MOU: MORE MEMORANDUM THAN UNDERSTANDING

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MOU: More Memorandum than Understanding

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How should the government manage its enterprises? The question has been a subject of long debate. Although several solutions have been suggested, it has remained a source of concern and frustration for all concerned. The Memorandum of Understanding (MOU) between the government and the enterprise is the latest technique adopted to improve the situation.

MOU, quite simply, is an agreement between two (or more) parties. MOU between the administrative ministry and its enterprise is expected to set out the mutual obligations and expectations. Once an MOU is signed, there would be no need, it is contended, for the government to interfere in the working of its enterprise. Managers would know what is expected of them. They would not require prior government sanction for each decision, while the Government can control the enterprise ex-post (Trivedi, 1988). If the two parties also agree on a performance evaluation system, they need only meet at intervals specified in the MOU to review the fulfilment of the obligations by each and of the working of the MOU itself (Trivedi, 1989). A system of rewards or incentives, associated with the level of fulfillment, completes the logic of the MOU.

MOU is thus presented as a simple but effective technique for establishing clear objectives and targets, unambiguous criteria for evaluation, and a system of rewards for achievement. This paper discusses, based on the experience so far, why MOUs may not achieve the results expected and indicates the direction in which solutions should be sought.

Origin of the Concept

MOUs, or the system of performance contracts between the government and its enterprises, originated in France in the late 1960s. The main objective of the early French contracts was to reduce government's budgetary aid to its companies. The duration of the two initial contracts with national electricity and railway companies was five years. Government budgetary aid was limited through agreed upon tariff rules that provided for the companies to adjust prices, without prior government approval, to cover variable costs and two-thirds of the finance charges on new investments (Nellis, 1988). To satisfy the government that they were not passing on their inefficiencies to their customers, the enterprises agreed to improve performance on well defined productivity measures.

It should be noted that the obligations of the government and the enterprise were appropriate to their respective roles and were confined to a few policy parameters. The government, as owner, specified the growth and financing. The managers, freed of government approvals on pricing and budgeting, were to concentrate on productivity improvements. The contracts focused on long-term policies and goals. They did produce results initially but were thrown out of gear, after the 1973 oil crisis, when the government refused to go along with the operation of the contracts which would have required a steep rise in tariffs to compensate the enterprise for the sudden and large increase in input costs. The government did not let staff reductions proceed as agreed upon. Political compulsions ruled over contract commitments. The contract with the electricity company was not renewed while that with the railway company was "extended" for two years.

The French government did not enter into a second set of contracts with enterprises until 1978-79, nearly a decade after the first round. These contracts, with four enterprises, were for a shorter duration of three years, to ensure better predictability of operating conditions. The second set of contracts also ran into rough weather because the Socialist party government, that came to power in 1981, unsettled the arrangement by simply revising the basic assumptions underlying the contracts. Only one contract, that with Air France, yielded positive results, according to Nellis's study, because it operated in a competitive market, which enabled the use of commercial, rather than administered, prices for evaluation of performance.

Because of their mixed experience, perhaps, the French have not been overly enthusiastic about performance contracts. They have used the technique selectively and intermittently. Even the socialist government, which nationalised in 1981 many large companies with national and international subsidiaries, entered into performance contracts only with the holding companies restricting government's say in them to the top and to matters of policy such as protection of employment, modernisation, and international competitiveness.

Another noteworthy innovation in managing public enterpises in Europe, in this context, was by the Italian government, which successfully experimented with the holding company as a buffer between the government and operating businesses, to combine and cushion the socio-economic policy objectives of the former and the profitability and competitive needs of the latter (Murthy and Nath, 1988).

Adaptation in India

The French and the Italian experiences provided the basic inspiration to the Arjun Sengupta Committee which reviewed government's policy for its enterprises in the context of their poor performance (Ministry of Finance, 1984). The Committee suggested a gamut of measures directed at evolving an arms-length relationship between the government and its enterprises and improving performance. One of these was that the government sign MOUs with a few holding/apex companies in the core sector whose corporate plans were closely linked to the national five-year plans in investment planning, financing, pricing and internal resource generation, and where "the details of tasks of either party could be specified." MOUs were not recommended for all the enterprises but only with holding or apex companies so as to restrict the role of government to formulating and monitoring long-term socio-economic policies and goals. The duration of each MOU was to be decided by the two contracting parties to suit their needs.

Performance evaluation was to be based on general criteria common to all public enterprises, which were identified as financial performance, productivity and cost reduction, technical dynamism, and effectiveness of project implementation. The evaluation was to be done by a group constituted by the administrative ministry consisting of its own representatives and those of the Planning Commission and the Bureau of Public Enterprises, and was to be linked to investment decisions, on the one hand, and appointments, promotions, confirmations, and extensions to top management, on the other.

Convinced that government-enterprise relations were not conducive to performance, the Committee wanted the multiplicity of monitoring systems reduced. It recommended that the current management information system and quarterly monitoring by the Planning Commission be dispensed with. Arguing that the involvement of the ministry in answering parliamentary questions diluted the autonomy of the enterprise, the Committee wanted a convention established of not admitting questions in parliament on the day-to-day working of the enterprise and a direct contact between the Committee on Public Undertakings of the Parliament (COPU) and the enterprise, eliminating the present intermediary role of the administrative ministry.

It can thus be seen that the Committee envisaged different roles for the administrative ministry in managing companies in the core and non-core sectors. The MOUs were to cover only the core sector holding companies. While the ministry was to divest itself of several of its current activities, performance evaluation was to remain central to its relationship with the enterprise.

Maiming the Recommendations

While the Sengupta Committee recommended the signing of MOUs with only a few holding or apex companies in the core sector, the government decided upon a policy to enter into MOUs with all its enterprises (Bureau of Public Enterprises, 1988a). Starting with ONGC and SAIL in 1986-87, MOUs were signed with 11 enterprises in 1988-89 and 18 enterprises in 1989-90. An additional 15 enterpries are to be brought under this arrangement in 1990-91.

In the process of implementation, the government has ignored several other recommendations of the Committee designed to reduce and simplify the areas of government involvement. The variance between the recommendations of the Committee and the way MOUs have been implemented are outlined in Table 1.

Insert Table 1 about here

The format of the MOU is common to all enterprises. Part I comprises a statement of the mission and objectives of the enterprise; part II lays down the enterprise's obligations under the MOU which relate primarily to annual physical, financial, productivity and project implementation targets, and specifies evaluation criteria with weights and grading rules; and part III details the obligations of the government, which consists basically of assistance to be provided to the enterprise by the administrative ministry in procuring inputs or market for outputs, speedier government approvals, or greater delegation of powers.

The MOUs purport to assign a composite score each year to each enterprise, based on the performance criteria and grading rules agreed upon in the MOU. The attempt is to compare the performances of diverse enterprises on a common five-point scale, although the criteria, their weights and grading rules may differ from one enterprise to the other. The scores are to be linked with motivational incentives; no incentives have, however, been awarded so far.

To give an idea of the obligations, the ministry may undertake to facilitate government approval for enterprise proposals such as on a capital expenditure project or for bulk release of foreign exchange within specified time limits.

The enterprise typically takes the obligation of meeting specified annual targets of physical and financial output or revenue per person employed or capacity utilisation. A 20 per cent weight is assigned to turnover in rupees crore for HMT and BHEL. To illustrate the grading rules, if HMT's turnover in 1989-90 is 20 per cent more than in 1988-89, it will get a score of one, or excellent, while Maruti will get it for an improvement in its turnover of 10 per cent.

The obligations in the MOU are based on certain assumptions. The MOU of the Steel Authority of India Ltd. (SAIL), for example, assumes that the administrative ministry will ensure inputs essential to production, such as coal, power and railway wagons and bulk release of foreign exchange. The 1989-90 MOU between BHEL and the Ministry of Industry assumes that the government would provide during 1989-90 orders for 5,000 MW. It also points out that the government had not met its obligations in the past; it had provided orders for only 2,572 MW in 1987-88 and for only 2,631 MW in 1988-89 against a commitment of 5,000 MW each year. The MOU for Indian Oil Corporation states that its crude processing/product pattern would change if crude mix/crude supplies fall short of assumptions made.

The responsibility for monitoring all the MOUs rests with a Committee of six secretaries to the Government of India, chaired by the Cabinet Secretary. To assist this Committee, several ad hoc committees are set up, chaired by the Additional Secretary, (BPE), and consisting of members drawn from a panel of experts -- professionals, accountants, former executives of public enterprises, retired secretaries to the government of India and members of Parliament. The Committee is seen as an "impartial authority," independent of either the administrative ministry or the enterprise (Bureau of Public Enterprises, 1988a). The administrative ministry is divested of formal responsibility for monitoring, because as one official stated, the ministry may not highlight the weaknesses of the enterprise under its charge.

Critique

The MOU approach seems to suffer from several internal contradictions. And if we go by the views of some of those who are actually involved in implementing it, these already appear to have created practical difficulties. Let us look at some of the questions that the approach raises.

First, the longer the duration of an MOU, the more difficult it is to set out mutual obligations precisely, and if the duration is too short, there is very little justification for writing it out formally. How well does the current duration of one year resolve this issue? Secondly, if one of the signatories to the MOU is unable to fulfill its obligations, how binding are the obligations of the other, as the two are closely inter-related? Thirdly, what should be the content of an MOU? An MOU that is too detailed and precise can overburden the process while too general an MOU may not be easy to monitor. In other words, how flexible should the MOU be? Too much flexibility may render a formal statement of the obligations meaningless while too rigid an adherence to the commitments may hamper response to the opportunities and threats as they arise. Then, who should take responsibility for assumptions regarding future conditions? How well can evaluation be adjusted to conditions that actually prevailed as opposed to assumed conditions? What knowledge and expertise does the evaluator need in order to make such adjustments? The question of uniform pattern for all enterprises is also valid. Too much uniformity can lead to a failure to respond adequately to the technical and economic compulsions of the enteprise. And, in an area full of judgemental pitfalls, should the evaluation be oriented towards getting results or towards neutrality between the contracting parties?

The questions raised above are interrelated and defy clear cut answers. What is clear is that the MOUs, as implemented so far, do not point to a change in the philosophy of managing public enterprises. MOUs have simply been superimposed on the existing system, which has failed to produce the desired results.

While it is too early to predict the outcome of this arrangement, what is likely to happen is that the MOUs will be bureaucratised into existing government enterprise relations, much like the performance budgets were some time ago. Besides, MOUs may result in misdirected attention, unhealthy game playing, and overloading of the top of the hierarchy. In fact, some of the executives involved in implementing the MOUs have already started articulating their dissatisfation on these accounts. Let us discuss these in detail.

<u>Bureaucratisation</u>: MOUs have not, in practice, resulted in a reduction in the existing information and reporting relations between the government and the enterprise. They have not also improved the ability of the administrative ministry to commit on behalf of the government or to discharge its obligations as agreed upon in the MOU. For instance, the Ministry of Industry has been unable to get BHEL 5,000 MW of orders year after year

even though such obligations were agreed upon in the MOUs. MOU proponents claim that MOUs have been able to pinpoint this weakness of the ministry. But the fact is that this weakness has long been known, and MOUs provide no solution. In fact, MOUs confound this weakness with enterprise inefficiencies.

As one executive commented:

"In any case, we can keep reminding our ministry their pending obligations, some of which have been carried over from 1988-89 into 1989-90. I cannot say that as a result of the MOUs, the day-to-day questions or the innumerable reports that we are requested to send has decreased."

In the opinion of another executive:

"If the government is unable to meet its obligations who do we go to? The ministry is not worried about five years from now. They are concerned about the short-term. The day-to-day problems gratify power far more than the intangible long-term issues. We have had different people in the ministry for the 1988-89 and 1989-90 MOUs. The government-enterprise relations do not change simply because an MOU has been signed. Neither access to inputs nor government approvals have improved notwithstanding the inclusion of such obligations for the government year after year."

An official concurs:

"I cannot say that there is a real change in government-enterprise relations as a result of the MOUs, although the powers delegated to the enterprises have been higher."

The problems in government-enterprise relations arise from the way a government manages its enterprises. Whenever an enterprise faces a scarcity of inputs or outputs, there is pressure for allocation or for allowing imports. A government can pursue well thought out policies or intervene in each case to determine who the individual beneficiaries should be. As interventions become routine, enterprises lose initiative and responsibility, and government their ability to hold enterprises responsible. Enterprises, as a consequence, become appendages of the government (Murthy, 1987). This, unfortunately has been increasingly the case in India in recent years. Consequently, the government's ability to commit has decreased. An MOU does not improve the situation.

It is not surprising, therefore, that the MOUs were not the result of hard negotiations between the enteprise pursuing financial performance, and a government committed to achieving social goals (Bureau of Public Enterprises, 1988b). According to those involved, most of the MOUs were prepared by the enterprises. They were approved by the ministries with minor modifications, especially in criteria weights or in the grading rules. For example, the negotiations between one enterprise and its ministry centered around whether a 10 per cent increase in rupee turnover was to be graded as "very good", or as simply "good".

Misdirection: MOUs misdirect attention to annual outputs and to irrelevant negotiations. MOU theorists believe that when a ministry decides whether production should carry a weight of 30 per cent or 25 per cent, it is giving signals to the managers on the direction the enterprise should take. But production, or other functional targets, howsoever weighted, cannot be the goal of an enterprise. Such partial approaches have failed even in centrally planned economies, where the governments could specify the best targets as also enforce them most ruthlessly. These governments have openly acknowledged their failure in steering their economies towards effective and efficient performance and are proceeding to decentralise initiative and responsibility for coordination. The problem is that management of complex industrial enterprises cannot be written down as memoranda of mutual obligations for a neutral higher authority to score the achievement after the event.

Top levels of government and management have to relentlessy pursue inspiring national goals such as how SAIL can become the lowest-cost producer of steel in the world, or how an enterprise such as HMT can be prevented from drifting from leadership in machine tool technology into producing consumer goods simply to supplement profits. Or how Maruti's modernisation of the automobile industry can secure for India its proud share in the world automobile industry. These goals are neither easy nor easily measurable and do not lend themselves to annual MOUs.

Unfortunately, MOUs focus attention on what is measurable than what is worthwhile. Although part I of the MOUs of many enterprises state lofty missions for themselves, the mutual obligations stated in parts II and III, do not flow from the mission statements. The result is misdirection. As one executive candidly conceded:

> "I have been going through the MOUs for the last three years. I am getting frustrated with the MOUs. Because the government is unable to fulfill their obligations, we are unable to meet ours. A defensive mechanism is setting in the company replacing the enterprising and risk taking climate that prevailed earlier. Managers have begun to feel that the environment is more favourable to taking a soft target and scoring rather than taking a hard target and failing. I think the MOUs in our case have become dysfunctional."

As can be seen from the above comment, MOUs distort the formulation of goals and misdirect attention from what should be attempted as a challenge, given the resources and opportunities, to what may be nothing better than a safe commitment. For, performance is measured against commitments made and not against what should have been attempted.

Game Playing: Even in operationalising annual production and financial targets, MOUs focus on meaningless scores rather than technical judgements and operational experience. Assessing what the output of steel can or should be for a given quality and quantity of coal, power, and rail wagons, either for setting the annual targets or evaluating the actual achievement, calls for considerable detailed information, technical judgement and experience. Such knowledge and expertise are not available with the ministry. This often results in a process, which was described by one executive in the following words:

"We took care not to commit ourselves more than we thought was necessary as a starting point. We did not want to expose the enterprise to uninformed or unsympathetic review and criticism. In addition, we included in the draft many government obligations, even when we knew that the government would not be able to implement them. Although our ministry circulated the draft MOU among all the concerned ministries, it was unwilling to agree on obligations such as granting the enterprise powers for appointing chairmen of subsidiaries, powers to make investment decisions, and release of foreign exchange. We had included about 20 such obligations. The ministry pruned it to seven. Some obligations were reworded to dilute the ministry commitment."

It is commonplace in management theory that when control of goals and objectives that require judgement are routinised -- as in the MOUs -- there is misdirection of activity and promotion of game playing (Hofstede, 1981).

Overload: The lifting of review responsibility to a high-powered committee of secretaries, chaired by the Cabinet Secretary, is bound to aggravate the overload at the top (Galbraith, 1973). Even full-time managers with the knowledge and experience in business find the reviewing of businesses in large organisations onerous (See, for example, the cases on General Electric, in Aguilar, 1988). How much time would a part-time Committee of busy and powerful secretaries have to review performance of individual enterprises? Also, what action can such a committee take when an enterprise or a ministry or both fail to meet their obligations, as has been happening in the case of the Ministry of Industry and BHEL and the Ministry of Steel and SAIL? Or yet again, what meaningful action can such a committee initiate knowing that Heavy Engineering Corporation has obtained a better composite score than Maruti Udyog Ltd.? The two enterprises face totally different situations. The committee can do little more than to appoint another committee to look into the problems.

It is no surprise, therefore, that the 1988-89 MOUs were not reviewed at all. Only two meetings of the high-powered committee could be held during the year and their discussions focused more on the methodology of evaluation than on reviews. The 1989-90 MOUs were, therefore, drawn without the benefit of the reviews of the 1988-89 MOUs. The 1989-90 MOUs are not yet due for review. However, as a preview, the Bureau of Public Enterprises has conducted an exercise applying the 1989-90 MOU criteria, weights and grading rules to the 1988-89 targets and achievements. In that exercise, it is stated, that the Heavy Engineering

Corporation secured a better score than Maruti Udyog Ltd. and Bharat Heavy Electricals Ltd. Would such reviews, across widely different enterprise conditions, improve performance?

The problem of overload at the enterprise level was expressed by one senior executive as follows:

"The amount of time I have been spending on the MOUs in the last few years is enormous. I have had to convene innumerable number of meetings of senior executives. The main problem is that we have to make assumptions about various aspects in making commitments to the government, assumptions that depend on the government. There is neither guidance on these nor do our executives believe that the government will meet its obligations. The blame, however, is always pinned on the enterprise."

Experience of the Developing World

The basic problem is that performance contracts in themselves can be of little avail unless the enterprises and the government have the capability and willingness to operate in a purposive manner. The experiences of African countries and of South Korea, which represent two contrasting ways of managing public enterprises in the developing world help illustrate the point.

<u>African Experience</u>: The widest application of the MOUs outside France has been in African countries, where the conditions for contracting have been least favourable. They have implemented MOUs to satisfy the conditions imposed by international lending agencies, the World Bank and the International Monetary Fund, whose primary objective is to limit budgetary aid to public enterprises. Much of the administration of contracts in these countries is done by outside consultants on behalf of international agencies.

Given the quality of government administration in these countries, it is not surprising that most African governments have not lived up to their commitments. Government-enterprise relations have remained the same or have gotten entangled in additional paper work inherent in contract signing and supervision. The contribution of contracting to performance improvement in African countries has been judged to be insignificant (Nellis, 1988).

South Korean Experience: Only South Korea has been relatively more successful with MOUs, primarily because of a structure of management, informed by managerial experience of large diversified companies (Kim, 1986). A performance evaluation system was introduced into this managerial environment in 1984.

The most important feature of this system is that there is a single focal point for all government decision-making for enterprises. A single supra-ministerial body takes responsibility for the planning and control of all the enterprises. Headed by the Minister of the Economic Planning Board (EPB), who is also the Deputy Prime Minister, the Management Evaluation Council (MEC) consists of the ministers of finance and the concerned departments, and eminent persons with appropriate knowledge and experience. The MEC formulates the goals and objectives, and issues guidelines for budgeting and performance evaluation of the government enterprises. Numbering only 24, these enterprises cover term-lending institutions, and companies producing coal, electricity, petroleum, and fertiliser as well as service and development agencies in tourism, agriculture and broadcasting.

Enterprises operate on a two-tier basis. At the apex is the board which acts as a decision making body and includes the minister in charge of the enterprise. The chief executive officer of the enterprise, constituting the second tier, is in charge of implementation. He is the only full-time employee appointed by the government for a three-year term and the only one who can be recruited from outside the enterprise. Enjoying wide powers, he is free to operate professionally and to fire even executive directors. The authority of the enterprises over procurement, budgeting, and personnel policy are complete (Park, 1987) and government does not review the budgets of enterprises (Song, 1988).

The MEC evaluation is of the management and not of the enterprise. It is linked to the government's means of controlling the enterprise, namely budgetary and performance guidelines and power to appoint the board of directors. It focuses on comprehensive measures of annual performance such as public or private profitablity or labour productivity as appropriate to the enterprise, growth, and administrative improvements with a long-term perspective (Ramamurti, 1986).

Political support for this system is broad based. The initiative for reform came from the President, who was an army general and familiar with the working of public enteprises. Both the ruling party and the opposition have supported the system through an enabling act of legislation. The involvement of other evaluative agencies such as the Controller and Auditor General and the Parliament has been reduced and made less frequent in view of the performance evaluation system introduced.

Culturally, there is a great acceptance in Korea of the management's right to take decisions with respect to evaluation, promotion, transfer and assignment of tasks to employees. Employee support has been mobilised through a generous system of enterprise-wide performance incentives, ranging between two to three months of salary.

A Disabled Hierarchy

In sharp contrast to a hierarchy in South Korea that enables purposive action, the context for the MOUs in India is one of a disabled hierarchy. Every level finds itself helpless to get any work done from the lower levels under it. Only personal influence can be used even for enforcing ordinary discipline such as punctuality. A determined chief executive of one enterprise would stand at the entrance to the building to see whether all the employees came to the office on time. He could hardly take any action against even habitual offenders without risking the danger of a diversion of his whole attention away from the organization's main goals. Many officers conveniently choose to close their eyes to hordes of employees, supposedly working under them, loitering or attending to personal businesses during office time.

The chief executive of one enterprise could not get a manager from among many in his highly overmanned organisation to head an important new activity that was to contribute to organisational goals and objectives. He could not transfer his staff to appropriate places or positions. The right not to be transferred had been institutionalised even at the officers level by union agreements. Even among the officers who had opted to stay in the transferable all-India cadre, the chief executive had to go way down in rank, seniority, and competence before he could get one manager to agree to undertake the responsibility. To pursuade that person, he had to give all kinds of undeserved incentives, including promotion, even before the manager had demonstrated competence for his new job. Public enterprises have become very inequitous indeed to individuals wanting to contribute to organisational goals and objectives.

Above the enterprise, the administrative ministries are unable to take any responsibility for timely coordination of government action in appointments, financing, investments, wages and industrial relations to achieve enterprise goals and objectives. While powerless in inter-ministerial coordination, the ministries can exercise their power in the hierarchy over a politically weak leadership in the enterprise. As a result, while day to day interventions, queries for information, and frequent high-priority meetings have become routine either to answer parliamentary questions or as a part of the governmental decision making, the system of quarterly performance review meetings, supposed to be chaired by the minister or the secretary and attended by the chief executive and representatives of the Planning Commission has atrophied. These meetings were to focus on the mututal obligations of the enterprise and the government in key areas. During the three-year period from 1977 to 1980, not a single review meeting took place in the case of about half the 133 enterprises surveyed (Committee on Pulic Undertakings, 1981-82).

The experience of several decades shows that as long as the major decisions such as on personnel, investments, pricing, wages and industrial relations remain bound by procedures unrelated to achieving enterprise goals, morale and performance, the enterprises drift into lifeless routines as appendages of the bureaucracy. It is true that individual chief executives in stray cases have brought some life for short periods of time. But that only shows how the present system is unsuited to solving the problems facing the enterprise. The increasing dependence on extraordinary leadership to overcome the procedure-based control system is well illustrated by the following comment of a former secretary to the Government of India who also served as the chief executive of one of the large public enterprises:

"In our set up, it is the personality that matters. A person like V Krishnamurthy can get around the rules and procedures. A large multi-unit company like SAIL needs people with stature. Otherwise, it becomes weak in our present system of control."

The problem that this comment alludes to is that the cancer of helplessness at various levels of the hierarchy in the enterprises has now spread to their administrative ministries.

They cannot, as in the case of the Ministry of Industry and BHEL, meet their obligations in the MOU even on targets derived from the national plans. Some chief executives have no alternative but to bear their ministry-level hierarchy as an unavoidable burden, while some, who have the political support, bypass it and deal with the government at the highest level.

Government policies and decision making determine, to a large extent, the performance of many enterprises. Commercial market conditions do not prevail for a large proportion of the investments. Most public enterprises sell their products and services or procure their inputs from other public enterprises. They operate under conditions of increasing demand and shortage in supplies, requiring large investments for growth. Many enterprises are so interdependent on each other and on government coordination that MOUs with individual enterprises are of little value. SAIL's performance cannot easily be separated from the performance of the government in procuring inputs for it from its other enterprises. BHEL's performance is sensitive to the extent to which the government ties up power plant capacity establishment to foreign monopoly suppliers with bilateral government funding, in which BHEL cannot compete.

Another significant proportion of government investments is locked up in sick enterprises. MOUs, especially annual ones, contribute little to improving the performance in such cases. What is required for performance improvement is evaluation based on information generated from outside the MOUs. Such information is not generated in administratively managed situations that pin down obligations and commitments for *post facto* reactive evaluation and exercise of power in an environment that is devoid of trust. Government is neither able to generate such information nor use it to build confidence and motivation.

Suggestions for Improvement

Suggestions for improvement have to be rooted in the answers to the question as to how large companies manage their multi-location, multi-business, multi-level hierarchies of managers. They have to start with the realisation that the complexities and uncertainties of business today do not lend themselves to neatly divisible and stable mutual obligations that can be written down for explicit measurement, at all levels of an arbitrary hierarchy of power, especially the top. The hierarchy has to adapt itself to the tasks in a meaningful manner.

What successful large diversified systems have found is that the purpose, duration, content, flexibility and ways of monitoring MOUs have to undergo significant changes to suit the role of a given level in the hierarchy. These have to be matched to the information, time, expertise, and the effectiveness of the means of intervention available to each level (Goold and Campbell, 1987). The number of levels has to be kept to a minimum by periodically eliminating those that do no add any value. Even so, as the number of levels increases with growth in complexity and diversity of businesses, top levels lose intimate knowledge of the businesses and of their current operating environments.

Top levels cannot centralise power or disable lower levels by uncoordinated rules. They have to continuously facilitate informed action at lower levels which are more knowledgeable and aware of the current situation. Hence, while an MOU has to be, and can be, detailed, measurable, highly current, task-oriented, short-term, technical and routinised at lower levels, it has to be inspiring, aggregative, goal and policy oriented, even if not easily measurable, long-term, judgemental, and non-routinised at the top (Anthony, 1965; Chandler, 1962; and Chandler & Daems, 1980). Failure to adapt the hierarchy along these lines would lead to inefficiency and failure. This is the main reason for the openly acknowledged economic failure in communist countries.

The major interventions available to the government are nationally-inspiring goal setting, policy making, appointments and allocation of resources. Should the government use these inappropriately -- for example, for private gain, or changing chief executives frequently, or make decisions at too detailed a level, as with MOUs currently -- it will lose its power to influence the enterprises.

The structure of government administration of public enterprises in India, which was patterned after the centralised planning and command structure of the bureaucracies of planned economies, has remained practically unchanged in the last four decades, except for marginal concessions to constitutional challenges by the Comptroller and Auditor General of India and the Parliament. It has yielded enormously, however, to the deteriorating political and bureaucratic command layers at the top, while the number, size, and complexity of the enterprises have increased several fold. Their domestic and international technological and other environments have changed beyond comprehension.

Failure to innovate in organisation and administration cannot be corrected by the cosmetics of memoranda of understanding. The only way out is that the responsibility of the government for the formulation and supervision of goals and long-term policy for various sectors of the economy must be separated from the responsibility for administration of the enterprises. For this purpose, related groups of enterprises, especially those closely interdependent, should be brought under one umbrella organisation, call it a holding company or a sectoral corporation. Government enterprises should be organised thus, into 10 or 12 umbrella organisations.

The government can have long-term goal and policy oriented MOUs with these organisations in conjunction with aggregate allocations of domestic and foreign exchange resources, leaving to them the responsibility of achieving better coordination between operational problems, appointments and investment decisions. These umbrella organizations should be allowed to follow their own policies on personnel, investments, financing, wages, research and development. The government in turn should strengthen its capacity to formulate economy-wide policies for achieving technological modernisation, international competitiveness, foreign exchange earnings, irrespective of the ownership and administration of enterprises.

For example, an umbrella organisation for the non-nuclear power sector, including the equipment manufacturers, can find innovative and dynamic ways of achieving a more healthy balance among cost, pricing, financing and growth than at present. The current organisation and modes of decision making in this sector have led to a situation where the government is stepping up capacity addition through bilaterally funded power projects from 14 per cent in the seventh to 43 per cent in the eighth plan. Such projects are estimated to be 46 per cent more expensive than BHEL's, which will face a decline in orders of nearly 23 per cent over the seventh plan level and head for a decline in performance. Can the extraordinary burden of servicing these expensive investments be borne by a power sector that is unable to recover its costs currently? The resulting structural imbalance between growth and financing would not be corrected by growth. It will be aggravated by growth, rendering its resolution even more difficult.

What is required is a better organisation that balances growth and financing from the lowest operating level upwards and encourages innovation in every area from cost reduction to financing methods and reduction in investments needed for growth. Excessive centralisation in decision making along departmental lines in the government has led to aggregate imbalances at the top while the operating units, which can find creative solutions, remain uninvolved and helpless. The same is true of the steel sector which has lagged behind in modernisation and market oriented growth.

The Economic Advisory Council has identified that a priority area of action is to correct the current structural imbalance between the pattern of growth and the pattern of financing of the economy (Ministry of Finance, 1989). This imbalance is more due to the government sector, which accounts for half the plan investments, than due to the promotion of consumer durable industries in the private sector as the Council appears to have concluded without breaking down the size of the imbalance by various sectors.

Innovation in government organisation and management of enterprises can contribute greatly to correcting this imbalance. The umbrella organisation is one such idea. ~~whose time has come.~~ They have to be set up in order to encourage a culture of individual and organisational responsibility than one of diffusion of responsibility that unfortunately is the nature of weak government. Each umbrella organisation can have its own functional specialist units such as for economic appraisal or foreign exchange scrutiny. Some of the personnel in units such as project appraisal, economic affairs, finance, and labour, currently dealing with different aspects of the enterprises and located in various mininstries and the Planning Commission can be transferred to the umbrella organisations.

Government can progressively reduce its aggregate financial responsiblities to the umbrella organisations but strengthen their resource raising capabilities from the product and the capital markets. This in fact, is the spirit of the recommendations of both the Arjun Sengupta Committee and of the Administrative Reforms Commission.

An argument against the proposal for umbrella organisations is that the holding company experiments have failed in the past. As a careful analysis of the Indian experience shows, the spirit of the holding company has never been implemented in India (Murthy and Nath, 1988). Where it has been allowed to work, it has succeeded. The experience of successful public enterprise systems in South Korea and Italy, point to the necessity for such reorganisation of government. The managerial nature of government administration of South Korean public enterprises was discussed earlier. The experience of IRI, the Italian statutory agency for holding state participation in industry is particularly relevant (Murthy and Nath, 1988).

The Italian government first organised the political control of its equity investments, bringing several of state participations under one ministry. It laid down the policy and financial framework which limited government funding while enabling IRI, its subholding financial companies and operating subsidiaries to compete in capital and product markets. Each level in the hierarchy -- the holding and subholding companies, and operating subsidiaries -- was able to achieve a better balance between the pattern of growth and the pattern of financing in its sphere of operations, so that acceptable market oriented enterprise performance could be combined with national goals. The highest levels of bureaucracy in India should boldly innovate in this area of organising government for more effective and efficient management than presiding over routinised scoring of operating performance of large and complex enterprises.

The Government of India's policy of entering into MOUs with all its 200-odd enterprises without regard to their control and operating environment is ill advised. It would be naive to expect that under the current structure of government administration, a technique of scoring enterprises as 3.54 or 1.72 and giving them incentives based on such scores would improve economic performance. It will only result in the scaling down of commitments in order to look good, applying pressure for inefficient sectoral policies, taking advantage of unexpected but favourable external conditions that lead to better scores, and finally to defending one's performance in relation to scores that are worse on a common, but irrelevant, scale. Government can achieve far more through innovative policies and structures that enable understanding and purposive action at lower levels than through methodoligical gimmickry.

The MOU system, as implemented in India so far, unfortunately, provides for just that -- more memorandum than understanding. What is required is just the opposite.

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Table 1: Variance between the Recommendations of the Arjun Sengupta Committee and MOU implementation.

Dimension	Committee	Implementation
Scope and Purpose	- MOUs to cover only a few enterprises, especially core sector public enterprises (PEs) - Long-term policy evaluation and adjustment in the light of the extent to which the understanding was fulfilled. Annual evaluation to be made available for plan discussions for next year and to Public Enterprises Selection Board (PESB)	- MOUs to cover to all PEs gradually; 11 in 1988-89 and 18 in 1989-90, and 33 in 1990-91 - Rank all PEs on annual performance and clarify why any obligation undertaken in the MOU could not be discharged; Incentives to enterprises based on composite score
Who evaluates?	A group constituted by the administrative ministry with representatives from Ministry, Planning Commission and Bureau of Public Enterprises (BPE).	- A committee chaired by Cabinet Secretary, and consisting of Secretaries from Finance, Planning Commission, Programme Implementation and chairman of the Bureau of Industrial Costs and Prices. Chairman/ Managing Director from a PE other than the one evaluated and other eminent persons may be coopted. - Addl. Secretary BPE will be the Secretary to this Committee.

Dimension	Committee	Implementation
Methodology of Evaluation	A general set of criteria based on common objectives covering four areas -- financial performance, productivity and cost reduction, technical dynamism and project implementation -- involving about 10 indicators for core and a smaller number for non-core sector enterprises	- A composite score for each PE - BPE, with the help of a consultant, will devise Key Result Areas, weights, and grading rules for arriving at a composite score for each PE
Government Enterprise Relations	- Reduce breadth and frequency of interaction between Ministry and PE; - Do away with detailed current MIS & Planning Commission's quarterly review meetings quarterly review meetings - Current reporting of production by DGID units and on progress in projects costing more than Rs 100 crore to continue.	- Existing interaction between PE and ministries to continue - Evaluation by a superior governmental body, which can put pressure on both the Ministry and the PE.
Differences in Evaluation by type of PE and level of hierarchy	- Differentiated - Ministry to monitor on a few indicators. The method and nature of evaluation to vary between core and non-core PEs, special tasks assigned to PE, profit making and non-profit making PEs - Detailed monitoring linking cost or profit centers to be left to the holding/Apex Company	- Uniform - Detailed monitoring of annual physical and financial indicators of production, indices of productivity and project management by high powered committee - Monitoring by Ministries on the same methodology as the high-powered committee on a more frequent basis quarterly or monthly - Corporate office of some PEs monitor their heads of activities (SAIL & STC with plants and overseas branches respectively) on separate MOUs.