Experience With Performance Contracting: A Survey

How to improve performance and achieve better economic efficiency has always been an important question in regard to management of state-owned enterprises (SOEs). Though public enterprises have been set up in different countries for a variety of purposes, how to choose the right instrument for interface between the owner and the management of the enterprise and the stakeholders has remained an issue of considerable interest to all the governments. Almost inevitably, the solution has been found in selecting a desirable management control system for the SOEs. Often the search for the proper control system has ended in the choice of performance contracting as the compatible system.

Performance Contract (PC) or Memorandum of Understanding (MOU) as we know it in India, is not unique to this country. It made its first appearance in France as a sequel to the famous Nora Report. Subsequently, the French Performance Contract System spread to some of the Francophone African countries. It was in the decade of the 1980s that the idea really caught on and a number of countries introduced the system for their state-owned enterprises. This period also saw the introduction of a new system of performance contracting which came to be known as the signaling system. Pakistan and South Korea were among the first to adopt this new system. At present, in nearly fifty countries, the PC is being practiced in one form or the other.

There were a few things which were common in the countries that introduced the PC system. In all the countries, the SOEs were established as a deliberate policy option. In most cases they were set up as an instrument to give effect to the policies of the State. Again, generally, creation of SOEs was thought to be an efficient way to bridge the huge gap - both technological as well as economic - that existed between the industrialized countries and the newly independent nations. Finally, almost universally the SOEs were created based on economic rather than on commercial justification.

This distinction between economic and financial justifications has important bearing on measurement of performance. It is one of the ironies that while evaluating SOE performance recourse is taken to an accounting system that judges performance solely on the criterion of financial profit.

It should therefore not come as a surprise that when these SOEs could not live up to the expectations with which they had been created and run into various problems, things were sought to be put in order through the adoption of a common management tool, i.e., performance contracting. In most of the countries, a long time has now passed since the introduction of PC system. It is therefore time to take a hard look at this policy and find out how far it has been able to meet the objectives. In the present chapter, we undertake this task by surveying the way PC has been functioning in some of the countries. The focus here will be on assessment of the system and not on its structure and design.

China: The Experience With Contractual Responsibility System

In China, the SOEs functioned under a rigid and cumbersome system. The management of the enterprise had no autonomy to decide on any matter, even on most trivial matters. What, where, when and how to produce was decided by the planning bodies and communicated to the managers of the SOEs. If the SOEs needed to borrow money from the bank, they had to do it from the designated bank at the designated time and for the designated amount and at the designated interest rate. Moreover, the SOEs had no claim on profit. It had to be handed over to the government. The control of the central organization was so complete that even in a basic task like R&D the enterprises had no role. The job of R&D had been assigned to specialized institutions.

The system was further complicated by the existence of two parallel management teams at the top, one appointed by the government and the other by the ruling party. Inevitably these rigidities and complex management systems gave rise to contradictions and conflicts which affected growth. The SOEs, in fact, were not business entities but mere production units. Thus in the wake of the macroeconomic reforms introduced in the 1970s, the SOEs were practically overtaken by the unfolding events and the management of the SOEs found themselves grossly inadequate in meeting the challenge posed by reforms from within their existing framework. SOE reforms therefore became inevitable and were viewed as the "central link" in the task of integrating the SOEs with the liberalized market economy.

Briefly, SOE reforms in China have so far passed through three phases. The first phase started in the late 1970s and lasted till the middle of 1980s. This period coincided with the period when the general principles of economic reforms were laid down and "socialist commodity economy" was announced as the overall policy objective of reforms. As a first step toward giving a "market orientation" to the SOEs, the SOEs were released from being bound by the rigidities of the policies of the planning bodies. SOEs were delegated some powers to run the enterprises on business principles. Among other things, the delegated power included the right to retain certain part of net earnings for reinvestment. This was an important departure from the earlier practice of SOEs having no claim whatsoever on profit.

The second phase started from the middle of 1980s and lasted till the early 1990s. It was during this phase that the Contractual Responsibility System (CRS) was introduced among the SOEs of China. The CRS had been tried out as an instrument for introducing reforms in
the farm sector nearly a decade earlier
and had proved highly successful. To
begin with, CRS was first introduced
only in a few selected enterprises.
When it was found to be successful in
these enterprises, CRS was extended to
cover all the SOEs. The most important
development during this period of
reform was the widespread acceptance of
the principle of "separating manage-
ment from ownership."

The third phase of reforms started in the
care 1980s and can be said to be
continuing at the present time. There is
a subtle shift in policy initiative during
this period. The "socialist com-
modity economy" of the first phase has
now been replaced with "socialist mar-
ket economy." The essence of SOE refor-
mal has shifted over to so called "modern
enterprise system" which aims at
 corporatisation of the SOEs (but not
privatisation).

The most notable outcome of the
reforms programmes in regard to SOEs,
has been the change in the approach to
the management of public enterprises.
Most SOEs have succeeded in
negotiating the transition from a
controlled economy to a competitive
and open economy. Consciousness
about quality of a product, profitability,
human resource, marketing etc. has
grown significantly since the
introduction of reforms. However,
China's SOEs are still faced with many
problems and difficulties. A majority of
them are far from competitive in an
economy which is fast getting integrated
with the global economy. Nearly half of
the SOEs are making losses either
explicitly or implicitly.

Contractual Responsibility System

The contractual responsibility system,
as already noted, was first introduced in
the farm sector which resulted in the
release of large productive potential
which had been unrealised for many
years. The success of the system
prompted the leadership to adopt it as a
model instrument for reforming the
public sector. In 1981, Capital Iron and
Steel Company signed the first ever
contract. As the experiment in the few
SOEs where it was carried out proved
immensely successful, in 1987 it was
decided to extend the system to the
remaining enterprises. The enactment of
the "Provisional Regulations for the
Implementation of the Contractual
Management System in State Owned
Enterprises" in February 1987, paved
the way for the SOEs to exercise
contractual management which was
based on legal foundation and
authority. From then until recently, this
system has been serving as the main
management pattern for SOEs.

The peak period of CRS was between
1987-92, when it covered practically all
the public enterprises in almost every
sector including manufacturing,
construction, foreign trade, transport and
communication. From 1994 CRS is no
longer considered as the major national
polic on enterprise management.
Instead, the focus is shifting to
management of public enterprises
through fiscal instruments. The Chinese
SOEs are now being required to pay
taxes from their revenue. New contracts
are being made only with SOEs which
have public service goals or make little
profit, accounting for two to three
percent of all public enterprises.

Objectives of CRS

The objectives of the CRS were
twofold:
1. Separation of ownership and
management of an enterprise by
means of a binding contract.
2. Integration of the SOEs both with
the emerging "socialist market
economy" as well as with the
global economy.

In addition to the separation of
management control and ownership,
CRS also addressed the issue of
improving internal management of
enterprises. After the management
signed a contract with the government,
the management in turn entered into
contracts with the sub units within
the enterprise. A contract was signed
with every division, department, plant
and workshop so as to make sure that
each one of them was aware about their
responsibility toward fulfilling the
agreement reached with the government
by the enterprise. The heads of the
units on their part concluded
contracts with each employee under
their charge.

Structure of the CRS

The CRS defines the obligations, rights
and claim to profit for the contracting
party. For the duration of the contract
the management of the SOE has the
freedom to handle the business
independently and is responsible for any
gain or loss.

There are four types of CRS, which vary
according to the nature of sharing profit
among the contracting parties.

i) The enterprise is held responsible for
turning over to the State a fixed amount
of profit and can keep the rest. This
method is applied to those enterprises
or sectors producing basic necessities at
a low rate of profit, which are in bad
shape and need support urgently.

ii) The enterprise is held responsible for
turning over to the State a fixed amount
of profit and a proportion of the remainder.
Both the enterprise and the State, share
the excess profit between them.

iii) The enterprise is held responsible for
any loss in profit over the target. If its
loss is less than the target, the difference
can either be shared or wholly kept by
the enterprise.

Performance Parameters

The CRS usually include one or more
of the following performance parameters:

(a) Target profit (or loss) and handed
over profit
(b) Net worth of the enterprise and rate
of return

c) The value added

d) Amount of capital to be reinvested for upgradation, expansion and technical innovation.

Apart from the above, for which specific targets are set in the CRS, performance is also checked and examined for factors like creation of brand name products, product development, product quality, safety measures, etc. Under the CRS the remuneration and benefits of enterprise management are linked to the performance parameters and if any enterprise fails to turn over the contracted amount of profit to the State it has to make up the deficit form its own reserve. The contracted base amount of the handed over profit is determined through negotiation between a group of relevant government departments and the enterprise. The starting point for negotiation is the last year's profit or dividend. Where profits are very variable, an average of last two to three years is used. Allowance is made for location of the enterprise its capital stock etc.

Assessment of the CRS

The most notable aspect of China's Contractual Responsibility System is that the policy itself had a predetermined goal to achieve. Thus once it was felt that the stated objective of integrating the SOE's with the new economic policy has been achieved in most of the enterprises from 1994 CRS was no longer considered as the major policy initiative. This is in sharp contrast to the PC system practiced elsewhere in the world. In most cases after the introduction of the system it has been allowed either to linger on without any clear cut role or purpose or, just to wither away with time. This has happened in places where the policy itself had no clarity of objective or where the policy makers had not been able to make up their mind whether the PC system was intended as a precursor to privatisation or an alternative to it.

The CRS helped bring about a new enterprise management system with a Chinese character. Essentially the contract system helped to integrate responsibility, authority, and benefit through an internal sub-contract system.

In the former highly centralised system of economic management the SOEs had no authority to make decisions and were in position of "do as told by those above" position. The CRS made a significant difference in the relationship.

It introduced a mechanism by which the SOEs got the power to raise resources from the market to meet their financial needs. At the same time it released the government from the burden of having to look for resources for the ever increasing needs of the SOEs. Simultaneously by ensuring an assured sum of profit for the owner CRS resulted in a steady revenue for the exchequer.

Though CRS resulted in greater financial autonomy for the SOEs it could not achieve complete separation of management rights from ownership as it could not alter to a great extent the mind set of "master and servant" relationship that prevails in the Chinese bureaucracy. Thus, for example, though under the contract system an enterprise has the right to sue the government in case of failure on the part of the government to meet its commitment, in practice no manager could actually do this.

The CR system suffers from the familiar weakness of absence of any accountability on the part of the government for failure to fulfill its commitments. While managers are liable to punishment (including loss of a job) for failure to meet their obligations under the contract, the Government never gets penalised for its failure. Therefore to the SOE managers CRS often appears to be an oddity and unfair.

The Chinese obsession to be thorough in every thing has made CRS an inflexible system. Though the idea of sub-contracts within the enterprise is a laudable one, the outcome to which this idea has been stretched is ridiculous and unproductive. By binding every person to a "target" it has encouraged short term behaviour. A person, division or plant is interested in meeting their "target" at the expense of all other considerations. It has also encouraged in documenting in the minutest details' rules, internal regulations, by laws, job description etc. At the end these enormous documents have only succeeded in confusing the issues rather than provide goal clarity which must have been one of the objectives in the first place. After all an enterprise can never be managed well by rules. At the enterprise level, the inflexibility of the system has led to an overriding preoccupation for maximisation of current profits, even at the cost of future growth of the enterprise. Long duration of the contracts (generally for three to five years) further complicated the matters. The targets were negotiated only once and no renegotiation was permitted. The rigidity so introduced failed to address the problem of uncertainty that any market driven economy necessarily has to contend. Sometimes it resulted in windfall profits for the enterprise but government could derive no benefit out of it since under most of the contracts it had no claim over the additional profits. At other times the enterprises had to dig into their reserves to meet the target of "handed over profit".

The problem of short term behaviour fostered by the CRS could have been minimised if the CRS did not place such an overwhelming emphasis on financial performance. In the CRS there are practically no targets for dynamic performance parameters. That is, such parameters the investment on which does not bring profit in the current period but several years later. The manager who is under pressure to meet current year's profit target would rather utilize the plant and machinery as to maximize profit. Particularly when the manager's pay, emoluments and future employment are dependent on the volume of profit earned he has every incentive to postpone expenditure on maintenance of plants, training of personnel and such expenses which will deplete profit during his tenure and bring in profit at a later time when someone else will be in charge.
If one has to make an overall assessment of the CRS the conclusion that can be drawn from the foregoing analysis is that CRS has been successful in spurring the SOEs to adopt commercial principles while running public enterprises, which indeed was the principal objective of the CRS.

Pakistan: Experience With Signaling System

The signaling system of Pakistan and MOU system of India are similar. Both the systems follow the five point scales for criterion variable, the criteria are assigned weights to reflect their importance between the performance parameters and at the end of the year the performance is evaluated based on a composite score which is calculated by multiplying the assigned target weight for each criterion by the points for the grade obtained. The goal of both the systems is "autonomy with accountability". However, the signaling system has certain special features which need to be mentioned.

Under the administrative control of the Ministry of Production a special unit, the Expert Advisory Cell (EAC) was set up in 1980 for monitoring and evaluating the performance of industrial public enterprises (IPEs). The EAC was given the responsibility for operating the signaling system or the performance evaluation system. The system has three components:

(a) Performance evaluation system
(b) Performance Information system
(c) Performance Incentive system

The system, as originally conceived, provided for "public profitability" (at constant prices) as the basic performance parameter. The concept of public profitability was supposed to be superior to private profitability, as it judged profit on the basis of the social contribution of the enterprise. The system also envisaged that public profit would be further adjusted to take into account the costs of any non-commercial, social objectives that might affect performance. However, both the concepts did not meet with favour within the government. The principal objection was that with an inbuilt incentive system, the signaling system was likely to send wrong signals by awarding incentives to the managers of loss making enterprises. This, they argued, was possible due to the adjustments that one made in the private profit for arriving at the public profit. The Finance Ministry was not convinced by the argument that public profitability alone could assess the extent of social gain and therefore ensure fair assessment of performance. Therefore the EAC uses profit after tax as the principal criterion adjusting it for certain other criteria representing social benefits, e.g., energy conservation, factor productivity, cost control, etc.

The EAC evaluates the performance at the end of the year and calculates a composite index of performance. Based on this index the enterprises are graded into different groups. The rewards are approved on the basis of grades according to the following schedules:

<table>
<thead>
<tr>
<th>Grade</th>
<th>Reward</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excellent</td>
<td>3 months' basic salary</td>
</tr>
<tr>
<td>Very Good</td>
<td>2 months' basic salary</td>
</tr>
<tr>
<td>Good</td>
<td>1 months' basic salary</td>
</tr>
<tr>
<td>Poor</td>
<td>15 days' basic salary</td>
</tr>
<tr>
<td>Unacceptable</td>
<td>Nil</td>
</tr>
</tbody>
</table>

There is no reward for the managers of the loss making units even if they succeed in reducing losses.

The system is not applied to all the IPEs. The chronic loss makers and the sick enterprises are not either included or excluded from the system once it has been established that they cannot be turned around. Currently the system covers only 36 operating units.

Assessment of Signaling System

The system was introduced in Pakistan in 1983-84. Since then, a number of studies have been carried out to determine the impact of the system on the enterprise performance. The earliest and perhaps, the most comprehensive, study was undertaken by the World Bank. The study covered 12 enterprises and analyzed their performance for the period 1983-86. It was based on quantitative measures and qualitative evidence. The study tried to answer two issues, namely, did the system succeed in achieving its stated objective of improving private financial profit and secondly, did it result in any efficiency gain, which was an underlying assumption of the system.

The study found it impossible to establish a link between the performance changes and the signaling system, it therefore tried to examine other explanations for performance to see if they left room for the system as a factor. The factors examined were, pricing, macro economic changes, changes in management and changes in the market. Of the four factors, pricing policy was the only one that definitely affected the extent to which achieving private profit targets requires SOEs to improve efficiency. Trend in public profit did not show a strong correlation with growth in GDP thus indicating that macro economic changes perhaps did not have a strong bearing on enterprise performance. Similarly, increased competition was not a major factor explaining the improvements in efficiency, but it was a reason for the deterioration in results in some cases. Lastly, changes in management did bring about some efficiency gain. These changes were caused by a variety of reasons in which the signaling system played an important role.

The study therefore concluded that since the other explanations could not fully

---

1 Public profit is calculated as follows:
Public profit = Profit after tax +
tax-adjustments + depreciation + (Non-operating income) - Opportunity cost of working capital + adjustments (social adjustment account)
Public profitability = Public Profit / Operating fixed assets


3 Ibid, Page 233
justify the efficiency improvement the argument that the improvement was, at least partially, caused by the signaling system cannot be ruled out. The study also added that, however, it (the preceding argument) was not fully persuasive because the targeting system was not really measuring efficiency and the system was operating under a number of constraints on its capacity to influence efficiency. Nevertheless, the system may have affected efficiency even though it was not measuring it. In sum, despite its flaws, the system seems to have had a positive impact on efficiency, an impact that was intimately linked to other changes in the SOEs managerial environment.

A later study, which also combined quantitative and qualitative methods to identify the impact of the signaling system on SOEs performance, came to the conclusion that the system in Pakistan at best has been a qualified success. The expectations that the system gave birth to at the time of its initiation have remained unfulfilled to great extent. Ironically, Masud finds that to a large extent the government failed to appreciate the full potential of the system, was responsible for this unhappy outcome. He feels that the system had the capacity to increase productivity gains, to which the government paid very little attention. Nor did the government make any attempt to use the large volume of information thrown up by the system to review the macroeconomic policy framework. All this led Masud to conclude, “the logical consequence of this seeming apathy is that the system has been reduced to routine reporting exercise.”

Performance Contracts: The Sri Lankan Experience

Sri Lanka experimented with the PCS system (PCS) only for a very brief period. In 1991 two enterprises, namely, Sri Lanka Tyre Corporation and Ceylon Leather Products Corporation were selected for the purpose. However, with the privatization of both the enterprises in 1993 the system was not tried out in other enterprises.

Sri Lanka adopted the signaling system for designing the PCS for the two enterprises. Like the Indian system the PCS were finalized through a process of negotiation between the chief executive of the enterprise and the government. The designs of the PCS were somewhat lopsided with the entire focus was on financial performance (90% in the case of Sri Lanka Tyre and 97% in Ceylon Leather) and very little attention was paid to dynamic factors. Human resource development was the only dynamic performance criteria included in the PCS. It is quite possible that the designs of the PCS were influenced by the ultimate objective of privatization that the policy makers had in mind in respect of the two enterprises, in which case the short term goal of improving financial performance made good business sense. However, since the private market system was not created to create alarming situation in the post privatization period. Sri Lanka Tyre which achieved the targets agreed in the PCS was obliged to pay three months’ bonus to the employees. The company continued to pay bonuses at the same rate after privatization as well. Though the PCS system itself had been abandoned by then. Thus payment of a bonus got institutionalised after the introduction of the PCS while retaining no link with labour productivity.

The PCS system did not make much of a headway in Sri Lanka. The short duration for which it was in operation had, perhaps, not prompted any evaluation of the impact of the policy on enterprise performance. Dheerasekara and Knight-John trace the truncated life of the PCS in Sri Lanka to the lack of political commitment. Even when privatization of SOEs is the only objective, it needs to be appreciated that the process of divestiture is usually a lengthy one. In the interim, performance contract can be immensely valuable in achieving the short term goal of improving the net worth of the enterprises earmarked for privatization. This enables the government to fetch a better price for the divested firms. Thus, performance contracting should not be viewed as an alternative or competitor to privatization. On the contrary it is complementary to privatization. Dheerasekara and Knight-John feel that the Sri Lankan government was not able to pursue the policy of gradual divestment because it was under pressure from the donor institutions to complete the privatization programme.

The Performance Agreement System of Thailand

Thailand is the latest entrant into the PC community. The Thai Cabinet approved the introduction of the system in June 1995. The Performance Agreement (PA) system introduced in Thailand is similar to the Signaling system. The outcome of the state enterprises performance is evaluated on five point scales. The Cabinet has also approved an incentive scheme based on performance. The Office of the Auditor General is responsible for administering and implementing the system.

Most of the SOEs in Thailand are in the service and infrastructure sector like, electricity, transportation, broadcasting, education, trade, banking, etc. Several of the SOEs are in the nature of departmental undertakings but have their own identity complete with Governing Boards and independent budgets.

---

1. Ibid page 297. Parenthesis comm.
3. Ibid. p. 9
The PA system will be applied to all the 53 enterprises by 1998. Seven SOEs had entered into performance agreement during 1995. Seventeen more enterprises signed in 1996.

In order to design appropriate PA and incentive formula the SOEs have been divided into four categories.

**Category 1** State enterprises which are operating in the competitive market along with the private sector fall under this category. At the moment there are 29 such enterprises, these are Thai Airways and Krung Thai Bank Ltd. These SOEs select performance indicators and employ incentive in conformity with the industry norm.

**Category 2** This category is made up of enterprises which are natural monopoly and which the Government intends to privatise in the long run. The SOEs under this category employ incentive system and select performance indicators similar to “Good Enterprise System” by adjusting some of its features to match the nature of operation of the SOE.

**Category 3** There are two types of SOEs under this category (a) SOEs under price and service control and running in losses, e.g., State Railway of Thailand and Bangkok Mass Transit Authority, and (b) SOEs that do not belong to (a).

**Category 4** Non-commercial enterprises are covered under this category. The incentive system and criterion values for these enterprises are agreed in the PA.

The performance of the enterprises is evaluated for the following six aspects:

1. Financial efficiency
2. Physical efficiency
3. Quality of service
4. Project implementation
5. Quality of strategic plan
6. Quality of management

There are two committees to implement and oversee the PA system. Both the committees have a subcommittee each under them. The Performance Agreement Committee (PAC) has been set up under the Permanent Secretary for Finance. The PAC comprises of 11 members six from private sector and five from government. This committee is responsible for negotiation PA, evaluating performance and improving the PA system. The PAC reports to the Follow-Up Committee. The Follow-Up Committee under the Prime Minister is the apex body. This committee is the policy making body. It also undertakes monitoring of performance and setting the criteria for performance evaluation.

An unique feature of the Thai PA system is that the task of implementing the Performance Evaluation process by gathering data, analyzing data and rating each SOE's final PA has been entrusted to a private agency - Thailand Rating and Information Services (TRIS) which is Thailand's premier rating agency.

An interesting feature of the PA system introduced in Thailand is that the PA is signed on behalf of the Government by the Permanent Secretary of the Finance Ministry and the line ministry. This is an interesting innovation which tries to remove one of the weakest elements of the PC system - the inability on the part of the enterprises to get the government to fulfill its obligations under the contract. Many a time the government obligations are in the nature of budgetary support, investment approvals, foreign equity participation or other measures on which the decisions ultimately rest with the Finance Ministry.

In situations where the PC is signed by the secretary of the line ministry alone, when failure takes place on the part of the government to meet its obligation the administrative ministries plead their inability and place the onus on the Finance Ministry.

**Some observations on the PA System**

It’s too early to make an assessment of the impact of the PA system in Thailand. A few observations on the design of the system however, may be in order.

All PA’s are cast in standard format of six performance parameters. While standardised format may be useful for making presentations to superior authority in respect of PA, it may give rise to certain contradictions or inconsistency. Some of these criteria may have no applicability in certain enterprises yet the enterprises may include them in their PA because boxes have been provided for them. For instance, an enterprise in the financial services sector may have no use for the criteria “Physical Efficiency.” Similarly “Quality of Strategic Plan” may not be relevant for all the enterprises. A general format might be useful as a broad indication, however, it should not become a rigid pattern. Each PA must be extremely specific and the aspects to be covered through performance indicators could vary from case to case.

Quality of management is one of the factors on which performance of the enterprise will be evaluated. Since the PA system as a whole is intended to measure management performance, it seems excusing to include a specific indicator measuring it. Moreover, having emphasised that the PA system is a result-oriented system, there seems to be a contradiction where a process such as management style is evaluated.

**The Performance Contract System of South Korea**

South Korea was among the first Asian countries to experiment with a performance contract. The immediate cause for introduction of the system was the apparent decline in performance of the Government Invested Enterprises (GIEs)\(^9\).

The first performance evaluation system in South Korea was introduced in 1968. Under the system it was rather difficult to measure performance as the target was based on the budget. Consequently,

\(^9\) The SOEs in South Korea are classified into two categories; central government owned enterprises and local government owned enterprises. The central government owned enterprises are further subdivided into government enterprises (GE), government sponsored enterprises (GSE) and subsidiaries of GIEs. The FC system concerns only the GIEs.
the system had little impact. A new evaluation system was introduced in 1973 which made several changes to the then existing system. The most significant change was an annual incentive bonus ranging from 50 percent to 200 percent of the monthly salary was tied to the evaluation results. "However, the new system proved to be inefficient because most of the enterprises ultimately qualified for the maximum bonus due to lack of discipline in implementing the system." The performance of the Korean GIEs continued to be poor. Therefore, in order to overcome the problem, in 1984 the GME Management Act which outlined a comprehensive SOE reform package was enacted. The central motive of the Act was greater SOE autonomy with accountability. By thus reducing governmental interference, the Act helped to improve the performance of the enterprises. For this purpose the Act introduced a new performance contract system whose features are akin to the signaling system. The Indian MOCG system and the Korean PC system have many similarities as also a few important dissimilarities (see box).

Measuring the performance of the public enterprises has never been an easy task. The Korean GIEs put emphasis on achieving public goals as well as financial goals, because these are established to meet public interests. Even if financial profitability is another management goal of GIEs, it is a means to achieve public goals rather than the ultimate goal itself. The Korean Government directly determines the major public goals of GIEs every year for the following year and evaluate the degree of achievement. However, in the case of SOEs financial performance are very different from those of the private enterprises. In the case of Korean GIEs financial profitability goals is evaluated on the basis of constant prices which adjust the items to revenue and cost. The emphasis on financial performance varies according to the characteristics and nature of the GIEs' business. Manufacturing enterprises lay more emphasis on financial profitability, but public service organizations like, South Korea Trade Promotion Corporation, place more emphasis on public goals.

In South Korea, the method of absolute targets and trend targets are largely used in the assignment of performance targets for quantitative indicators. Absolute target values are given to the indicators which the government uses to encourage GIEs to achieve public goals in terms of quantity or completion rate. On the other hand, some targets like financial profitability, may be assigned by observing performance trends. Specifically, in cases where indicators have some limitations on improving performance, the targets are generated by analysis of past trends which give more weight to the most recent performance.

A financial parameter, which is evaluated on the basis of profit before tax and interest, is the major indicator of performance. In addition the system also puts emphasis on evaluation of management achievement. The performance criteria in this respect are divided into four sections: comprehensive management, major business, efficiency of management and business administration. Comprehensive management is evaluated either quantitatively or qualitatively and usually carries a weight between 10% and 20%. The emphasis is on measurement of management's efforts at improving the efficiency of the operating fixed capital and the top management's effort for responsible management. For measuring 'major business', the indicators are enterprise specific and performance is evaluated either quantitatively or qualitatively, the weight is in the range of 38% to 49%. Efficiency of business management is measured through business management expenses, personnel expenses, funds management, cost of sales management etc. These indicators are measured quantitatively. Finally, for measuring business management, the indicators that reflect efficiency and rationality of the business supporting system are mainly evaluated with a weight of 25% to 28%.

The performance criteria of each GIE consist of the common criteria and the GIE specific criteria. The weight of the common criteria is about 65%.

Assessment of the Korean PC System

The Korean system has been the subject of a number of evaluation. The seminal work in this respect is that of Daeh Hee Song. This study was undertaken four years after the introduction of the PC system. The study measured the effectiveness of the Korean system by two different methods: one by opinion poll and the other by a consumption estimation of the cost reduction. Song's study found that from the point of performance, evaluation score and the grades obtained by the enterprises on this basis, the performance of the SOEs had begun to decline. Similarly the number of default enterprises and its size had substantially reduced since the introduction of the new policy in 1983.

The results of the opinion survey of 750 employees of 25 SOEs covered by the new policy presented some interesting outcomes. The survey was conducted through a questionnaire and the respondents were distributed into five classes, namely, executive director, director, department chief, assistant department chief and workers. Since the sample of employees covered in the survey had experienced both the pre and post 1983 public enterprise control systems, the group was in the ideal position to tell whether the new policy had any effect on SOE performance. The highlights of the study are:

- Across all classes, 64% of the respondents agreed that the overall management had improved since 1984.
- Majority of respondents believed that there had been drastic change in the behaviour of the top management and in the work attitude of the workers.
- Service quality and R&D activities
also were perceived to have improved after the introduction of the PC system.  

- 55% of respondents felt there was improvement in budget management, procurement and contract management and in the management of long term planning and strategies.  

- On the issue of personnel management, only 29% thought that there was improvement, while 15% were of the opinion that it had worsened, the remaining was undecided about the outcome.  

In order to measure the overall cost effectiveness of the new policy, Song compared the ratio of total cost to total revenue (RCSTR) of the two periods. The differences between the two RCSTR were assumed to be the impact of the policy. The study found that in most cases the RCSTR in the post PC period was lower than the estimated RCSTR which implied that the impact of the new policy was universally positive among Korean GIEs. The study estimated that the cost savings rates of RCSTR for all the 25 GIEs went up from 3% in 1984 to 5.4% in 1986.  

On the basis of his study Song concluded that the impact of the new Korean public enterprise policy the efficiency improvement of public enterprises was found to be substantial.  

\[ \text{\dots and management efficiency improved at least during the first three years under the new policy.} \]  

Dae-Hee Song’s second study analyzed the impact of the Korean PC system on the performance of the GIEs by observing the changes in the behaviour of various performance parameters. The study made the following observation:  

- Financial performance of the GIEs improved after the introduction of the system. Profits net of government transfers grew by about 10% in real terms between 1983 and 1986.  

- Real profits net of transfers of GIEs also increased by 10% during the same period.  

- Public profitability showed a dramatic improvement after the introduction of the PC system.  

- The ratio of cost of sales to total revenues in constant prices was found to have improved more than what was expected. There was also a striking consistency in the improvement of this parameter over different sectors,  

- the reforms made a distinct impact on the way the GIEs carried their business. Government intervention had been curtailed, managerial appointments were being made from within the enterprises and performance evaluation played an important role in the GIEs own assessment of its plans and personnel.  

A similar kind of analysis on the impact of the Korean PC system on enterprise performance has been done by Il-Sup Kim & Hwa-June Cho. The study covers the period 1984-1991. A comparison of performance before and after the new system is made to show the influence of the new system. This study confirms the conclusion made by Song. The financial as well as qualitative parameters show an unmistakable improvement in the post PC period.  

**The Contract Programme of Morocco**  

Morocco has notable experience with Contract Programme (CP). They were first introduced in 1982 as a possible solution to the problems of coordination and control of public enterprises. Since then a number of contracts have been signed, some have been renewed and others allowed to lapse. The CPs follows the French system.  

Morocco’s portfolio of public enterprises is quite broad based and covers almost all the sectors of the economy, including electricity generation and distribution, water treatment and distribution, energy, construction, telecommunication, health, transportation, mining, agriculture, fisheries and manufacturing. However, despite the spread the importance of public enterprises in Morocco’s economy is limited. In 1994, the approximately 800 SOEs accounted for 12% of GDP, 12% of wages and salaries and only 6% of the urban formal sector labour force. About a third of the 130 large SOEs were showing losses in 1994. Overall SOEs recorded a loss equal to 0.7% of GDP.  

The commonly observed problems found in most other countries also afflicted Morocco’s SOEs. “Inefficiency and poor performance are terms that can clearly be used to describe the state owned firms.” The genesis of these problems can be traced to the combined regime of administered pricing, SOE monopoly, slack control, high level of State arraers, poor management, accounting and auditing practices. This situation was made worse by the inability of the government to enforce any form effective monitoring of SOEs performance which left it incapable to either reward or punish the SOEs management and staff.  

Viewed in the light of the problems just mentioned, the introduction of the CP was anticipated to herald a new era in SOE management. The enterprises as well as the government saw in the CP a panacea that would solve all their problems. Each, however, had different reasons for their optimism. The government expected to solve the vexed problems of coordination, control and interface with SOEs. The government...  

**Footnotes**

12 Dae-Hee Song, _Op cit_, p. 36.  
felt that with a bonus system built in with the CP, it would be easier to put in place a system of reward and sanction for the SOEs management. There was also the hope the CP would foster the spirit of competitiveness among the SOEs which will make the task of adjusting to a liberalised economy less painful for the SOEs. The SOEs on the other hand were more enthusiastic about CP because they felt that CP would lead to a solution to the problem of arrears. It will also provide them a safeguard against unwanted interference of the administrative ministries as well as force the government to compensate the SOEs for socially or politically imposed burdens.

Morocco used two types of contract programmes. The simpler one called protocole d'accord (draft agreement) limited the agreement to few select indicators such as budget as a proportion. The more detailed contract, called contrat-programme (contract programme) examined a wide range of problems, proposing an equally wide range of solutions. In some cases, the protocole d'accord preceded the contrat-programme. The preparation and negotiation process of CP are usually rather long. They typically take between one and two years. The negotiation meetings very often get bogged down by contentious issues which are often easy solutions. Some of the issues that frequently cropped up were:

- Compensation to SOEs for any socially or politically imposed obligations;
- Level of financial support to the SOEs from the government through the budget allocation of the government;
- Payment of arrears to the SOEs;
- Revision of administered prices;
- Autonomy to SOEs to borrow from abroad;
- Nature and degree of financial control to be exercised by the government;
- Technical control of the SOEs by the administrative ministries;
- Choice of performance parameters.

Assessment of the Moroccan System

The programme ran into problems almost from the beginning. Whereas one of the objectives of the CP was set as replacing a priori financial controls with a posteriori management control, the Ministry of Finance took the position that strong a priori financial control was not only an absolute necessity they should, in fact, be further reinforced. The difference in perception, as mentioned, of the government and the SOEs regarding what the CP system was supposed to achieve, also led to conflict. The SOEs held the view that CP could be introduced only after settlement of prior arrears that were owed to them by the government and other public enterprises. The Ministry of Finance on the other hand wanted to make CP the basis for settling arrears. Differences also arose on the question of treatment of forces majors conditions while evaluating SOE performance. Thus the first attempts to finalise contracts generally proved abortive. Only two contracts were signed, one in 1982 with Royal Air Maroc and the other in 1985 with CTM-LN, a large intervention bus company.

Around this time, however, a push for the introduction of CP came from an external source. By 1983, when the external debt ratio had climbed to 53%, the Government of Morocco realised that solution to the country’s problem was badly needed economic reform. The government therefore, undertook a macroeconomic stabilisation programme with the support of the IMF and a structural adjustment programme with the assistance of the World Bank. The World Bank provided a loan under the Public Enterprise Restructuring Loan (PERL) to assist the government’s efforts to stabilise the economy. Signing six CPs with named SOEs was a condition for the release of a part of the PERL.

During the past 17 years, since the introduction of CP, 18 contracts have been signed. On the positive side, the CP resulted in the efforts on the part of SOEs to maximise their autonomy and efficiency within the constraints imposed by the contracts. Wherever government control had been reduced streamlining of company decision making and reduction in bottlenecks resulted. The SOEs had more freedom to act when the government accepted the need to compensate the SOEs for imposed social obligations. Much of these positive gains is counter balanced by the weaknesses of the programme.

The long process it takes to finalise the contracts substantially reduces the importance of the system in the eyes of the participating parties. To negotiate contract issues over such a long period before coming to an agreement is viewed by the participants as having only marginal benefits. The effectiveness of CP has been compromised by the reluctance on the part of the government to fulfill its obligations under the contract. Although in many cases the contract had been signed by the Finance Minister, the officials of the finance ministry and those of other ministries as well, felt less bound by the clauses of the contract. The SOEs therefore are less interested to sign a second contract after the first one has lapsed. Furthermore, the CP did not lead to a reduction in control over the SOEs by the government. On the contrary by imposing extra reporting requirements for the financial controllers and supplementary "technical" control, the external control of the ministry got further reinforced. This served to discourage the SOE managers from wholehearted acceptance of the policy. Lastly, the CP was never linked to the general policy of liberalisation and market orientation. Due to all these weaknesses the overall impact of the CP policy has been less than satisfactory. The promise of a simultaneous solution to a series of problems that would benefit the government, the public enterprises and the consumers have not been met.

Conclusion

This concludes our survey of the international experience with the performance contracting system. The survey is by no means exhaustive. There are somewhere around fifty countries following the FC system and

16 Sandoz, op cit.
the present survey covers only a handful of them. The survey, however, serves the purpose for the objective in hand. It sets a perspective against which the assessment of the Indian MOU system could be undertaken. Before we undertake this task, it would be in order to summarise the lessons that can be drawn from the international experience.

The PC system is most successful when it is introduced as part of a public enterprise reforms package. This is seen in the early success of the system in China and South Korea. The experiences of Sri Lanka and Pakistan clearly indicate that as a stand alone policy PC can deliver only limited results. Perhaps it is also necessary to have an end date (or duration) when the policy should terminate, as in the case of China. In the contrary, the policy appears to lose direction and gets routinised. The problem of soft targeting tends to get endemic as the system gets older. The enterprise management becomes adept at negotiating the ‘right’ targets (as opposed to ‘fair’ targets). Consequently the performance evaluation of the enterprises suffers by categorising a large number of enterprises as high achievers and very few as poor achievers. This in turn affects the credibility of the system (cf. South Korea and Pakistan).

### Performance Rating for the Year 1996-97

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Public Enterprise</th>
<th>Score</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Cotton Corporation.</td>
<td>1.00</td>
<td>Excellent</td>
</tr>
<tr>
<td>2</td>
<td>Power Grid Corp.</td>
<td>1.07</td>
<td>Excellent</td>
</tr>
<tr>
<td>3</td>
<td>National Thermal Power Corp.</td>
<td>1.00</td>
<td>Excellent</td>
</tr>
<tr>
<td>4</td>
<td>Rail India Taxi Serv. Services</td>
<td>1.04</td>
<td>Excellent</td>
</tr>
<tr>
<td>5</td>
<td>Cochin Refineries Ltd.</td>
<td>1.04</td>
<td>Excellent</td>
</tr>
<tr>
<td>6</td>
<td>Bharat Petroleum Corp.</td>
<td>1.04</td>
<td>Excellent</td>
</tr>
<tr>
<td>7</td>
<td>Bhart Heavy Electrical</td>
<td>1.04</td>
<td>Excellent</td>
</tr>
<tr>
<td>8</td>
<td>Hindustan Petroleum Corp.</td>
<td>1.04</td>
<td>Excellent</td>
</tr>
<tr>
<td>9</td>
<td>Ferro Scarp Nigam Ltd.</td>
<td>1.09</td>
<td>Excellent</td>
</tr>
<tr>
<td>10</td>
<td>National Minerals Dev. Corp.</td>
<td>1.09</td>
<td>Excellent</td>
</tr>
<tr>
<td>11</td>
<td>National Industrial Dev. Corp.</td>
<td>1.09</td>
<td>Excellent</td>
</tr>
<tr>
<td>12</td>
<td>Power Transmission Corp.</td>
<td>1.02</td>
<td>Excellent</td>
</tr>
<tr>
<td>13</td>
<td>Indian Oil Corporation Ltd.</td>
<td>1.14</td>
<td>Excellent</td>
</tr>
<tr>
<td>14</td>
<td>Gas Authority of India Ltd.</td>
<td>1.16</td>
<td>Excellent</td>
</tr>
<tr>
<td>15</td>
<td>Central Electronics Ltd.</td>
<td>1.17</td>
<td>Excellent</td>
</tr>
<tr>
<td>16</td>
<td>Shipping Corp. of India Ltd.</td>
<td>1.18</td>
<td>Excellent</td>
</tr>
<tr>
<td>17</td>
<td>Bharat Dynamics Ltd.</td>
<td>1.19</td>
<td>Excellent</td>
</tr>
<tr>
<td>18</td>
<td>Industrial Cloth India Ltd.</td>
<td>1.20</td>
<td>Excellent</td>
</tr>
<tr>
<td>19</td>
<td>India Trade Promotion Org.</td>
<td>1.23</td>
<td>Excellent</td>
</tr>
<tr>
<td>20</td>
<td>Modern Refineries Ltd.</td>
<td>1.25</td>
<td>Excellent</td>
</tr>
<tr>
<td>21</td>
<td>National Aluminum Co. Ltd.</td>
<td>1.25</td>
<td>Excellent</td>
</tr>
<tr>
<td>22</td>
<td>Rural Electrification Corps.</td>
<td>1.25</td>
<td>Excellent</td>
</tr>
<tr>
<td>23</td>
<td>Hospital Services Cons. Corp.</td>
<td>1.28</td>
<td>Excellent</td>
</tr>
<tr>
<td>24</td>
<td>Engineering Projects (India) Ltd</td>
<td>1.28</td>
<td>Excellent</td>
</tr>
<tr>
<td>25</td>
<td>Dredging Corporation of India</td>
<td>1.29</td>
<td>Excellent</td>
</tr>
<tr>
<td>26</td>
<td>Hindustan Coke (India) Ltd.</td>
<td>1.30</td>
<td>Excellent</td>
</tr>
<tr>
<td>27</td>
<td>Housing &amp; Urban Dev. Corp.</td>
<td>1.31</td>
<td>Excellent</td>
</tr>
<tr>
<td>28</td>
<td>Jindal Steel Ltd.</td>
<td>1.32</td>
<td>Excellent</td>
</tr>
<tr>
<td>29</td>
<td>Kirloskar Iron Ore Co. Ltd.</td>
<td>1.32</td>
<td>Excellent</td>
</tr>
<tr>
<td>30</td>
<td>Container Corp. India Ltd.</td>
<td>1.33</td>
<td>Excellent</td>
</tr>
<tr>
<td>31</td>
<td>SONA International Ltd.</td>
<td>1.38</td>
<td>Excellent</td>
</tr>
<tr>
<td>32</td>
<td>Bharat Telefilm Ltd.</td>
<td>1.38</td>
<td>Excellent</td>
</tr>
<tr>
<td>33</td>
<td>Hindustan Aerosol Ltd.</td>
<td>1.39</td>
<td>Excellent</td>
</tr>
<tr>
<td>34</td>
<td>Nuclear Power Corp. Ltd.</td>
<td>1.39</td>
<td>Excellent</td>
</tr>
<tr>
<td>35</td>
<td>Fertilizers and Chem. (T.) Ltd.</td>
<td>1.40</td>
<td>Excellent</td>
</tr>
<tr>
<td>36</td>
<td>Naga Oil &amp; Gas Corp.</td>
<td>1.40</td>
<td>Excellent</td>
</tr>
<tr>
<td>37</td>
<td>National Buildings Coop. Corp.</td>
<td>1.42</td>
<td>Excellent</td>
</tr>
<tr>
<td>38</td>
<td>Central Warehousing Corp.</td>
<td>1.42</td>
<td>Excellent</td>
</tr>
<tr>
<td>39</td>
<td>Videsh Sanchar Nigam Ltd.</td>
<td>1.43</td>
<td>Excellent</td>
</tr>
<tr>
<td>40</td>
<td>Hindustan Organic Corp. Ltd.</td>
<td>1.44</td>
<td>Excellent</td>
</tr>
<tr>
<td>41</td>
<td>Modern Food Incus. (I) Ltd.</td>
<td>1.45</td>
<td>Excellent</td>
</tr>
<tr>
<td>42</td>
<td>Wast. &amp; Pow. Cons. Serv. (UTC)</td>
<td>1.46</td>
<td>Excellent</td>
</tr>
<tr>
<td>43</td>
<td>Telecom Cons. of India Ltd.</td>
<td>1.47</td>
<td>Excellent</td>
</tr>
<tr>
<td>44</td>
<td>Hindustan Latex Ltd.</td>
<td>1.47</td>
<td>Excellent</td>
</tr>
<tr>
<td>45</td>
<td>Indian Airlines</td>
<td>1.49</td>
<td>Excellent</td>
</tr>
<tr>
<td>46</td>
<td>National Hydroelectric Power Corp</td>
<td>1.49</td>
<td>Excellent</td>
</tr>
<tr>
<td>47</td>
<td>Oil India Limited</td>
<td>1.52</td>
<td>Very Good</td>
</tr>
<tr>
<td>48</td>
<td>Cochin Shipyard Ltd.</td>
<td>1.53</td>
<td>Very Good</td>
</tr>
<tr>
<td>49</td>
<td>Hindustan Insecticides Ltd.</td>
<td>1.53</td>
<td>Very Good</td>
</tr>
<tr>
<td>50</td>
<td>India Tourist Development Corp.</td>
<td>1.53</td>
<td>Very Good</td>
</tr>
<tr>
<td>No.</td>
<td>Company Name</td>
<td>Grade</td>
<td>Assessment</td>
</tr>
<tr>
<td>-----</td>
<td>-------------------------------------</td>
<td>-------</td>
<td>------------</td>
</tr>
<tr>
<td>51</td>
<td>Hindustan Vegetable Oils Corp.</td>
<td>1.56</td>
<td>Very Good</td>
</tr>
<tr>
<td>52</td>
<td>Godrej India Ltd.</td>
<td>1.92</td>
<td>Very Good</td>
</tr>
<tr>
<td>53</td>
<td>Lubrizol India Ltd.</td>
<td>1.64</td>
<td>Very Good</td>
</tr>
<tr>
<td>54</td>
<td>Union Knitted Socks &amp; Eng.</td>
<td>1.50</td>
<td>Very Good</td>
</tr>
<tr>
<td>55</td>
<td>State Trading Corp. of India Ltd.</td>
<td>1.75</td>
<td>Very Good</td>
</tr>
<tr>
<td>56</td>
<td>National Handloom Dev. Corp.</td>
<td>1.83</td>
<td>Very Good</td>
</tr>
<tr>
<td>57</td>
<td>HCL Tech Ltd.</td>
<td>1.55</td>
<td>Very Good</td>
</tr>
<tr>
<td>58</td>
<td>Metallurgical &amp; Eng. Comb. (I) Ltd.</td>
<td>1.89</td>
<td>Very good</td>
</tr>
<tr>
<td>59</td>
<td>Sterlite</td>
<td>1.80</td>
<td>Very Good</td>
</tr>
<tr>
<td>60</td>
<td>Dabhol Power &amp; Port Ltd.</td>
<td>1.97</td>
<td>Very Good</td>
</tr>
<tr>
<td>61</td>
<td>Indian Steel Corp.</td>
<td>1.90</td>
<td>Very Good</td>
</tr>
<tr>
<td>62</td>
<td>Hindustan Zinc Ltd.</td>
<td>1.95</td>
<td>Very Good</td>
</tr>
<tr>
<td>63</td>
<td>Manganese Dept.</td>
<td>1.07</td>
<td>Very Good</td>
</tr>
<tr>
<td>64</td>
<td>National Small Scale Dept.</td>
<td>2.35</td>
<td>Very Good</td>
</tr>
<tr>
<td>65</td>
<td>UGC Ltd.</td>
<td>2.06</td>
<td>Very Good</td>
</tr>
<tr>
<td>66</td>
<td>Indian Steel &amp; Iron Ltd.</td>
<td>2.18</td>
<td>Very Good</td>
</tr>
<tr>
<td>67</td>
<td>National Textile &amp; Clog Ltd.</td>
<td>1.82</td>
<td>Very Good</td>
</tr>
<tr>
<td>68</td>
<td>Export Credit Guarantee Corp.</td>
<td>2.43</td>
<td>Very Good</td>
</tr>
<tr>
<td>69</td>
<td>Mistry Dhaba Nigam Ltd.</td>
<td>2.55</td>
<td>Good</td>
</tr>
<tr>
<td>70</td>
<td>Mistry Bros.</td>
<td>2.50</td>
<td>Good</td>
</tr>
<tr>
<td>71</td>
<td>Karnataka Antibiotics &amp; Pham. Ltd.</td>
<td>2.60</td>
<td>Good</td>
</tr>
<tr>
<td>72</td>
<td>Hinduja Bros.</td>
<td>2.66</td>
<td>Good</td>
</tr>
<tr>
<td>73</td>
<td>Hindustan Steelworks Coas. Ltd.</td>
<td>2.66</td>
<td>Good</td>
</tr>
<tr>
<td>74</td>
<td>Bharat Alloys Company Ltd.</td>
<td>2.98</td>
<td>Good</td>
</tr>
<tr>
<td>75</td>
<td>MMTC Ltd.</td>
<td>2.83</td>
<td>Good</td>
</tr>
<tr>
<td>76</td>
<td>Rashtriya Eapal Nigam Ltd.</td>
<td>3.01</td>
<td>Good</td>
</tr>
<tr>
<td>77</td>
<td>Bharat Eapal Epl Shri Nigam Ltd.</td>
<td>3.15</td>
<td>Good</td>
</tr>
<tr>
<td>78</td>
<td>Indian Petrochemicals Ltd.</td>
<td>3.14</td>
<td>Good</td>
</tr>
<tr>
<td>79</td>
<td>Eletro Equipment Ltd.</td>
<td>3.32</td>
<td>Good</td>
</tr>
<tr>
<td>80</td>
<td>Ruchi Soya Ltd.</td>
<td>3.35</td>
<td>Good</td>
</tr>
<tr>
<td>81</td>
<td>Midha Dhaba Nigam Ltd.</td>
<td>3.51</td>
<td>Good</td>
</tr>
<tr>
<td>82</td>
<td>Godrej Fertilizers Ltd.</td>
<td>3.60</td>
<td>Good</td>
</tr>
<tr>
<td>83</td>
<td>Godrej Fertilizers Ltd.</td>
<td>3.60</td>
<td>Good</td>
</tr>
<tr>
<td>84</td>
<td>Steel Authority of India Ltd.</td>
<td>3.30</td>
<td>Good</td>
</tr>
<tr>
<td>85</td>
<td>Central Leather &amp; Corpo of India Ltd.</td>
<td>3.90</td>
<td>Good</td>
</tr>
<tr>
<td>86</td>
<td>Bharti Earth Movers Ltd.</td>
<td>3.89</td>
<td>Good</td>
</tr>
<tr>
<td>87</td>
<td>Electrical Corporation Ltd.</td>
<td>3.65</td>
<td>Good</td>
</tr>
<tr>
<td>88</td>
<td>Project Equipment Corp.</td>
<td>3.58</td>
<td>Fair</td>
</tr>
<tr>
<td>89</td>
<td>North Eastern Electric Corp.</td>
<td>3.89</td>
<td>Fair</td>
</tr>
<tr>
<td>90</td>
<td>Eastern Electric Corp.</td>
<td>3.89</td>
<td>Fair</td>
</tr>
<tr>
<td>91</td>
<td>MTC Ltd.</td>
<td>4.11</td>
<td>Fair</td>
</tr>
<tr>
<td>92</td>
<td>National Fertilizer Ltd.</td>
<td>4.17</td>
<td>Fair</td>
</tr>
<tr>
<td>93</td>
<td>Jindals Sugar Ltd.</td>
<td>4.69</td>
<td>Fair</td>
</tr>
<tr>
<td>94</td>
<td>Pardeep Phosphates Ltd.</td>
<td>4.50</td>
<td>Good</td>
</tr>
<tr>
<td>95</td>
<td>National Fertilizer Ltd.</td>
<td>4.50</td>
<td>Good</td>
</tr>
<tr>
<td>96</td>
<td>BHEL Ltd.</td>
<td>5.00</td>
<td>Poor</td>
</tr>
<tr>
<td>97</td>
<td>Allied Lamps Mfg. Corp. Ltd.</td>
<td>5.00</td>
<td>Poor</td>
</tr>
<tr>
<td>98</td>
<td>National Steel Corp.</td>
<td>5.00</td>
<td>Poor</td>
</tr>
<tr>
<td>99</td>
<td>Rash. Fertil. Nirmal Nigam Ltd.</td>
<td>5.00</td>
<td>Poor</td>
</tr>
<tr>
<td>100</td>
<td>Hindustan Steelworks Coas. Ltd.</td>
<td>5.00</td>
<td>Poor</td>
</tr>
</tbody>
</table>

**Joint Ventures: Critique and Inferences**

In today's world, international alliances make more sense than at any other time in the history of international trade because:

- the expansion of international competition is making it more difficult for single companies to approach the

---

³Contributor: Jeetendra Panwar, Bharat Heavy Electrical Ltd.
global market with only their own internal resources.

- the reduction of product cycle is making it necessary to move faster to establish international markets and to make international sales.

- the growing cost of research and development, and marketing, is forcing many companies to increase their efficiencies in both domestic and international markets.

Joint ventures are often formed because none of the parties individually has all of the assets and expertise needed to best exploit the available opportunities. In the simplest form of joint venture, formed between an external partner and a domestic partner to exploit market opportunities in the domestic partner’s home market, the external partner would normally contribute:

- capital
- technology
- management expertise including marketing expertise
- training and consulting
- finished product

The host country partner would normally also contribute any of the above items as well but might also contribute:

- an existing presence in the host country
- knowledge of the local language, culture and local business conditions
- marketing and sales expertise

Companies entering into joint ventures are able to share costs and reduce risks, create economies of scale, obtain better access to certain markets and create a larger marketing presence. A joint venture also enables participants to pool or exchange technologies and to potentially tap larger or better capital sources.

However there are downsides that have to be considered. Firstly, as costs and risks are shared, so any profits have to be shared. How profits are to be used is often a difficult question to resolved, especially where one party wishes to distribute profits to shareholders whilst the other partner wants to employ the profits in the business.

Parties to any joint venture often different goals and objectives at the outset and these differences can become large as the relationship progresses. It is important to define what objectives each party has at the beginning of the relationship. Similarly, the partners must decide now the joint venture entity will be controlled. There are usually three reasonable choices. These are:

1. the foreign party controls the joint venture,
2. the domestic partner controls the joint venture, or
3. thirdly that the parties agree to let the joint venture itself establish its own control.

**Major Issues in Forming a Joint Venture**

Before any joint venture is formed, there are a number of critical issues that have to be discussed any agreed on to avoid major problems later on. These issues are:

- how the partners will be compensated
- the control issues
- calls for additional capital
- staffing of the JV
- termination issues

**Partners Compensation**

Not unreasonably, partners to any joint venture will expect to be compensated at some stage for their efforts. The form and manner of compensation can raise considerable concern as the joint venture progresses. Normally, profits are distributed in relationship to each party’s percentage of ownership. However, shareholders often need to recognize that the respective roles of each party in the operation of the joint venture may cause this formula to be altered. To the extent that it is possible to plan for this, it should be provided for in the initial agreement which should also be kept flexible enough to allow for changes in compensation arrangements as they arise.

**Control**

The most common manner of controlling a joint venture is through equity control, however equity control does not always equate to effective control. Control issues are perhaps the most important issues that have to be faced at the beginning of any joint venture relationship.

**Calls for Additional Capital**

Determining the financial needs of a joint venture is not always easy. Hopefully the joint venture will generate enough revenue and profit for its own needs and that additional equity capital or debt will not be require. Realistically however this is often not the case and therefore, the parties should determine at the outset how they will deal with future additional capital or debt financing needs. In particular, parties need to agree to what extent they are individually willing to guarantee any debt acquired by the joint venture.

**Management and Staffing**

To succeed, the joint venture needs to be properly staffed and managed. Generally, a compromise is achieved where the parties each contribute some management with the remaining being from external sources. It is important however that clear management control is determined at the outset. The decision on control largely has to depend on the real needs of the joint venture and who can best satisfy these needs.

**Termination**

The best time to plan for any termination is when the relationship is being established. The parties should build
but sell provisions into the agreement since most joint ventures eventually wind up by being acquired by one or other of the parties. Provision has to be made for future ownership of any jointly developed technology.

**In Summary**

Creating a joint venture is one of the most complex legal relationships that can be entered into and requires a number of detailed legal agreements. Proper legal advice needs to be obtained in this regard.

In addition to a formal Equity Joint Venture, which is the base agreement used to design the actual relationship, several other agreements may need to be designed and executed including:

- Articles of Incorporation and By-Laws for the joint venture
- Management Agreements
- Supply Agreements
- Technical Assistance/Training Agreements
- License Agreements

**Check List for Joint Venture Entry**

Purpose of the Joint Venture
- Objectives/strategy of the foreign partner
- Objectives/strategy of the domestic partner
- Reconciliation of the objectives

**Contributions of Each Partner**
- What are they?
- How do they contribute to the success of the joint venture?

**Equity Structure**

- Capital Structure
- Legal structure of the joint venture
- Equity capital
- Loan capital
- Future increase in equity capital

**Management**

- Appointment and composition of Board of Directors
- Appointment and authority of executive officers
- Organization
- Production
- Operations
- R&D
- Quality control
- Training and Education

**Finance**

- Accounting/control system
- Working capital
- Capital expenditures
- Dividends
- Pricing
- Borrowing and loan guarantees

**Marketing**

- Product lines, trademarks, and trade names
- Target markets
- Distribution channels
- Promotion

---

**Quotable Quotes**

The issue is not public versus private. It is competition versus monopoly.

- John Moffitt

Never tell people how to do things. Tell them what you want them to achieve and they will surprise you by their ingenuity.

- General George S. Patton

[From 1975 through the 1990 social] innovation was the form of creating new public service institutions...The next twenty or thirty years will be very different. The need for social innovation may be even greater, but it will very largely have to be social innovation within the existing public service institution. To build entrepreneurial management into the existing public service institution may thus be the foremost public task of this generation.

- Peter Drucker

David Osborne and Ted Gaebler on power of performance measurement

If you don't measure results, you can't tell success from failure.

If you can't see success, you can't reward it.

If you can't reward success you are probably rewarding failure.

If you can't see success, you can't learn from it.

If you can't recognize failure, you can't correct it.

If you can demonstrate results you can win public support.

'There is no substitute for planning'