except Government ownership? Can we readily conceive of a survey of private enterprises similar to the Public Enterprises Survey brought out by the BPE? Even when surveys of large numbers of firms/companies are prepared (e.g. by the Reserve Bank of India), these usually serve to indicate trends in the economy and are not used as the means of assessing managerial performance.

8. There are vast diversities in the circumstances in which different enterprises came into being in the public sector; in the conditions of operation which vary from industry to industry, and from location to location; in the infrastructural needs, availabilities and problems; in the state of technology; in the vintages of the plants; and so on. In terms of profitability there are high performers and poor performers and a whole range in between (including those which in the nature of things can at best be marginally profitable). We can hardly take satisfaction in the fact that the public enterprises as a whole produced, let us say, a profit of a few hundred crores in a particular year if this is the net result of a large profit made by the profitable units and a large loss made by the loss-making units. Contrariwise, a loss in the aggregate can conceal very good performance on the part of individual units.

9. We are not suggesting that surveys in aggregate terms are pointless. The fact that the massive investment in public enterprises yields, in the aggregate, a relatively meagre quantum of reinvestible resources, is indeed a matter for concern. But no remedial action can follow directly from this recognition. For remedial action of any kind, the performance of individual enterprises would need to be looked at. Figures of total investment in public enterprises, total profits before and after tax, etc., serve a statistical and not a managerial purpose. It is of course possible that as we proceed with an examination of the profitability of particular enterprises we might repeatedly come across certain factors which have an impact on performance, and some or several of these might be found to be common to many public enterprises; but such generalizations have to arise out of a series of individual assessments. As the total surplus of public enterprises is among the resources taken into account for the Plan, aggregate figures may indeed have to be given in the 'overview' section of the Public Enterprises Survey brought out by the BPE; but it should be clearly recognised that this is not information of managerial significance, and the temptation to present graphs and charts which have the appearance of projecting the performance of one large corporate entity called the 'public sector' should be avoided.

10. As mentioned above, the aggregate figures include both profitable and unprofitable enterprises. The latter can be classified into a number of categories in accordance with the factors responsible for the losses. Some enterprises were not meant to make profits at all, e.g., the Food Corporation of India; the question in such cases is not how to make the unit profitable but how to minimise losses, and to what extent the losses arise from managerial inefficiencey rather than from Government policies. Some enterprises are the victims of investment decisions which were necessary or justified at the time when they were taken but which in retrospect turn out to have been commercially unsound; in such cases efforts have to be made to see whether the consequences of the original investment decision can be mitigated either through measures such as diversification, revamping, etc., or through some capital reliefs. In certain cases, the financial difficulties arise from over-capitalization resulting from time and cost over-runs; appropriate lessons have to be drawn from the experience of such projects to ensure that such time and cost over-runs are avoided in the future, and for existing projects some mitigation of the over-capitalization might be needed. Over-capitalization could also result from social over-heads such as townships, hospitals and other amenities and facilities; here again, it may be necessary to separate the capital investment on such over-heads from the capital invested in productive assets for the purpose of determining profitability. Where the difficulties of enterprises cannot be attributed to past mistakes or over capitalization the losses can be classified under three heads; (a) those attributable to governmental policies, (b) those attributable to adverse conditions now prevailing which could perhaps take a turn for the better, and (c) those attributable to managerial weaknesses. These diverse categories of public enterprises are dealt with in greater detail in the ensuing paragraphs.

III

11. Let us consider first those enterprises which incur losses because of investment decisions which might have been all right when they were made but which have since turned out to be commercially unsound. The Surgical Instruments Plant at Madras is a clear case of this kind. The plant

have been handicapped from the start by the virtual absence of a demand for its products (which were based on Russian designs whereas the surgical profession in India is accustomed to Western designs), and subsequently even more by its inability to compete with the low-cost instruments produced by small scale units. The plant has been making losses ever since its inception. Its problems have been studied repeatedly but no effective solutions have been found. By way of 'diversification' a pharmaceuticals formulations unit was put up, but this was a cosmetic rather than a real solution, as there is no logical connexion between the two units, and the mere fact that they are housed near each other does not make them an integral complex in which the losses made by one part can be off-set by the profits made by the other. We visited the plant and had discussions with the Management but they had no effective rehabilitation proposals to put forward; they requested duty concessions and subsidies, but there was no evidence of any constructive thought towards a viable long-term future for the plant.

12. Another example is the Salem Steel Plant, which is not a steel plant at all but merely a cold-rolling mill. It was conceived as the first stage of what would eventually be an integrated steel plant. In the first stage it was to cold-roll imported hot hands and eventually it was to proceed by way of backward integration first to hot-rolling and then to metal production. No such backward integration has taken place or seems likely to take place in the foreseeable future. Meanwhile, the plant has virtually been sick from the date of commissioning partly because of low demand and partly because of the very high cost of production. There have been problems associated with the import of high-cost material and the heavy incidence of duty thereon. While duty concessions have been thought of, these are only partial solutions. A part of the problem is that the demand for high-quality stainless steel sheets of the kind produced by Salem is low because there is not enough investment in projects, and as regards the manufacturers of utensils, they do not seem to be particularly interested in quality but are able to get what they need from the small-scale and unorganized sector, or from the 'mini' steel units which have been allowed to diversify into stainless steel, or through imports coming in partly through the canalysing agency and partly through REP licences. In this case also, the investment decision seems in restrospect to have been of doubtful wisdom.

13. The Heavy Engineering Corporation at Ranchi is yet another example of an investment decision which has gone sour. A massive complex of large capacities for castings, forgings and machine-building was put up at an early stage of our planning based on visions of rapid industrial development which materialised only partly. As a result, the capabilities built up could never be utlilised properly, and the complex has been operating at a very low level of capacity utilization even since its inception.

14. The Kudremukh Iron Ore Company Ltd., is a more complex case. The complete uncertainty as to whether Iran will be able to lift the iron ore concentrate at all and if so when and in what quantities, the virtual absence of an alternative market for the concentrate, and the very low prices at which even small quantities can be sold, have resulted in extremely low production levels and large losses. A further investment has been made in a pelletising plant in the expectation that iron ore pellets would be more easily marketable than the concentrate, but it appears that in the depressed conditions of the steel industry in the world as a whole this hope is not being borne out. The prospects for this company in the foreseeable future seem to be one of desparately seeking orders for iron ore concentrate or for pellets from diverse parties all over the world, keeping the production going at a level far below capacity, and incurring enormous losses year after year. This is hardly an acceptable long-term prospect. Drastic decisions seem to be called for. Various options may need to be considered : e.g., to put the whole project in moth balls so as to minimise further losses; to undertake further downstream investments towards steel-making; to explore possibilities of using some part of the concentrate and the pellets (priced on a marginal cost basis) as sinter-feed or blast-furnace-feed respectively in our steel plants. We are not making any definite recommendations in this regard and we are sure that the Steel Ministry are aware of both the problems and the possibilities.

15. Hindustan Steelworks Construction Ltd., is yet another organization which finds itself in an impossible situation. An inadequacy of orders because of a slow-down in investment programmes, a substantial burden of fixed capital in the form of heavy construction equipment, and a large surplus labour force which the company is unable either to retrench or redeploy, have together crippled the company financially. The problems of the company have been studied several times, but no workable solutions have emerged. If a public sector unit cannot have the flexibility that private sector construction companies have in the matter of mobilizing and demobilizing the work-force, then perhaps this is an activity which is best left to the private sector. So far as we can see, the company's prospects in the foreseeable future are those of recurring losses and massive annual infusions of Government funds.

16. In certain cases it may be necessary to keep a loss-making public enterprise going because it serves certain public or social purposes. However, there are cases in which the nature of the activity is not such as to warrant the continued maintenance of a public enterprise of low or negative profitability. For instance, Scooters India Limited has been making losses of large magnitude year after year; it is difficult to contend that any public purpose is served by keeping this unit alive and by tolerating recurring losses.

17. In all the cases mentioned above the losses are the result either of difficulties inherent in the project right from the beginning or of adverse developments subsequent to the investment decision. Not all the examples given are necessarily to be classified as hopeless cases. Solutions may indeed be available in some cases, if we look for them. Detailed studies will have to be undertaken by expert groups in each case to analyse the problems and to identify the possible options. There may be a few cases in which no solution readily suggests itself, and the closure of the unit may be among the possibilities which have to be seriously considered. An alternative approach may be to try to minimise at least the cash losses, even though accounting losses (which include overheads) may still continue. So long as the variable costs are covered, it may be worthwhile keeping the operations going and maintaining the work-force, even if there is no contribution towards the fixed costs. If the problem is one of an accumulation of inventories, perhaps pricing on the basis of marginal costs (ignoring the sunk costs) might help. Such a re-adjusted price policy may even lead to a revival of domestic demand and perhaps open up export possibilities. If by such methods a material improvement in the cash-flow position could be brought about, this should be given serious consideration. Yet another possibility may be to see whether some of the equipment which is lying unutilised or under-utilised could be put to fuller use elsewhere. For instance, it has been suggested to us (though we have not examined this in detail) that the heavy forge in HEC, Ranchi, could meet certain requirements of BHEL which have to be met by imports because the latter's own forge does not have the capacity of the one at Ranchi. In a few extreme cases there may indeed be no option but to close down the operations. What is important is that the necessary examination should be completed quickly, all the options reviewed carefully and the appropriate decisions taken at a very early date. The worst possible option is to keep hopeless cases going indefinitely and accept a continuing haemorrhage of recurring cash losses with no prospect of any improvement.

18. An area in which it seems difficult to justify a public sector presence at the cost of low or negative profitability is the hotel industry. In the fifties the Government of India invited UNESCO to hold a session in New Delhi. It was then discovered that accommodation of an adequate standard to put up the delegations was simply not available, and in record time, the Ashoka Hotel was constructed for the purpose. Thereafter, with this as the nucleus, the public sector involvement in the hotel industry has been steadily increasing. The investment at present stands at about Rs. 80 crores. While the turnover is reasonable in the case of the ITDC hotels, the profitability is quite low compared to that of the private hotels, on account of higher operating expenses and lower occupancy ratios. In 1981-82 while East India Hotels (EIH) and Taj Group of hotels made a net profit of Rs. 474 lakhs and Rs. 394 lakhs respectively, ITDC's net profit was only Rs. 133 lakhs. Compared to the total assets these work out to 5%, 10% and 2.5% respectively. The turnover of the three groups in 1981-82 was the same around Rs. 36 crores. The ratio of net profit to turnover was 13% in EIH, 11% in the Taj Group and as low as 3.5% in ITDC. The position must have deteriorated in 1983-84 as a result of the heavy investment in new hotels. NDMC/DDA have entered into lease arrangements with private hotels, viz., Taj, Meridien and the Taj Palace, all in Delhi. It seems worthwhile considering the possibility of similarly leasing out or entrusting on management contract those public sector hotels which are not doing well, to established private sector groups on the basis of guaranteed returns.

19. We now turn to losses attributable to over-capitalization arising from substantial time and cost over-runs. Even after the mechanical completion of certain projects there have been prolonged commissioning delays, the projects continuing to be plagued by problems of various kinds and failing to reach a reasonable level of capacity utilization for years. These problems arise from a variety of reasons, such as deficiencies in project design; the putting together of plant and equipment from a multiplicity of sources because of the allocation of foreign exchange from different aid sources, leading to technical mis-matches bottlenecks, etc; the acquisition of know-how and plant and machinery from sources which are not the best in the world, again because of foreign exchange constraints; the lack of unified responsibility for project management; and a heavy emphasis on the use of indigenous capabilities for engineering, equipment fabrication and erection, and project construction and management. All this has resulted in large delays in the implementation of projects-e.g., a number of fertilizer projects undertaken by the Fertilizer Corporation of India in the sixties and early seventies. There have been also instances in which pioneering ventures have been undertaken into new areas such as large coal-based fertilizer projects, and a heavy price has been paid by way of time and cost over-runs and continuing operational problems. These projects have suffered because of a multiplicity of objectives. Where the emphasis was essentially on timely

completion and quick commissioning, and all arrangements and procedures were aimed at that objective, the projects have done very well, e.g., the Kalol/Kandla Project of IFFCO, Madras Fertilizers. Similarly, the special arrangements made in the case of the Kudremukh Iron Ore Project enabled the Management to complete the project within the sanctioned cost and time.

20. The lessons to be drawn from such successful examples of project implementation are reasonably clear : the allocation of foreign exchange from not more than one or two sources, and preferably of a kind that can be used globally, bulk releases of foreign exchange; a hand-picked management team; emphasis on timely project implementation with the responsibility for it firmly fixed; recourse to proven technology and tried and tested sources of equipment; the grant of considerable operational freedom to the Management; and special arrangements for prompt import clearances. In the case of the Kudremukh Project there was a special sense of urgency and a feeling that delays in project implementation were simply not acceptable; this was because of the severe penalties which were payable to the Iranians in the event of delays. However, timely completion and quick commissioning are equally important in the case of all projects; there are penalties attached to delays, even if these are not payable to another country or an external organization. Every month's delay in the completion and commissioning of a major project means the capitalization of large sums by way of financing charges. The kind of attitude and arrangements adopted in the case of Kudremukh would therefore be appropriate in the case of all projects.

21. These observations, however are applicable to future projects. In the case of projects where such heavy over-capitalization has already occurred, we have to consider how best the burden can be lightened. While not condoning managerial inefficiencies, we must point out that in several cases the over-capitalization has been the result partly of external factors such as the limitations imposed by the foreign exchange constraints on the sources of technology and plant and equipment, and partly of the tremendous effort that has been made to maximize the use of indigenous capabilities—which were as yet developing—for engineering, equipment fabrication etc. In essence, therefore, at least a part of the over-capitalization can be attributed to the processes of development and learning and the ambitious effort at self-reliance, i.e., what may be called the 'learning curve'.

22. Moreover, some of the projects have been the training ground for other public sector organizations, particularly the equipment suppliers such as Bharat Heavy Electricals Ltd., Bharat Heavy Plates & Vessels Ltd., etc., and the engineering and consultancy organizations such as MECON, PDIL, etc. Some of the fertilizer projects, power stations, steel plants, etc., have had to accept serious delays, cost escalations and commissioning difficulties arising from engineering and equipment problems and the relative inexperience of consultants and construction agencies, but in the process the capabilities of BHEL, BHPV, HEC, MECON, etc., have been built up; and today some at least of these organizations have greatly improved their technological, engineering and fabrication capabilities and have even become internationally competitive.

23. At the same time, the projects which suffered delays continue to be crippled by the heavy burden of over-capitalization. The Managements which are now in charge, however efficient they may be, cannot possibly overcome this severe initial handicap entirely. It is unreasonable to expect them to service adequately the heavy capital that they have been burdened with. The continuing losses are self-perpetuating because the deficits have to be covered through non-plan Budget support which adds to the burden of debt; and the demoralizing effect of the losses impairs managerial confidence and ability. In such cases, while measures such as balancing, de-bottlenecking, modernization, technological upgradation, etc., must certainly be undertaken, there is also need for some kind of financial restructuring which would make the problem of capital servicing more manageable. The devices which have been adopted in a number of such cases are the provisions of moratoria on loans, interest holidays, and the conversion of a portion of the debt into equity. Such methods are not wholly satisfactory. The over-capitalization will remain in such cases, and its impact on costs and prices through the capital-related elements will continue to be felt. What is called for is a judicious write-down of capital to the extent that the capital represents the cost of learning and development. Once this has been done, the Managements can then be legitimately expected to service the reduced capital satisfactorily and show reasonable profits.

24. This is of course a remedial measure which has to be used with very great care. Detailed studies of individual projects would be necessary to identify the extent to which the over-capitalization in a given case can be attributed to the cost of learning or to external factors such as foreign exchange constraints which were beyond the control of the project Management. Our intention is not that inefficiency in project management should be obscured and the challenge to the capabilities of the current Management weakened through a writing-down of capital; nor do we envisage this as a window-dressing device for reducing losses or converting them into profits. However, having taken note of such dangers and possible objections, we do feel that there are instances in which a write-down of capital is necessary and appropriate. Other Governments, such as the U.K., have written

off large amounts of investment in nationalized industries. The Government of India, however, has been reluctant to do so. As a result, some of our pioneering public enterprises continue to be plagued by a capital investment which bears no relationship to their current production capabilities, and which cannot possibly be serviced even by a super-efficient management.

V

25. Another factor leading to the over-capitalization of a number of public enterprises is the element of social overheads such as townships, hospitals, schools and other civic amenities such as water and power supply arrangements, markets and other facilities. These constitute substantial additions to the project costs. The need for these arises partly because public enterprises are often established in green-field sites far away from urban centres, and partly because it is Government policy that public enterprises should be model employers and should provide certain amenities and facilities to the workers and officers. Not only do such social overheads increase the capital costs of projects and consequently the costs of production, but they also set up recurring maintenance costs of a high order. Moreover, the provision of townships, hospitals, schools, etc., means in turn, further additions to the manpower by way of engineers, doctors, teachers, etc., and these in turn go to increase the size of the population for which such facilities and amenities have to be provided. Thus the cost of providing civic amenities has a significant impact on the financial picture. Quite apart from the financial impact, the maintenance of large industrial townships and the attendant problems tend to divert the attention of the Managements from their primary function, namely, the production of goods and services for sale, to problems of municipal administration. It may be worth considering whether municipal administration cannot be divorced from production management by transferring the responsibility for the construction and maintenance of townships, etc., to a civic organization such as a Notified Area Authority or a municipality.

26. Even if this is not feasible, it seems at least desirable to isolate the capital costs on such social overheads from the main project costs for the purpose of determining profitability, so as to avoid inflating the capital base which has to be serviced. It is of course true that the townships are financed through the grant of equity and not loan, but it is fallacious to think that equity capital does not have to be serviced. It does become part of the project cost and enters into costs and prices *via* the capital-related-elements, such as depreciation, return on capital, etc. We would recommend that this should be avoided by treating the capital cost of social overheads as grants which should not enter the project cost.

VI

27. That brings us to enterprises which are not the victims of past mistakes and do not suffer from over-capitalization. As mentioned earlier, the losses of such units can be classified as those attributable to governmental policies, those attributable to adverse conditions now prevailing which could perhaps take a turn for the better in due course, and those attributable to managerial weaknesses.

28. Among the governmental policies which have contributed to the losses of public enterprises in the past have been pricing policies. There was a time when many of the goods and services produced by public enterprises were grossly under-priced and it was necessary to stress the need for appropriate economic pricing. Fortunately, that situation has largely changed. During the last few years there have been substantial upward revisions of the prices of basic commodities and industrial materials such as steel, coal, cement, etc. There were also instances in the past when public enterprises were expected to make supplies to other public enterprises or to Government Departments at less than economic prices. Examples of this were the supply of rails, wheels, axles, etc. by the public sector steel plants to the Railways, and the supply of special steel plates to the Heavy Vehicles Factory at Avadi. In both these cases the prices at which the supplies had to be made were unduly low for several years. Fortunately, this has been remedied.

29. However, a point which still needs to be reiterated is that if there is any subsidization of any such product to be done for any public economic or social purpose, this ought to be done by the Government and not by the producing public enterprise. For instance, if the Government desires to make steel available at international prices to the exporters of engineering products, the subsidization involved should come from the Government; the steel plants should not be expected to supply steel at subsidized prices to the exporters.

30. Secondly, if the output of a public enterprise is an input for one or more down-stream industries, the profitability of the latter and the presence or absence of a price control on these industries should be taken into account before Government intervenes in the pricing decisions of the public enterprise. Down-stream industries in several sectors are in the hands of the private sector and they

are usually free to fix their own prices with reference to market conditions. The pricing of the product of the public enterprises should be such as to enable the down-stream units to make reasonable profits, and no more. If the profit margin is found to be unreasonably large, there should be no hesitation on the part of the public enterprise in appropriately increasing the price of its own product, which is the input for the down-stream units. On the other hand, if the product of the down-stream industry is subject to price control, the public enterprise should maintain its price in line with the price of the finished product. If this price is unremunerative, the public enterprise and the down-stream units should jointly seek an upward revision of the price of the finished product.

31. When the Government is concerned about increases in price levels and is anxious to contain inflationary pressures, it sometimes addresses communications to the Managements of public enterprises requesting them to observe a price restraint. Private enterprises normally do not receive such exhortations, or if they do, ignore them with impunity. This kind of informal request or direction places the public sector at a serious disadvantage compared to the private sector. Besides, the practice constitutes an interference in the autonomy of public enterprises and undermines their accountability. In any case, an artificial price restraint on some industries is not the best means of countering inflation; this has to be achieved through proper economic management.

32. Where a statutory price control or an administered pricing system is in force, the profitability of public enterprises sometimes gets depressed because of delays in governmental approvals to price adjustments in response to changes in input costs. Even when there is a formula for price adjustments with reference to changes in major cost factors, considerable delays take place in obtaining governmental approval to price changes through the application of that formula. This has happened more than once in the case of aluminium. There have also been delays in such price adjustments under the aegis of the Drug Price Control Order in the drugs and pharmaceuticals industry. Some of these matters relating to price approvals have been dealt with in our Report on 'Government and Public Enterprises : Governmental Clearances and Approvals' (EARC II/ Report No. 6) extracts from the summary chapter of which are given in the annexure to this Report.

33. There are certain other governmental policies which have an impact on the profitability of public enterprises. For instance, an obligation has been cast on public enterprises to foster the development of small-scale units as well as ancillary industries; among other things, public enterprises are expected to extend a price preference to them. This involves the obtaining of supplies and services at prices higher than would be warranted on purely commercial considerations. Similarly, supplies are also sometimes expected to be made by public enterprises at concessional rates to selected categories of buyers. For instance, steel used to be supplied at concessional prices to small-scale units. Similarly, at one stage a scheme was introduced for the opening of rural steel distribution centres for ensuring the availability of steel in rural areas, and supplies were to be made at concessional prices. While there may be very good reasons for some of these measures, in general we would say that the imposition of a non-commercial obligation by the Government on public enterprises should be accompanied by a specific compensation for such an obligation.

34. An example of the manner in which governmental policies and bureaucratic arrangements impinge on the profitability of public enterprises is that of the National Mineral Development Corporation which produces iron ore for export to Japan. The past losses of this company arose at least partly from a skewed distribution of the export proceeds among the different agencies involved, viz. the Government which collected an export duty; the MMTC, the exporting agency which took a small service charge; the Vishakhapatnam Port which levied port dues; the Railways which claimed their share by way of freight, which they were at liberty to raise from time to time; and the NMDC, which was the mining agency which produced the iron ore for export. The profits and losses of individual agencies were somewhat artificial, and economic calculations would have been necessary to determine the country's overall profit or loss on the export operation. However, as the NMDC was a separate corporate entity, it had per force to display large financial losses year after year; and as a means of assistance Government extended moratoria on loan repayments and interest holidays to the Company, creating the impression that NMDC was a sick organisation which required governmental support, whereas the position was that the company received a very small fraction of the export price realised from Japan. It would have made much greater sense to pay the company a proper price for its output and expect it to service its debt to the Government, than pay it an extremely low price and then provide it with debt relief.

35. Similarly, until some years ago the gold produced by Bharat Gold Mines Limited used to be taken over by the Government at a very low price (which was paid to the BGML by the Mint) and then a supplementary payment used to be made by the Department of Mines as a 'subsidy'. Instead of paying a part of the price as a subsidy, the better course would have been to pay the company a proper price for its product. The peculiar procedure followed earlier in this case was changed later, though the price formula to be adopted has been under prolonged discussion. In the case of other non-ferrous metals in respect of which there is some indigenous production supplemented by

imports (copper, zinc), the domestic price tends to get fixed with reference to international prices which are sometimes grossly inadequate for the high cost of production in this country arising from the nature of the natural endowments and the adverse mining conditions.

36. The general conclusion that we draw from these examples is that where free market forces have for one reason or another not been found to be acceptable and production has to be kept going under difficult conditions for reasons of self-reliance or strategic considerations or on socio-economic grounds, or where there is a multiplicity of public sector and governmental agencies involved in one economic operation, the producing agency should be paid an appropriate price which would cover the cost of production and provide a reasonable return on the investment, subject to the application of certain efficiency norms. Depressing the price and then extending a subsidy or debt-relief or non-Plan budget support does not make much sense.

37. As regards those cases in which the losses are caused by adverse conditions which could be expected to change for the better, examples would be the piling up of large quantities of steel ingots for want of adequate power supply to the rolling mills in 1979-80 and 1980-81; the accumulation of large unsold inventories of finished steel materials by the integrated steel plants in 1983-84; the persistently low levels of capacity utilization at the Korba Smelter of Bharat Aluminium Company Limited because of the chronic inadequacy of power; intermittent and sometimes prolonged shut-downs of fertilizer plants or of 'mini' steel plants because of power cuts; and so on. It is difficult to make any special recommendations in regard to such problems. In so far as infrastructural problems (such as inadequacies and fluctuations in power availability, problems in regard to the availability and quality of coal, railway transportation problems, etc.)are concerned, the Government has a role to play in resolving them, and accordingly a Coordination Cell has been functioning in the Cabinet Secretariat. However, though many of these problems might be regarded as external, Managements are not necessarily totally helpless in responding to such constraints. Within limits there is room for flexibility and ingenuity on the part of a resourceful Management in coping with external constraints, and indeed some public sector Managements have displayed the necessary resilience. Similarly, marketing problems arising from a demand slack in certain sectors also pose challenges to the Management. All that we can say is that there should be serious managerial efforts at the evolution of strategies for responding promptly to such adverse developments, and either overcoming them or at least limiting the damage done by them.

38. That brings us to the last factor we had mentioned earlier as contributing to losses, viz., managerial weaknesses. These could arise from the quality of the managerial personnel or from the inability of even good Managements to function effectively because of the public sector ethos and the impact of the governmental machinery. In so far as the calibre of managerial personnel is concerned, we can only stress the importance of selecting the right men both at the top Management level and at the level of the Boards of Directors, and giving them reasonable tenures for showing results. These matters have been gone into the Report on 'Government and Public Enterprises : The Top Management and the Boards' (EARC II/Report No. 2). As regards the question of how best Government can facilitate, or at least not hamper, the effective functioning of a good Management team, we would stress the importance of granting the autonomy necessary for businesslike functioning; a proper understanding of concepts and procedures relating to accountability; and a radical re-ordering of the relationship between Government and public enterprises. These matters have been dealt with in our Reports on 'Government and Public Enterprises : Autonomy and Accountability' (EARC II/Report No. 4) and 'Government and Public Enterprises : Governmental Clearances and Approvals' (EARC II/Report No. 6).

VII. Summary of conclusions and recommendations

39. (1) The present Report is essentially concerned with the financial profitability of public enterprises. This is both relevant and important as a yardstick of performance, though the evaluation of the performance of public enterprises has to be done with reference to diverse goals, targets and objectives.

(Paragraphs 1—5)

(2) (a) The presentation of performance figures in aggregate terms for public enterprises as a whole is open to serious question. While the total surplus generated by public enterprises may be of relevance in the context of reckoning resources for the Plan, the temptation to present graphs and charts which have the appearance of projecting the performance of one large corporate entity called the 'public sector' should be avoided.

(b) The aggregate figures include both profitable and unprofitable enterprises. The latter could be classified into a number of categories in accordance with the factors responsible for the losses, e.g., enterprises which were meant not to make a profit at all; enterprises which

are the victims of investment decisions which in retrospect turn out to have been commercially unsound; enterprises which have suffered over-capitalization because of time and cost overruns in project completion; and enterprises which carry a heavy burden of capital investment on social overheads such as townships, hospitals and other amenities and facilities. In regard to enterprises which are not victims of past mistakes or of over-capitalization, the losses can be classified as those attributable to Government policies; those attributable to adverse conditions now prevailing, which could perhaps take a turn for the better; and those which are attributable to managerial weaknesses.

(Paragraphs 7—10)

(3) (a) In a number of cases the losses are the result either of difficulties inherent in the project right from the beginning or of subsequent adverse developments which have vitiated the investment decision. Examples of these are given in the body of the Report. Detailed studies will have to be undertaken by expert groups in each case to analyse the problems and to identify the possible options. There may be a few cases in which the closure of the unit may be among the possibilities which have to be seriously considered, but there could be other options such as keeping the operations going while minimising cash losses; reducing inventories through marginal-cost pricing; and transferring under-utilised equipment to other public enterprises which may have greater use for it. It is important that the necessary examination should be completed quickly, and the appropriate decisions taken at a very early date. The worst possible option would be to keep hopeless cases alive and accept a continuing haemorrhage of recurring cash losses with no prospect of improvement.

(b) One area in which it seems difficult to justify a public sector presence at the cost of low or negative profitability is the hotel industry. It seems worthwhile considering the possibility of leasing out or entrusting on management contract those public sector hotels which are not doing well, to established private sector groups on the basis of guaranteed returns.

(Paragraphs 11—18)

(4) (a) In a number of cases substantial cost and time overruns on project completion have led to heavy over-capitalization and contributed to recurring losses. It is very important to avoid such time and cost overruns in future projects, by applying the lessons drawn from successful examples of project implementation in the past : the allocation of foreign exchange from not more than one or two sources and preferably of a kind that can be used globally; bulk releases of foreign exchange; a hand-picked management team; emphasis on timely project completion with the responsibility for it firmly fixed; recourse to proven technologies and tried and tested sources of equipment; the grant of the necessary operational freedom to the Management; and special arrangements for prompt import clearances. Timely completion and quick commissioning are equally important in the case of all projects; there are penalties attached to delays even if these are not payable to another country or an external organisation. The kind of attitude and arrangements adopted in the case of the Kudremukh Project would therefore be appropriate in the case of all projects.

(b) In the case of past projects which have suffered time and cost overruns, at least a part of the over-capitalization can be attributed to the processes of development and learning and the ambitious effort at self-reliance (i.e., what may be called the 'learning curve'). What is called for in such cases is a judicious write-down of capital, to the extent (to be determined in each case with care) that the capital represents the cost of learning and development.

(Paragraphs 19—24)

(5) In some cases over-capitalization results from the element of investment in social overheads such as townships, hospitals, schools and other civic amenities; such social overheads also set up recurring maintenance costs of a high order, and they tend to divert the attention of the Management from the primary function of production of goods and services for sale, to problems of municipal administration. It may be worth considering whether the responsibility for the construction and maintenance of townships cannot be transferred to a civic organization such as a Notified Area Authority or a Municipality. In any case it seems at least desirable to isolate the capital invested in such overheads from the main project cost for the purpose of determining profitability. The inflation of the capital base which has to be serviced should be avoided by treating the capital costs of social overheads as grant which do not enter the project cost.

(Paragraphs 25—26)

(6) (a) Among the governmental policies which have contributed to the losses of public enterprises in the past have been pricing policies, but the under-pricing of basic materials such as steel, coal, cement, etc., has been largely remedied. However, a point that still needs to be reiterated is that if any subsidization of any product is to be done for a public economic or social purpose, this should be done by the Government and not by the producing public enterprise.

(b) If the output of a public enterprise is the input for one or more down-stream industries, the profitability of the latter and the presence or absence of a price control on those industries should be taken into account before Government intervenes in the pricing decisions of the public enterprise. The pricing of the product of the public enterprise should be such as to enable the down-stream units to make reasonable profits and no more. If the down-stream industry is subject to price control, the public enterprise should maintain its price in line with the price of the finished product. If this price is unremunerative the public enterprise and the down-stream units should jointly seek an upward revision of the price of the finished product.

(c) Informal requests or directions to public enterprises to observe a price restraint places the public sector at a serious disadvantage compared to the private sector. An artificial price restraint on some industries is not the best means of countering inflation; this has to be achieved through proper economic management.

(d) Matters relating to governmental approvals to the pricing decisions of public enterprises have been dealt with in our Report on 'Government and Public Enterprises : Governmental Clearances and Approvals' (EARC-II/Report No. 6), extracts from which will be found in the Annexure to this Report.

(e) The imposition of a non-commercial obligation by the Government on a public enterprise should be accompanied by a specific compensation for such an obligation.

(f) Where free market forces have for one reason or another not been found to be acceptable, and production has to be kept going under difficult conditions for reasons of self-reliance or strategic considerations or on socio-economic grounds, or where there is a multiplicity of public sector and Governmental agencies involved in one economic operation, the producing public enterprise should be paid a proper price which would cover the cost of production and provide a reasonable return on the investment, subect to the application of certain efficiency norms. Depressing the price and then extending a subsidy or debt-relief or non-Plan Budget support does not make much sense.

(g) As regards those cases in which the losses are caused by adverse conditions which could be expected to change for the better, the Government has a role to play in resolving the infrastructural and inter-sectoral coordination problems. There should also be serious efforts on the part of the Managements of public enterprises at the evolution of strategies for responding promptly to such adverse developments, and either overcoming them or at least limiting the damage done by them.

(h) As regards losses arising from managerial weaknesses, the way to avoid them is to select the right men both at the top management level and at the level of the Boards of Directors, and give them reasonable tenures for showing results; it is also important to grant to the Managements the autonomy necessary for businesslike functioning. There is also need for a proper understanding of the Accountability concepts and procedures, and a radical re-ordering of the relationship between the Government and public enterprises. These matters have been dealt with in our Reports on 'Government and Public Enterprises : The Top Management and the Boards', 'Government and Public Enterprises : Autonomy and Accountability' and 'Government and Public Enterprises : Governmental Clearances and Approvals' (EARC-II/Report Nos. 2, 4 and 6).

(Paragraphs 27—38)

ANNEXURE TO EARC-II/REPORT NO. 7 ON 'GOVERNMENT AND PUBLIC ENTERPRISES : THE PROFITABILITY OF PUBLIC ENTERPRISES'

Extract from EARC-II/Report No. 6 on 'Government and Public Enterprises : Governmental Clearances and Approvals'

9.7 *Price Approvals :*—(i) Among the existing guidelines on pricing by public enterprises, the one which lays down that where a public enterprise is in a competitive situation the pricing should be left to be determined by the market forces, enunciates a sound principle which should be scrupulously adhered to. The second guideline, namely, that in the case of public enterprises which are in a monopolistic or semi-monopolistic situation the landed cost of comparable imported goods should be treated as a ceiling for the domestic price, is based on some assumptions which may not be borne out by the facts, and could place public enterprises in a difficult position.

(ii) Except for items for which a price control applicable to both the public sector and the private sector is in force, the Management of a public enterprise should have the freedom to adjust prices with due regard to its own profitability and the market conditions.

(iii) To the extent that for certain items, because of their critical importance to the economy or because of the dominant position of the public sector, a measure of regulation is considered to be essential, this should be done through guidelines drawn up with due regard to the nature of the product in question.

(iv) Once the guidelines are laid down, actual pricing decisions should be left to be taken by the enterprises. Any requirement of governmental approval for each individual pricing decision would not merely mean a delayed response to changes in costs or in the market conditions, but may also make the decision more difficult and more controversial because it would get politicized. If there is a pricing formula with a provision for variations with reference to changes in certain elements, price adjustments on the basis of the formula should not need a reference to the Government but should be left to the enterprises, so that price revisions could take place smoothly and gradually from time to time, rather than at long intervals and in large jumps.

(v) The Management should be given a measure of flexibility and discretion in the application of the guidelines and not required to adhere to a rigid policy without regard to the environment in which it operates.

(vi) Where a reference to the Government does become necessary, it should be handled with the maximum speed. A drill should be laid down to ensure the communication of the decision within a stipulated period (say a fortnight), failing which the public enterprise should be free to go ahead with the proposed price change. The examination of such proposals should be preferably left to a professional body like the BICP rather than be subjected to dilatory processing in the Secretariat.

(vii) In an exceptional case where considerations of public policy call for governmental intervention in the pricing of a particular item or commodity which is produced by a public enterprise, this should take the shape of a directive formally issued with the concurrence of the Finance Ministry; and the consequences of this directive should be explicitly recognised in the subsequent evaluation of the performance of the public enterprise.

(viii) Where there is no requirement of Governmental approval, any tendency on the part of the Managements of public enterprises to refer their pricing decisions to the Government directly or indirectly for approval should be discouraged.

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