OFFICE MEMORANDUM

Subject: Guidelines for signing Memorandum of Understanding (MoU) between CPSE and Government Department/Ministry, for the year 2008-09.

The undersigned is directed to refer to the subject mentioned above and to forward herewith a copy of the Guidelines for drafting of MOU for the year 2008-09.

2. CPSEs under the administrative control of your Ministry/Department may be advised to draft MOU for the year 2008-09 on the basis of the enclosed Guidelines. CPSE concerned should submit the same to this Department by 30th November 2007 through the administrative Ministry/Department.

3. The MOU negotiation meetings for the year 2008-09 will commence from January 2008 to finalize the MoUs before 31st March 2008 in the presence of the MoU Task Force. It is, further stated that 15th March 2008 will be the cut off date for the MoU negotiation meetings. Those CPSEs who do not sign or delay in signing the MoU beyond 31st March 2008, their performance will be rated as “Poor” and the same should be reflected in the Annual Confidential Reports of the CMD/Chief Executive Officer of the CPSE concerned. There will be no exemption for any CPSE (other than subsidiary CPSE) from signing of the MoU with the respective Department/Ministry.

4. Subsidiary CPSE of Holding Companies will sign MoUs with the respective Holding Companies. Performance targets of the subsidiaries should be appropriately reflected in the performance targets of Holding Companies.

5. Following documents may also be sent to DPE along with the draft MOU for 2008-09.

i) Two copies of the Annual Report for the year 2006-07.
ii) One copy of the updated Corporate Plan.

iii) Financial data for calculating various ratios/evaluation parameters

(in Annexes VII, VIII and IX)

6. These guidelines are also available on DPE website www.dpe.nic.in. The Guidelines may kindly be gone through and the draft MOUs prepared and sent to Adviser of this Department by 30th November, 2007.

(S.S. Negi)
Director (MOU)

To: Secretaries to the Government of India (as per list)

Copy to: Chief Executives of PSEs (as per list)

MOU Guidelines for the year 2008-2009

Memorandum of Understanding (MOU) is a negotiated agreement and contract between the Government and the Management of the Central Public Sector Enterprise (CPSE). It is intended to evaluate the performance of the CPSE at the end of the year vis-à-vis the targets fixed in the beginning of the year.

Part I

1.1. MISSION/VISION AND OBJECTIVES OF THE CPSE

1.1.1. Mission/Vision:

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

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

1.1.2 Objectives:

v 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.

v 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.

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

1.2 AUTONOMY AND DELEGATION OF FINANCIAL POWERS

1.2.1 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 resource management etc. may be incorporated in the MOU.

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

1.3 PERFORMANCE EVALUATION CRITERIA AND TARGETS

1.3.1 MOU Assessment Format for different sectors

v In view of the CPSEs falling in the categories of ‘Industrial sector’, (Manufacturing & Mining sector), ‘Social sector’, ‘Trading & Consulting sector ’ and ‘Financial sector’, the different CPSEs may adopt the MOU assessment format as provided at Annex- I to IV.

v ‘Sick & Loss making CPSEs’ and ‘CPSEs under construction’ may adopt the MOU assessment format as provided at Annex – V & VI.

1.3.2 Performance Targets and their determination

1.3.2.1 With a view to distinguish ‘excellent performance’ from ‘poor performance’, 5 different performance targets should be fixed in the MOU assessment format on a 5 point scale in the ascending order, that is, (1) ‘Excellent’, (2) ‘Very Good’, (3) ‘Good’, (4) ‘Fair’ and (5) ‘Poor’.

1.3.2.2 The basic target will be placed in "Good" column in respect of CPSEs which are in growth phase and are operating below 100% capacity utilization. CPSEs which are performing near or above 100% capacity utilization and are fully operative, the basic target will be placed in “Very Good” column.

1.3.2.3 The targets set should be realistic and growth oriented and be significantly higher compared to targets, for the previous year (2007-08) and should be reflected in the BE for the year 2008-09. While evaluating the MoU for the year 2006-07, it has been observed that in case of a number of CPSEs there is a large difference between the targets fixed and the actual achievements for that year. This aspect needs to be noted while fixing the targets of the MoU for the year 2008-09, in order to have realistic targets.

1.3.2.4 The difference in target values between "Very Good" and "Good"; "Good" and "Fair"; and "Fair" and "Poor" columns should be atleast 5% (may be uniformly at 5%).
1.3.2.5 The difference between “Excellent” and “Very Good” targets should be significantly higher than 5%. For the industrial sector CPSEs (‘Manufacturing and Mining CPSEs’) in the growth phase operating below 100% capacity utilization, the differential of 10% between Excellent and Very Good should be maintained. In case of CPSEs operating at or above 100% capacity utilization, the Task Force may fix the differential between “Excellent” and “Very Good” targets in the range of 5% to 10%.

1.3.2.6 In case of benchmarking targets with national/ international standards, the discretion of Task Force on MOU will apply.

1.3.2.7 The targets for qualitative indicators should be indicated in the MOU assessment format itself. If these targets are on a time scale, only such target should be included which fall within the MOU year (ending 31st March, 2009).

1.3.2.7 No provisional or conditional target fixation is permissible. Hence, all performance targets have to be unconditional.

1.3.3 Evaluation Parameters and Weights

1.3.3.1 Performance evaluation is based on the ‘Balanced Score Card’ approach and includes both ‘financial’ and non-financial parameters having equal weights of 50% each. The non-financial parameters are further divided into Dynamic parameters (30%), Enterprise-specific parameters (10%) and Sector-specific parameters (10%).

1.3.4 Dynamic Parameters (weight: 30%)

During the deliberations of the MOU negotiation meeting, if the Task Force comes to the conclusion that any of the dynamic parameter(s) as indicated in the MoU Assessment Format is not relevant to a particular CPSE, then the Task Force may evolve new parameters and adjust the balance weight relevant to that particular CPSE.

1.3.5 Sector-specific Parameters (weight: 10%)

Task Force will identify/evolve suitable sector specific parameters that reflect how the macro environment affects the performance of a particular CPSE, which is beyond the control of the CPSE management, and pertain to industry/sector in which the company operates.

1.3.6 Enterprise-specific Parameter (weight: 10%)

Enterprise-specific parameters relate to parameters like safety, environment, and ecological considerations i.e. parameters that do not get reflected in increased profits either during the year of investments or later but are considered important from the viewpoint of the society.

1.3.7 In regard to both ‘Sector-specific’ and ‘Enterprise-specific’ parameters, the Task Force may alter weights in consultation with the Administrative Ministry where fine-tuning is felt necessary. This should, however, be resorted to as an exception and not in a routine manner.
1.4 COMMITMENTS/ASSISTANCE FROM THE GOVERNMENT

1.4.1 Commitments/assistance expected from the Government should be relevant and related to fulfilling the agreed performance targets.

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

1.5 DEFINITIONS

The different financial performance parameters should conform to definitions as given below:

1.5.1 Gross Margin: - It is the profit before depreciation, interest, taxes, deferred revenue expenditure and excludes extra ordinary items (Net).

1.5.2 Gross Profit: - It is the gross margin less depreciation, less deferred revenue expenditure.

1.5.3 Net Profit: - It is the gross profit less interest and less provision for tax less extra ordinary items (Net).

1.5.4 Net Worth: - It is the paid-up capital plus reserves less accumulated losses and deferred revenue expenditure to the extent not written off.

1.5.5 Gross Block: - It represents original cost of procuring and erecting fixed assets as appearing in the annual accounts of the CPSEs at the end of the accounting year and takes into account additions thereto and deductions there from by way of sales and transfers.

1.5.6 Capital Employed: - It is the Gross Block less accumulated depreciation plus working capital.

1.5.7 Gross Sales: - It means the total turnover and includes elements of excise duty, commission and discounts, etc.

1.5.8 Added Value: - Added value is the residual after meeting the due returns to labour, capital and materials that reflects the overall efficiency of the CPSEs. 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 CPSEs and @10% for all other CPSEs.

PART- II

2.1 METHODOLOGY AND PROCESS OF MOU EVALUATION:

2.1.1 RAW SCORE
2.1.1 Raw Score reflects where ‘actual performance’ falls/belongs in relation to the 5 point scale of MOU targets (as mentioned in para 1.3.2.1 within). If actual performance is equal to or more than the Excellent target (1), Raw score would be 1.00. If actual performance is equal to or less than the Poor target (5), Raw score would be 5.00. If actual performance falls in between Excellent (1) and Very Good (2) in that case Raw score would be \( 1 + \frac{\text{Excellent-Actual}}{\text{Excellent-Very Good}} \). If actual performance falls in between Good (3) and Fair (4) target in that case Raw score would be \( 3 + \frac{\text{Good-Actual}}{\text{Good-Fair}} \). The raw score for the rest can be similarly calculated if ‘the actual’ falls in between other columns.

2.1.2 COMPOSITE SCORE AND GRADING OF SCORE

2.1.2.1 Composite score is an index of the performance of the CPSE that is calculated based on the aggregation of all the weighted score of “the actual achievements” vis-à-vis ‘the targets’ set out on a 5-point scale. The Composite Score may either be (1), (2), (3), (4), or (5) or may have values between (1 to 2), (2 to 3), (3 to 4) or (4 to 5).

2.1.3 The grading of the MOU composite score will be as follows:

**MOU Composite score Grading**

<table>
<thead>
<tr>
<th>Score Range</th>
<th>Grading</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.00 - 1.50</td>
<td>Excellent</td>
</tr>
<tr>
<td>1.51 - 2.50</td>
<td>Very Good</td>
</tr>
<tr>
<td>2.51 - 3.50</td>
<td>Good</td>
</tr>
<tr>
<td>3.51 - 4.50</td>
<td>Fair</td>
</tr>
<tr>
<td>4.51 - 5.00</td>
<td>Poor</td>
</tr>
</tbody>
</table>

2.1.4 PROCESS OF EVALUATION

2.1.4.1 Once the MoUs are signed between the CPSEs and the Ministries/Departments, no revision of targets will be permitted.

2.1.4.2. The self-evaluated ‘Performance Evaluation Report’ shall be submitted by the CPSE at the end of financial year and should be based on targets finalized by the Task Force on MoU and signed by the CPSE and the administrative Ministry.

2.1.4.3 MoU evaluation of CPSE will be done only once in the year based on audited accounts of the concerned CPSE. Those CPSEs, who do not submit self-evaluation report based on audited data to the Department of Public Enterprises by 31st August, 2008 will not be eligible for the MoU Excellence Award and the MoU Excellence Certificate.
2.1.4.4 The concerned Syndicate Group of the Task Force on MoU would finalize the MoU Composite Score and ratings of CPSEs in each Syndicate by end of October, 2008.

2.2 MoU EXCELLENCE AWARDS

2.2.1 The total number of MoU Excellence Awards will be 12 (1 from each of the 10 Syndicate groups, 1 from the listed CPSEs, 1 from amongst the turnaround sick and loss making enterprises). All other excellent performing CPSEs will get MoU Excellence certificates.

2.2.2 The following three basic principles for selection of CPSEs for MOU Excellence Awards from amongst the Syndicate groups will be adopted:

(i) The profit of the CPSE in the year should be higher compared to the previous year.

(ii) It should not be a loss-making enterprise.

(iii) The composite score of the CPSE should not be more than 1.5 and has been rated as Excellent.

2.2.3 As the Excellent grading has a range of 1 to 1.5, CPSEs getting a composite score upto 1.5 will be eligible for MoU Excellence Awards and Certificates.

2.2.4 In case in a Syndicate Group, 2 or more CPSEs score the same, the highest growth rate of net profit over the previous year secured by a CPSE will be getting the Award.

2.2.5 Ranking of CPSEs for MOU Excellence Award in the category of ‘listed CPSEs’ and ‘sick and loss making CPSEs’ will be done by the Department of Public Enterprises.

2.2.6 Compliance of Corporate Governance will be one of the criteria for the consideration for MoU Excellence Awards.

2.3 GENERAL POINTS

2.3.1 The revised MoUs based on minutes of the MoU negotiation meetings should be sent through administrative Ministries/Departments for authentication by DPE before signing of the MoUs.

2.3.2 The minutes of the previous year MOU negotiation meetings alongwith a list of major suggestions made during the concerned meeting should be annexed with the draft MOU document.

2.3.3 (a) To ensure that MOU system is conducted effectively in the DPE, the following activities would be taken into consideration in MOU for the year 2008-09.
(i) Timely submission of Draft MOU for 2008-2009 after due discussion with Administrative Ministry/Department with the target date of 30th November, 2008.

(ii) Timely signing of MOU for the year 2008-09 with the target date of 31st March 2008.

(iii) Timely submission of Performance Evaluation Report (composite score) for the year 2007-08 on the basis of Audited data along with the Audited Accounts, Balancesheet and Profit and Loss Account of the CPSE for the year 2007-08 with target date of 31st August, 2008.

(iv) The data for compilation of Public Enterprise Survey 2007-08 including flash results for the six months ending 30th September, 2008 should be submitted timely by the CPSEs within the target date of 15th October 2008.


(b) These activities will carry penalty mark of 1 each for non-compliance. There will be penalty mark of 1 for each 15 days delay and the composite MoU score would be adjusted accordingly. The delay in data relating to PE survey would carry a penalty of 1 mark for each day’s delay.

2.3.4 All CPSEs including sick and loss making CPSEs and CPSEs under construction would sign MoU with the Ministries/Departments concerned by 31st March every year. In case, CPSEs do not sign or delay in signing, their performance will be rated at “Poor” and the same should be reflected in the Annual Confidential Reports (ACRs) of Chief Executive of CPSE concerned.

2.3.5 There will be no exemption for any CPSE from signing of MoU.

2.3.6 The revised MoUs based on minutes of the MoU negotiation meetings should be sent through administrative Ministries/departments for authentication by DPE before signing of the MoUs.

2.3.7 The Action Taken Report (ATR) on the minutes of MoU negotiation meetings 2006-07 issued by DPE should be furnished along with draft MoU 2008-09.

List of Annexures

Annex-I: MoU Assessment Format for Industrial CPSEs– Manufacturing and Mining CPSEs

Annex-II: MoU Assessment Format for ‘Trading and Consulting Sector’
Annex-III: MoU Assessment Format for ‘Social Sector’

Annex-IV: MoU Assessment Format for ‘Financial Sector’

Annex-V: MoU Assessment Format for ‘Sick and Loss Making CPSEs’

Annex-VI: MoU Assessment Format for ‘CPSEs under Construction’

Annex-VII: Income-Expenditure Statement (as on 31st March)

Annex-VIII: Balance Sheet Data (as on 31st March)

Annex-IX: Management Ratios (as on 31st March)

Annex I

MoU Assessment Format for Industrial CPSEs- Manufacturing and Mining CPSEs

MoU Target

Excellent (1) V. Good (2) Good (3) Fair (4) Poor (5)

Evaluation Criteria

1. Static/Financial Parameters | Unit | Weight (in %)
--- | --- | ---

a) Financial indicators-profit related ratios

i) Gross margin/gross block | % | 2

ii) Net profit/net worth | % | 10

iii) Gross profit/capital employed | % | 10

b) Financial indicators-size related

i) Gross margin | Rs. Cr. 8 | ≥ 800

ii) Gross sales (Rs. Crore) | Rs. Cr. 4 | ≥ 3000

iii) Gross sales (Rs. M) | Rs. M 4 | ≥ 3000

4. Financial returns-productivity related

i) Earnings before interest and tax (Rs. M) | Rs. M | ≥ 500

ii) Return on capital employed (ROCE) | % | ≥ 50
| i) PBDIT/total employment | % 7 |
| ii) Added value/sales     | % 9 |