Formatted: Right: 0.9", Top: 1", Bottom: 1", Footer distance from edge: 0.3"

<u>Chapter 4</u>

PARADIGM SHIFT

4.1 INTRODUCTION

Soon after independence, India adopted the model of Centrally Planned Economic Development. Industrial Policy Resolution of 1956 made it clear that Public Sector will play a major role in industrial development and Private Sector will have a limited role. Accordingly, a large number of Public Sector companies came into being in virtually every sector of Economy. Oil, Coal, Electricity Generation and Distribution, Iron and Steel, Telecommunication, Air Transport, Heavy Engineering, Ship Building etc. became virtual Public Sector monopolies. With strict control on imports and exports, most of the international trade also became Public Sector monopoly. Growth of Private Sector was constrained by strict system of licensing and controls.

4.1.1 Apart from the core and strategic areas, Public Sector units were set up in several other sectors such as Chemicals, Pharmaceuticals, Consumer Goods, Construction, Light Engineering, Consultancy, etc. Government also nationalized some of the industries either with a view to remove foreign control as in case of Oil Sector or to protect employment as in case of Textile Sector.

4.1.2 By the end of 70s, Public Sector had attained commanding heights in Indian Economy. Though Public Sector played a very significant and vital role in economic development of the Country, over a period of time it also developed several negative traits. Monopolistic operations and a cost plus pricing system led to large operational inefficiencies and recruitment of manpower far in excess of actual requirement. Management started getting politicized and many times decisions were taken on considerations other than sound commercial logic. Several CPSEs failed to foresee future and adopt new technologies and, management practices and became sick.

4.1.3 By early 80s, it was realized that rapid economic development couldn’t be achieved through Public Sector only and that Private Sector also has to play equally important role. It also became clear that Public Sector monopoly was as bad as Private Sector monopoly and competition is essential to bring about efficiency in economy. Despite this realization, nothing significant happened in the decade of 80s to rectify the situation. However, the economic and financial crisis of 1991 forced the government's hand and economic philosophy in India underwent a sea change.

4.1.4 Post 1991 a series of initiatives were taken by the government towards economic reforms. Government gradually disbanded the system of licensing and controls and opened up almost all sectors of economy to private investment, including foreign private investment.

4.1.5 Since major part of industrial activities was reserved for Public Sector during the first four decades after independence, apparently job opportunities for engineering and management graduates were also largely in Public Sector. Also since the rate of economic growth was relatively low, number of jobs created was also relatively low. By the end of 60s and early 70s, there was stagnation in employment opportunities even for graduates from good engineering colleges. In this situation Public Sector employment became the most sought after career option for bright graduates from premier engineering and management schools in the country. Civil Services and CPSEs attracted the best students from premier institutions. Working in Civil Services and CPSEs became a matter of great prestige. Apart from prestige, in a stagnant job market, security of employment was a major consideration for those seeking employment. Although, all executive appointments in CPSEs were made on contract basis, over a period of time, partly due to judicial decisions and partly on account of social and political pressure, employment in CPSEs became almost as permanent as in Civil Services. Employment in CPSEs, therefore, became second best option after Civil Services.

4.1.6 With the opening of Indian economy in early 90s, private sector started operations in almost all sectors of economy that were earlier reserved for CPSEs. Post 1991, private sector has grown at far rapid rate than the Public Sector. With the entry of MNCs, the rate of growth of private sector further increased. This growth in private sector has led to large demand for technical and managerial talent from the private sector.

4.1.7 Views of Justice Mohan Committee

4.1.7.1 Justice Mohan Committee which was set up to recommend compensation packages for executives of CPSEs in 1996 did recognize this change and noted the difficulties that the public sector was facing in the wake of liberalization of Indian Economy. It is worthwhile to reproduce certain observations of Mohan Committee on impact of Parliamentary and Executive control, judicial intervention and forces of competition on working of CPSEs.

a. "A characteristic feature of India's Public Sector is the role of Parliament. The public and Parliament expect the executives of the Public Sector to answer their complaints and enquiries in almost the same detailed manner as they expect government servants to do - so much more in detail than a normal shareholder expects of the corporate management in the Private Sector. As a result, unlike in other more mature economies, in India, the Parliamentary Committee in general and the system of questions in particular tends to go into many details of day to day operations. Besides agencies of government like Central Vigilance Commission, and the Central Bureau of Investigation exercise powers of superintendence over acts of omissions and commissions on the part of the executives of Public Sector Enterprises. The result has been the culture of intervention by government bureaucracy in functioning of Public Sector Enterprises. This leads to second guessing of decisions of Public Sector Enterprises and the effective subordination of PSEs to hierarchy of secretariat"

"In addition to all these, India's Public Sector Enterprises have a doubtful privilege of being treated as a limb of state as a result of judicial pronouncements. Employees of public sector units get the same rights in respect of their tenure of service as if they are employees of government. This means that Courts have jurisdiction in matters relating to action taken against any officials of Public Sector Enterprises. Besides, even genuine commercial decisions of PSEs are subject to writ jurisdiction offering a temptation to litigious suppliers and customers.''

b. "It is against this background of a multitude obstacle race run by India's public sector that one has to adjudge its progress and its problems. Public Sector Enterprises in India are constrained as they are by a mix of invasive vigilance as well as parliamentary and judicial intervention have still to perform in an increasingly competitive environment, where both the Indian private sector and international majors fight for the market. For these and other reasons it is obvious that there is no level playing field to compete with each others."

"In addition to all this comes a rather constrained policy framework which governs pay and allowances of public sector executives as against the private sector which is able to offer relatively attractive salaries and perquisites".

4.1.7.2 While recognizing serious disadvantages that CPSEs face in the changed economic scenario, Justice Mohan Committee did not make any recommendation to provide a level playing field to the CPSEs, particularly in the matter of executive compensation. The committee made the following observations:

"while the pecuniary attractions offered in the private sector are real, the countervailing circumstance of heavy losses in many public sector enterprises also has to be borne in mind. Besides Government as owner of Public Sector Enterprises cannot ignore important aspect of considering all these divergent goals against a broad social objective viz., to maintain a balanced overall structure of wages and income. The task before the Committee has therefore been an exercise in constrained optimization."

4.1.7.3 Justice Mohan Committee, therefore, did not propose any radical change in compensation of CPSEs and by and large followed the then existing principles of relativity.

4.1.8 Significant changes have taken place in Indian economy since Justice Mohan Committee submitted its report. India has emerged as one of the fastest growing economies in the world and industrial growth in the last couple of years has been consistently over 10%, which was never achieved in the days of controlled economy. India is poised to become one of the top economic powers by 2025 and will be the third largest economy after US and China. Rapid expansion in economy has for the first time created a situation, where demand for talent far exceeds availability.

4.1.9 Since major investment in core sector in the first four decades after independence was only in public sector, apparently talent and skills in sectors such as Oil, Power, Coal, Heavy Engineering, Power equipment, Telecommunication, and International trade etc. were available only in the public sector. With the entry of the private sector and MNCs in all these areas, CPSEs have become hunting ground for talent by private companies, which offer several times higher compensation than what CPSES offer particularly at the middle and higher levels of management. Apart from this, with increasing globalization, talented Indians find job opportunities not only in India but also in several countries abroad. There is a paradigm shift in Indian Economy and job market and CPSEs have ceased to be a career option for young Indians, coming out of Premier Engineering and Business Schools for the following reasons:

- Compensation levels in CPSEs are far inferior to those available in private sector and MNCs.
- In an expanding job market, job security offered by CPSEs is no more relevant to bright individuals, who are hopping from job to job looking for better prospects.
- With changing social values jobs in civil services and CPSEs no more enjoy the prestige they used to enjoy in the yore.

4.1.10 Paradigm Shift in Terms of Reference to the Present Committee

Realizing this paradigm shift, the Government made terms of reference of this Committee far more comprehensive and broad based than those of Justice Mohan Committee. Important points that this Committee was required to take note of, (and which did not form part of terms of reference of Justice Mohan Committee) are reproduced below.

"The Committee will make recommendations that will transform the CPSEs into modern, professional, citizen friendly and successful commercial enterprises that are also dedicated to the service of the society."

"The Committee will work out a comprehensive pay package, that is suitably linked to promoting efficiency, productivity and economy through rationalization of structure, organizations, systems, and processes as well as promoting financial and operational autonomy within the public center enterprises with a view to leveraging economy, responsibility, transparency, discipline, accountability, assimilation of technology, and research and development."

"The Committee will make recommendations to harmonize the functioning of CPSEs with the demands of the emerging national and global economic scenario. This would also take into account, among other relevant factors, the totality of benefits available to the employees, need of rationalization, and simplification thereof, prevailing pay structure and retirement benefits available under the CPSEs, the economic conditions in the country, need to observe financial prudence in the management of CPSEs, the resources of CPSEs and demands thereon on account of economic and social development and the global economic scenario and the competitive environment."

The Committee is acutely conscious of this paradigm shift and need for bringing about requisite changes that will enable CPSEs to operate and grow in the fast changing global economic scenario. The Committee, therefore, proposes a radical change in the principles to be adopted in deciding compensation packages for the executives of CPSEs.

4.2 RELATIVITY

4.2.1 Relativity With Civil Services Or Private Sector

i. Compensation packages in CPSEs, thus far, have been decided keeping in mind salary structure in the Government. In the initial years of formation of CPSEs, most of the managerial positions, particularly at senior levels were filled up by deploying civil servants from the Government. Therefore, government system of compensation was automatically adopted in CPSEs. Even after CPSEs developed their own managerial cadres, the relativity was by and large maintained, except that CPSE executives got a marginally higher basic pay, as they did not enjoy the benefit of pension.

ii. As stated earlier, in the light of vast changes that have taken place in Indian economy and job market, the principles of relativity with civil services cannot be employed to CPSEs any more. In the days, when CPSEs had monopoly in several sectors of industrial production, they did not face any competition in operations as well as in recruiting and retaining talent. With liberalization of economy, they are facing competition in operations as well as recruitment and retention of talent from Indian private sector and MNCs in India and abroad. The compensation in CPSEs, therefore, has to be progressively aligned with their counterparts in private sector and MNCs and not with the Government.

iii. At para 2.2.6 of the Resolution dated 30.11.2006 of the Government of India appointing the Committee, Government desired that while finalizing its report, the Committee will also take into account the report of the Sixth Pay Commission.

4.2.2 Observations of the Sixth Pay Commission on Parity between Civil Services and CPSE executives

i. Sixth Pay Commission gave considerable thought to the issue of parity in the compensation package to Government employees and employees of the CPSEs. Taking into account recommendations of earlier Pay Commissions and after detailed examination of all relevant issues, the sixth Pay Commission made the following observations.

"PSUs, being commercial undertakings which are required to function in a competitive environment and have the commercial objective as the predominant objective, a comparison of salaries between the public sector and the Government may not be appropriate as it would not be a comparison between similarly placed entities."

ii. Commission took the view that there can be no comparison between the pay structure of Government employees and employees of public sector in as much as

- There are variations in the job content and conditions of service in the public sector and the Government.
- The objectives with which the PSUs have been set up are not comparable with that of the Government.
- The autonomy granted to PSUs in the matter of determining their pay scales does not render an equal comparison possible.

iii. In the light of above analysis and the observations of the Sixth Pay Commission, the Committee is of he view that the principle of parity between PSEs and the Government has to be given up.

4.2.3 Relativity between CEO and entry level executives and workers.

Following the past practice, the Justice Mohan Committee recommended a relativity of 1:4 between the entry level executive and CEO of CPSEs. It also recommended a relativity of 1:10 between the lowest paid worker and the CEO. The Committee has examined several reports on the subject of relativity, including the report commissioned by the Committee through Institute of Public Enterprises, Hyderabad. It has been found that while at entry-level compensation for executives in CPSEs is comparable to their counterparts in private sector, the difference increases at higher levels. Salaries of comparable CEOs in private sector are higher by factor of 10 or more. The relativity of compensation between entry-level executives and CEOs in private sector can go as high as 1:50. At median level the ratio between the lowest and the highest paid executives in private sector is 1:8 to 1:12. The Committee feels that while the ratio of 1:50 is exceptional and does not appear reasonable or rational, a **ratio of about 1:10 between the lowest and the highest paid executives** in CPSEs would recognize the level of responsibility a CEO is expected to discharge in a fiercely competitive market and also appears respectable with reference to his counterparts in the private sector. The Committee recognizes that this change will increase disparity of income between the lowest level worker and the highest paid executive in CPSEs. However, in an open economy and competitive market it is inevitable. Equity perhaps has to be brought about through the fiscal instruments of taxation and public expenditure and not by artificially fixing ratios of minimum and maximum for public sector, without reference to the changing market situation.

4.3 AFFORDABILITY

4.3.1 The Committee believes that CPSEs being commercial organizations have to generate adequate resources to be able to pay their executives and workers a market determined compensation. So far, CPSEs have adopted uniform package of compensation to different levels of executives irrespective of size of organization, its profitability, affordability and nature of business. The only exception is at the level of Directors and CEOs. Their compensation levels vary depending upon the category to which the company belongs.

4.3.2 CPSEs operate in several sectors of economy and have wide variations in their size, number of employees, geographical spread of their operations, levels of technologies, complexity of operations, levels of profit etc. Demand supply situation for talent also varies significantly from sector to sector and keeps changing from time to time.

4.3.3 The Committee is of the view that the same level of compensation cannot be fixed for all kinds of companies. There is also need to provide enough flexibility in compensation structure so that CPSEs can make upward or downward revision depending upon market situation and their capacity to pay. The Committee has, therefore, decided to reclassify CPSEs into different sectors and categories for the purpose of deciding variable and fixed components of the compensation. The principles followed and classification suggested have been described in detailed in chapter 5.

4.3.4 The committee feels that within the framework suggested by the committee, Board of Directors of CPSEs should decide compensation for different individuals keeping in view affordability of the company and performance of the individual. There should be no question of government giving any support for paying dues of CPSE employees, except in respect of sick CPSEs proposed for rehabilitation or closure.

4.4 FIXED AND VARIABLE COMPENSATION:

4.4.1 CPSEs, so far have been following a system wherein almost entire compensation is guaranteed, irrespective of performance of company or that of the individual. In private sector a significant component of compensation is variable. Variable compensation is used in private sector to motivate and bring about desired behavioral changes in the employees and to reward those employees who have made significant contribution to the company's performance. The Committee proposes to change the current pattern of compensation and is of the view that a significant part of compensation should be made variable. The variable component will be relatively low for lower level executives and progressively increase to as high as to 200% of the basic pay at the level of CEOs. The variable component to be called Performance Related Payment (PRP) will be drawn from the Profit

Before Tax (PBT) and will be linked to individual, group, business-unit and company performance. It is proposed that in multi unit companies or a holding company having a number of subsidiaries, variable component is largely decided based on performance of each unit and not on the basis of overall profits of the company. This will provide incentive to poorly performing units to catch up with the better performing units. The practice of better performing units subsidizing poorly performing units should be discouraged.

4.4.2 In order to ensure that there is continuous improvement in performance of CPSEs, part of PRP will be paid out of current profit and part out of the incremental profit.

4.4.3 While devising PRP, accounting profits alone should not be taken into account. Accounting profits are inherently short term and managers who focus only on accounting profits, may take actions that may increase current profits at the cost of future profitability. Such actions are common in Mining and Oil industry, where emphasis on current profits may lead to over production of minerals at the cost of removal of over- burden or over-production of Crude Oil that might compromise with long term recovery from the Oil Field. Similarly, managers may reduce R&D expenditure, which has potential for increasing future profits, with a view to increase current profits. Besides this, accounting profits can be manipulated by discretionary adjustments in accruals or by shifting earnings across periods.

4.4.4 Remuneration Committee of the Board as proposed hereunder will have to be very careful while recommending bonus pool and the manner of its distribution. The Remuneration Committee will have to go into details of physical targets achieved and the manner in which accounts have been presented.

4.5 PERFORMANCE MANAGEMENT SYSTEM

4.5.1 A significant PRP assumes existence of a robust and transparent performance management system. The present practice of grading most of the executives as ‘Outstanding’ in CPSEs has to be given up in favour of a ‘bell curve shaped approach’ which is followed by most of the private sector companies and MNCs. Ordinarily no more than 10 to 15 percent of the executives should be graded as outstanding and 10 percent non-performing executives should also be graded, as average/below par. PRP should vary depending upon the performance.

4.5.2 For determining the amount of variable payments, companies as well as executives will have to achieve pre-determined physical as well as financial targets. It is proposed that signing of annual MOUs is made mandatory for all CPSEs. The companies should internalize MOU process up to the lowest operative level and link it with the performance management system for deciding PRP.

4.5.3 The Committee has been informed that MOU targets are generally on liberal side and can be easily achieved. The Committee recommends that parameters in MOU should be decided by bench-marking with similar companies in private sector and MNCs and should not be based merely on past performance.

4.5.4 Only those companies that achieve 'excellent' MOU rating should pay up to 100% of PRP. Companies achieving "very good", "good" and fair rating should pay a maximum of 80%, 60% and 40% respectively. No PRP should be payable if MOU rating is 'poor'. Similarly, Executives who get ''Outstanding'', Very Good'', ''Good'' and ''Fair'' performance rating should get up to 100%, 80%, 60% and 40% PRP. No PRP is recommended for those achieving 'Poor' rating.

4.6 REMUNERATION COMMITTEE

4.6.1 The PRC is conscious of the conflict of interest between shareholders (government) and management in deciding managerial compensation. It is proposed that annual bonus pool and policy for its distribution across the executives is decided by the Remuneration Committee of the company. The said Committee should be headed by an Independent Director and could take assistance, if necessary, from out side experts in the field to decide on bonus pool and distribution policy.

4.6.2 Availability of Independent Directors on the Board of companies is a pre-requisite for constitution of a Remuneration Committee. Equally important is the credibility of Independent Directors. Since they will decide a significant part of executive compensation, Independent Directors should be capable of withstanding unwarranted pressures and make balanced and rational recommendations keeping in view long term interests of all the stake holders and that of the company itself. Government should, therefore, ensure that Independent Directors are persons of eminence, whose credibility and integrity is above board. PRC has been informed that all CPSEs do not have Independent Directors on the Board. The Committee recommends that Independent Directors be appointed on the Boards of all CPSEs and the process for appointing Independent Directors is made time bound. PRP will be decided only by a Remuneration Committee.

4.7 CONCEPT OF THE COST TO THE COMPANY

4.7.1 While devising compensation packages, all private companies and MNCs employ the concept of the cost to the company (CTC). Committee recommends that the concept of CTC should also be introduced in the CPSEs. Executives of CPSEs enjoy a large number of benefits in cash and kind that are not always quantified as part of wages in the books of accounts. The Committee recommends that the entire cost of an executive is explicitly made known by companies adopting the system of CTC for the purpose of reporting executive compensation. Pay, Allowances, Perquisites, and Retirement benefits should all be monetized and included while reporting cost of manpower to the company.

4.7.2 COMPONENTS OF CTC: Following structure of compensation for the executives to be included in the CTC.

a) Fixed Pay

The Committee is recommending that fixed pay be divided into two components - Basic Pay and Risk Pay. Risk Pay will have following three objectives:-

1) Risk pay will not be considered in determining pay-linked benefits. Thus, while leaving enough cash in the hands of the executives, it will reduce long term liabilities of the companies.
2) While normally Risk Pay will form part of the fixed pay, in exceptional situations, if the company is passing through a crisis and there is serious erosion in profitability, Risk Pay may be withdrawn partially or in full
3) While implementing recommendations of the Committee, all companies except those reporting cash losses should pay basic pay proposed. Risk Pay can be allowed in phased manner, keeping in mind company's ability to pay.

b) Dearness Allowance

At present most of the CPSEs are governed by Industrial Dearness Allowance (IDA). A parallel Central Dearness Allowance (CDA) scheme is applicable in some of the CPSEs, which absorbed erstwhile government servants, who have not opted to come under IDA. The Committee recommends that with the implementation of recommendations of this Committee, all the executives should be brought under IDA scheme. Payment of Dearness Allowance may be continued as per the existing IDA Scheme.

c) Annual Increment

Private companies and MNCs do not have the concept of fixed annual increment. In these companies annual pay increase is based on companies' ability to pay and individual performance. At present in CPSEs annual increment is about 2.5% to 4% of minimum basic pay. The Committee recommends that in keeping with the practice followed in private sector, concept of fixed annual increment may be given up and replaced by a flexible increment of 2% to 4% of basic pay, depending upon company's ability to pay and performance of the individual.

d) House Rent Allowance

Most of the CPSEs have created self-contained townships with all amenities at their plants or project sites. However, housing facilities are not available in respect of executives posted to cities where company accommodation is either not available or available to a limited extent. The Committee recommends housing allowance at following rates for different category of cities:

Cities with population In lakhs	**HRA as % of Basic Pay**
1) 50 or more	**30%**
2) 5 > but < 50	**20%**
3) < 5	**10%**

In big cities, it may not always be possible to get housing accommodation consistent with the status of an executive based on the proposed house rent allowance. Committee recommends that the Board of the Company may be empowered to fix standards of housing accommodation for executives at different levels for company leased accommodation. While deciding on leasing accommodation for its executives, companies should not hire accommodation in the most expensive localities and need for economy should not be lost sight of.

In respect of executives, who work in big cities and reside in agglomerations around such cities, house rent may be paid at same rate as applicable to such cities.

e) City Compensatory Allowance

CCA forms a very small component of the total emoluments of executives in CPSEs. There are advantages and disadvantage of working in cities as well as project or industrial sites. Committee feels that the concept of CCA is not of much relevance in today's situation and can be dispensed with.

f) Other Allowances

1) Apart form House Rent Allowance, Dearness Allowance, and CCA, CPSEs provide a range of other benefits such as LTC, Conveyance Allowance, Chauffeur driven car, Canteen subsidy, Club membership, Newspapers and Magazines, Uniform Allowance, Washing allowance, Children's Education allowance, Entertainment Allowance, Remote Area Allowance, etc. The Committee recommends that in future as far as possible companies should adopt a 'Cafeteria approach' for perquisites and allowances, leaving choice of package to the executives within the prescribed ceiling. To the extent that the facilities have been created at project or industrial sites, perquisites for the purpose of CTC should be valued at actual cost to the company and not at nominal rates. Committee recommends that allowances may be allowed to the extent of maximum 50% of the basic pay.

2) At present most of the CPSEs operating in the North Eastern States give North East allowance at 12.5 % of basic pay. Committee is of the view that in view of extremely difficult working conditions in the North Eastern States, this allowance may be kept out of the 50% cap indicated above.

3) Similarly underground allowance in mining companies should be kept outside the ceiling of 50%. However, underground allowance should be allowed to only such executives, who actually work underground and not to others, who only provide support services to underground mines.

4) Also, non-practice allowance for medical practitioner and special allowance for serving in difficult and far flung areas should also be kept out side the ceiling of 50 % limit.

g) **Company Car:** The committee recommends that facility of chauffeur driven car should be limited only to the CMDs and Directors. During execution stage of projects, where providing companies' vehicles becomes necessary, companies should hire vehicles instead of purchasing vehicles.

h) Superannuation Benefits

1) In the past, superannuation benefits of CPSEs were limited to contributory provident fund and gratuity. A contributory pension scheme has been introduced in some of the CPSEs in recent past.

2) Medical treatment becomes a significant component of expenditure for retired executives. While a few CPSEs provide post retirement medical treatment, most of the retired CPSE executives do not have access to medical facilities.

3) In order to have pension and medical care as additional superannuation benefits, Committee proposes to enhance superannuation benefits to 30% of basic pay. Superannuation benefits including gratuity, however, should not become a long-term financial liability for the company. CPSEs should therefore, devise suitable defined contribution plans and operate on their own or through insurance companies. Pension, gratuity and post retirement medical treatment should come out of such insurance linked instruments. Upper limit on gratuity could be removed and gratuity payment could be linked to the performance of the defined contribution schemes.

4) Post retirement medical facilities and pension will be admissible to only such executives, who retire on superannuation from CPSE and have put in minimum service of 15 years.

i) Long-Term Incentives

1) In a market where there is serious shortage of talent, it becomes necessary for companies to devise methods by which highly performing executives, particularly at higher levels of management could be retained. Stock options are considered the most effective element of compensation that can

help retention of talent, create wealth for loyal and performing employees and ensure a sense of ownership amongst employees.

2) The Government has issued guidelines for introduction of stock options in CPSEs. The Committee is told that in its current form, stock options are at best a savings option and not an incentive and there are no takers for this scheme.

3) The Committee recommends inclusion of stock options as long-term incentive, in order to seek high level of commitment of executives to company's performance. Committee recommends that CPSEs should pay part of PRP in the form of company stocks. The stock options could vary from 10% of PRP for junior level executives to 25% at the level of Directors and CMDs.

4) The Committee is not making any recommendation as regards vesting (lock-in) period and exercise price. These may be decided by the Board of the Companies, based on the recommendations of the Remuneration Committee.

5) Since only few of the CPSEs are listed on the stock exchange and whose shares are actively traded, the Committee recommends that other CPSEs may also be encouraged to get listed on the Stock Exchange and a small portion of equity, say up to 10% may be disinvested in favour of employees and retail investors.

4.7.3 MANPOWER REDUNDANCY

4.7.3.1 While the Committee is recommending a sizeable increase in level of compensation, it wants management of CPSEs to clearly understand that such increase cannot be at the cost of profitability and health of CPSEs. Resources for increased compensation will have to be found from increased productivity and performance.

4.7.3.2 It is a matter of common knowledge that most CPSEs have manpower far in excess of their needs. Despite operation of VRS for several years, excess employment continues. Time bound promotions have been given without reference to need for higher-level positions or performance of the individuals. Several CPSEs have created a large number of positions at higher levels by simply upgrading existing incumbents, without any change in their job content or responsibility.

4.7.3.3 In order that companies are able to pay enhanced compensation without dipping into their profitability, all these defects in manpower management have to be addressed on a war footing. Companies should make proper assessment of their manpower requirement at different levels, consistent with their business requirement, duly benchmarking their manpower cost and productivity with the best available in the respective sectors in private and multinational companies. Remuneration Committee should take these factors into account while deciding on annual pay rises and variable component of compensation (PRP).

4.7.4 VOLUNTARY RETIREMENT VS COMPULSORY RETIREMENT

4.7.4.1 A number of CPSEs have been operating VRS for several years. However, very often these schemes have been taken advantage of by more talented people who after taking VRS from CPSEs have found lucrative jobs in private sector. CPSEs have not been able to get rid of poorly performing executives under VRS. It is therefore, proposed that VRS schemes be replaced by Compulsory Retirement Schemes (CRS) and management of CPSEs should have right to compulsorily retire surplus manpower by paying adequate compensation.

4.7.4.2 As far as executives with consistently poor record of service are concerned, their services should be terminated in terms of contract of employment. The Committee is aware that Supreme Court in some of its pronouncements has held that CPSEs are extension of government and, therefore, courts can go into service matters of executives of CPSEs. It is suggested that Government may approach Supreme Court for review of these decisions so that in the changed economic environment, CPSEs are treated as any other commercial enterprise operating under the ambit of Indian Company Law and have full autonomy in management of their manpower and commercial operations, without interference from the Courts.

4.7.5 COMPENSATION PACKAGE FOR EXECUTIVES OF SICK CPSES

4.7.5.1 A basic question, which concerns the working of Central Public Sector Enterprises and emoluments of their employees, is the manner in which is an important issue

Deleted: <#>¶
RETIREMENT AGE¶
Several companies and Associations of executives have requested for enhancement of retirement age to 65 years. From the perspective of demographic profile, working age population (15 to 60 years) in India is likely to comprise 60% of the total population. Given this profile of population mix, there is no case for increasing age of retirement in general.¶
¶

Deleted: A

the Committee deliberated upon was about compensation packages for the sick and loss making enterprises, amongst the CPSEs. Of the 216 operating CPSEs as on 31st March 2007, 59 CPSEs had incurred loss for the year 2006-07. Though during the last few years, the number of loss making CPSEs have come down from 110 in 2000-01 to 59 in 2006-07, still all of them have not come out of the woods.

Deleted: are to be treated.

Deleted: 2.

Deleted: The Government has been making efforts to revive these sick/loss making CPSEs through the process of BIFR.

4.7.5.2 Out of 75 CPSEs registered with BIFR till 30.6.2007, it had sanctioned revival schemes for 19 CPSEs and recommended winding up in respect of 26 CPSEs. BIFR has declared 5 CPSEs as 'no longer sick' and dismissed/dropped 7 cases as not maintainable/net worth becoming positive. The remaining CPSEs are under various stages of consideration of BIFR/AAIFR. The process of revival/ rehabilitation through the BIFR has been very slow.

4.7.5.3 The National Common Minimum Programme (NCMP) of the Government, inter alia, stipulates that while every effort will be made to modernize and restructure sick public sector companies and revive sick industry, chronically loss-making companies will either be sold-off, or closed, after all workers have got their legitimate dues and compensation. The private industry will be inducted to turnaround companies that have potential for revival.

4.7.5.4 The Government constituted the Board for Reconstruction of Public Sector Enterprises (BRPSE) in December 2004, an advisory body to advise the Government on the revival of sick CPSEs. As on 31.3.2007, 83 CPSEs have been identified as sick and referable to BRPSE. 62 CPSEs have been referred to BRPSE for advice on their revival or otherwise. BRPSE has given its recommendations in respect of 52 CPSEs in the last three and half years. Based on the recommendations of BRPSE, Government has approved proposals for revival of 31 CPSEs and closure/winding up of two CPSEs so far. The recommendations of BRPSE in respect of remaining 18 CPSEs are under various stages of approval of the Government.

4.7.5.5 The Committee is aware that, under the existing law, reference of sick industrial CPSEs to BIFR is mandatory under Sick Industrial Companies (Special Provisions) Act. The Committee is also aware that even after the enactment of

Deleted: 6.

Deleted: The Committee thus perceives an anomalous situation in which employees in different categories of public sector enterprises are treated differently. The Committee believes that the present processes of reference of sick public sector enterprises to BIFR have been time consuming. Originally, benefits were expected in terms of implementation of a quick revival package that would be evolved. This has not materialized.

SICA Repeal Act in 2003, the issuance of notification abolishing BIFR/AAIFR is pending due to the stay imposed by Madras High Court on constitution of National Company Law Tribunal (NCLT) which is expected to coincide with such abolition.

4.7.5.6 The present system of referral of sick CPSE to the BRPSE and also to BIFR is time consuming and makes revival very difficult. In fact this process negates the very purpose for which BRPSE was created. The Committee is of the view that CPSEs may be withdrawn from the jurisdiction of BIFR as early as possible, if necessary by making suitable amendment to Sick Industrial Companies (Special Provisions) Act, in case abolition of that Act is likely to be delayed further. BRPSE should be the final authority to advise the government on revival of sick industries.

4.7.5.7 Today, sick/loss making public sector enterprises fall under three categories. The first category is public sector enterprises that follow the Central Dearness Allowance pattern. In these enterprises, the benefit of 5th Central Pay Commission had been allowed to a certain section of the executives, who are governed by Central DA irrespective of their financial position. In the same enterprises, the employees who are governed by Industrial DA have not been granted the benefits of 1992/1997 wage revisions. In the second category of sick enterprises numbering 14, even the benefit of 1992 wage revision has not been granted. In the third category of sick enterprises numbering 29, the benefits of 1997-wage revision have not been granted.

4.7.5.8 The Committee is of the view that employees' contribution in terms of increased productivity is the most important component of a revival strategy. It is futile to expect that executives, who are in 1987 or 1992, scales are motivated enough and will be able to revive these industries Further, most of the sick CPSEs have already reduced their employees through VRS and in this process many talented persons had left these CPSEs. With 1992/1997 scales of pay in operation, it will be impossible for these sick CPSEs to recruit even moderately talented executives at middle and senior levels.

4.7.5.9 It is suggested that BRPSE should be requested to make a quick appraisal of all sick companies within a period of 6 months and recommend their closure or revival. Committee is also informed that in most cases, revival is only financial restructuring, without dealing with issues of technological obsolescence, product mix and managerial deficiencies. Without examining issues relating to technology and management, financial restructuring may only result in illusion of revival, and such companies may again lapse into sickness. BRPSE should, therefore, look at issue of revival holistically and not only in terms of financial restructuring.

4.7.5.10 Executives in companies that are proposed for closure should be given retirement benefits based on the Basic Pay recommended by the Committee. In respect for companies proposed for revival, recommended basic salary should be allowed and should form part of the revival package. Other benefits like risk pay and other allowances may be allowed to the executives of sick companies as the revival process progresses. The employees of sick CPSEs may also be committed deferred incentives linked to achieving revival targets.

4.7.5.11 It may be desirable, and some times necessary to bring an entirely new management team for revival of sick industries. In such cases the new team may be inducted with proposed compensation package, while linking PRP to the turn around targets.

4.7.5.12 Pending decision about their closure or revival, such of the sick companies that are making cash profit (without provision for depreciation and interest) should be allowed to pay basic salary (without risk pay and other allowances), as long as these do not incur cash loss because implementation of proposed scales.

4.7.6 RETIREMENT AGE

Several companies and associations of executives have requested for enhancement of retirement age to 65 years. From the perspective of demographic profile, working age population (15 to 60 years) in India is likely to comprise 60% of the total population. Given this profile of population mix, there is no case for increasing age of retirement in general.

Formatted: Bullets and Numbering

4.7.7 OTHER RECOMMENDATIONS

4.7.7.1 Non Commercial Companies

Some of the companies out of 216 CPSEs, including all the Section 25 companies, are strictly speaking not commercial organizations but have been set up to implement government programmes for specific sectors or sections of the society. List of these CPSEs is at **Annex-4.1.** These are not operating in a competitive market and do not normally function with a profit motive. These are in the nature of extension of government work and chief executives of these companies are also normally government officers on deputation. Apart from this, there are some companies that are exclusively set up to provide services to the Indian Railways or other Government Departments.

4.7.7.2 The Committee suggests that these CPSEs listed at **Annex- 4.1** should be taken out of the proposed pay revision and Government may adopt scales of Pay recommended by the 6^{th} Central Pay Commission in respect of these companies. However, in case there is some difficulty in accepting this proposition, these companies will follow the compensation package proposed for the respective category to which they belong.

4.7.7.3 'D' Category Companies

All the companies in "D" category have a turn over of less than or around 50 crores. These are too small to be of any importance to the national economy. Combined income of all these companies is only 0.12% of the total income of CPSEs and manpower employed is less than 0.50 % of total CPSEs manpower. All of them by virtue of being CPSEs come under the jurisdiction of their respective Ministries, Parliament, Central Vigilance Commission, and Central Bureau of Investigation. The Committee feels that, agencies of the State listed above have far more important responsibilities to discharge than to deal with affairs of such small companies. Many of these are sick companies and will not be able to pay the compensation packages recommended by the Committee. The Committee is of the view that except companies listed as non commercial, which have some social objectives, Government should withdraw from these companies through merger, privatization, or otherwise.

*****