

MEMORANDUM OF UNDERSTANDING (MoU) - A PERFORMANCE MEASUREMENT TOOL FOR CPSEs

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[This paper attempts to discuss about the Memorandum of Understanding (MoU) signed between the Administrative Ministries and the concerned CPSEs as a performance measurement tool for CPSEs. The paper highlights the evolution of the concept of MoU framework for CPSEs in India, the concept of MoU, the MoU process and the benefits and the significance of the MoU framework with respect to the CPSEs. This paper will help to make an understanding about the process of MoU as a performance measurement framework for the CPSEs.]

Keywords: Memorandum of Understanding (MoU), CPSEs, Accountability, Autonomy, Performance Evaluation, Performance Contract, Negotiation, Signaling System, Balanced Scorecard.]

Introduction

Public sector enterprises were established by the governments of the less developed economies to provide services to the public at low cost and also to catch up with the more advanced economies. The evolution of CPSEs in India started with the incorporation of the first five year plan (1951-56). Government decided to establish five Public sector enterprises in the area of basic and heavy core industries like railways, post and telegraphs, All India Radio and aircraft industries. With this humble beginning,

today the footprints of Central Public Sector Enterprises (CPSEs) are present in a diverse range of activities like coal, steel, heavy machinery, engineering, oil & gas, petrochemicals, textiles, manufacturing and pharmaceuticals.

The eminent role played by the CPSEs in the industrial and overall development of the country is well acknowledged. CPSEs have contributed to the country's industrialization and economic growth by creating a diversified industrial base. Post liberalization (1991), Central Public

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Sector Enterprises (CPSEs) have faced internal as well as external competition. The measurement of performance of CPSEs was on the forefront as it was widely believed that the CPSEs were performing below par and the return on investments was also very low. Further it was felt that the CPSEs are less efficient than their private sector counterpart with less or no accountability. Similarly, there are varieties of agencies which keep setting different objectives for the enterprise which are often conflicting leading to hindrance in performance of the CPSEs.

Government was very much concerned with the performance of the CPSEs but at the same time was against mass scale privatization of public assets. The main concern was reforming the CPSEs; under what conditions the management of the CPSEs and the managers are more likely to act in the public's interest. Thus evolved the concept of 'Performance Contract' or 'Memorandum of Understanding (MoU)' as an alternative to privatization and to make the CPSEs more accountable and deliver better performance. The concept of Memorandum of Understanding (MoU) has been designed to provide flexibility and autonomy to Central Public Sector Enterprises (CPSEs) such that it facilitates them in pursuing the objectives and purposes, for which the enterprises have been set up. Accountability has to be understood in a wider sense by associating it with answerability for the performance of the tasks and the

achievement of targets negotiated mutually between the Government and the CPSE.

The Performance Contract System for measuring performance of public enterprises originated in France in the late 1960s. A number of French enterprises entered into performance contracts with the Government specifying the objectives and mutual commitment for a specified period of three to five years. The French contract plan is used in France, Senegal, Zambia, Morocco and a few countries in Latin America. Prof. Leroy P. Jones (Director, Public Enterprises Programme, Boston University) developed a new system termed as the 'Signaling System' for performance contract of public enterprises. This was pioneered by South Korea and Pakistan. Today countries like Sri Lanka, Bangladesh in Asia, Ghana in Africa, Columbia in Latin America, and Romania in Europe to name a few adopts this system of performance contract.

The Memorandum of Understanding (MoU) System in India as a measure of performance contracting for CPSEs was introduced in the year 1986, after the recommendations of the Dr. Arjun Sengupta Committee Report (Report of the committee to review policy for Public Enterprises, 1984). The report recommended that the CPSEs enter into agreements with their Administrative Ministries for five years, while progress would be reviewed annually. The committee recommended three parameters for regulating the control-freedom interaction between government and CPSEs: price fixation, investment

planning and financial management. These parameters are essentially financial in nature. The first set of MoU was signed by four CPSEs for the year 1986-87.

The system was revamped in 1989 and it moved closer to the “Signaling System” of the South Korean model. This new MoU system implemented from the financial year of 1989-90 became an annual event from its earlier five year period. Some of the other important value additions were (i) inclusion of qualitative aspects of performance, (ii) addition of criteria and (iii) objectivity and expertise through a High Power Committee (HPC) and an Ad-hoc task Force (ATF).

The Public Enterprise Survey Report (1988-89) presented to the parliament on 15th March, 1990 spelt out the purpose and mechanism of MoU as ‘In order to improve the performance of the public sector, government took a policy initiative by introducing the concept of Memorandum of Understanding (MoU). MoU is an instrument which defines clearly the relationship of the PSU with the government and clarifies the respective roles of the PSU as well as the government, to achieve better performance.’ The Industrial Policy of 1991 stated that the public enterprises will continue to remain with the government and government will provide much greater degree of management autonomy through the system of MoU.

The MoU system was again revamped in 2004-05 on the basis of the outcome of the study conducted by the National Council of Applied Economic Research (NCAER) engaged by Department of Public Enterprise (DPE). NCAER recommended for adoption of the

Balanced Scorecard (BSC) approach and allocate equal weights (50%) to both ‘financial’ and ‘non-financial’ parameters as against the 60% weight allocated to ‘financial parameters’ and 40% weight to ‘non-financial parameters’ of the existing process. The financial parameters are presented in absolute values as well as in ratios. The non-financial parameters are further divided into dynamic parameters, enterprise-specific parameters and sector-specific parameters.

In 2008, the government engaged a Working Group headed by Shri Ashok Chandra, the then Chairman Task Force to review the MoU guidelines in CPSEs. The report recommended that the past five years performance of the CPSEs must also be considered while determining the annual targets to reduce distortions. The report also advocated continuance of the usage of the BSC approach with equal 50% weightage in financial and non-financial parameters. Suggestion was made that the weightages for financial and non-financial parameters may be suitably altered for enterprises, which are not purely commercial in nature, or which are operating in a purely government administered pricing regime, or enterprises working in social and financial sectors.

DPE engaged MDI, Gurgaon in 2011 to suggest measures for improving the system of MoU. The report suggested six different kinds of formats for MoUs between CPSE and its Ministry (Manufacturing and Mining Sectors, Trading and Consulting Sectors, Social Sector, Financial Sector and Sick enterprises). MDI report also suggested

certain parameters to be used in MoU such as Quality (ISO certification, internalization of quality within SBU/ products), Customer Satisfaction, Adoption of innovative practices, Capital Expenditure /Greenfield investments/ Joint Ventures, Extent of globalization (internationalization, joint ventures, exports, strategic, market presence in emerging economies, internationalization along value chain), Cost Rationalization etc.

A Working Group to review the MoU systems under the Chairmanship of Shri PG Mankad was constituted and the report was submitted on 22nd October, 2012. The recommendations are, (i) limiting the task force members to five (ii) constitution of members of the resource group for the task force as support mechanism (iii) constitution of a panel of experts (iv) pre-negotiation meeting on draft MoU (v) joint meeting of CPSEs having common targets (vi) determination of basic target and the difference between levels on a five point scale at the discretion of the task force (vii) negative marking for non-compliance of Corporate Governance guidelines / DPE guidelines.

During the initial years of MoU implementation, Government of India laid greater emphasis on the core sectors like Steel, Heavy Engineering, Coal, Power, Petroleum and Fertilizers. Over the years, more CPSEs were brought within the system and for the year 2013-2014, 196 CPSEs have signed MoUs with their respective administrative ministries.

Memorandum of Understanding (MoU) is a negotiated performance agreement between the management of CPSE and Government of India (Administrative Ministry). It is an instrument to evaluate the performance of the management of a CPSE in a given year with reference to the commitments made. MoU clearly defines the relationship of the CPSE with the Administrative Ministry and clarifies the respective role of the CPSEs as well as the Administrative Ministry for achieving better results. The achievable objectives have to be clearly defined alongwith the strategies for achieving the objectives. The responsibility of the management of the CPSEs and the owner (Administrative Ministry) has to be clearly determined, resources required for achieving the desired goals have to be identified and mobilised. The MoU is essentially a management audit which attempts to bring a proper balance between accountability and autonomy. The emphasis is on achieving the negotiated and agreed objectives rather than interfering in day to day affairs of the CPSEs. If either of the above two conditions is violated, the effectiveness of the MoU as an instrument of performance improvement is bound to be affected. In short, MoU makes an attempt to move the management of PSEs from reliance on ex-ante control to a system of ex-post control.

MoU is signed by all CPSEs – Holding Companies as well as their subsidiaries. The Holding Companies sign MoU with their Administrative Ministries / Departments and the subsidiaries sign

MoU with their Holding CPSEs. There are about 250 CPSEs out of which 60 nos. are in Schedule-A, 71 nos. are in Schedule-B, 46 nos. are in Schedule-C, 4 nos. are in

Schedule-D and 69 in Others-Uncategorized. The year wise details of MoU signed by CPSEs is give in the table below.

Year	No. of MoU's Signed	Year	No. of MoU's Signed
1987-88	4	2006-07	113
1991-92	72	2007-08	144
2001-02	104	2008-09	147
2002-03	100	2009-10	197
2003-04	96	2010-11	202
2004-05	99	2011-12	197
2005-06	102		

Source: Annual Report 2011-12, Ministry of Heavy Industries, Govt. of India.

The objectives of MoU can be summarized as under.

1. Measure the performance of CPSEs taking into account the complexity of the social and financial objectives and translating them into measurable parameters.
2. Improve the performance of CPSEs through considerable autonomy and accountability of management
3. Remove the fuzziness in the goals and objective of the CPSEs.
4. Set up an objective performance evaluation system and introduce a performance incentive plan.
5. Provide a mechanism to reward good performance incentives to stimulate improved performance
6. Set-up new institutions and administrative and personal system.

7. Replace 'multiple principles with multiple objectives' with clarity in goals and objectives.

The need for an institutional arrangement for implementing MoU came in due to criticism/ objections raised by the CPSEs. CPSEs termed MoU as a contact between "unequals" and felt that the Government was not technically equipped to make a proper assessment of PSEs. In response to such concerns, the Government of India decided to have a formal institutional arrangement. The detail of this institutional arrangement and their inter-linkage are as follows:

High Power Committee (HPC) - This is the apex committee constituted to assess the performance of CPSEs with reference to the commitments made by them in the MoU and also to assess how far the Administrative Ministries/Departments

have been able to give the necessary support as committed in the MoU. HPC is a Committee of Secretaries (COS) with 10 members headed by the Cabinet Secretary, Government of India. The other members are Finance Secretary, Secretary (Expenditure), Secretary (Planning Commission), Secretary (Statistics & Programme Implementation), Secretary (Performance Management), Chairman (PESB), Chairman Tariff Commission, Chief Economic Adviser and Secretary (Public Enterprises) as the Member Secretary. Since the performance of both parties will be evaluated, both parties will be equally accountable for the performance of concerned CPSE.

Task Force on MoU: The Committee of Secretaries decided in its meeting on 26th December, 1988 to constitute a Task Force for determining the parameters and weights of the MoU and also for evaluating the performance of the CPSE. The main objective was to take care of the concern regarding the imbalance in technical expertise available the Government for evaluating CPSEs performance. The members of the Task Force includes ex-Civil Servants, ex-Chief executives of CPSEs, Professionals and academicians from relevant disciplines. The Task force is further divided into different groups called syndicates for

providing greater professional and technical expertise to the CPSEs and objective evaluation. From 2010-11 CPSEs were categorized into 11 syndicates with each syndicate having 6 members comprising of Convener (the senior most member), ex-Secretary to GOI (administrative member), ex-CMD of any CPSE, finance/CA expert, renowned academician and a domain expert. In 2011-12 there were 67 Task Force members and one Chairman. The 11 syndicates are: 1. Crude Oil, Gas and Petroleum. 2. Power generation and transmission. 3. Engineering, Transport equipment and Consumer Goods. 4. Sick and Loss Making CPSEs. 5. Steel, Coal and other Minerals. 6. Electronics, Telecommunications & Information Technology. 7. Transport and Tourism. 8. Trading and Marketing. 9. Agriculture, Fertilizers, Chemical & Pharma. 10. Contract and Consultancy. 11. CPSEs registered under Section 25 of Companies Act & Financial Services.

MoU Division in the Department of Public Enterprise (DPE) - It acts as the permanent secretariat to HPC and Task Force and assists in any matters related to MoU.

The process of MoU starts with the issue of guidelines by MoU Division of DPE and culminates with the evaluation of the performance of the CPSEs with respect to the MoU Signed.

Issue of Guidelines

MoU Division of DPE issues of Guide lines for the year(November). These guidelines indicate the broad structure and aspects to be covered in the draft MoU including the weights to be the financial parameters. These guidelines reflect the concerns of the Government and give the general direction to the PSEs.

Drafting of MoUs & Pre-Negotiation Meetings

CPSEs prepare the draft MoU and submitted to DPE after due discussion in Board and the concerned Administrative Ministry/Department. (December). The draft MoU received in DPE are examined in MoU division in consultation with Task Force. A Pre-negotiation meeting is to ensure that the targets proposed in the draft MoU are realistic and challenging is sought from PSEs/Ministries.

MoU Negotiation Meeting

MoU negotiation meetings are held in the month of February/March. These meeting are attended by the concerned Board Members of the CPSE. Administrative Ministry and DPE with the Task Force members. The targets under various parameters are discussed are finalised during these meetings.

Signing of MoU

After approval of DPE/TF, MoU is signed by Chief Executive of the CPSE and Secretary of the concerned Ministry by 31st March.

Evaluation of MoU

Performance of Mou signing CPSEs is evaluated with reference to their MoU targets in May/June on the basis of provisional results and in October/ November on the basis of audited. On the basis of their performance, the CPSEs are graded as 'Excellent' 'Very Good' 'Fair' & 'Poor'.

Performance evaluation is done based on the comparison between the actual achievements and the MoU targets agreed. The targets constitute of both financial and non-financial parameters with different weights assigned to the different parameters. In order to distinguish 'excellent' from 'poor', performance during the year is measured on a 5-point scale as given below.

MoU Composite Score	Rating
1.00-1.50	Excellent
1.51-2.50	Very Good
2.51-3.50	Good
3.51-4.50	Fair
4.51-5.00	Poor

The summary of the performance of MoU signing CPSEs as reflected in their MoU rating during last six years is tabulated as under:

Rating	No. of Public Sector Enterprises						
	Year	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Excellent		45	49	46	55	47	73
V.Good		31	32	37	34	34	31
Good		12	15	13	15	25	20
Fair		10	06	06	08	17	20
Poor		01	00	00	00	01	01
Total		99	102	102	112	124	145

Source: Annual Report 2011-12, Ministry of Heavy Industries, Govt. of India.

The implementation of MoU system for performance measurement of CPSEs has resulted in enhancement of performance of the MoU signing CPSEs. This has led to increase in the number of CPSEs signing MoU over the years. The autonomy and the accountability of the CPSEs have increased. The Autonomy of the CPSEs has been increased due to grant of greater delegation of powers, reduction in the multiple evaluations by different government agencies with a single system, reduction in the frequency of evaluation and reduction in the bureaucratic interference in day-to-day functioning of CPSEs. Further the Accountability of the CPSEs has been increased due to clear specification of performance criteria, comprehensiveness of performance criteria, prioritizing performance criteria and Ex-ante agreement of judging deviations from performance target (criteria values).

The significance of the MoU system on the CPSEs can be highlighted as under.

- Performance Related Pay of all Executives based on the performance of the CPSE.
- Performance Appraisal of CMD, Functional Directors and EDs, GMs based on MoU performance.
- MoU Excellence Awards & Certificates.
- Grant of Maharatna / Navratna linked to MoU performance.
- Enhance the credibility and morale of CPSEs.

Memorandum of Understanding (MoU) system in India has been consistently moving towards improvement to eventually become a management tool. The tool not only measures the performance of CPSEs on financial parameters but also on strategic, non-financial parameters. The MoU division of Department of Public Enterprise (DPE) have constantly trying to strive for continuous improvement of the system. Still the MoU framework has to be continuously researched, modified for overcoming the shortcomings that arise during the signing and the evaluation process. The dynamism of the MoU process makes it a continuous process of change and innovation for performance evaluation of CPSEs.

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