

CHAPTER V

MEMORANDUM OF UNDERSTANDING

6. DPE/Guidelines/V/6

GUIDELINES FOR MOU FOR THE YEAR 2005-06

Memorandum of Understanding (MOU) is a negotiated agreement between Government as owner of public enterprises and the management of the public sector enterprises (PSEs). MOU is meant to measure the performance of the management of the PSE at the end of the year in an objective and transparent manner.

The contents of the MOU may be divided into following five parts.

Part I Mission/Vision & Objectives of the PSE

Part II Exercise of enhanced Autonomy and delegation of Financial Powers

Part III Performance Evaluation Parameters and Targets

Part IV Commitments/Assistance from the Government

Part V Action Plan for implementation and monitoring of the MOU

1. MISSION/VISION AND OBJECTIVES OF THE PSE

Mission/Vision:

1.1.1 Mission should be a concise statement incorporating the rationale for existence of the enterprise and its business/activities.

1.1.2 The Mission statement should be formulated keeping in view the fresh initiatives being planned/under active consideration by the enterprise.

1.2 Objectives:

1.2.1 The objectives should be related to the mission of the enterprise and listed in order of priority as approved by the Board of Directors of the enterprise.

1.2.2 These objectives should cover both quantitative and qualitative aspects, commercial and non-commercial aspects and static as well as dynamic aspects of the operations of the enterprise.

1.2.3 Efforts should be made to ensure that all objectives get reflected in the MOU assessment format.

2. EXERCISE OF ENHANCED AUTONOMY AND DELEGATION OF FINANCIAL POWERS

2.1 The exercise of enhanced autonomy and delegation of financial powers on capital expenditure, joint ventures, strategic alliances, organizational restructuring, creation and winding up of the posts, schemes relating to personnel and human resources management, etc. should be incorporated in the MOU.

2.2 Specific areas in which further autonomy and financial powers desired may also be incorporated with justification as to how these additional powers will stimulate the growth of the company.

3. PERFORMANCE EVALUATION PARAMETERS AND TARGETS

3.1 Selection and weightage of performance parameters

3.1.1 While selecting different performance parameters and assigning weight against them, the issues concerning strategic factors, profitability, growth, etc. have been kept in focus. Critical aspects such as modernisation, upgradation of technology, merger and acquisition, diversification, organisational restructuring, manpower rationalisation, employee's skill upgradation, etc., which enhance the long-term competitiveness of the PSE, have been taken into consideration.

3.1.2 It is also necessary to give emphasis on Project Implementation, Safety, Environment, Health, HRD, Productivity, Customer satisfaction, Quality improvement/ISO certification, Preparation of strategic/corporate plan, etc.

3.1.3 It is not necessary to include any social (or non-commercial) obligation unless it has been cast on the PSE by the Government (Statutory obligations or voluntary action by the PSE in the interest of good industrial or neighbourhood relations do not qualify for inclusion).

3.2.1 The weight to various parameters should be assigned as follows.

Part A

Common Parameters for all PSEs other than Social, Financial, Trading and Consultancy PSEs

I. Static Financial Parameters (50%)

(a) Financial performance indicators

(i) Gross Margin/Gross Block P 02

(ii) Net Profit/Net Worth P 10

(iii) Gross Profit/Capital Employed P 10

(b) Financial indicators – Size

(i) Gross Margin P 08

(ii) Gross Sales P 04

(c) Financial returns – Labour productivity and Total Factor productivity

(i) PBDIT/Total Employment P 07

(ii) Added Value/Gross Sales P 09

II. Dynamic Parameters (30%)

(i) Quality (ISO certification,
internalisation of quality) P 04

(ii) Customer Satisfaction

(Customer orientation – Strategic Business

Unit-wise/product-wise) P 04

(iii) HRD (Employee training & motivation) P 03

(iii) R & D for sustained & continuous

innovation (R&D investment as percentage of sales turnover) P 04

(iv) Project Implementation

(modernisation and expansion) P 07

(vi) Capital Expenditure/Greenfield investments/

Joint Ventures P 04

(vii) Extent of globalisation

(Internalisation, foreign JVs, exports,

strategic alliances, etc.) P 04

If the Task Force after deliberations comes to the conclusion that any of the above dynamic parameter(s) is not relevant to a particular PSE, then the Task Force may adjust the balance weightage by evolving new parameters relevant to that particular PSE or against the remaining dynamic parameters. The PSE concerned may also make suggestions in draft MOU document in this regard.

However, in order to address the specific nature of some of the PSEs, the following special provisions have been incorporated in the Guidelines.

In case of Social, Financial, Trading and Consultancy PSEs, the above financial performance indicators will be applied subject to suitable modifications. The financial performance indicators of these PSEs will be as follows:

Social PSEs: Task Force would set parameters in consultation with the PSEs which reflect return on funds deployed in programmes for comparison with the cost of raising these funds.

Financial PSEs: Disbursements of funds, Resource Mobilization, Loan Sanctions, Projects commissioned in value terms and Financial returns (Difference in cost of borrowings and disbursements) would be the financial performance indicators for Financial PSEs. Selection of the financial performance indicators will be decided by the Task Force in consultation with the concerned PSE and Administrative Ministry.

Trading and Consultancy PSEs: Gross Margin/Turnover ratio and Operating turnover/Number of Employees ratio will be the financial performance indicators for Trading and Consultancy PSEs. The Task Force would decide the distribution of weight in consultation with the concerned PSE and Administrative Ministry.

Further, Task Force may effect change in parameters bearing upto 15 out of the 50 weight in the static financial parameters category to maintain uniformity within social sector PSEs as different from commercial enterprises.

Part B

Specific Parameters (20%)

1. Sector-specific (10%): Task Force will identify/evolve suitable sector specific parameters that reflect how the macro environment affects the performance of a particular PSE, which is beyond the control of the PSE management, and pertain to industry/sector in which the company operates.

2. Enterprise-specific (10%): Enterprise-specific parameters relate to parameters like safety, environment, ecological considerations viz. Parameters that do not get reflected in increased profits either during the year of investments or later but considered important from the viewpoint of the society.

Task Force can alter weights in consultation with Administrative Machinery where fine-tuning is felt necessary as a matter of exception but not in a routine manner.

3.2.2 It should be ensured that original and revised cost and time estimates are mentioned for the projects included in the MOU.

3.2.3 To ensure that MOU system is properly monitored in the DPE, the following three activities would be taken into consideration in draft MOU for the year 2005-06.

(i) Timely submission of Draft MOU for 2006-2007 after due discussion with Administrative Ministry/Department with the target date of 8th December, 2005.

(ii) Timely submission of Performance Evaluation Report (composite score) for the year 2004-2005 on the basis of the provisional data with the target date of April 30, 2005.

(iii) Timely signing of MOU for the year 2005-06 with the target date of 31st March 2005.

These activities will carry penalty mark of 1 each for non-compliance and the MOU composite score would be adjusted accordingly.

3.3 Determination of performance targets

3.3.1 The targets set should be realistic and growth oriented and be significantly higher compared to targets and achievements, whichever is higher, for the previous year 2004-05 and should be reflected in the BE for the year 2005-06.

3.3.2 Budget Estimates (BE) 2005-2006 and BE 2004-2005 figures for various performance parameters are to be indicated in the MOU assessment format itself as separate columns.

3.3.3 BE for 2005-2006 in respect of the performance indicators is the basic target and will be placed in "Good" column in respect of PSEs which are in growth phase and are operating below 100% capacity utilization. PSEs which are performing near or above 100% capacity utilization and are fully operative, BE will be placed in Very Good column. The proposed Good/Very Good target should indicate an improvement over BE for 2005-2006 and Provisional/RE(2004-2005).

3.3.4 The difference in target values between "Very Good" and "Good"; "Good" and "Fair"; and "Fair" and "Poor" columns should be uniform at 5%.

3.3.5 The difference between “Excellent” and “Very Good” targets should be significantly higher than 5%. For manufacturing industry PSEs in the growth phase operating below 100% capacity utilization, the differential of 10% between Excellent and Very Good should be maintained. In case of PSEs operating at or above 100% capacity utilization, the Task Force may fix the differential of 5% to 10% between Excellent and Very Good targets.

3.3.6 In case of benchmarking, the discretion of Task Force would apply.

3.3.7 It should be ensured that all the performance targets are unconditional.

3.3.8 For qualitative indicators, the targets for each of the points on the 5-point scale should be indicated in the MOU assessment format itself. If these targets are on a time scale, only such target which fall within the MOU year (ending 31st March, 2006) should be included.

Additional Points

3.3.9 Absolute values of Gross Profit (GP), Net Profit (NP), Net Worth(NW) and Capital Employed (CE) should be indicated in the footnote of the MOU assessment format. Capital Employed and Net Worth figures should invariably be as at the end of the year of performance. Comparable data for earlier year may be given separately.

3.3.10 The MOU should contain the past five years’ performance data on criteria included in the MOU in an appendix. It should also indicate the projections for the next five years, as far as possible consistent with the corporate plan.

3.3.11 The minutes of the last year’s MOU negotiation meetings alongwith a list of major suggestions made during this meeting and action taken thereon should be annexed with the draft MOU document.

4. COMMITMENTS/ASSISTANCE FROM THE GOVERNMENT

4.1 The commitments/assistance expected from the Government should be relevant and related to fulfilling the agreed performance targets.

4.2 These obligations should have a direct bearing on the performance of the enterprise and their effect on the performance should be quantified.

5. ACTION PLAN FOR IMPLEMENTATION AND MONITORING OF THE MOU

5.1 Action plan for implementation of MOU with expected gains from each of the MOU criteria should be clearly mentioned in the MOU.

5.2 The frequency of monitoring by the Board/Administrative Ministry should be mentioned in the MOU. Annual evaluation will be done by DPE.

MOU Evaluation:The grading of the MOU signing enterprises would be same as in the previous years and is as follows:

MOU Composite score Grading

1. 1.00 – 1.50 Excellent
2. 1.51 – 2.50 Very Good
3. 2.51 – 3.50 Good
4. 3.51 – 4.50 Fair
5. 4.51 – 5.00 Poor

All the financial performance parameters should conform to definitions as given below.

1. **Gross Margin:** It is the profit before depreciation, interest, taxes, deferred revenue expenditure and excludes extra ordinary items (Net).
2. **Gross Profit:** It is the gross margin less depreciation, less deferred revenue expenditure.
3. **Net Profit:** It is the gross profit less interest and less provision for tax less extra ordinary items (Net).
4. **Net Worth:** It is the paid-up capital plus reserves less accumulated losses and deferred revenue expenditure to the extent not written off.
5. **Gross Block:** It represents original cost of procuring and erecting fixed assets as appearing in the annual accounts of the PSEs at the end of the accounting year and takes into account additions thereto and deductions there from by way of sales and transfers
6. **Capital Employed:** It is the Gross Block less accumulated depreciation plus working capital.
7. **Gross Sales:** It means the total turnover and includes elements of excise duty, commission and discounts, etc.
8. **Added Value:** Added value is the residual after meeting the due returns to labour, capital and materials that reflects the overall efficiency of the PSEs. Added value may be computed as gross margin less returns to capital, which in turn may be computed as capital recovery factor @4 % the capital employed for social sector PSEs and @10% for all other PSEs. >

(DPE OM No. 3(4)/2004-DPE(MOU) dated 7th January, 2005)
