PERFORMANCE CONTRACTS

A Handbook for Managers

Commonwealth Secretariat

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1995

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FOREWORD

Governments everywhere are seeking various ways to improve the performance of public enterprises (PEs) and to increase their productivity. The long debates on what to do with loss-making enterprises are over and many governments have sought solutions in privatising or commercialising selected enterprises for several reasons, including the need to make them more efficient and to instil market discipline in them. But wholesale privatisation of the public enterprise sector has not happened yet, at least not in countries outside the former Eastern European and Soviet Republics. It is therefore a fact of life that government still has a role to play in managing some key public enterprises. It is important that these enterprises be properly managed.

One of the important problems facing public enterprises relates to poor management of the interface between government and PEs. While PEs usually believe that they lack operational autonomy to carry out their assigned responsibilities, governments often contend that PEs lack initiative, are wasteful in the use of resources and give back poor returns on investment. While the need for accountability is generally recognised by the PEs' management, the board and the government, problems arise when one tries to find out who is accountable for what and to ascertain the mutual obligations of the parties.

This book is written to assist in providing some answers to the thorny questions facing the performance of public enterprises. It sets out in some detail the mechanisms for determining enterprise performance and a framework for assessing enterprise productivity across the board. It explains the concept and methodology of the performance contracting system and provides case studies from five countries to clarify the approach.

The first chapter deals with the concept and rationale for performance contract and explains the underlying principles for its adoption in selected countries. Chapter two discusses the development of the performance contracting system and traces its history from the early 1960s in France to its current use in various countries, with special reference to France, Korea, Pakistan and the Gambia. The institutional arrangements for performance contracts are covered in the third chapter which also outlines the arrangements in use in selected countries like France, Korea, India, Nigeria, Bangladesh and Ghana. In chapter four, the contents of a performance contract are explained in detail, including criteria identification, target setting and assigning weightages. Monitoring and evaluation are the subject of chapter five which provides a definition for monitoring and evaluation, and distinguishes one from the other. The importance of monitoring and evaluation is fully explained and their central role in the system highlighted. A critical issue in performance contracts is the Incentive System and this is discussed in chapter six. The last chapter examines the process of installing the performance contracting system, providing a checklist at the end for successful operation of the system.

The second section of the book contains five well-researched cases, all of which were specially commissioned for this publication. These cases are from Pakistan, India, Bangladesh, Ghana and The Gambia. Each of the cases provides useful information on the evolution and practice of performance contracts in the country and the lessons learnt to date in adopting the system.

On behalf of the Commonwealth Secretariat, I would like to thank Mr. T. L. Sankar and Dr. Olu Fadahunsi who prepared the manuscripts and Messrs Istaqbal Mehdi and M B Njie for their comments and suggestions in assisting the authors to finalise the manuscripts for publication. I am also grateful to the case writers: M Abdul Kalam Mazumdar (Bangladesh), M B Njie (The Gambia), W A Adda (Ghana), Suresh Kumar (India) and Istaqbal Mehdi (Pakistan).

This publication is for practising managers. It is written in an easy to read language, with copious illustrations to make it a useful companion to policy-makers and students of public sector management. It is hoped that the book will contribute to a better understanding of the design and implementation of a performance improvement tool that undoubtedly holds great promise for the management of our public enterprises.

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CONTENTS

LIST OF FIGURES

1

Performance Contract: Concept and Rationale

Performance Contract (PC) is attracting a lot of attention in discussions on the reform of public enterprises in developing countries. By its very name, PC is a prelude to the evaluation of performance. In normal circumstances, the evaluation of enterprise performance is made with reference to its Annual Statement of Accounts. If an enterprise gives rise to certain benefits or costs which are not captured in the statement of accounts, they are mentioned in the Annual Reports of the companies. What is the need then for PC?

The concept of a PC and its rationale varies from country to country. PC is a contract between the owner of an enterprise on the one side and the management of the enterprise on the other, setting out certain targets/results to be achieved in a given time frame. It also enumerates the mutual obligations of the two parties in achieving the targets set in the contract. Such contracts have been called by different names, such as, Contract de Performance, Memorandum of Understanding and so on.

The widely accepted rationale for PC is that public enterprises have got multiple objectives and multiple principals. These fussy objectives lead to, or are an alibi for, poor financial performance in many cases. One view is that because public enterprises (PEs) are required to carry out several functions they are unable to do any one of them very well. The other is that while a PE might have done well in achieving many of the objectives, its performance may be judged with reference to one objective in which it has not done well. A PC would remedy the situation of multiple objectives by listing the preferred objectives which the owner (government) would like the PE to achieve. It would remedy the multiplicity of principals by forcing one agency to sign on behalf of all of them.

Other reasons for advocating the PC include:

a) The strong persuasive influence of the International Financial Agencies (IFAs) and several bilateral agencies who advocate the PC system as an important element of the reforms in the PE sector. IFAs have emphasised this because of routine interference of government in the day-to-day operations of the enterprises, and such interference has not encouraged productivity.

b) PEs may have to pursue certain social goals and such pursuits may affect the financial results of the operations of the PE. Therefore, a prior understanding of the extent to which financial results can be traded off against social objectives to be achieved by a PE through a PC would help to clarify PE objectives.

c) Several PEs, on the basis of current operations, could be recording losses but such balance sheet results alone would not indicate the effort put in and the success achieved by the management of the PEs in improving their operations. If a PC target for the year is to reduce loss from the level of previous years, the achievement of such a target should win commendation, boost the morale of the current management and spur them on to better performance.

BOX 1.1: The Role of Performance Contract in Ghana

The performance contract system constitutes a major element in Ghana's public enterprise reform programme. The system incorporates two main elements – the corporate plan and a performance contract, linked in an annual cycle of monitoring and evaluation activity. Each state-owned enterprise (SOE) participating in the system is required to prepare and update regularly a comprehensive corporate plan. The implementation of this plan is disciplined by means of a negotiated contract agreement which sets annual performance targets and is monitored on a quarterly basis.

The Planning, Monitoring and Evaluation (PME) system for updating the corporate plan, negotiating annual performance objectives and targets, followed by quarterly reporting and annual evaluation has come to be accepted as a useful framework for managing the interface between Government and enterprise. An annual cycle of activity now links supervising ministry and enterprise with the State Enterprises Commission and the Ministry of Finance and Economic Planning in the setting of performance objectives for core public enterprises. This contribution is of particular significance in Ghana's case, restoring discipline to a system of SOE governance that had lost both credibility and effectiveness during nearly ten years of enterprise self-management by a committee of its employees.

Source: W.A.Adda, Performance Contracts in Ghana: A Case Study. Prepared for the Commonwealth Secretariat, London 1994, p.1

In the recent PE reform literature, PC is also advocated as a mechanism to smooth the PE-Government interface and increase the autonomy of PEs. The view is that the PC system forces government to set out what it expects from the PE at the beginning of the year and should therefore, discourage the tendency to interfere in its day-to-day operations during the year. Also, PC forces the PE to set out its requirements of assistance from the government at the beginning of the year. This should discourage the PE from requesting unnecessary assistance during the year.

PC has also been advocated as an alternative to privatisation of PEs – especially in the case of those PEs which are financially viable. The financial benefit expected by divestment of shares could be set out in 'flow terms' in the PC as the agreed financial targets. This view has been opposed by some scholars who suggest that developing countries with a large public debt should privatise the profitable PEs without significant public interest and use the cash revenue to reduce the debt. Some have also pointed out that the introduction of the PC system may be a prelude to privatisation, as it might reduce the accumulated losses of the PE and improve its overall image in the market.

BOX 1.2: Performance Contract as a Tool of Commercialisation Programme in Nigeria

As a tool of the commercialisation programme, performance contracts are expected to instil an attitude of accountability within the PEs and govern the relationship between Government and the PE management. The system will:

(a) help formalise the corporate plan and mutual obligations of the PE and the Government;

(b) require PEs to strictly adhere to well-defined performance objectives and targets under performance contracts;

(c) help measure the performance of PEs against these targets in a transparent and systematic manner; and

(d) provide appropriate monetary rewards and penalties to induce management to achieve the agreed goals, including adjustments in the financial support from the Government.

Source: Technical Committee for Privatisation and Commercialisation (TCPC) "Framework for Commercialisation", The Presidency, Lagos, 1993, p.3

Types of Performance Contracts

Performance Contracts are referred to by various names in different countries. The most popular terms include: Performance Contracts, Contract Plan, Contract De Programme, Letter of Agreement, Performance Agreement and Memorandum of Understanding.

There is a general consensus that there are only *two* main types of contract and all other arrangements fall under one or the other. These two systems are commonly known as:

a) The French-Based System; and

b) The Signalling System – which originated in Pakistan and Korea.

The main difference between the two is that the typical French Contract Plans do not allocate weights (and point calibrations) to targets. Thus there is no distinction between targets in terms of emphasis (by weighing them differently) and as such, performance evaluation is affected by a high degree of subjectivity. This system is practised in France, Africa (e.g. Senegal, Benin and Morocco) and Latin America.

The Signalling System is popular in Asia (e.g. Pakistan, South Korea and Bangladesh), Africa (e.g. Ghana, Nigeria and The Gambia) and Latin America. It should be noted that both systems may be practised concurrently in the same country such as the case in India where the initial Memoranda of Understanding (MOUs) were based on the French System, while those signed more recently follow the Signalling System.

Pakistan's signalling system is based on the principle that given the capital stock in hand, how best can the management make use of it. The system aims at motivating management to maximise return on the sunk capital. To attain this objective, attempt is made to evolve a primary criterion of evaluation which reflects the improvement in real productivity which in turn leads to an increase in socially relevant profit (as against privately relevant profit). A PC is signed at the beginning of the year in which management is committed to improvement in real profitability. At the end of the year, and based on a comprehensive evaluation system, the management is awarded a performance bonus which is determined by the improvement in real performance. Thus Pakistan's signalling system is based on the principle that public enterprise management should be appropriately guided to aim at improving real productivity and its efforts should be acknowledged and rewarded by an incentive system.

The parties involved in the contract system do vary, both in number and role, from country to country. In Senegal for instance, the contract is signed by the Prime Minister in the Presidency, the Sectoral Minister, the Minister of Economy and Finance, and the Managing Director. In Nigeria, contracts are signed by a representative of the Federal Government with the Board of Directors *and* management; in Ghana contracts are signed by management and board with the State Enterprises Commission (SEC) also signing as witness to the agreement. In India MOUs are signed by Managing Directors and Line Ministries (represented by

Secretaries of States). In The Gambia, the contracts are signed rather uniquely by H. E. The President and management. In Pakistan, the Experts' Advisory Cell – an independent technical agency with the Ministry of Industries and Production negotiates targets on behalf of the Government with the Chief Executives of Enterprises.

BOX 1.3: The Concept of PC

During the past few decades, improving efficiency in the Public Sector Enterprises has been a challenge confronted by various countries. In order to attain this objective, a number of organisational devices and management systems were tailored conforming to the specific requirement of public enterprise management. The concept of the performance contract system was originated in the late 1960s by Simon Nora to improve the public sector enterprises in France. This system was generally known as **"CONTRA PLAN"** though adopted by several enterprises outside France suffered from a number of difficulties. The development of the signalling system in the early 1980s was a major step forward in evolving the performance contract system. The system addressed some of the complex technical issues of evaluating real performance of public enterprise managers. The system was pioneered in the early 1980s almost simultaneously in Pakistan and South Korea. Since then it has been adopted in various modified forms by a number of countries.

Source: Istaqbal Mehdi, Signalling Systems for PEs: A Case Study of Pakistan. Prepared for the Commonwealth Secretariat, London 1994, p 1.

The few number of signatories to the Contract in the Gambia, and more importantly, the involvement of the head of government, is generally accepted to have increased accountability and improved credibility which have helped to streamline communication between PEs and government. Furthermore, there is a high level of political commitment where the Head of State personally signs the contracts. However, another school of thought has argued that line ministries and the Board of Directors, as interested parties, are likely to be more committed to their crucial roles where they are signatories to the contract.

The introduction of a PC in any country requires the preparation of a document and the signing of such a document which will constitute a contract between the parties to the agreement. Contract documents, while they have many contents in common, differ greatly in details. The contractual document can vary considerably in length (from a short "letter of mission" to an extensive "programme contract" incorporating multi-year plans and budgets), depending on the availability of data on past performance, operating norms, future investment/rehabilitation needs and the specificity of objectives. A performance contract differs from a Memorandum of

Understanding in that the PC is a precise document which specifies objectives and targets, and secures the commitment of enterprise management and government.

It has been suggested that the Gambian and Senegalese documents are the most voluminous, while India's MOUs and the Pakistan's Signalling Systems use forms that are considered relatively simple. It is believed that detailed documents run counter to the autonomy objectives which is implicit in the PC system. In the next chapter, we shall examine in greater detail, the development of the PC system in selected countries.

2

The Development of the Performance Contract System

The PC system has a fairly long history and has been tried out in a number of countries. In each country, the content of the PC, the procedures of finalising it and the institutional arrangements for the PC system have been influenced by the needs of the country and the prevailing environmental conditions in that country.

The PC system originated in France in the late 1960s. It was later developed with a great deal of elaboration in Pakistan and Korea as 'a signalling system' and was introduced in India in 1986/87. With the World Bank's approval of the PC system as one of the principal measures of reform for the PEs, it has been adopted in a number of developing countries in Africa, including Nigeria, The Gambia and Ghana. Attempts to adopt it have also been made in Sri Lanka, Bangladesh and Venezuela among others. Both Pakistan and South Korea have used the system extensively.

BOX 2.1: Evolution of MOU in India

Performance Contracts for Public Sector Units are known as MOUs (Memorandum of Understanding) in India. The MOU is rooted in an evaluation system which not only looks at performance comprehensively, i.e. at both commercial and non-commercial criteria of performance in their static and dynamic aspects, but also ensures and forces improvement of performance of managements and industries by making the autonomy and accountability aspects clearer and more transparent. It is an annual document which is an intrinsic part of a long-term corporate plan in which the government (represented by the Secretary in the line ministry) and the public enterprise (represented by its CEO) lay down their mutual obligations and responsibilities, based on the missions and objectives of public investment, and after mutual negotiations. The idea is to choose appropriate criteria, assign mutually acceptable priorities to them and decide at the beginning of the year how the achievement of targets (and deviations therefrom) are to be evaluated. The crux of the evaluation system is to set the evaluation parameters in advance and before the actual performance is delivered. Further, the process of negotiation is assisted by an objective third body which finally evaluates the performance also importing complete objectivity into the system.

SOURCE: Suresh Kumar, Performance Contracts: An Indian Case Study. Prepared for the Commonwealth Secretariat, London 1994, p.2

France : Contract de Performance

The French experiment in the late 1960s was initiated with the primary objective of reducing the government budgetary support to the public enterprises. It was called 'contract de performance' and was based on a report of a committee headed by Mr Simon Nora. It was intended as a mutually agreed contract between the government and selected public enterprises which had a high level of public purpose, to plan activities jointly and to establish reciprocal commitments on the part of the government and public enterprise.

In the first year, only two contracts were signed, one with the French State Railways, **SNCF** and the other with the French State Electricity Agency, **EDF**. In fixing the targets for price and profitability and other indicators of efficiency, both parties agreed that these were subject to certain factors (e.g. economic variables like GDP, inflation rates, fuel prices, foreign exchange rates etc.). The agreement, therefore, provided that when these assumptions changed, the targets could be re-opened for mutual discussion and further modifications. The contract was for a period of five years. The first contract for five years with EDF was subjected to four changes.[1]

The contract provided for certain investments in the growth of the public enterprises and the government budgetary support for that growth was fixed. It was agreed that the prices of the goods or services produced by the PE could be adjusted without prior government approval to cover variable costs and two thirds of the financial needs on the new investments. The indicators of performance were few. The contract fixed the long-term policies and goals, and specified clearly that the company did not need to come to the government for price increases as long as their achieved operational efficiency was in accordance with the terms of agreement. It proceeded well, during the initial years, but with the 1973 oil crisis, most of the macro-economic assumptions were thrown overboard and the government went back on the agreement; the government did not allow companies to increase prices as per the PC. The EDF contract was not renewed, while that of the railways was renewed for only two years.

The second round of contracts was initiated in 1978-79 with four enterprises. The duration was reduced to three years to ensure better appreciation of the economic environment that might affect enterprise operations. But in 1981 when the socialist party came to power, these contracts were subjected to rough weather and only the contract with Air France was operational because it was in a globally competitive

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[1] J Sridhar Sharma – "The Enterprise Contract System in PE Management: the French Experience " Journal of Institute of Public Enterprise", Hyderabad, December,1982.

environment. These experiences have somehow dampened the French enthusiasm for performance contracts.

In the French experiment, the institutional arrangement was quite simple. The administrative machinery monitoring the public enterprise formed a committee which included all other ministries involved in the activities of the public enterprise. The public enterprise also formed a Committee of the Board of Directors who would constantly monitor negotiations, with the CEO as the chief negotiating agent. There was a constant flow of information on the negotiations to the board of directors, the executives and workers. Due to the information asymmetry between the government and enterprise, there were long delays in negotiations and some of the contracts took two years to negotiate and finalise.[2]

In addition, the French system did not introduce any special rewards for achieving the targets nor penalties for non-fulfilment of the terms of the contract.

Korea : The Signalling System

The next major experiment in the PC system was in Korea. In the early Eighties, Korea had few public enterprises but they were very important for the development of the national economy. There were four departmental enterprises called Government Enterprise (**GE**), namely rail, road, postal services and grain management departments. There were also 24 Government Investment Enterprises (**GIE**) in which government had more than 50% equity. Important among these are: Korean Equity Corporation, KEMPCO and Korean Telecommunication Authority. These GIEs also had 67 subsidiaries. The GIEs and their subsidiaries were yielding a much lower return than similar companies in the private sector. This problem was examined in detail by the Korean Development Institute which proposed a package of enterprise reforms, including suggestions for a complete realignment of the Government-PE interface. The Institute proposed special legislation setting out the relationship between the PEs and government, and spelt out the details of the PC system to be organised in the Act itself.

The PC system was to consist of three parts:

(i) Performance Information System

(ii) Performance Evaluation System

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[2] Nellis, John (1988), Contract Plans and Public Enterprise Performance, Working Papers Country Economics Department, Washington, DC, The World Bank.

(iii) Performance Incentive System

The Government accepted all the recommendations and implemented them as detailed hereunder.

Public Enterprise – Government relations were defined under an Act of Parliament, called 'Government Invested Enterprise (GIE) Management Act of 1984'. The Act sets out clearly the provisions which guarantee autonomy to GIEs. The Act defined in general terms what the Government would do for all public enterprises in Korea, leaving the negotiated PCs to define only what is expected from each of the public enterprises by Government and the people.

The centrepiece of the Korean PC system is the Management Evaluation Council (**MEC**). The new Act (G.I.E. Management Act of 1984) defines the functions of the MEC as follows:

i) formulation of general guidelines for the draft preparation of management objectives of GIEs;

ii) establishment and co-ordination of management objectives of GIEs;

iii) formulation of common guidelines for the budget preparation of GIEs;

iv) evaluation of the managerial performance of GIEs;

v) other matters concerning the management of GIEs as determined by Presidential Decree.

With regard to the evaluation of management performance, the MEC, with the help of the Ad Hoc Task Force and other agencies, formulates the performance evaluation criteria and target values, decides the incentive bonus rates for GIEs based on performance evaluation results, and may suggest the dismissal of officers of GIEs for poor management.

MEC is assisted by the performance information system which collects the broad data and historical working of the company as well as information relating to similar industries elsewhere.

The incentives for the GIEs are based on the score gained by the GIE. The Korean PC system is based on the firm belief that unless performance evaluation leads to some rewards and penalties, the incentive system will have no teeth.

Analysis

The Korean Performance Contract System has several merits. It was introduced as part of a total reform package in which several elements of operational autonomy were given to PEs. It was introduced through an Act of Parliament and the Act confers several powers on PEs and clarifies what PEs can expect from government.

It gets the commitment of the political executive by having the Minister of Economic Planning on the Management Evaluation Council, and by involving ten other concerned ministers within this Council. The presence of the ministers makes it possible to attract the highest level of academic and industrial talent to serve on the Council. The Korean Development Institute, which has been deeply involved in academic studies on the functioning of the Korean economy as a whole and public enterprise in particular, has not only designed the Performance Appraisal System but is providing information support. It has become possible, therefore, to obtain objective advice on matters relating to the fixing of criterion values. The fact that the results of the evaluation have a direct bearing on the rewards given to public enterprise (both the executive and the workers within it) has created an evaluation system of great importance to public enterprise. There is a great deal of seriousness attached to the whole exercise, from the top political executives to the workers of PEs.

The Korean PC system also ensures that workers are involved in the whole exercise and are committed to the target fixed by the MEC. Performance Evaluation starts with a Self-Evaluation Report by the PE and during the course of evaluation, written comments and complaints can be submitted to the Task Force.

These arrangements are possible because the number of PEs which are subject to evaluation under the system is quite limited. The performance of PEs has improved significantly.

Pakistan: Signalling System

Pakistan's signalling system was established essentially to improve the operational efficiency of public industrial enterprises. Until the late 1970s, these enterprises were characterised by a combination of adverse financial and operational features, i.e. declining profitability leading to weak financial structures, imbalanced debt equity ratios and inefficient asset usage, etc. In the early 1980s, the Government entrusted the task of new investments to the private sector and the public sector was expected to improve its operational efficiency.

BOX 2.2: Evolution of the Signalling System in Pakistan

During 1981, in order to improve operational efficiency of the public industrial sector under the Ministry of Production, the Government decided to set up the Signalling System for Public Enterprises. In November 1981, the Experts Advisory Cell (EAC) was given the responsibility of setting up the project. The project has three components:

(i) A performance information system to measure accurately actual behaviour.

(ii) A performance evaluation system to specify socially desirable behaviour.

(iii) An incentive system to reward or penalise managers for their actual performance at the end of the period, i.e. one year.

The development of the system took about three years. During this process major efforts were made to evolve a performance information system. In 1983 the Government approved the operation of the system but after significantly modifying the original proposal.

The Signalling system originally envisaged that social profitability, known as public profitability, should be the primary indicator of performance. Public profits are private profits adjusted for those elements not deemed relevant to a PE. For example, taxes and interest which are private costs but public benefits, are excluded so as not to encourage PE managers to devote to minimise taxes or interest arbitrage. In other words, public profitability aims at encouraging managers to maximise net economic benefits judged from the national perspective. However, in approving the signalling system, private profitability instead of proposed public profitability at constant prices, was kept as the primary criterion of evaluation. The task of incorporating improvement in productivity in this criterion was left to the professional in the Cell.

Source: I. Mehdi, op.cit, p.3

Following this policy as a first step, several re-organisation measures were adopted to streamline the organisational structure of this sector. At the completion of the exercise, a fairly smooth control structure emerged. In this new structure, about 70 manufacturing enterprises were controlled by the administrative ministry through eight holding corporations. Since, in this organisational set up, the ministry was operating like a head office of a large industrial conglomerate, an independent technical unit, i.e. the Experts' Advisory Cell (EAC) was created to assist the ministry in performing this function. The need for this unit was felt, since the ministry run by civil servants was not equipped with the expertise required for the new function.

One of the first tasks of the cell was to identify ways and means of improving the performance of public enterprises. It was identified that there was a need for setting up institutional arrangements to guide and evaluate performance of managers so that they could also be rewarded for good performance. It was against this background that the signalling project was developed at EAC.

The Gambia

The performance contract system for public enterprises was introduced in The Gambia in 1987. As a prelude to identifying those PEs to come under the PC system, the PE sector was divided into three schedules:

(i) enterprises in which government is a minority shareholder;

(ii) enterprises in which government is a majority shareholder, or has 100% shareholding; and

(iii) strategic corporation/departments.

Only PEs under schedule three were identified as suitable candidates for performance contracts. Under the first phase in 1987, performance contracts were developed for three PEs only. Under the second phase in 1990, performance contracts were developed for another three PEs. It was envisaged that contracts for the third phase would be consummated in 1994 for yet another three PEs.

The contracts were executed for a period of three years, and were signed by His Excellency the President on behalf of the Government, and by the Managing Director on behalf of the enterprise.

The PC system involves the following steps:

- definition of enterprise objectives;
- identification of the commercial and non-commercial activities of the enterprise;
- development of the mechanism for reimbursement of non-commercial/social services;
- selection of performance indicators and fixing of targets for a particular year;
- determination of management incentive/sanctions scheme;

- execution of the performance contract;
- monitoring of contract compliance;
- performance evaluation on a quarterly (now bi-annually) and yearly basis;
- award of management (bonus) or sanction.

3

Institutional Arrangements

The institutional arrangements for performance contracting depend on the environmental conditions in which the PC is introduced, the elements which go into the PC and the process that is adopted for drawing up and evaluating contracts. In short, institutional arrangements for any PC system depend on:

- environmental factors;
- content of the contracts;
- the number of agencies to which the PE is accountable; and
- the process.

The structure of the institutional arrangements and the process of the PC system are closely inter-related and one influences the other.

The environmental conditions in which the PC system is introduced may vary from a highly centralised, authoritarian administrative system to a highly decentralised, democratic form of governance. The PC system may be introduced in a country with a parliamentary form of government where ministerial responsibility is to a large number of parliament members or in a country with a presidential or autocratic form of governance where accountability at a higher level is to one person only. The institutional arrangements for the PC system would vary in both cases.

If a PC system is introduced in a country susceptible to high inflation or other changes in the macro-economic variables, the institutional arrangements should include a machinery, independent of the parties to the PC, which could compute the extent to which the achievement differed from the contracted figures, due to the impact of the unexpected variations in the macro-variables and for reasons beyond the control of the PE management.

If the country where the PC system is introduced has a regular planning process with periodic plans, e.g. five-year plans, the institutional arrangements should ensure that the targets and strategy for PE negotiated under the PC system are in line with the targets and overall strategy of the country's development plans.

The institutional arrangements would depend on a number of persons/agencies to whom a public enterprise is accountable. It is well known that PEs in general have multiple principals as well as multiple objectives. The administrative ministry concerned with the PE and the Ministry/Department of Public Enterprises are directly linked to PEs. But, on many matters, PEs have to take the permission and sanctions of the Ministry of Finance, especially the department dealing with economic/foreign exchange matters. In many countries, the Prime Minister's Office or the President's Office is the centre of power which controls all organisations of government, including PEs. Several strategic decisions of the PEs have to go the Cabinet. Needless to say, parliament has a very important role, both in defining the role of a PE as well as in evaluating its performance. Since the minister is directly responsible to parliament, he cannot be kept out of the institutional arrangements. Increasingly, in developing countries, ministers have been taking on the attitude and behaviour of the owners of the public enterprises – though their 'ownership' is described as "holding in trust on behalf of the people". The proprietorial attitude of the minister concerned would suggest that institutional arrangements should include the minister at the centre of PC system.

Institutional arrangements also depend on the nature of the contract, i.e. the details in which the performance targets relating to productivity and profitability are spelt out and the indicators used to capture the efficiency of the static and dynamic performance. Normally, the contract is signed by the PE Chief Executive and the Secretary of the administrative ministry. Admittedly, the PE has less powers than the ministry but the PE would have more information about the technical and commercial operations of the sector in which the PE operates than the administrative ministry. If elaborate indicators are used in the PC, the information needed would include the business environment, industry structure (global and national level), the public reaction to the quality and price of the product, the competitors to the specific PE, their market position, the technological advances foreseen by the industry in the short run and in the long run. It is obvious that public enterprise would have more information on many of these aspects, than the ministry. As these pieces of information are relevant to their day-to-day work, PE would keep the information up to date. This information asymmetry is unavoidable. Outside PE, such information could, however, be available with scholars and academics, working in that particular sector. Institutional arrangements should, therefore, include a Performance Information System which would collect the information needed for fixing targets and for evaluation. It is important to emphasise that the Performance Information System is critical, both at the time the PC is being drawn up and the targets are being fixed, and subsequently for monitoring and evaluation purposes. Reliable and accurate data are vital to the success of the entire system.

BOX 3.1: Institutional Arrangements for PC in The Gambia

After the introduction of the performance contract system, the ultimate control and responsibility was taken over by the Office of the President, as His Excellency The President executed the contracts on behalf of the Government. The steering committees having representatives from line ministries, the Office of the President, National Investments Board (NIB) and the enterprises were formed. ???? These committees were given the responsibility of approving the budgets, performance indicators/targets, performance evaluation and management incentive (bonus)/sanctions. The line ministries were expected to concentrate their efforts on the development of sectoral policies, objectives and the framework within which public enterprises were expected to operate.

Source: M.B.Njie, Performance Contract System in the Gambia. Prepared for the Commonwealth Secretariat, London 1994, p.6

The criteria which are adopted in finalising contracts between the government and public enterprise depend very much on these factors as well as the expectations of the government from the particular PE industry or from PEs in general.??? This may be a very simple system of specifying only the return on investments made, physical production levels and employment, or it may be a sophisticated system in which various factors relevant to the current performance as well as the sustained growth of the company are spelt out. But, irrespective of the degree of complexity of the PC system, there should be an attempt to ensure that the PC is finalised with clauses which are fair to the public enterprise and to the government. Consequently, an impartial agency should examine the past performance of the PE and the information on the specific industry obtained from the Performance Information System and determine the extent to which the achievements of the PE could be improved by the efforts of the management. This would constitute the Performance Evaluation System. The same agency would, at the end of the period of the contract, evaluate the actuals against targets and make allowance for deviation from expectations due to factors beyond the control of management.

There should be a high level agency/person to receive the performance evaluation report, consider the recommendations of PEs and decide on the rewards or penalties for good and poor performance. The scale of incentives and how they would be determined should be made known to all PEs concerned. This would constitute the Performance Incentive System.

It follows from the discussion above that a typical PC system should have three sub-systems:

- Performance Information System;

- Performance Evaluation System; and
- Performance Incentive System.

Under certain conditions, the Performance Evaluation System and Performance Incentive System may be merged into one. These three systems may be grafted onto existing institutions or separate agencies set up specifically to handle the tasks. The important point is that the agencies entrusted with the tasks of these sub-systems should be able to fulfil the roles expected of them.

Institutional arrangements for the PC system in selected countries

A brief study of the institutional arrangements for the PC system established in selected countries, viz France, Korea, and India, is useful for illustrative purposes at this stage.

France

In France, no separate institutional arrangements were set up for the formulation of "Contracts de programme". The French thought that it would be adequate for one committee to be set up representing the Government and negotiating the contract with a PE. The administrative ministry was to preside over the committee. Logically, several other ministries, such as the Ministry of Foreign Trade, the Ministry of Vocational Training, and the Ministry of Solidarity, would have to be on the committee. However, it was realised that if all the ministries affected by the performance of the PE were to be included in the committee, the committee would become too large and unwieldy to carry out the negotiations, which could be time-consuming and involve several meetings. This difficulty was overcome by having on the committee only representatives of the 'nodal' ministry which sets the policies for the particular sector in question, and representatives of the Ministry of State Planning (which represents all other ministries), and the Ministry of Economy, dealing with finance & economic affairs.

On the PE side, it was provided that the CEO should negotiate the contract, and report to the Directors of the Company. The constant flow of information to the Board of Directors enabled the Board, and through the Board executives and workers, to be involved in negotiations. The signed draft contract was transmitted to all parties in the PE involved in the negotiations.[3]

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[3] Yves Carsalade: "PE, State Plan and Managerial Autonomy -The French Experience" in Management and Role of PE. Indo-French Experience Ed. S.B. Jain Vol. I,

A shortcoming of the French System was that it did not provide for any correction of the information asymmetry between government and enterprises. The French Government was totally dependent on the enterprises for information which forms the basis for setting targets. This led to long delays in negotiating contracts (in some cases two years), and to specifying the targets in conditional terms. The conditionality led to frequent renegotiating of the contracts. Much of this could have been avoided if they had had a Performance Information System.[4]

While the contracts provided for mutual discussion and revision of targets, there were no sanctions in the event of either party not abiding by the provisions of contract. This is more so from the government side.[5]

Korea

The Korean PC system, based on the recommendations of the Korean Development Institute, consists of an Act of Parliament and three parts:

- Performance Information System;
- Performance Evaluation System;
- Performance Incentive System.

The extent to which government intervenes in PE affairs was defined for all PEs in the Act of Parliament called Government Invested Enterprises (GIE) Management Act of 1984. What should be done to the PE and what is expected of the PE was to be defined in the negotiated PC and these should be done in specific terms. The Act also provided for the broad outlines of PC system.

The Performance Contract System of Korea, often referred to as Signalling System, approved by the Government is set out in the figure that follows:

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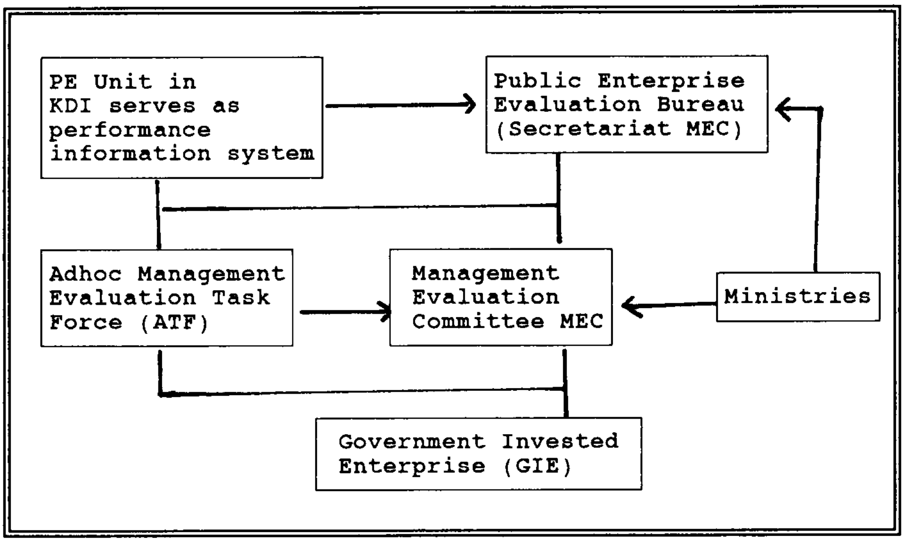
published by BPE, India in collaboration with SCOPE, Delhi 1986.

[4] Prajapati Trivedi: Theory and Practice of the French System of Contracts, " Public Enterprise", 1988, Vol. 8. No.1.

[5] Sridhar Sharma. Ibid.

The Performance Contract System of Korea



The performance evaluation is done through an institutional set up which evaluates the performance with reference to targets and criteria fixed using the Information System and the Task Forces which help in evolving the criteria for evaluation and other related details. Broadly, the evaluation responsibility was entrusted to a Management Evaluation Council (MEC) which takes all the decisions regarding co-ordinating the objectives of the GIEs, setting up of criteria for evaluation and criterion values etc. Apart from evaluating performance, MEC is supported by a secretariat which is called Public Enterprise Evaluation Bureau which is attached to the Economic Planning Board. This Evaluation Bureau is supported on the one hand by the relevant ministries who supply information obtained from government sources and also from departmental policies which might have a bearing on the evaluation of the PE. On the other hand, it is supported by an independent unit in the Korean Development Institute called the Public Enterprise Research Unit. The Bureau feeds the information into an Ad hoc Management Evaluation Task Force of experts which is set up to help the MEC. This serves as the Performance Information System.

The centre-piece of the Korean PC system is the MEC. The Act (G.I.E. Management Act of 1984) defines the functions of the MEC in detail as follows:

(i) formulation of general guidelines for the draft preparation of management objectives of GIEs;

(ii) establishment and co-ordination of management objectives of GIEs;

(iii) formulation of common guidelines for the budget preparation of GIEs;

(iv) Evaluation of the managerial performance of GIEs;

(v) Other matters concerning the management of GIEs as determined by Presidential Decree.

With regard to the evaluation of management performance, the MEC, with the help of the Ad Hoc Task Force and other agencies, formulates the performance evaluation criteria and target values, decides the incentive bonus rates for GIEs as a function of performance evaluation results, and may suggest the dismissal of officers of GIEs for poor management.

The Public Enterprise Evaluation Bureau works as the secretariat to the MEC and reports directly to the Chairman of the MEC. All the preparatory work and follow-up actions of the MEC, such as the selection of the Performance Evaluation Task Force members and the assignment of specific jobs to each Task Force member, are handled by the Bureau. The Bureau has to liaise with ten other ministries on matters concerning GIEs.

The role of the Performance Evaluation Task Force (an Ad Hoc Task Force) is to assist the MEC on professional and technical matters connected with performance evaluation. The major assignment of the Task Force is to draw up a performance evaluation manual of management guidelines and to evaluate the management performance according to the evaluation criteria of the manual. Members of the Task Force include professors in economics and business administration, senior staff from research institutes, certified public accountants and businessmen.

Analysis

The institutional arrangements for the Korean Performance Contract System has several merits. The PC system itself was introduced and is seen by PEs as part of a total reform package in which several elements of operational autonomy were given to PEs. It was introduced through an Act of Parliament and the Act confers several powers on PEs and clarifies what PEs can expect from government.

Institutional arrangements get the commitment of the political executive by keeping on the Management Evaluation Council (MEC), the Minister of Economic Planning and involving ten other concerned Ministers within the Council. The presence of the ministers on the Council makes it possible to attract the highest level of academic and industrial talent to serve on the Council. The Korean Development Institute, which has been greatly involved in academic studies on the functioning of the Korean economy as a whole and the public enterprise in particular, has not only designed the Performance Appraisal System but is providing support for it. It has become possible, therefore, to obtain objective advice on matters relating to the fixing targets and criterion values. The fact that the results of the evaluation have a direct bearing on the rewards given to the executive and workers of public enterprise has made evaluation system of great importance to the public enterprises. There is a great deal of seriousness attached to the whole exercise from the top political executive to the workers of PEs. In making any evaluation of the performance under the PE system, it becomes necessary to determine the extent to which the variation of the performance from the targets is due to reasons beyond the control of the public enterprise. The Korean Development Institute and the Minister on the MEC who deal with other developmental programmes in Korea are involved and are, therefore, in a position to identify these factors easily and their opinion is also accepted by all departments of government.

The Korean PE system also ensures that the workers are involved in the whole exercise and are committed to the target fixed by the MEC. Performance Evaluation starts with a self-evaluation report by the PE and during the course of evaluation, written comments and complaints may be submitted to the Task Force.

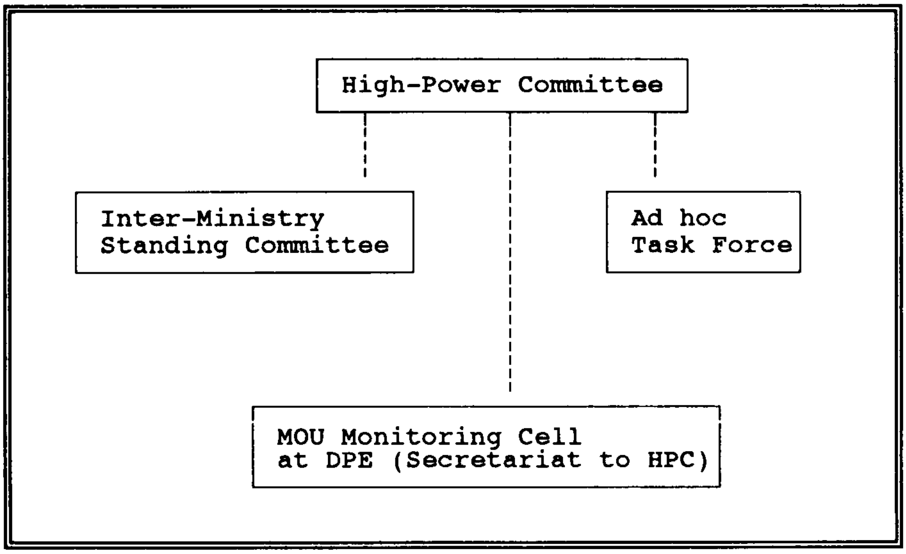
These arrangements were possible because the number of PEs subject to evaluation under the PC system were quite limited.

India

In India, the Performance Contract System is called the Memorandum of Understanding System (MOU System). The present institutional arrangements of the MOU system are set out in the diagram on the following page.

The MOU system is under the overall charge of the High Power Committee (HPC). This committee, which is chaired by the Cabinet secretary, consists of those secretaries who do not sign a MOU themselves but are concerned with the various aspects of the work of the public sector. It is set up as a third party to judge and evaluate the performance of PEs and their concerned departments in a fair, objective and unbiased manner.

The HPC is assisted by an Inter-Ministry Standing Committee (IMSC). This committee is under the chairmanship of the Secretary (PE) and consists of members from the Planning Commission, the Department of Economic Affairs, the Department of Programme Implementation and the Department of Public Enterprise. It is constituted to monitor and evaluate the MOUs at the first stage, when received from the Ad Hoc Task Force for the consideration of the HPC, and to maintain a continuous link between these entities. It is an executive committee. The actual



negotiations on targets and PC clauses are done by the Ad Hoc Task Force (ATF). It consists of independent experts such as eminent managment experts, ex-chief executives, chartered accountants, academicians and economists. This group of independent experts is expected to bring in a high level of expertise and also credibility to the design and evaluation of the MOUs.

MOU-Monitoring Cell

The Secretariat of the whole MOU System is the MOU-Monitoring Cell in the Department of PEs. It is the nodal point in the Department of Public Enterprises constituted for co-ordinating all the activities relating to the design, drafting, finalisation, monitoring and evaluation of the MOUs. It acts as the secretariat to the HPC and services the Standing Committee and the ATF.

The current institutional arrangements in India were designed after a careful study of the Korean PC system. The merits claimed for it are that it:

- ensures commitment from the highest level, i.e. the HPC, an apex body chaired by the Cabinet Secretary;

- enables objective third party evaluation, i.e. the independent third party (ATF) introduces an objectivity into the whole exercise as ATF members are neither a part of the PE nor the Government;

- provides a high level of expertise (ATF) and ensures a professional approach to the examination of MOUs and performance evaluation at the end of the year;
- creates a perfect buffer between HPC & ATF through inter-ministry Standing Committee to ensure a smooth two-way flow of information.

Analysis

The major difference in the system adopted in other countries and in India is the number of PEs covered under the Indian MOU system. It started with about 14 and now within four years, over 110 PEs are covered. It is proposed to cover over 200 PEs in the years to come. Furthermore, MOUs are signed on an annual basis. The large numbers and frequency have made the MOU negotiations highly routinised, as adequate time is not available for the deliberation of the issues concerned.

The Korean system was based on the recommendations of a very influential research institute and was introduced as part of a comprehensive PE reform package which was considered by Parliament which passed an Act approving the comprehensive package.[6] On the other hand, the Indian system is a partial reform to correct the PE-government interface and has not received the strong support of Parliament as in the Korean case. Another important difference lies in the political will which backs up the two systems. The MEC in Korea is presided over by the Vice-Prime Minister and includes nine other ministers, while the Indian counterpart, a High Power Committee (HPC) is headed by the Cabinet Secretary, (no doubt the most senior civil servant but not the same as a political executive). A number of cases have already come to notice where the assurances given by the 'government' through the PC by the administrative ministry have not been fulfilled by the other departments.

The other major difference is that the Korean evaluation system would directly lead to the distribution of rewards to workers and executives of the enterprise concerned, in a graded manner according to performance. The Indian MOU system only leads to an award (not a cash dividend) to the best performing enterprise based on the

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[6]Song, Dae Hee, "A New Performance Evaluation System of Korean Enterprises", Public Enterprise, Vol. 8, No.1, 1988, pp. 84-92.

composite score. Even then, the enterprise which gets the award does not give any monetary benefit to the executives or workers.[7]

Lessons from the review of country experiences

From the foregoing review of experiences with the use of the PC system, the following observations and suggestions could be made. A PC, even though contracted between PE and the administrative ministry of the government, is best negotiated under the guidance of an independent agency. Nowadays, in most of countries, there are nodal agencies or departments of government in charge of PEs. Such a department or agency can be used as the nucleus of the PC system for that country. While such an agency/department can provide secretarial assistance, the essence of the PC system should be a Performance Evaluation Committee or Council. In order to give it proper political backing, it should be headed by the minister in charge of PEs or in charge of planning, or the minister in the Prime Minister's Office or in the finance ministry, nominated by the Prime Minister or the President of the country. Other members of the Council should be the most senior secretaries in charge of the Cabinet, finance, PE, planning and in the important administrative ministries which deal mostly with PEs, i.e. the Department of Industry. In addition, one or two ministers selected from among these ministries could also be members. This should be treated as a senior committee whose function is only to give guidance and to record the performance.

In order to evaluate the performance and to study and fix the targets which are to be included in the criteria in each individual PE, there should be another junior body consisting of experts and working on a part-time basis. Depending on the number of PEs which are to be brought into the PE system, this group of experts could be one or several. These may be called PC teams or task forces and for best results its members should be drawn from academia, the corporate sector and include former civil servants and public and private enterprise executives. The number of teams/task forces would have to be decided with reference to the number of PEs to be covered under the PC system. A team or task force can deal effectively with about six PEs. It is also necessary that widely divergent PEs are not placed under one task force. If there are a number of mining industries in the public sector, a task force exclusively for the mining industry may be appropriate.

The task forces as well as the performance evaluation council should be serviced by a performance information system. This should be set up as a new division

[7]Sankar, T L., MOU: The Wrong End of the Stick, The Journal of the Institute of Public Enterprises, Hyderabad, Vol. 13, No. 2, 1990.

within the planning department or the department of PE. The best arrangement would be to contract out the service to an academic institution within the country.

The work of the PC system should be made manageable by reducing the number of PCs covered by the system. Usually a question is raised as to how to reduce the number of PEs to be covered by the PC system, especially where the country has a large number of PEs. This is not difficult. First, PCs which have no public purpose or functioning under competitive market conditions should be given to a competent board of management and allowed to function in competition with other private enterprises in the same sector. The profits shown in the balance sheet could be a good indicator of the performance. If the country is undertaking liberalisation or divestiture, such enterprises (without public purpose) could be chosen for at least partial divestiture. If it is partially divested, the price variations of the shares of these enterprises on the stock market under normal conditions could be taken as a good indicator of performance.

PEs which are subjected to a PC system should be limited to a few enterprises whose performance could not be judged purely on the basis of the annual financial accounts. The criteria of evaluation to be included in the PC system should be few, while long and complex discussions on criteria and weightages could be avoided if meaningful and widely agreed typology of PEs is developed, and criteria/weightages are fixed for each type accordingly. The criteria should be easily understandable and quantifiable.

The PC system should provide an opportunity for the negotiator, on behalf of the PE, to detail the Board of Directors, select a group of workers and executives, and get their acceptance or views before referring back to the PC system for further negotiations or for signing the contract.

There should be a vital linkage between the performance efficiency as evolved under the PC system and the rewards and penalties imposed on the executives and workers. The incentive system should be fair to all PEs and to the government and should be well understood by all, including the general public.

If there are major changes in the macro-economic environment during the period of the contract to an extent which was not anticipated at the time of signing the contract, the PC system should provide for procedures and principles for correcting the achieved performance with reference to the changes in macro-economic environment.

Box 3.2: Lessons from the Bangladesh Experiment with PC

In Bangladesh the experiment of design, development and implementation of performance contracts is the first action-research project of its kind. The main purpose of the experiment was to ascertain whether the methodology that proved most effective in other countries could be implemented in Bangladesh and if so, in what shape. The experimental application of the system in 20 PEs over the last eight years has revealed the following:

1. In a situation where political linkage of the ruling party flows to the PE managers, staff unions and down to the labour leaders, the implementation of a goal-oriented performance scheme is a difficult task. Especially in a corporate culture where workers, employee and officers all have the tendency to gain more through political linkages other than working hard, it is difficult to earn confidence for such systems.

2. The institutional structure planned for implementing the contracts could not establish its due footing. In the absence of any clear decision from the controlling ministry, other ministries and corporation officials involved in the process were not adequately enthusiastic. The Cell had limitations of manpower, both in terms of number and skill to handle a large number of contracts. The Task Force, planned for developing goals, objectives and strategy with the help of technocrats, could not function.

3. In the absence of appropriate institutional support, the Monitoring Cell of the finance ministry had to take up the role of supreme authority for implementing/applying the contracts. The finance ministry, being at the parallel position with other ministries, did not have the full authority to instruct the supervising ministries. Whatever support it had was by virtue of its authority to approve the PE annual budgets.

4. As the contracts are technical in nature and the personnel implementing them are of limited management qualifications and background, the fewer the number of criteria, the less complicated the exercise will be.

5. Any reform measure, to be effective, must be acceptability to those who are involved in the implementation process. In an environment where the implementors are inadequately educated in the field of modern management techniques and are prone towards controlling the PEs, the need for attitudinal change is of utmost importance.

7. The whole process of formulating clear goals and objectives, strategic planning, target-setting and achievement of the targets, provides better appreciation of the problem of PEs. This served as a good vehicle for management development by providing effective training to personnel who do not have the appropriate management background. The process of preparing the contract – through analysing, discussing and inter-

organisational communication, was as valuable as the end-product of the exercise (i.e. the contract).

8. If any of the parties involved in the contract are having goal incongruent behaviour. the whole exercise becomes ineffective. To cite an example, one of the contracts handled by the Monitoring Cell was involved in a second PE that was the sole purchaser of its output. Due to the conflicting interests of some of the senior officials in the second PE, the management of both the PEs could not be brought to agree on this criteria and an account of the conflict, the contract was abandoned.

Source: M.A.K. Mazumdar, Performance Contracts in Bangladesh. Prepared for the Commonwealth Secretariat, London 1994, p.16 & 17

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Content of Performance Contracts

The content of a PC may be brief or very long, depending on the wishes of the country's policy-makers. While the details of the contents may vary, a PC should contain certain important conditions and statements which are discussed in this chapter.

Essentially, the PC should reflect the following:

Long-term contents :	1. Mission 2. Objectives
Short-term contents:	3. Performance criteria 4. Performance criteria weights 5. Targets against criteria
Mutual obligations :	6. Obligations of PEs 7. Obligations of government

Statement of Mission and Objectives: Nature and Purpose

A PC system is adopted primarily to ensure that the performance of a public enterprise is judged, not merely with reference to its financial performance, but also with reference to all the social objectives which have been assigned to the enterprise. Therefore, the PC should clearly set out the mission of the public enterprise which represents its long-term goal. The objectives should highlight the short-term benefits which the government expects from the public enterprise and these objectives, as far as possible, must be quantifiable. Where they cannot be quantified, some measurable surrogates have to be identified. In achieving the objectives the public enterprise would expect certain assistance or help from the government and such expectations should be set out in some detail.

The mission and objectives do not change in the short run and therefore remain constant for a reasonably long period. The remaining conditions which mention the targets to be achieved may change frequently.

Mission

All public enterprises are presumed to serve the public. There is a tendency therefore to state a mission in very broad terms and in such a way that anything which is considered good for the public is included. There is also a tendency to describe the mission in grandiose terms. For example, the mission of a public enterprise which is in the consultancy business is set out "to be the most important international consultancy organisation in the world". While there is nothing wrong in setting out the mission somewhat ambitiously, there is the need to make it realistic and achievable in the next 20 to 25 years. For example, a refinery which is set up to process crude oil in a particular region can state its mission as: "to process the crude from such and such region in a more efficient manner and work towards the total utilisation of all the by-products and stimulate the growth of petro-chemicals in the region." The growth of petro-chemicals may not be possible in the near future but is a distant possibility which can be kept in view by the PE.

In writing a mission statement, there should be a judicious balance between the great expectations on the one hand and the achievable results on the other hand. A simple way to write up the mission is to ask why was the public enterprise set up. Or simply to ask: What business are we in? In the memorandum or Act setting up the enterprise, some mention of the mission is normally made, but such a statement is usually lumped together with several things that the enterprise could do. The precise mission statement has to be 'extracted', from the general statements. Sometimes a public enterprise purpose should be modified to reflect the managerial considerations for setting up a particular unit.

When a PE is established through an Act of Legislature, the mission statement is drawn up more in political terms. In the PC this statement should be interpreted in managerial terms. Normally a mission statement should not exceed a few lines. It is a good practice to get the Board to consider the mission and approve it.

Objectives

Objectives are concrete results or outcomes that are expected by the public enterprise in the short run or during the period covered by the PC. It should be a complete list in order of priority of the results or achievements expected from the public enterprise. For example, in the consultancy firm earlier referred to, the objectives may be in terms of achievement of consultancy, e.g. increase in consultancy operations in specific areas, such as urban transport. In the case of the manufacturing unit, they may be the products which are to be manufactured and their market share. Objectives should be the achievements which further the mission. There should be coherence between the objectives and the mission.

The commitments of public enterprise

The next part deals with the real substance of the contract and this should be discussed each year. It sets out the performance targets which are agreed on by the public enterprise and the government. The values and the relative weightages of these targets should also to be specified. There is a temptation among professionals, especially PC experts, to have too many targets.

The real issue is that targets should be such that they not only describe the static operational efficiency but also take care of the dynamic effects. It is obvious that it is easy for a manager or chief executive to achieve higher static performance targets which may have an adverse dynamic effect. For example, a higher level of operating hours can be achieved in the case of an electricity generating plant or road transport vehicles by skipping the normal maintenance operations for a year. However, this will lead to the equipment breaking down and may lead to major repairs in a few years' time.

One of the key reasons for performance targeting is the need to give adequate weightage to social obligations contributed by the public enterprise. These are obligations which are not captured by the annual financial accounts. It is therefore important that the performance criteria should include those relating to such social obligations.

It is also necessary to give some weightage to project implementation efficiency whenever the PE has a new project under construction, as the impact of such efficiency will not be captured by the balance sheet in the short run. The efficiency of project implementation usually has a serious long-term effect.

Sometimes the preparation of a corporate plan is also included as a performance criterion. Of course, the normal commercial and financial performance criteria such as the market share of the company's product, its total profitability etc. are included as criteria.

In designing the PC system, great attention should be given to the number of criteria that are to be included in the PC. A larger number of criteria, with various weightages attached to them, leads to a fuzzy and vague interpretation of real performance. It is important to emphasise the need to identify a very limited number of clearly measurable criteria. A recent Conference of Public Enterprise Chief Executives in India (1993), which reviewed the experiences of the MOU system in India, recommended that the total number of criteria should not be more than five. Generally, the most important elements for evaluation of the public enterprise performance are: production, profitability and employment. The dynamic effects should be captured by including criteria such as R&D, maintenance efficiency, staff training and development etc. The social benefits, if any, expected

Box 4.1: Principles of Performance Target Setting

The principles on which the targets are set by the Experts' Advisory Cell (in Pakistan) are:

1. Efficient target setting should be carried out in a participatory process. Without this approach, targets tend to take the form of formal directives which are often overtly accepted and covertly resisted.

2. Targets should be clear-cut.

3. Targets should neither be too low nor too high. This could give wrong signals to the managers.

4. Each enterprise must be looked at in its own unique environment which must be taken into account.

5. The targets for incentives should ensure that generation of a surplus is significantly more than distribution by way of bonus.

6. Targets must take into account the social tasks which enterprises are invariably asked to carry out.

Source: I.Mehdi ,op.cit, p.9

from a public enterprise could be specified separately. Some scholars have frowned on the practice of regarding targets for the welfare of the public enterprise workers as social benefits. Social benefit targets should be special targets such as, the benefits given to the local community by way of training their youth or providing opportunities for the community to acquire skills. Human resource development is one of the very important elements which will affect the dynamic efficiency of an organisation but it is not a social benefit.

Assigning weightage to criteria

After agreement is reached on the criteria to evaluate performance, weights have to be attached to indicate the relative priority of the criteria. For example, as in Pakistan, if a PE has an expansion programme, in the PC it negotiates the three agreed criteria which may be:

(i) production;

(ii) profits; and

(iii) completion of the expansion project on time.

But the parties may give the relative priority to these criteria in terms of weights as:

Production	30%
Profit	50%
Project implementation	20%

The weights may be specified as percentages when they should add to 100. Alternatively, the weights may be fractions adding up to one. In the example above, in decimal fractions the weights would be specified as 0.30, 0.50 and 0.20, adding up to 1.00.

Box 4.2: Structure of Performance Contract in Ghana

From 1991, the structure of the performance contracts in Ghana was standardised around five main heads:

- objectives of the enterprise (a statement of mission);
- performance indicators to be monitored and annual targets to be achieved during the contract period;
- mutual undertakings of Government and enterprise;
- critical assumptions made in setting specific targets; and
- reporting requirements.

Source: W.A.Adda, op. cit, p.4

Each year, after agreement has been reached on the criteria to evaluate the performance, weights have to be assigned to each of the criteria. This is important because criteria selected are not of equal importance and the importance of one criterion may also vary from year to year. One could say that profitability is the most important criterion in a particular corporate entity but it may be production in another company. India started with a low of 20 per cent weightage for profitability in most companies. It has now been increased to 50 per cent weightage to all companies. In the first phase of its PC, The Gambia assigned a weight of 60 per cent to quantitative indicators and 30 per cent to qualitative indicators. The remaining 10 per cent was assigned to overall performance. During the second phase, the weights assigned to quantitative and qualitative indicators were 60 per cent and 40 per cent respectively. It should be noted that while the process many appear easy on the surface, it is in fact generally difficult to agree on weightages. The discussions invariably lead to long arguments on all sides. For example, the market share may be given very high weightage by one party to the PC while the other may consider the profitability to be of greater importance and should therefore attract higher weightage. The important requirement is that an agreement should be reached on the relative weightage and be accepted by the PE and the government.

An example from an actual PC showing the large number of criteria and their relative weightage is given below:

Criteria	Weightage
I. **Profit Related** (50%)	
New profit/capital employees (%)	30
Gross margin ($ million)	20
II. **Production/Turnover Related** (25%)	
Product I ('000 tonnes)	10
Product II ('000 tonnes)	10
Exports ($ million)	05
III. **Dynamic Efficiency** (15%)	
R&D expenditure	05
Project implementation	10
IV. **Social Obligation** (10%)	
Expenditure on green belt	05
Training of local community (No. of persons trained)	05
	100

Fixing the Target Value

After settling the criteria and their weightages, the value for the criteria or targets in specific numbers have to be prescribed. For example, net profit/capital employed may be fixed at 18 per cent and the gross profit $240 million. Similarly, for each criteria, the values in the relevant numeraire have to be settled.

In the case of a PC with the three criteria referred to above, the PC should spell out clearly the target level of production, profit and index of project implementation efficiency, say, expenditure on new project implementation, e.g.

Production	20,000 tonnes
Profit	20 million currency units
Project implementation expenditure	200 million currency units.

If the enterprise performance at the end of the contract period reached these target levels in all three indicators, it can be awarded 100 per cent marks during evaluation. If the profit is zero, then the PE can only get 30 per cent for production and 20 per cent for project implementation to make 50 per cent performance if the PE has performed well on those two scores. In real life, different enterprises may fulfil the targets to different levels and to get a relative evaluation of these enterprises, the targets are arranged on a three-point scale; which of the two scales is selected is entirely subjective. We will discuss both.

In a three-point scale, the target level considered very good may be kept in the middle of the three points. Let us say a specified percentage above the contracted target is considered excellent and kept as 1, and a level below the target is considered unsatisfactory and kept as 3:

Performance Level	1	2	3
Score	1.0	0.8	0.5
Indicator 1 - Production (tonnes)	>25,000	20,000	<10,000
Indicator 2 - Profit (currency units)	>22.0	20.0	<15.0
Indicator 3 - Project Implementation (currency units)	>240.0	200.0	<100.0

(Note that the scores for excellent and unsatisfactory are subjective.)

In such a scoring system the maximum will be 1.0 and the minimum 0.5. If all the three targets are reached, the unit would get 0.8 or 80 per cent. A score of 1.0 or 100 per cent is only possible when the performance is above the targets and at a level considered excellent. Let us see how. Let the actual performance be:

Production:	26.000 tonnes
Profit:	12 million
Project implementation:	210 million

In respect of production and project implementation, the achievement is above target but in respect of profits it is far below target. How to evaluate the performance and give a composite score will be explained in Chapter Five.

Similarly, in a five point scale, we could make 1 as excellent and 5 as poor as follows:

1	Excellent	>target
2	Very Good	target
3	Good	a little below target
4	Just satisfactory	minimum acceptable level
5	Poor	unacceptable

The target for different scores

One would have to settle on what would be the performance assessment for deviations from the target. This need not be the same for all criteria. For example, a 10 per cent deviation in profitability may not be valued in the same way as a 10 per cent deviation in production or in R&D expenditure. On an agreed scale, the criteria values should be settled. While the easiest way would be to have a three point scale, the five point scale seems to be the preferred one. Say, at the evaluation stage, the achievement of the target is considered very good. As 10 per cent above the target could be considered excellent or outstanding, 10 per cent below would be considered as good, but 20 per cent below would be considered as just satisfactory and anything more as very poor. In order to make the evaluation transparent, it is necessary that the criteria values are specified clearly. An illustration is provided in Chapter Five.

There is yet another system where the maximum points awarded is set at three times the score for target achievement and all the scores are enumerated on a number of points. (This is used on a limited scale.)

Indicator	Return of Capital Employed (ROCE)	Rating Score
	18.0%	30
	17.0%	25
	15.5%	20
	14.5%	15
Target	**13.5%**	**10**
	11.5%	5
	10.0%	1

Obligations

The next part of the PC spells out the assistance required from government by the PE. Usually, this lists the powers to be delegated to the enterprise. Often, the enterprise will seek delegation of power to sanction projects up to a particular limit say $0.5 million or to sanction staff up to a particular salary level. It could be also a request for a release of funds according to certain deadlines.

The third part of the PC contains the methods and dates of evaluation agreed upon. If a reward and penalty system has been approved as part of the PC system this will also indicate the penalties and rewards which the public enterprise will get on achieving the targets set at the beginning of the year or the penalties for poor performance or non-attainment of agreed targets.

5

Monitoring and Evaluation of Performance

Evaluation is the appraisal of the performance of the PE against the targets set out in the PC at the end of the period of each contract, which is usually one year. Monitoring is the periodical follow-up of the performance during the period of the contract, with a view to ensuring that the PE performance is on course and to provide some mid-course corrections, if necessary.

Evaluation

Evaluation of performance is the main purpose for setting up a PC system. As discussed in Chapter One, PEs generally perform under conditions that distort their financial performance if the Annual Accounts alone are used. The PC system, therefore, attempts to supplement the Annual Accounts by providing detailed information such as the degree to which the PE has been successful in achieving set targets and how successful each PE has been in relation to other PEs. The PC system, therefore, provides a means for computing the performance of PEs on a scoring scale which permits the evaluation of results in terms of a maximum achievable score. The composite score tells government and the management of PE at a glance the level of relative achievement of all the PEs under the PC system. This composite score, then, can be used to distribute rewards (in the form of bonus or other non-financial awards) or penalties. Just as the final project/loss figure is the 'bottom-line' in financial accounts, the composite score is the bottom-line of the PC system.

Computing a composite score

Chapter Four provides a description of the contents of PCs. All PCs should contain a clear enumeration of all the criteria of performance, the relative weights attached to the criteria and the target levels for each criteria on a three-point or a five-point scale. The methods of computing the composite score in each case are described below.

In a three-point scale scoring system with, let us say, only three criteria, the PC will contain a statement as follows:

NO	CRITERIA	UNIT	WEIGHT	SCORE		
				1.0	0.8	0.25
1	Production	thousand (tonnes)	0.3	»22	20	«15
2	Profit	million (currency units)	0.5	»25	20	«18
3	Project implementation	million (currency units)	0.2	»30	25	«20

Let us consider the example of a PE with the following performance:

Production: 26,000 tonnes
Profit: 12 million currency units
Project implementation: 260 million currency units

The score will be calculated in a simple system as follows:

Let us take a simple procedure wherein the values in between the score value are not given any consideration. In other words, if the actual production lies anywhere between 20,000 tonnes and 22,000 tonnes, the score will be only 0.8 (or 80 per cent). only when it exceeds 22,000 tonnes will the score value jump to 1.00 (or 100 per cent).

In the case above, in production the achievement of 26,000 tonnes is above the score target for 1.0. So the score would be 1.0. The score value is 1.0 x weightage = 1.0 x 0.3 = 0.3. For profit, the score is 0.25 as the achievement is below the score target of 18 million for minimum score.

The score value is 0.25 x 0.5 (weightage) = 0.125. For project implementation the score is 0.8 as the actual is between 250 and 300 million. The score value is 0.8 x 0.2 = 0.160. The composite score = 0.3 + 0.125 + 0.160 = 0.585.

In other words, the enterprise has obtained 58.5 per cent marks in overall performance. It maybe remembered that in the scale adopted, the minimum mark an enterprise can get is 25 per cent and not 0 per cent.

In this method, the scores are discrete and jump at certain stages. One could also make the scores move gradually between two score values as in a number line. For example, the production score can be placed on a number line as below:

Score	0.25	0.8	1.0
	15,000	20,000	22,000

Any value between the points may be read off the number line. It may be noted that the movement between two points may not be on the same scale. This can also be handled arithmetically. We will illustrate it with a five-point scale scoring system.

The example of the five-point scale scoring system given in Chapter Four is as follows:

NO	CRITERIA	UNIT	WEIGHT	TARGET	SCORES				
					1	2	3	4	5
1	Production	000 tonnes	0.3	25	28	25	20	16	12
2	Profit	million tonnes	0.5	20	24	20	16	12	8
3	Project implementation	million units	0.2	200	240	200	160	120	80

Note: The scores in this are quite different from the scores in the three-point scale. This is just to give another illustration.

Also note that no percentage scores are given. The scores are discrete numbers from 1 to 5. The highest score possible is 1 and the lowest score is 5.

Score value can be calculated accurately as follows (as in a number line): first, identify the higher and lower score targets in between which the actual value lies.

Then the score is:

$$\frac{\text{Higher score - Actual score}}{\text{Higher score - Lower score}} + \text{Higher Score Value}$$

In the above illustration for production, the actual value is 26,000 tonnes; it lies between the values 28 and 25. Then the score is:

$$\frac{28 - 26}{28 - 25} + 1$$

$$\frac{2}{3} + 1 = 1.66 \text{ (score value)}$$

It is easy to see that the score 1.66 could have been easily obtained on a number line.

The score multiplied by the weight will give the score value. In this case, since weightage is 0.3, the score value for production is 1.66 x 0.3 = <u>0.498</u>.

Similarly, we can illustrate the "profit" criterion. Actual profit is 12 million. It is just on score 4. But the weightage for profit is 0.5. Therefore, the score value for profit is 4 x 0.5 = <u>2.0</u>.

Now for project implementation. The actual value of 260 million currency units is above the value for score 1.0. But its weightage is 0.2. Therefore, the score value for project implementation is 1.0 x 0.2 = <u>0.2</u>.

The composite score then is (0.498) + 2.0 + 0.2 = <u>2.698</u>

In this method, the enterprise would have score 2.0 if it achieved all the targets agreed to in the PC. It would get 1.0, if it exceeded, by a specified amount, all targets. The composite score of 2.698 indicates that the overall performance is between 'very good' and 'good'.

Reaching an agreement on the number of criteria to evaluate the performance and weights which are assigned to each of the criteria is difficult. This is important because criteria selected may not be considered of equal importance by government and PE. One could say that profitability is the most important criterion in a corporate entity. In fact, India started with a low of 20 per cent weightage for profitability and it has now been increased to 50 per weightage in the current year. Other criteria such as production, market share, employment etc. are also difficult to assign weightage. The task invariably lead to long arguments on all sides. For example, the market share may be given very high weightage by one party to the agreement, while others may consider profitability to be of greater importance and should therefore attract higher weightage. Needless to say, assignment of score values is more difficult. The important thing is that an agreement should be reached on the relative weightages and score and be accepted by the company and by government.

With an increase in the number of criteria and the score values to be assigned to each criterion, the objectivity and accuracy of the composite score may be affected.

BOX 5.1: Guidelines for Selecting Performance Criteria

The selection of a proper performance criterion is as important as the selection of an appropriate measure. For instance, there is very little point in measuring R&D performance in terms of funds utilised unless a nexus between the two has already been established. Further, it is desirable that:

- Performance criteria, like corporate objectives, should be limited.
- There should be a congruence between objectives and performance criteria.
- There should not be any duplication in the selection of performance criteria.
- Selected performance criteria should be measurable and their evaluation method pre-determined and laid down in the MOU.

SOURCE: Suresh Kumar, op.cit, p.6

Monitoring

The arrangements whereby public enterprises which are brought under the PC system are subjected to reviews during the period between the signing of the contract and the end of the contract period has generated some heated debates. Some of the PEs have argued that once the government and the enterprise have reached an agreement as to the performance that is expected of the PE, the government should wait until the end of that period to see whether the PE has been able to achieve the targets. Any review, say, on a half-yearly basis will certainly affect the autonomy given to the enterprise management. If the enterprise is made to accept some instructions at the time of the reviews, it will certainly hamper their managerial freedom. On the other hand, a review on a quarterly or a half-yearly basis may give the PE the alibi that whatever happened was with the knowledge of the government, that the suggestions given by the government to meet the different problems were implemented and therefore the PE chief executive and the management cannot be held responsible for the non- achievement of the targets.

In spite of the controversy, the generally accepted view is that the PE performance should be subjected to at least a half-yearly review or better, quarterly review. If the problems of the PE are not heard by the government periodically, and certain suggestions for modifications of government policy and programmes are not undertaken in the course of the year, the whole year could be wasted and the PE performance may be poor due to circumstances which could have been remedied through such a review. The consensus therefore is that there should be a review, which should be properly managed, so as to contribute to the overall effectiveness of the PC system.

BOX 5.2: Performance Evaluation in the Gambia

Performance evaluation is undertaken on a quarterly as well as an annual basis. The quarterly evaluation is undertaken with the objective of monitoring as well as identifying the variances so that corrective measures can be taken and performance can be improved. The annual evaluation is undertaken to judge the management's performance during the year as compared to agreed targets and to decide on the level of incentive, i.e. bonus or sanctions, to be awarded/applied. The process of the annual evaluation commences immediately after the enterprise submits to NIB it annual report and audited accounts. The enterprise also submits to NIB its own assessment of its performance.

On receipt of the annual report and audited accounts of an enterprise NIB undertakes its own evaluation. For quantitative targets the annual audited accounts are used as the source of information. NIB examines and evaluates each performance indicator and scores them. The scores of all indicators achieved are totalled and compared with total targeted scores and accordingly, recommendations about the incentives (i.e. bonus payment or sanctions) are made. The evaluation is finalised and recommendations (i.e. bonus or sanctions) to be imposed are submitted to The Office of The President in a report from NIB. In the report, the management's assessment of performance is also included.

Source: M.B.Njie, op.cit, p.12

It is well known that, while fixing the targets for the PE under the PC system, both the government and the PE make certain assumptions about the macro-economic environment that would prevail during the year. For example, the international recession in developed countries, or the currency exchange value of the home country vis-a-vis other currencies and the rate of inflation within the country, would have been assumed at certain levels. But in reality, these things may change considerably in the course of the year. It then becomes necessary for both PE and government to examine these factors and give their views as to what would be the impact of the new macro-economic factors on the performance of the public enterprise and the achievement of PC targets. Such a development may in fact call for a special review meeting.

The MIS should be based on a good understanding of the particular enterprises and the information requirements of all stakeholders. If the questions often asked in parliament relating to PE or the various queries raised by the administrative department of the ministry are carefully analysed, one can identify the issues that are critical to the performance of the PE in question. The information relating to these issues should be regularly reported to government who can convey the information to the Minister or the Parliament without additional reference to the PE.

Needless to say, the MIS designed for monitoring and evaluation would be different from the MIS for normal decision-making for management of the PE. The important element is that an MIS should be comprehensive but not too elaborate. Any enterprise would maintain certain data on production, sales, cash, etc. The MIS should be so designed that these are reported on in a monthly pro forma and sent to various supervisory agencies. If there are any abnormalities relating to the details sent, the government could call a review meeting to discuss such abnormalities.

On the whole, the general practice is to institute at least a bi-annual review of performance that could make possible mid-term corrections. It is the practice in certain countries to have a quarterly review. Whichever arrangement is adopted, it would be helpful to develop other methods of securing prompt and reliable information from the PEs.

The question then is, should the review be conducted by the same agency which does the performance contracting or by a different agency? It is now common that, in most of the cases, the review is done by the ministry which oversees the work of the PE, though the contract of the PE may be signed by a superior agency or even the President of the country. If the review leads to identification of certain external factors which have hampered the work of the public enterprise and there is need for renegotiating the target agreed on earlier, the procedure to follow will have to be repeated.

6

Incentive System

The Performance Incentive System is considered critical to the successful operation of the PC system. The PC system is an elaborate exercise which sets out performance targets and provides for an equally elaborate system of evaluation. All these would be meaningless, if not fruitless, unless the efforts of those who strive hard to fulfil the provisions in the contract are recognised and given some kind of special remuneration. The incentive system provides motivation for both the executives of the enterprise and the workers.

Legal Hurdles

In operating an incentive system, the first hurdle to clear is the legal provisions of the country as they affect the incentives, such as bonuses distributed to employees. In several countries, there are laws which permit the workers to take up collective bargaining in order to get a proper share of the surpluses generated by the company. Several decades of collective unionism have entrenched the practice in such countries among the management and workers alike. The workers are very reluctant to give this up; they expect that the minimum guaranteed incentives which come from the PC system to be treated as a deferred wage which is paid because they have achieved certain, and maybe "special", targets. The surplus to be shared by them has to be negotiated and this right cannot be taken away from them. In India, for example, prizes are distributed to those PEs which have excelled during the reporting year; no monetary rewards are given. In The Gambia, the incentive system includes monetary awards.

In countries where there are no legal hurdles, the incentive system has been installed as part of the PC system without any complications. Since monetary incentives require large financial resources, it is important that the performance evaluation, which is the basis for such an award, be transparently efficient. Otherwise, the incentives may become a de-motivating factor, especially for those PEs which have striven hard and have achieved better results but were not properly evaluated. The most important aspect of designing an incentives system is that it should be based on an effective evaluation system which is understood by all the PEs involved in the PC system.

BOX 6.1: The Incentive System in Ghana

> Performance contracts negotiated in 1989 and in subsequent years provide for bonuses to be paid to all employees of the enterprise, both management and workers. This practice differs from that in other countries where a performance contract defines the criteria for payment of incentives or bonuses to managers. The incentive bonus referred to in current performance contracts is generally assumed by enterprise management to correspond to the provision in many collective agreements for payment of an annual bonus to all employees. The distribution rules followed in most SOEs mean that all employees in qualifying enterprises receive an annual bonus of approximately 10 per cent to 15 per cent of their salary.
>
> *Source: W.A.Adda, op. cit, p.7*

Type of Incentives

An incentive system may be pecuniary or non-pecuniary or both. Some countries attach great importance to certain titles conferred by the government, e.g. Malaysia. In some countries the executives may be motivated more by non-pecuniary rewards (i.e. titles), whereas the workers may opt for a pecuniary reward.

Key Issues

It must be emphasised that for an incentive system to be effective, it should be transparent and well understood by all the parties to the contract so that, right from the time the contract is signed, the parties will be motivated not only to achieve the targets but also to achieve the extra levels of performance which will earn the bonus. Unless the incentive system is clear to all, there will be disagreements which may adversely affect the operations of the entire system.

Another issue that should be noted is the imposition of penalty for non-achievement of performance. There is the view that penalties should be the other side of the coin of incentives. Penalties such as stoppage of increment and a small cut in salary for the succeeding year may be included in the contract. But there is another view that, until the PC system is well established, the imposition of penalties for non-achievement of *targets* may lead to suspicion among workers and executives who feel that these have been brought in to punish them. This perception may reduce the acceptability of the PC system. Others have argued that the non-receipt of a reward can itself serve as a penalty. The fact that other enterprises in the same position and in the same industry are able to get rewards in terms of bonuses or titles for the executives, may be an active motivating factor. All this points to one conclusion: that the incentive system deserves thorough discussion before a decision is taken on its introduction.

The next question is: Who are to be covered under the incentive system? In some countries, there is a history of executives not getting a monetary reward in terms of bonus. The award of monetary incentives in these countries may possibly lead to some kind of suspicion on the part of workers. The Indian situation is along these lines. However, there are countries where incentives have been given to executives as well as to workers. There are also cases where incentives are confined to a small team called a management team which takes responsibility for achieving the performance targets as contracted and to exceed those targets. This is the case in The Gambia, where the management team can earn as much as two years' salary as bonuses.

It would be useful, right from the beginning, to spell out who will receive a pecuniary benefit for achieving performance levels above the target and how the total bonus or reward will be shared by the executives and workers. Otherwise, each time a reward or bonus is announced, unnecessary industrial dispute may result. In some countries it may be necessary to enter into a separate contract with workers or their unions before the incentive provisions are included in the PC.

There are different views as to how much of a surplus should be used as a reward for executives and workers of the PE. Questions to be answered include: Can a bonus be given in loss-making enterprises? Should the amount distributed be linked with cash or profit generated?

It is important that the PC itself should specify clearly the extent of the surplus generated over and above the target level should qualify as reward to the workers and managers. In some countries, it has been accepted that one-third of the surplus generated should go to the workers, but there is a problem that in certain countries, rewards have been announced in terms of the number of months salary they would get as bonus for achieving different target levels. If a careful and thorough computation is not undertaken, the PE may end up paying bonuses out of the surpluses that should legitimately finance the operations of the PE.

There is also the question whether the company as a whole should get the rewards or just certain sections of it. An example would be an industry where there is very poor technological performance by way of conversion of raw material into the finished product. It may require a great deal of attention to the production machinery to see that the input/output ratio is significantly upgraded. Should there be a separate mention regarding incentives to be given to the people who work on this section if they make an extraordinary contribution to the achievement of targets? Similarly, in the case of certain enterprises, such as electric companies in developing countries, the performance of meter reading, billing and revenue collection may be very poor, but this is attended to by a group of non-technical workers in the electricity companies. If one fixes a target for better revenue collection, can one say that technical workers who are engaged in this area of activity alone would receive the incentive? These are issues which cannot be resolved in general terms. They have to be carefully examined on a case by case basis and to be resolved before embarking on a system of incentives appropriate and acceptable to all.

As the PC system is also to cover loss-making units, it may cover the units which make cash losses. In such companies, even for their day-to-day performance, they have to get a subsidy or a loan from the government to cover the cash deficits each year. There are scores of industries under the central government which make cash losses. If the improvement of performance is specified in certain terms in the PC, and if the company's management and workers achieve the targets, and the company is still making a loss, who will pay for the bonus? This naturally has to be paid by the government which may have to build up a pool of resources from surpluses paid in by profit-making companies. The justification, according to one school of thought, is that the company deserves the bonuses for improving its performance and for achieving its targets, even though it is not in a position to pay out such bonuses because the company makes cash losses.

Concluding Notes

Finally, a well-designed incentives system can lead to a situation where employees and the government take the PC system seriously. But the incentives system must be designed in such a way that it is acceptable to executives and workers alike, and the evaluation system is closely linked to the incentive system so as to ensure that the distribution of the surpluses by way of incentives is transparent and acceptable to all. Otherwise, the incentive system, instead of motivating employees may not only de-motivate them but also become a source of irritation and adversely affect the overall performance of the company.

7

Launching the Performance Contract System

As discussed earlier, the process of installing a PC system depends on a number of factors, including the environment in which the PC is implemented, the number of performance indices included in the contract and the institutional arrangements.

The best performance contracting arrangements are those which are introduced as one of the measures in the comprehensive reform package for PEs. A government policy might classify public enterprises as those to be wholly privatised, partially privatised and those to remain in the public domain. Each country will need to decide on this classification, but the important thing is that a clear-cut government policy is necessary right from the start. Such a policy may be backed up by a government white paper or even an Act of Parliament.

Invariably, public enterprises which continue in the public sector may become prime candidates for the introduction of the PC system. Typically, such a list would include public utilities, mining enterprises, core industries for industrial growth, i.e. industries which have a very significant forward and backward linkage and industries which produce goods which have to be distributed to the poor through non-market channels. This list would contain only enterprises which have long-term goals and social benefits which cannot easily be captured under the financial accounting system usually adopted in the preparation of the balance sheet and profit and loss account in the conventional way. There may also be industries which have some special environmental benefits.

Depending on the size of industries slated for the performance contracting system, the institutional arrangements should be designed and installed. Typically, the responsibility for guiding performance contracting and monitoring the achievement should be given to a neutral department or ministry of the government such as the Department of Public Enterprise, Bureau of Public Enterprise or Planning Department or the Prime Minister's Office. Needless to say these agencies would be having a large variety of duties and the responsibility for performance contracting should be entrusted to a separate division. This would become the secretariat of the PC system.

There should be a special agency to guide and monitor the performance contract. Since the actual contracting is usually done, by the head of the administrative machinery or ministry and the Chief of the PE, the monitoring agency should be headed by someone senior to them. From the experiences of different countries, it appears that the arrangement is to have a minister, or someone of ministerial rank, designated by the President or Prime Minister to head the monitoring agency. Members should be representatives of the highest levels from the PEs, industry, finance and planning.

Depending on the number of PEs brought under the PC system, one or more teams/task forces should be formed. The members of the teams could be those who do not currently have contact with PEs. They could be former chief executives, secretaries to government, leaders of private industries who do not have conflicts of interest with the PEs, academics, retired labour leaders or representatives of people's institutions like the Consumer Council, the Environmental Forum and so on. The whole team/task force may be large but it should be divided into small teams, each of which is entrusted with three to five enterprises. Each of these small task forces should advise on the terms of the contract and later review the performance with reference to the terms of the enterprises. An information sub-system should be set up and this could be entrusted to an existing academic or consultancy agency.

One way to start off the performance evaluation system is to have a workshop of all the PEs participating in the PC system, including the ministries and members of the task force. Such an approach would simplify the process. Another way is to entrust this task to a group of experts who will then issue a report for distribution to the PEs affected.

It may be useful to provide an opportunity to task force members to visit the enterprises which they are to guide to see for themselves the conditions under which they operate.

There should be two sets of meetings every year. One at the time of performance contract setting and a second when the performance is fully known and needs to be reviewed. It should be noted that it would not be possible under the normal annual budgeting system followed in most countries to fix targets after knowing the performance of the previous year. Typically, the budget year is April to March. All the financial commitments made by the government and the promises of achievement by the PE in the contract would be taken into account in finalising the budget for the year beginning in April. In order to do this, the figures have to be supplied by the PE not later than the end of January. In effect, figures for approximately six months' performance should be available when setting the contract for the next year. The performance as audited should be available between July and September. It would be good practice to have a review meeting in August/September.

Check-list for the Successful Operation of PC

Before launching the PC system, it is important to take careful note of the factors which may significantly influence the successful operation of the system.

First, a policy statement on the introduction of a PC system should be issued. The statement should clearly set out the goals and objectives of the system to be designed and the institutional framework to be used. A performance contracting system can be simple or complex depending on the policy pronouncements of the government. It can be an elaborate system which may involve several ministries playing a developmental role in relation to the public enterprises affected, or it may be a simple system that involves only key ministries deemed to represent the interests of other administrative ministries. The important point is that a clear-cut institutional framework should be available.

Second, categorise or classify the PEs with a view to identifying the enterprises to be contracted. This is usually done through studies and requests that enable governments to make the crucial policy decisions.

Third, the PEs to be contracted should first set their house in order. Each should have a corporate plan. The design of a corporate plan is usually a pre-requisite to signing a performance contract. PEs up for contracts should therefore be required to go through the exercise of producing a corporate plan.

Fourth, the performance contracting system needs to be "sold" to the PE management and rank and file. This already assumes that the government has the political will to carry out the reform. The "selling" can be done in various ways, including seminars and workshops for appropriate officers, policy statements, information and other data disseminated through the media – electronic and print – and circulars.

Fifth, and to summarise, PCs are most successful when there is:

- a high level of political commitment for PE reforms;
- an adequate system and agency for monitoring the enterprise performance;
- an in-depth organisational study before entering into the contract;
- an adequate management information system;
- an institutional framework – especially a technical unit established and located at the appropriate level of government;

- an extensive and meaningful involvement of the management team and their officials in preparing for performance improvement, including, as a pre-requisite, the development of a corporate plan;

- a capable management imbued with team spirit;

- rewards and sanctions closely related to performance;

- agreement among the enterprise management, supervisory ministry and central agencies on the key assumptions in the PC system and the strategic directions of the PE.

CASE STUDIES

I

Performance Contracts in Ghana's Public Enterprise Reform Programme

The performance contract system constitutes a major element in Ghana's public enterprise reform programme. The system incorporates two main elements – the corporate plan and a performance contract – linked in an annual cycle of monitoring and evaluation activity. Each state-owned enterprise [SOE] participating in the system is required to prepare and update regularly a comprehensive corporate plan. The implementation of this plan is disciplined by means of a negotiated contract agreement which sets annual performance targets and is monitored on a quarterly basis.

The Role of Performance Contracts in the Reform Programme

From the beginning of the public enterprise reform programme in 1987, the performance contract system has been used to structure programmes for improving the performance of those core or priority SOEs that were to continue in public ownership. This core group of enterprises includes the Ghana Cocoa Board, a major source of government revenue, and 16 other enterprises, concentrated for the most part in the energy, transportation and communications sectors. The performance of these enterprises deteriorated badly in the 1970s and early 1980s and their recovery was considered to be of major importance to the success of the economic recovery programme.

While initially conceived as an instrument contributing to the improved performance of priority public enterprises, the performance contract system has gained acceptance as a useful framework for managing transactions across the interface between government and enterprise. The legal and institutional framework of SOE governance had been seriously eroded during the preceding years of economic decline and political instability, and effectively set aside in 1982. In that year, the Interim Management Committees (Public Boards and Corporations) Law (PNDCL 6) was enacted and the pre-existing system of SOE management by boards of directors largely abolished.

Under this 1982 legislation, the boards of 57 major SOEs were dissolved and replaced by Interim Management Committees. These Committees excluded any representation of the supervising sector ministry, as well as external directors, and comprised entirely employees of the enterprise as follows:

- the chief executive;
- the financial controller or chief accountant;
- the head of the main operations division;
- a representative of middle-level management;
- a representative of the workers' union, nominated by the workers;
- two representatives of the (local) People's Defence Committee, later Committee for Defence of the Revolution (CDR).

This act introduced a period of SOE self-management that extended over the better part of a decade. In this interval of participatory management the chief executive was assigned or assumed authorities previously exercised by the board. Ad hoc interventions by supervising ministries tended to proliferate and the discipline provided by a coherent and consistent governance structure virtually disappeared.

The broad thrust of reform in the area of SOE governance has been to concentrate accountability for enterprise direction and performance on a board of directors, and to increase operational autonomy by reducing the extent of both authorised and ad hoc ministerial interventions in enterprise operations. Supervising ministries were directed in 1991 to reconstitute the boards of directors of enterprises in their portfolios. However, implementation of this directive has been slow and remains incomplete. As recently as December 1993, a third or more of SOEs reporting did not have a board in place.

This background is important for an appreciation of the contribution made by the performance contract system to the overall reform programme. The Planning, Monitoring and Evaluation (PME) system for updating the corporate plan, negotiating annual performance objectives and targets, followed by quarterly reporting and annual evaluation, has come to be accepted as a useful framework for managing the interface between government and enterprise. An annual cycle of activity now links the supervising ministry and enterprise with the State Enterprises Commission and the Ministry of Finance and Economic Planning in the setting of performance objectives for core public enterprises. This contribution is of particular significance in Ghana's case, restoring discipline to a system of SOE governance that had lost both credibility and effectiveness during nearly ten years of enterprise self-management by a committee of its employees.

Elements of the Planning, Monitoring and Evaluation System

The Planning, Monitoring and Evaluation [PME] system is one of the main components of the SOE Reform Programme. For this reason it comprises a major part of the ongoing workload of the State Enterprises Commission. The system provides an improved mechanism for managing the interface between government and public enterprise and for guiding the implementation of measures to improve performance. The system incorporates three elements linked in an annual cycle of activity:

- updating the corporate plan;
- negotiating the performance contract;
- quarterly monitoring and annual evaluation and reporting of enterprise performance.

Performance contracts are negotiated agreements between a sector ministry and the managers of a public enterprise accountable to that ministry. Each contract defines the respective intentions, obligations and responsibilities of government and the enterprise. Underlying each agreement is the presumption that it is derived from or based upon a comprehensive corporate plan that is updated on an annual basis. The contract agreement, normally negotiated on an annual basis as well, sets performance objectives and describes the planning assumptions and the resources and other commitments of government and enterprise upon which the realisation of performance targets depends. All agreements are signed by the sector minister, the Minister for Finance and Economic Planning, the chief executive of the SOE and witnessed by the State Enterprises Commission.

The Corporate Plan

In 1983, at the beginning of the Economic Recovery Programme [ERP], no major public enterprise had a relevant or current corporate plan. In consequence, one of the first tasks in the introduction of the performance contract system was a concerted effort to prepare such plans for the core enterprises serving the economic infrastructure. Between 1987 and 1988, a number of corporate plans were prepared, many by external consultants as most SOEs lacked any significant corporate planning capability. Further difficulties encountered in the initial crash programme to prepare corporate plans included the general absence of current financial information for SOEs, and uncertainties about the direction of government policy affecting their operating environment.

In the course of 1988, concurrent with the negotiation of the first performance contracts, it became apparent that neither enterprise management nor the sector ministry had been much involved in these corporate planning exercises. Managing directors expressed both confusion and alienation regarding corporate plans prepared on their behalf by consultants. This atmosphere was intensified by the general failure to involve sector ministries in the corporate planning exercise or in the negotiation of the 1989 performance contract agreements.

These early experiences with corporate planning focused attention on the general lack of both plans and planning capability at the enterprise level. While this capacity weakness required the continued use of consultant expertise in the short-term, a systematic effort was made in subsequent years to involve both the sector ministry and enterprise management in the preparation and updating of corporate plans. By the end of 1991, all core SOEs, except the Ghana National Petroleum Corporation, had prepared a comprehensive corporate plan and reviewed it with the supervising ministry as well as the State Enterprises Commission. Few SOEs, however, have yet reached the stage of routinely updating their corporate plan on an annual basis, and several continue to depend on external consultants for this purpose.

Ultimately, the success of the efforts made through the performance contract system to improve the efficiency and productivity of core public enterprises will depend on the extent to which corporate planning logic and results-oriented management informs the thinking of agencies responsible for their direction. To strengthen planning capacity at the enterprise level, the Commission organised in 1991 two general corporate planning workshops. This programme of training sessions was continued on a limited basis in 1992. Meanwhile, plans were made for the delivery in 1993 of a more focused and systematic training programme for SOE board members and senior management staff, targeted on the 47 enterprises participating in the performance contract system in that year. This programme was delivered to some 22 enterprises in 1993 and is being repeated in 1994 for the remaining twenty-five.

The Performance Contract

The annual performance contract is negotiated between SOE management on the one hand and the supervising sector ministry and the Ministry of Finance and Economic Planning on the other. The role of the Commission is one of facilitating and co-ordinating the negotiation process.

From 1991, the structure of performance contracts has been standardised under five main heads:

- objectives of the enterprise (a statement of mission);
- performance indicators to be monitored and annual targets to be achieved during the contract period;
- mutual undertakings of government and enterprise;
- critical assumptions made in setting specific targets; and

- reporting requirements.

The setting of specific performance targets for the enterprise and its sector ministry, in a format that can be monitored, is intended to provide a basis for evaluating performance and improving accountability in the public enterprise sector. The agreements are also related to an incentive bonus scheme for enterprise management. The State Enterprises Commission functions as a facilitator in the negotiation of agreements and has responsibility for monitoring and evaluating performance against agreed objectives and targets, and for making recommendations to government for the payment of incentive bonuses.

Annual Negotiations 1989 to 1994

The 1989 performance contract agreements were negotiated between the State Enterprises Commission and enterprise management. The exercise was carried through in relative haste, under strong pressure of conditions attached to the second Structural Adjustment Credit. With one significant exception, neither sector ministries nor the Ministry of Finance and Planning participated in the 1989 negotiations. In the case of the Ghana Cocoa Board, the Office of the PNDC, to which the Board was accountable, participated actively in both the corporate planning exercise and the negotiation of a multi-year performance contract. The signing of this contract was a condition of second tranche release for the first structural adjustment credit.

In the negotiation of the 1990 performance contracts, only one sector ministry was directly and fully involved. The Ministry of Transport and Communication participated in the formulation of agreements for Ghana Airways, Ghana Railways, the State Shipping Corporation, Ghana Ports and Harbours Authority, Ghana Posts and Telecommunications Corporation, Omnibus Services Authority, City Express and the State Transport Corporation. For each of these SOEs (except Ghana Airways) a corporate plan had been prepared and served as the basis for negotiating the content of the contract agreements and the selection of performance indicators. All other performance contracts for 1990 were negotiated, as in 1989, between the enterprise and the State Enterprises Commission without the participation of the various sector ministries. All agreements were signed, however, by both the sector ministry and the Ministry of Finance and Economic Planning.

In both 1991 and 1992, performance agreements were negotiated with the full participation of supervising ministry and enterprise management. The political prominence given to the signing of 1991 performance contracts stimulated demands from a number of ministries and enterprises for inclusion in the system. By mid-April, an additional 30 public enterprises had been accepted for inclusion in the system, and a review of corporate plans and the drafting of 1991 performance agreements was begun by staff of the State Enterprises Commission. Since 1992, a total of 46 public enterprises have participated in the system, although not all have progressed to the point of having an agreed corporate plan and performance agreement.

Monitoring and Evaluation

All performance contracts require the submission of quarterly and annual reports on progress towards achievement of the targets established in them. The Commission is responsible for the monitoring and evaluation of these reports (except in the case of SOEs in the energy sector), and for the preparation of an annual report to government on issues arising from the performance of SOEs participating in the performance contract system.

All enterprises participating in the performance contract system are required to submit a financial and operational report to the State Enterprises Commission, within four weeks after the end of each quarter. The contents of these quarterly reports include:

- an operating statement showing actual performance against budget for the quarter and year to date;
- a balance sheet as at the end of the quarter;
- cash flow for the quarter showing actual against forecast;
- a report of capital projects compared to budget;
- a report on the achievement of agreed performance targets;
- a report on progress achieved, explaining deviations and indicating the most important trends of the quarter.

Reporting to Government

Annual performance evaluation reports are prepared by the State Enterprises Commission on the basis of quarterly reports received from the enterprise. These reports cover the following points:

- a basic information sheet that explains the main activities, outputs, inputs, pricing and other aspects of enterprise operations and mission;

- a comparison of performance targets and actual results;
- a performance index sheet comprising a weighted overall performance score based on actual vs targeted performance;
- a profit and loss statement, initially for four years, to be extended to five for 1990 and later years, as a summary of progress by the enterprise; and
- a performance review assessment of factors underlying actual performance and departure from targeted levels, and of importance to future planning and programming.

The annual evaluation reports are submitted to the Office of the President and the standing Committee of Parliament responsible for state-owned enterprises. Copies are also forwarded to the sector ministry and the Ministry of Finance and Planning. The State Enterprises Commission is responsible for the monitoring and evaluation of all performance contracts. Annual evaluation reports covering the core or priority SOEs have been completed for 1990, 1991 and 1992.

The Incentive Bonus Issue

The performance contracts as negotiated in 1989 and subsequent years provide for bonuses to be paid to all employees of the enterprise, both management and workers. This practice differs from that in other countries where a performance contract defines the criteria for payment of incentives or bonuses to managers. The incentive bonus referred to in current performance contracts is generally assumed by enterprise management to correspond with the provision in many collective agreements for payment of an annual bonus to all employees. The distribution rules followed in most SOEs mean that all employees in qualifying enterprises receive an annual bonus approximating 10 to 15 per cent of salary.

Institutionalisation of the System

The introduction and development of the performance contract system was closely linked with conditions attached to a succession of three structural adjustment credits (SACs). Under SAC I, effective in May 1987, the completion of corporate plans for ten enterprises was a condition of effectiveness. The drafting of the 1988 performance agreements for four enterprises and the signing of an agreement with Ghana Cocoa Board were the conditions for second tranche release. The terms of SAC II, effective in May 1989, required finalisation and updating of corporate plans for all core SOEs and the signing of performance agreements for 1989 and 1990.

These conditions were continued in SAC III, effective from February 1991, for the years 1991 and 1992.

The coverage of the performance contract system advanced between 1987 and 1992 in parallel with the conditions of successive structural adjustment credits. The first agreement, with the Ghana Cocoa Board, was signed in 1988. Core SOE participation increased to 14 in 1989, and to 17 in 1990 and 1991. Early in 1991, the State Enterprises Commission, responding to requests from a number of other SOEs, targeted an additional 30 enterprises for inclusion in the system. This extension was intended to bring these additional SOEs, many engaged in a major restructuring exercise, within the scope of the improved system for SOE governance.

While 46 public enterprises currently participate in the performance contract system, not all have actually signed a performance agreement. The reasons for this relate primarily to delays in preparing and agreeing the details of a corporate plan with the supervising sector ministry. While performance contract negotiations were initiated in both 1992 and 1993 with all participating enterprises, the updating of corporate plans and performance targets has lagged among many, particularly those added to the system in 1991 and 1992. By 1993, a total of 46 SOEs were participating in the PME system. However, only 23 of these signed performance contracts in that year as compared to 27 in 1992, a difference largely accounted for by the withdrawal of energy sector SOEs in 1993. The return of most energy sector SOEs for the year 1994 assured the continued coverage of the major core public enterprises.

The initiatives represented in the performance contract (PME) system have contributed to the institutionalisation of a reformed system for the governance of Ghana's public enterprises. In this system, responsibility for corporate planning and target setting is shifted from sector ministry to the directors and senior management of the enterprise. The Commission's review and evaluation of experience with the performance contract system, completed in 1993, suggested that in the eyes of both enterprise managers and sector ministry, representatives the principal benefit of the system is as a mechanism for structuring the dialogue between government and enterprise. The strengthened emphasis on a commercial orientation of operations, and the setting of feasible but challenging performance targets are widely perceived as additional major benefits.

Over time, the pro forma compliance of earlier years with conditions imposed by the terms of successive structural adjustment credits has yielded to a more enthusiastic acceptance of the system as a framework for managing the interface between government and enterprise. With this change in perception, the role of the State Enterprises Commission has become more of a facilitator than an initiator in the negotiation process.

Case Studies

Two enterprises, more or less representative of Ghana's experience with the performance contract system for core SOEs, are reviewed here. Both the Electricity Corporation of Ghana [ECG] and the Omnibus Services Authority [OSA] have participated in the system from 1989. While both have realised some improvement in performance, neither has consistently met annual performance targets. Nevertheless, by 1992, ECG appears to have established a sustainable basis for profitable operations. OSA, on the other hand, appeared still to be some way short of that goal.

Electricity Corporation of Ghana

A summary profile of the Electricity Corporation of Ghana abstracted from the 1994 Performance Contract is shown in Annex 1. The Corporation is the sole distributor of electrical energy to some 381,000 domestic, commercial, industrial and Government consumers in southern Ghana. ECG did not conclude a performance contract for 1993 but returned to the system in 1994.

The annually negotiated performance targets for ECG are summarised in Annex 2.1. All indicators are in current value terms. Three measures – revenues, net profit and return on assets – emphasise the profitability objective of reform. Each year, from 1988 to 1994 inclusive, ECG has targeted for revenue growth increasingly profitable operations and a return on assets employed in the order of 8 per cent. Other targets included an increase in electricity supplied and improved efficiency through a reduction in staff numbers and in staff costs, expressed as a ratio to total revenues.

The results achieved by ECG, summarised in Annex 2.2 in current value terms, are complete only for 1992, the latest year for which a complete evaluation has been made. Partial data for 1993 is derived from draft and audited accounts for that year. Following a series of overall and operating losses during 1991, the Corporation rebounded sharply to record strong revenue growth in both 1992 and 1993 and substantial profits. Progress on the efficiency indicators was less dramatic, as reductions in staff numbers were offset in most years by staff costs, which were higher than at target-level.

A somewhat different perspective on ECG performance is provided by reference to the trends in constant value terms shown in Annex 3. These indicate that real revenues increased by about 50 per cent between 1988 and 1992, while cost growth was restrained to near 20 per cent over the same period. This favourable relationship between revenue growth and cost increases underlies the strong improvement in ECG profitability, although the return on assets employed continues to fall well below target levels.

Omnibus Services Authority

A summary profile of the Omnibus Services Authority, abstracted from the 1994 Performance Contract, is shown in Annex 4. The Authority provides bus passenger transportation services in competition with two other state-owned enterprises, and with the operators of private road transport bus services.

The annually negotiated performance targets for OSA are summarised in Annex 5.1. All indicators are in current value terms. Three measures – revenues, net profit and revenues per bus/kilometre – emphasise the profitability objective of reform. Each year from 1988 to 1994, OSA has targeted revenue growth, a reduction in overall losses, and an improving revenue per bus/kilometre. Other targets included a succession of year-on-year increases in bus kilometres driven, and improved efficiency through a reduction in staff numbers and in staff costs expressed as a ratio to total revenues.

The results achieved by OSA, summarised in Annex 5.2 in current value terms, are complete only to 1992, the latest year for which a complete evaluation has been made. Partial data for 1993 is derived from preliminary reports for that year. The most obvious discrepancy between planned and actual performance relates to bus kilometers operated. In the case of OSA, this is the result of consistent optimism about the numbers of new buses that would be provided by government. For 1992, the Authority has recorded a succession of operating and overall losses but considerable improvement in revenues generated per bus/kilometre. It is apparent, however, that these remained well below cost-recovery levels during 1992. Among the efficiency indicators, progress was less impressive as the benefit of reduced staff numbers was offset by the sharp increase above targeted levels in 1992 of staff costs as a percentage of revenue.

In constant value terms, the performance of OSA presents a more pessimistic impression. In 1992, after five years of losses, the Authority is essentially at the same place in real volume terms as it was in 1988. Its costs continue to exceed its revenues by a substantial margin, and it would appear to have made little progress in competition with other suppliers of road transport services.

Contribution of the Performance Contract System to Reform Objectives

There is little doubt that the performance contract system has been successful in re-introducing systematic corporate planning as a priority concern of SOE management. This focus has also led to significant progress towards a number of other objectives of the SOE Reform Programme. There has been, for example, dramatic progress in reducing the over-staffing problem of core enterprises. Total employment in these enterprises has declined from 96,000 in 1986 to 70,000 in 1991. Broadly speaking, the labour productivity of these SOEs has increased substantially, although there are exceptions as illustrated by the OSA case study.

From the perspective of government, the improving performance of core enterprises has translated into the elimination of direct subvention-support, except that provided to the Ghana Railways Corporation. Tax and dividend returns have also increased as government has been better able to monitor financial performance and enterprise management has been made more accountable. Better documentation of the problems facing the core enterprises has contributed to a more appropriate policy response in such areas as the timely appointment of external auditors, the strengthening of financial management capability, the management of workforce rationalisation measures, opportunities for privatisation and recapitalisation.

From the perspective of SOE managers, the system is proving to be a useful means of formalising, and thus reducing, ministerial interventions in day-to-day operations. The resultant improvement in managerial autonomy is a major benefit of the reform programme as accountability is focused on SOE management and referenced to defined performance targets.

Experience also suggests that the introduction of performance contracts has been instrumental in changing ministerial perceptions of an appropriate and effective means of structuring the relationship between ministry and SOE. The entrenchment of these perceptions and benefits is an important policy objective for the next phase of the reform programme as the emphasis shifts toward a major expansion of service delivery capacity.

Annex 1

Summary Profile: Electricity Corporation of Ghana

Name and Background:

ECG was set up in 1967 by Government Decree (NLCD 125) to succeed the Electricity Division of the Ministry of Works and Housing.

Sector Ministry:

ECG operates under the Ministry of Mines and Energy (MME) and is governed by an 11-member board of directors.

Main Inputs:

ECG buys electric power in bulk from VRA at 33,000 volts for distribution. Very limited thermal generation of power using diesel is done to serve Kete Krachi.

Main Output:

ECG is a state-owned utility selling electric power to its customers at Voltage Standard of 230 volts + 6%, -10%, i.e. 244 volts maximum and 207 volts minimum.

Market:

The Corporation is responsible for the distribution of electricity in designated regions in southern Ghana. In 1987, the Volta River Authority (VRA) took over from ECG the responsibility for electric power systems in northern Ghana. ECG serves about 381,300 customers in the Greater Accra, Ashanti, Western, Central, Eastern and Volta Regions.

Power Sector Tariff:

The price at which ECG sells its service to its customers is reviewed and determined by Parliament annually. The corporation, however, submits tariff proposals to the Government through MME for recommendation to Parliament.

Recent Performance:

ECG has had the good fortune of a quick turn-around from decline to growth in the recent past under the Economic Recovery Programme (ERP). The last two financial years saw steady growth in customer satisfaction and corporate viability. Some indicators were:

		1993	1992
		¢billion	¢billion
1.	Revenues	46.749	27.946
2.	Operating Profit	10.144	4.999
3.	Net Profit	7.375	4.150

ANNEX 2: Electricity Corporation of Ghana

	Units	1988	1989	1990	1991	1992	1993	1994
2.1 **Performance Targets**								
Revenues	cedi million	7,800	8,153	12,554	19,778	26,282	ns	73,544
Net Profits	cedi million	ns	ns	532	786	2,311	ns	17,226
Return on assets	percent	ns	8%	7%	8%	8%	ns	8%
Electricity sales	Gwh	1,040	1,087	1,242	1,427	1,565	ns	ns
Salaries/Revenue	percent	ns	ns	8%	10%	8%	ns	10%
Employees	number	3,660	3,260	3,040	2,940	2,865	ns	ns
2.2 **Actual Performance**								
Revenues	cedi million	7,996	9,633	10,880	14,243	27,946	46,749	
Net Profits	cedi million	(4,463)	306	(1,122)	(4,065)	4,151	10,144	
Return on assets	percent	-28.6%		3%	-1.2%	3.6%		
Electricity Sales	Gwh		1,203	1,310	1,403			
Salaries/Revenue	per cent			11%	10.1%	15.8%		
Employees	number	3,639	3,196	3,106	2,845			

ANNEX 3: Financial Performance of Electricity Corporation of Ghana

(constant 1984 values in cedi millions)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
Revenues	583	909	846	482	1,484	2,122	2,747	2,552	2,917	2,777	2,247	2,471	4,413
Costs	446	674	587	351	783	1,238	2,490	3,582	3,125	2,435	2,190	2,314	3,640
of which wages & salaries	0	0	0	0	0	133	263	0	0	640	526	238	699
Other income, including Subvention	(37)	(22)	(34)	(21)	(10)	12	354	56	50	61	41	39	159
Extraordinary items	(31)	(27)	(22)	(386)	(274)	(785)	(3,377)	(1,448)	(1,471)	(315)	(330)	(231)	(294)
Profits before tax	(131)	186	223	(275)	325	111	(3,057)	(2,422)	(1,629)	88	(232)	(705)	258
Tax/dividend/transfer payments	0	0	11	0	21	6	0	0	0	4	0	0	0
Subvention Receipts	0	0	0	0	0	0	0	0	0	0	0	0	0
Net Lending Receipts	0	0	0	0	0	0	0	1,407	2,216	2,294	759	2,015	2,198
Investment	0	0	0	0	0	129	(37)	693	439	1,247	99	48	3,561
of which Foreign finance	0	0	0	0	0	(902)	168	1,100	724	431	0	362	360
Value added	(131)	186	223	(275)	321	245	(2,794)	(2,422)	(1,329)	729	344	(467)	1,357

Annex 4

Summary Profile: Omnibus Services Authority

Sector Ministry:	Ministry of Transport and Communications
Main Outputs:	Provision of urban and urban-rural transport services
Main Inputs:	Buses; diesoline; lubricants; tyres, batteries; spare parts and labour
Market:	The market consists of passenger transport. The main competitors of OSA are City Express Services and Private Transport Operators
Pricing:	The fares charged by both private and public operators are regulated by the Ministry of Transport and Communications. The fares are adjusted in response to increases in the costs of inputs, particularly diesoline. The tariff structure is graduated according to distance travelled.
Recent Performance:	Turnover has shown no significant growth. The Authority had continuously been making losses. However, stringent cost control measures instituted by management since 1991 have resulted in considerable reduction of the losses. The 1992 Audited Accounts showed a loss of ¢570.2 million which was an improvement over the 1991 net loss of ¢811.4 million. Provisional out-turn for the 1993 Accounts shows gross profit of ¢517 million and a net profit of ¢215 million after depreciation charge of ¢302 million. Revenue per labour force and fleet utilisation showed some marginal improvement in 1993. OSA continues to be burdened with high debt servicing obligations, in the face of zero working capital support.

ANNEX 5: Electricity Corporation of Ghana

	Units	1988	1989	1990	1991	1992	1993	1994
5.1 **Performance Targets**								
Revenue	cedi million		1,822	2,318	3,2058	2,914	3,118	6,370
Net Profit/(Loss)	cedi million		(803)	(767)	(727)	239	(22)	127
Staff Costs/Sales	percent		18.6%	22.0%	19.0%	20.0%	18.0%	18.0%
No. of Employees	number		1,636	1,270	1,340	1,324	1,259	
Bus/Kilometers	kilometers		12,552	8,737	10,237	13,438	15,040	15,400
Revenue/bus/km	cedi		110	210	300	242	287	409
5.2 **Actual Performance**								
Revenue	cedi million	1,056	1,046	1,980	2,398	2,238		
Net Profit/(Loss)	cedi million	(552)	(915)	(1,780)	(811)	(152)		
Staff Costs/Sales	percent	14.7%	13.6%	21.2%	17.2%	26.0%		
No. of Employees	number	1,484	1,412	1,255	1,324	1,211		
Bus/Kilometers	kilometers	10,039	9,941	7,995	9,979	8,663		
Revenue/bus/km	cedi	105	105	248	240	258	355	

ANNEX 6: Financial Performance of Omnibus Services Authority

(Constant 1984 values in cedi millions)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
Revenues	73	132	124	146	108	162	381	302	409	416	353
Costs	93	124	143	212	206	473	587	575	782	561	452
of which wages & salaries	0	0	0	0	0	0	0	41	54	72	96
Other income, including subvention	2	4	2	7	7	5	5	10	5	4	7
Extraordinary items	0	0	0	0	0	0	0	0	0	0	1
Profit before tax	(19)	12	(17)	(59)	(90)	(307)	(201)	(264)	(368)	(141)	(90)
Tax and Dividiend payments	0	0	0	0	0	0	0	0	0	0	0
Subvention Receipts	0	0	0	0	0	0	0	0	0	0	0
Net Lending Receipts	0	0	0	0	0	0	0	0	0	0	0
Investment	0	0	0	0	0	0	0	0	0	0	0
of which Foreign finance	0	0	0	0	0	0	0	0	0	0	0
Value added	(19)	12	(17)	(59)	(90)	(307)	(201)	(223)	(314)	(68)	5

II

The Performance Contract System in The Gambia with special reference to The Gambia Ports Authority

Reasons for Establishing Performance Contracts in The Gambia

The financial performance of public enterprises deteriorated sharply during the pre-performance contract era (up to 1987). The PE sector reported aggregate profits in 1977/78 and 1978/79 and thereafter reported substantial aggregate losses to 1982/83 in excess of D110m. Most PEs financed these losses by inadequately maintaining their assets and accumulating arrears with banks and suppliers.

Among the major causes of the poor performance of PEs were the imposition of non-commercial objectives and uneconomical pricing policies, managerial and technical weaknesses and poor initial project design and/or financial structure. The poor state of PEs led to debt accumulation and deterioration of plants and equipment which necessitated substantial financial restructuring and investment to rehabilitate the run-down plants and equipment. In 1985, the Government adopted a comprehensive Economic Recovery Programme (ERP) to address the structural imbalances in the economy and increase productivity and performance.

Reforms were introduced in the PE sector in the form of Performance Contracts and privatisation and rationalisation of PEs. The reforms followed the following strategy:

- identifying the causes of poor performance;
- identifying which PEs or activities should be rehabilitated, privatised or liquidated;
- preparing rehabilitation plans for PEs to be retained;
- setting explicit enterprise objectives and clarifying government/ enterprise relationships.

The Introduction of the Performance Contract System in The Gambia

The performance contract system as developed in The Gambia involved the following steps:

- definition of enterprise objectives;
- identification of commercial and non-commercial activities of the enterprise;
- development of mechanism for reimbursement of non-commercial/social services cost by the Government;
- selection of performance indications and fixing of targets for a particular year;
- determination of management incentive/sanctions scheme.
- execution of performance contract;
- regular reporting of enterprise performance and its monitoring;
- performance evaluation on quarterly and yearly basis;
- award of Management Incentive (bonus) or sanction.

The first phase of performance contracts was signed with three enterprises, i.e. Gambia Ports Authority (GPA), Gambia Produce and the Marketing Board (GPMB), and Gambia Utilities Corporation (GUC), on a trial basis between January and June 1987. In July 1987, the performance contracts were formally executed with these enterprises. The contracts were executed for a period of three years, and were signed by His Excellency the President on behalf of the Government, and the Managing Director on behalf of the management of the enterprise. The issues covered in the performance contracts included:

(i) Purpose and Duration

(ii) Enterprise objectives

- scope of activities
- strategies
- performance targets

(iii) Undertakings of Enterprise to the Government

- responsibility for enterprise performance
- adherence to plans and policies
- use of assets and responsibility for their safeguard
- supporting non-commercial/social services

- declaration and payment of dividends
- notification of exceptional events
- payment of amounts due to government

(iv) Limits of Management Authority

- capital expenditure
- borrowing limits
- procurement
- organisation changes
- institutional arrangements
- approval of tariff
- adherence to government regulations
- contract compliance

(v) Undertaking of Government to the Enterprise

- recognition of management's autonomy
- non-commercial/social services costs and its reimbursement
- tariff approval
- settlement of debts to enterprise
- annual budget procedure
- monitoring of contract compliance
- arbitration and settlement of disputes
- management incentive/sanctions scheme

After the introduction of the performance contract system, the ultimate control and responsibility of public enterprises were taken over by the Office of the President, as His Excellency The President executed the contracts on behalf of the Government. The steering committees, having representatives from line ministries, the Office of the President, the National Investment Board (NIB) and the enterprises, were formed. These committees were given the responsibility of approving the budgets, performance indicators/targets, performance evaluation and management incentive (bonus)/sanctions. The line ministries were expected to concentrate their efforts on the development of sectoral policies, the objectives and the framework within which the public enterprises were expected to operate.

The National Investment Board was brought under the purview of the Office of the President and was given the central role of reviewing enterprises' policies and plans, monitoring and evaluation of their performance, ensuring contract compliance and analysing their operations to identify key issues and provide assistance for resolving them. NIB was also made responsible for regularly reporting the performance and other operational activities of public enterprises to the Office of the President.

The boards of public enterprises were reconstituted to include key members of management and representatives of line ministries and NIB. In order to consolidate the existing legislation under which various public enterprises were operating and to give them requisite autonomy and make their institutional arrangement effective, the Public Enterprise Act 1989 was enacted. The Act contained provisions relating to the execution of performance contracts, annual budget procedures, reporting requirements, monitoring of contract compliance by NIB and the appointment of directors, chief executives and the chairman of board of public enterprises. The NIB Act was also amended to incorporate the expanded role assigned to it under the performance contract system.

Roles and Responsibilities

The responsibilities and roles of various institutions as envisaged under the performance contract system are detailed below:

(i) ***Public Enterprises***

The public enterprises were assigned the responsibility to:

- ensure that their planned operating budgets lead to the achievements of objectives;
- meet and comply with the budget procedure and reporting requirements of NIB;
- implement the approved budgets, corporate plans and investment programmes.

(ii) ***Line Ministries***

Under the performance contract system, the line ministries of public enterprises were expected to concentrate their efforts on the development of sectoral policies and objectives within which PEs had to operate.

The line ministries were also expected to:

- represent the ministries in the steering committee;
- specify the non-commercial activities and negotiate the cost to be paid to PEs;

- participate in the selection and fixation of performance indicators/targets;
- examine budgets, corporate plans and investment programmes;
- review tariff policies.

(iii) ***National Investment Board (NIB)***

NIB was assigned a central role in the implementation of the performance contract system. NIB's responsibilities include:

- submitting performance contracts for execution;
- ensuring that PEs budgets/reports are submitted within the agreed time frame;
- examining budgets, plans, investment proposals to ascertain that they conform to the objectives of the enterprises and policy guidelines;
- selecting and fixing performance indicators/targets in consultation with the enterprises and line ministries;
- convening and chairing steering committee meetings;
- monitoring and evaluating performance of PEs and identify key issues affecting their performance;
- making recommendations to the Office of The President for the award of management incentive (i.e bonus) or sanctions;
- preparing and submitting to the Office of The President quarterly, annual reports/evaluation on performance of PEs;
- providing assistance to PEs in attaining their objectives, implementing their budgets/plans and resolving key issues affecting their performance.

(iv) ***Steering Committee***

This is a form where all the parties to the performance contract are represented, i.e. enterprise, line ministry, Office of The President and NIB. The Steering Committee approves and negotiates the selection and setting of performance indicators/targets; approval of budgets; plans; performance evaluation and recommendations for management incentive (i.e. bonus) sanctions.

(v) ***The Office of the President***

The Office of The President is ultimately responsible for performance of PEs. The Office of the President's responsibilities include:

- execution of performance contracts by the President;
- approval of budgets, corporate plans, tariffs and related matters;
- approval of performance indicators/targets and evaluation;
- appointment of chairman, managing directors, directors and members of management teams;
- award of management incentive (i.e. bonus) or sanctions.

Performance Evaluation Mechanism

The performance evaluation mechanism under the performance contract system is based on the principle that once the government and enterprise relationship is clearly established, and management is given autonomy for the operation of the enterprise, the performance of the enterprise shall be monitored and evaluated against targets agreed at the beginning of the year, including both operational and financial parameters. The management receives an incentive (i.e. bonus) for exceeding the targets, and sanctions or penalties, including dismissal, for poor or inadequate performance. The evaluation mechanism consists of the following elements:

- selection of performance indicators and fixing of targets;
- assignment of points/scores to selected indicators so that their relative importance is reflected;
- submission of quarterly and annual performance reports by the enterprises;
- submission of annual audited accounts and management's assessment of its enterprise's performance;
- annual performance evaluation and recommendation of management incentive (i.e. bonus) or sanctions.
- review and finalisation of NIB's performance evaluation by steering committee;

- submission of performance evaluation report and recommendation of management incentive (i.e. bonus) or sanctions by NIB to Office of the President;

- approval of NIB's performance evaluation and management incentive (i.e. bonus) or sanctions by the Office of the President.

Selection of Performance Indicators and Fixing of Targets

As performance indicators/targets are the primary instruments of evaluating management performance, they are the focal point of the performance evaluation mechanism. The performance indicators being used are classified under quantitative and qualitative measures. Under each group, various indicators are selected. These indicators reflect different goals of the enterprise and help in judging the management's achievement of these goals. Among the quantitative group, the indicators which are normally regarded as key to the success of the enterprise are financial (i.e. profits, return on capital employed, trade debtor ratios and other costs ratios), operational and productivity-related. The qualitative performance indicators include measures/changes or systems which the management is expected to implement over the period and which are expected to contribute towards higher efficiency and effectiveness of the enterprise. Examples of such indicators are the introduction of management information and corporate planning systems, and computerisation of accounting and other systems.

The performance indicators, especially operational indicators, vary from enterprise to enterprise. In order to give an idea about the performance indicators and their applicability, the performance indicators used for evaluation of GPA are presented below. The variations primarily exist in operational performance indicators as they are dependent on the nature of the business or operations in which an enterprise is engaged. The performance indicators are finalised by the steering committee after discussions and negotiation between the Government/NIB and the management of the enterprise.

Once performance indicators have been selected, the next step is to assign weights to each group, i.e. quantitative and qualitative, and then to assign scores to the individual indicators in each group. This is once again discussed and negotiated between the enterprise and the Government/NIB in the steering committee meetings. The weights and points/scores assigned are based on the importance of the group or individual indicators to the enterprise and the priorities of the Government.

In the performance contracts executed under the first phase, the quantitative indicators were given a weighting of 60 per cent while qualitative indicators were assigned a weighting of 30 per cent. The balance of 10 per cent was given to overall performance. In the second phase, the distribution of weights for quantitative and qualitative indicators has been kept as 60 per cent and 40 per cent.

In the case of GPA, the quantitative indicators include net profit; return on capital employed; cargo handled; debtors as percentage of turnover and number of employees. The qualitative indicators include timely submission of the corporate plan, debt servicing and the staff development programme.

Apart from the indicators discussed earlier, the first-phase contracts assigned 14 points for overall management/operational performance. The need for assigning these points was felt as during any year, there are aspects of running the business which are not reflected appropriately in the indicators discussed above because of unusual circumstances beyond management's control.

The examples of such eventualities can be:

- specific actions taken by management to contain cost because fuel oil prices rose significantly and there was no compensating tariff adjustment;
- detailed and meritorious efforts to implement a new programme, e.g. development of EDP;
- opening new markets or obtaining higher selling prices from new customers.

The practice of assigning points for all management/operational performance has been discontinued in contracts executed in the second phase, as well as for GPA.

The final stage is the setting of targets. The targets to be achieved by each enterprise are incorporated in the annual budget approval process. The quantitative indicators/targets, i.e. financial, operational and productivity, are set out by the management in their budget proposal. The budget proposal as well as targets are reviewed by NIB and the respective line ministry, the targets are finalised in the steering committee meetings. The targets are finalised after taking into consideration:

- enterprise performance during recent years;
- various financial and operation constraints which the enterprise is expected to face during the evaluation period;
- the enterprise's macro-economic environment.

The Case of The Gambia Ports Authority

(i) ***Key Assumptions***

The key assumptions for the GPA are, for example:

- tariff levels;
- physical levels of production and input (tonnage throughout, number of vessels calling at port and availability of equipment);
- macro-economic factors;
- inflation;
- exchange rate;
- interest rate; and
- GDP/market growth.

The non-quantitative indicators/targets are primarily fixed considering the state of the enterprise and the priorities of the Government.

Apart from finalising the quantitative and qualitative indicators and targets, the steering committee also determines which point on the scale of points the enterprise has achieved. This point is illustrated by the example of GPA.

The approved budget of GPA for a certain year aimed to generate a return on capital employed of 13.5 per cent and net-profit of D7.150 million, and a weightage of 25 points was attached to this indicator. If GPA is exactly on target for these indicators it will score 25 points. But actual return and profits are bound to vary from the target figure. In order to cater for this eventuality, a scale of points is used, to determine the points for different levels of performance achieved by the enterprise.

As reported, when return and profits increase, a higher point score is awarded, while less points are awarded for a lower level of return and profits. Normally, a maximum points award is set at three times the point score for target achievement. The scale points are shown below:

Indicator		Rating Score
Return of Capital Employed (ROCE)		
	18.0%	30
	17.0%	25
	15.5%	20
	14.5%	15
Target	**13.5%**	**10**
	11.5%	5
	10.0%	1

(ii) ***Performance Evaluation***

Performance evaluation is undertaken on a quarterly as well as on an annual basis. This quarterly evaluation is undertaken with the objective of monitoring and identifying the variances so that corrective measures can be taken and performance can be improved. Annual evaluation is undertaken to judge finally management's performance during the year, as compared to the agreed targets, and to decide on the level of incentive, i.e. bonus or sanctions to be awarded/applied. The process of annual evaluation begins immediately after the enterprise submits to NIB its annual report and audited accounts. The enterprise also submits to NIB its own assessment of its performance.

On receipt of the annual report and audited accounts of an enterprise, NIB undertakes its own evaluation. For quantitative targets, the annual audited accounts are used as the source of information. NIB examines and evaluates each performance indicator and scores them. The scores of all indicators achieved are totalled and compared with total targeted score and accordingly, recommendations regarding the incentive (i.e. bonus payment or sanctions) are made. The evaluation is finalised and recommendations about the incentive (i.e. bonus) or sanctions to be imposed are submitted to The Office of the President in a report from NIB. Management's assessment of performance is also included in the report.

Strengths of the System

The assessment of the performance contract system and its impact on the enterprises, as well as on their operating environment, has revealed that, on an overall basis, the system as implemented in The Gambia can be deemed successful. However, there is a need to strengthen the system in order to avoid the shortcomings of the past and to improve further on the results achieved so far:

- Prior to the introduction and execution of the contracts, an in-depth appraisal of the enterprise should be undertaken and the required developments and changes determined, i.e. that almost all pre-conditions to the signing of the contracts are met.

- The performance contract system has been able to introduce a performance-oriented culture at management level.

- The bonus system is based on a management incentive scheme with sanctions, which therefore provides a motivation for the management team.

- A database should be developed and updated on a regular basis at the enterprise level.

Weaknesses of the System

- At present, no arrangement exists with NIB to verify the performance data of various operational and financial indicators, so that the reliance is placed on reported figures.

- Ministries are not involved to the level envisaged in the system.

- NIB should also evaluate and report enterprise performance on the basis of financial and public profitability. It is a considered opinion that public profitability in constant prices is a more meaningful measurement of operational efficiency.

- It is generally felt that considerable time is taken for obtaining budget approval, subsequent changes to it and other similar matters.

- The bonus system is based on a management incentive scheme and therefore does not motivate employees in general (beside management).

Lessons Learned

Performance contracts are most successful when:

- management has been extensively involved in their preparation;

- they are supported by adequate management information systems and rehabilitation plans;

- there is agreement among the enterprise, the ministry responsible and central agencies on the key underlying assumptions and strategic directions;

- there is an adequate system to monitor PE performance; and

- there are rewards and sanctions related to performance.

ANNEX I

Gambia Ports Authority

Objectives

The Enterprise shall:

a) provide safe, efficient and reliable port services, pilotage and navigation services;

b) act on behalf of the Government of The Gambia in regulating seaborne and inland waterways transport;

c) offer a competitive pricing structure that is based on cost recovery for the benefit of port users without necessarily weakening its financial position;

d) operate and extend loss-making services as defined in Section 2.3 and 2.4 only where required to do so by Government in such circumstances the Enterprise shall manage loss-making services with maximum efficiency in order to minimise cost and the need for subsidies;

e) achieve an average rate of return on capital employed, after the Government subsidy referred to in (d) above of at least 15 per cent, measured as: profit before interest, tax and depreciation on total net assets employed;

f) maintain its strong financial base. Conscious efforts will continue to be channelled towards maintaining adequate levels of liquidity consistent with the level of business and building up of financial reserves. These reserves will be utilised for future investments, and also serve as an instrument of support in adverse times.

Strategies

For the duration of the Contract, the Enterprise shall:

a) ensure maximum serviceability of all assets of the Authority through the upkeep of an efficient maintenance system;

b) ensure cost-effectiveness in the maintenance of all assets;

c) ensure the implementation of projects planned for a particular period, to be completed within the approved contract schedule;

d) establish a sound equipment replacement policy;

e) with respect to (d) undertake to finance a part of the expenditure with internal resources. In this regard, a special reserve account will be set aside mainly for equipment replacement purposes;

f) introduce a scale of fees to recover the full cost of maritime regulatory services other than the provision of advice to Government;

g) continue its discussions with the Government towards the acquisition of all land designated port area under the Greater Banjul Land Use Plan 2000;

h) initiate discussions with Government for additional land space in the Greater Banjul Area to be designated Port Area for future development of a distribution and transhipment centre;

i) undertake measures to enhance the competitiveness of the Port through effective marketing strategies;

j) implement a 24-hour pilotage service to improve ships' turn around time.

Summarised Accounts (1980/81 - 1984/85)

(Thousands of Dalasi)

Profit and Loss Account	1980/81	1981/82	1982/83	1983/84	1984/85
Revenue 11,003	10,163	13,919	15,867	15,998	
Operating Costs	(7,579)	(10,903)	(11,574)	(12,131)	(12,159)
Gross Profit (Loss)	3,424	(740)	2,345	3,736	3,839
Depreciation	(2,286)	(2,405)	(2,423)	(2,567)	(2,205)
Interest (995)	(995)	(1,059)	(996)	(964)	(3,808)
Prior Year Adjustment	-	-	405	250	952
Net Profit (Loss)	143	(4,204)	(669)	(45)	(1,222)
Balance Sheet					
Fixed Assets	32,768	33,566	45,819	61,328	63,708
Current Assets	8,960	8,751	9,280	12,694	15,863
Less: Current Liabilities	(2,539)	(4,571)	(6,331)	(11,390)	(15,571)
Net Worth	39,189	37,746	48,768	62,632	64,000
Financed by:					
Debt	22,348	24,264	33,433	46,981	51,318
Equity and Reserves					
- Equity & Grants	9,498	10,343	12,500	12,643	6,122
- Revaluation Reserve	6,116	6,116	6,076	6,045	9,866
- Retained Profits/Losses	1,227	(2,977)	(3,241)	(3,037)	(3,306)
Net Worth	39,189	37,746	48,768	62,632	64,000

GAMBIA PORTS AUTHORITY
FINANCIAL AND STATISTICAL SUMMARY 1987-1993

	1987	1988	1989	1990	1991	1992	1993
FINANCIAL Revenue	25,952	35,274	42,124	45,344	60,710	74,106	64,190
Working Expenses	20,071	18,063	27,049	25,276	27,343	31,759	35,104
Net Earnings	**5,881**	**17,211**	**15,075**	**20,068**	**33,367**	**42,347**	**29,086**
Debt Servicing Charges	8,400	8,925	8,858	9,253	9,290	10,093	9,004
Other Charges	(9,122)	(752)	(622)	(2,134)	(5,521)	(5,727)	(10,491)
Balance Surplus/Loss	**6,603**	**9,038**	**6,839**	**12,949**	**29,598**	**37,981**	**30,673**
Fixed Assets (loss depreciation)	115,125	160,808	158,815	120,501	117,815	137,261	136,737
Net Current Assets	23,733	33,035	31,686	36,865	61,632	87,676	106,049
Net Operating Assets	**138,858**	**193,843**	**190,501**	**157,366**	**179,447**	**224,937**	**242,786**
Capital Work-in-Progress	13,948	7,114	12,594	6,354	1,758	1,532	2,571
Long-Term Investment	-	-	-	16,099	16,333	16,202	16,202
Net Assets	**152,806**	**200,957**	**203,095**	**179,819**	**197,538**	**242,671**	**261,559**
Public Debt	99,869	101,830	100,298	103,555	96,113	106,104	85,569
Equity and Reserve	52,937	99,127	102,797	76,264	101,425	136,567	178,090
RETURNS Ratio of Working Expenses to Revenue	77	51	64	56	45	43	55
Ration of Net Earnings to Net Operating Assets	4.20	8.90	7.90	13.00	18.59	18.83	11.98
Ratio of Net Earnings to Net Assets	3.80	8.60	7.40	11.00	16.89	17.45	11.12
Ratio of Net Earnings to Equity and Reserves	11.10	17.40	14.70	26.00	32.90	31.01	16.34
STATISTICAL Ships entering Gambian Ports (No.)	282	280	284	262	258	264	245
Cargo Handled ('000 Tonnes)	432	539	448	527	623	675	742
Passengers embarked/ disembarked ('000s)	1,221	1,300	1,390	486	-	-	-
Vehicles handled (Ferries) (No.)	176	162	90	-	-	-	-
Vessels Slipped (No.)	39	26	47	31	-	-	-
Number of Staff employed	682	664	652	478	395	403	390

III

The Signalling System for Public Enterprises: A Case Study on the Experience of Performance Contracts in Pakistan

Introduction

During the past few decades, improving efficiency in public sector enterprises has been a challenge confronted by various countries. In order to attain this objective, a number of organisational devices and management systems were tailored to conform to the specific requirement of public enterprise management. The concept of the performance contract system was originated in the late 1960s by Simon Nora to improve the public sector enterprises in France. This system, generally known as "**Contra Plan**", although adopted by several enterprises outside France, suffered from a number of difficulties. The development of the signalling system in the early 1980s was a major step forward in evolving the performance contract system. It addressed some of the complex technical issues of evaluating real performance of public enterprise managers. The system was pioneered in the early 1980s almost simultaneously in Pakistan and South Korea. Since then it has been adopted in various modified forms by a number of countries. Both Pakistan and South Korea have now completed 10 years of operation of this system. It is therefore an appropriate time to carry out an analysis of the experience and accomplishments of the signalling system. This study gives an account of the main features of the signalling system's operations in Pakistan and its impact on the behaviour of management and, in turn, on the performance of public sector enterprises. In order to give a detailed account of the operation of the system, a case study of one specific enterprise has also been included.

The study is divided into three parts. Part One comprises the historical background and the main features of the signalling system in Pakistan. It also includes an account of the organisational system of the public industrial sector where the system was installed. Part Two comprises a detailed study of a fertiliser industrial enterprise. This case study attempts to walk through the whole process of evaluation to illustrate all the elements of this exercise. Part Three includes an examination of the impact of this system and its achievement on the public industrial sector in Pakistan.

Part One

In the early 1970s, following a policy of nationalising "basic industries" and the launching of an ambitious investment programme, the size of the public industrial sector in Pakistan rapidly increased. As a result, until the late 1970s, the focus was on expansion and little attention was given to operational efficiency. Consequently, the public industrial sector was frequently characterised by a combination of adverse financial and operational features, i.e. a weak financial structure with imbalanced debt equity ratio; negative or inefficient working capital; slow-moving assets; inefficient material usage; large inventories and slow receivables etc. In the late 1970s, following a change in industrial policy, the Government assigned the task of new investments to the private sector while the activity of the public industrial sector was restricted to its consolidation and the improvement of operational efficiency. In order to attain these objectives, a wide range of re-organisational steps were taken. A number of restructuring measures, such as mergers, close-downs of un-economical units and streamlining the control structure of this sector, etc., were introduced.

After this re-organisation exercise, the public industrial sector was organised on the pattern of a large industrial conglomerate. This conglomerate which included a wide spectrum of industries such as steel; fertiliser; automobile; cement; chemicals, etc., was almost directly controlled by the administrative ministry. Its newly emerged control structure of public industrial sector comprised of about seventy operating enterprises directly controlled by the administrative ministry, namely the Ministry of Production, through eight holding corporations. In order to assist the Ministry of Production, the Experts Advisory Cell (EAC) was created with the objective to develop systems for monitoring; evaluation; planning and restructuring of industries. Almost immediately after its inception, EAC initiated a study to assess the reasons for inefficiencies in public enterprises and to recommend corrective measures. This study discovered that one of the major reasons for persistent inefficiency in public sector enterprises was that there were no institutional arrangements for guiding and evaluating the performance of managers in public enterprises in Pakistan. Nor was there any system of motivating the managers to improve performance. Only a vague method was followed to assess management performance, based on the criteria of maximisation of production, increase in profit and the successful control of labour problems.

This method had many obvious drawbacks. First, profit was measured in the privately relevant rather than publicly relevant sense. Second, it was not really possible to evaluate managers on the basis of profit since, in many cases, profit was mainly determined by the decisions and policies of government, or, by foreign exchange allocations which were again beyond the control of managers. Third, the cost component was totally ignored in emphasising increased production. There was neither any institutional arrangement for evaluating enterprises nor any other effective follow-up on the achievement of targets in the form of penalty or reward. Generally, the managers of enterprises were not rewarded in pecuniary terms and only modestly in non-pecuniary terms. While most, if not all the corporations, had a well-defined bonus system applicable to workers, top managers were not included at all and middle-level managers only partially. This was due to a government policy under which board members and the top three management tiers were barred from receiving bonuses, and the next five tiers received bonuses only on an inverse sliding scale.

Installation of the Signalling System

During 1981, in order to improve the operational efficiency of the public industrial sector under the Ministry of Production, the Government decided to set up the Signalling System for Public Enterprises. In November 1981, EAC was given the responsibility of setting up the signalling project. The project had the three following components:

(i) A performance information system to measure accurately actual behaviour;

(ii) A performance evaluation system to specify socially desirable behaviour;

(iii) An incentive to reward or penalise managers for their actual performance at the end of the period, i.e, one year.

The development of the system took about three years. During this process, major efforts were made to evolve a performance information system. In 1983, the Government approved the operation of the system but after significantly modifying the original proposal.[1]

The signalling system originally envisaged that social profitability, known as public profitability, should be the primary indicator of performance. Public profits[2] are

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[1]For a detailed account of the system see:

(i) Mehdi I. "The Pakistan Experience of Signalling System" Public Enterprise, ICPE, Ljubljana, 1988, Vol 8.

(ii) Shirly Mary, "Managing State-Owned Enterprises: The World Bank, Washington D.C. 1988, P.34.

[2]Public profitability attempts to assess the total surplus generated by a manager given the capital stock in his hand. For evaluating the real performance of public enterprise efficiency, we arrive at an adjusted profit which not only takes care of public ownership peculiarities of the enterprise but also make alterations in the normal accounting procedure which distort the information concerning the real surplus generated by public enterprises. This adjusted profit is called public profit. The concept of public profit recognises the fact that while a private manager is taking care of only one economic

private profits adjusted for those elements not deemed relevant to a PE. For example, taxes and interest which are private costs but public benefits, are excluded so as not to encourage PE managers to devote time to minimising taxes or the interest arbitrage. In other words, public profitability aims at encouraging managers to maximise net economic benefits judged from the national perspective. However, in approving the signalling system, private profitability rather than proposed public profitability at constant prices was kept as the primary criterion of evaluation. The task of incorporating improvement in productivity in this criterion was left to the professionals in the Cell.

The existing system is based on the principle that at the beginning of the year, performance targets will be negotiated between the individual enterprise management and the EAC. The negotiated targets are converted into an agreement or performance contract signed by the chief executive officers and EAC. During the course of the year, the performance of the enterprise is monitored against the agreed targets, and a performance bonus is awarded according to the level of achievement.

Operations of the signalling system involve the following elements:

- selection of performance criteria;

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factor (private shareholder), the manager of a public enterprise has to keep in view interests of all the domestic economic groups. Public profit is derived from a single period variable social benefits less variable social costs: that is, the value to society of the difference between what the enterprise takes out of the economy (costs) and what is puts back (benefits) in any one period. Public profit, therefore is:

II = X - R - rk-

Where

X	= Output at factor cost
II	= Intermediate inputs at purchaser's prices
R	= Factor rental expenses
rk	= Opportunity costs of working capital

Given the fixed capital placed at his disposal, the manager is expected to maximise this variable public profit. Thus, public profitability can be defined as:

$$\text{Public Profitability} = \text{vv} \quad \frac{\text{Variable Benefits Less Variable Costs}}{\text{Fixed Costs}}$$

(For a detailed account of this concept see: (1) Jones. L.P. and Sakong, II. "Social Accounting System for Public Enterprises". Seoul: Korea Development Institute. July, 1975; KDI Working Paper No. 7604 and (2) Mehdi, I. "Performance Evaluation of Public Enterprises in "Essays on Relations Between Government and Public Enterprises" ICPE, Ljubljana, Yugoslavia, 1985.

- selection of units by which performance is to be measured (e.g. percentage increase in profitability);

- negotiation and determination of targets to demarcate strong and weak performance. For this, a performance scale (A, B, C, D and E targets) rather than one target, is negotiated so that the unit can be categorised in any of the five grades of performance;

- At the end of the year, based on the audited accounts, the achievement of the units is compared with the original targets. Following this appraisal, units are categorised in one of the five classes so that the pre-determined bonus amount, linked with each grade, can be allocated to their chief executive officers who in turn distribute it among their managers.

The operation of the system is marked by a series of activities spread throughout the year. They are as follows:

PERFORMANCE EVALUATION CYCLE

(Fiscal year in Pakistan commences on 1st July)

Activity	Date
♦ Receipt of budgets from companies/units	April-May
♦ Target setting meetings	May-July
♦ Receipt of audited accounts for the previous year from units/companies	October-December
♦ Information received on diagnostic formats	October-February
♦ Preparation of diagnostic report	February-April
♦ Final Grading	April

The signalling system is supplemented, and to a very large extent its effectiveness is enhanced, by two other managerial systems:

i) Management Information System; and

ii) Corporate Planning System.

Management Information System

In setting up the signalling system, it was considered that an information system should be established which would assist the various levels of control structure by equipping them with timely and appropriate information so that in time corrective action could be taken to achieve the desired results. For this, EAC revamped the existing monitoring system, and a computer-based management information system was established to develop a comprehensive reporting mechanism. This system delivers a required set of information on a monthly basis. The monthly, quarterly and annual reports highlight the shortfalls or distortion in performance to facilitate corrective action and for policy decisions by the decision-makers in the Ministry of Production.

Corporate Planning System

One of the major weaknesses identified during the operation of signalling was that it has only a one-year time horizon. As a result, managers were inclined to take action which showed improvement in a given period, i.e. one year, even if it were at the expense of the long-term health of the enterprises. Therefore, it was considered necessary that the signalling system should be operated with reference to the long-term corporate plan of the enterprises. It was, therefore, vital that a corporate planning system be established to ensure maximisation of return on investment in the long run. Therefore, five-year rolling corporate plans are prepared at the unit/corporation level and the first year is used for budget preparation for the current year.

Part Two

A Case Study of Pak-Saudi Fertiliser Ltd

The objective of this case study is to highlight all the major technical elements of the operations of the signalling system, i.e. to illustrate budget analysis; target negotiation; signing of a performance contract; monitoring during the year and evaluating the enterprises at the end of the year. The study also attempts to identify the levels and trends of the major indicators and sub-indicators to assess the performance; and to narrow down to the trends in real efficiency of the enterprise management.

Pak-Saudi Fertilizer Ltd was incorporated as a public limited company in June 1975. The unit was established with an annual installed capacity of 557,000 m. tons of ammonia. The unit started trial production in April 1980 and went into commercial production in October 1980. As at 30 June 1992, the National

Fertiliser Corporation of Pakistan (Pvt) Ltd held 100 per cent of the ordinary paid-up share capital of Rs 60,000 million.

The mission/aim of the company is to manufacture chemical fertiliser and to market these and other related products, both domestically and abroad. In order to fulfil this aim effectively, the management has set out certain objectives in its corporate plan which are:

(i) to maintain leadership in the domestic industry while ensuring Pakistan's requirements for urea and ammonia are fully met;

(ii) to generate sufficient cash from operations to enable the self-financing of the future development of the business.

During the period FY '83 to FY '93, Pak-Saudi Ltd. experienced a secular rising trend in profit before tax (except for dips in 1987-88 and 1991-92). During this period there was almost a four-fold increase in profit before tax, i.e. RS825 million in the 1993 financial year, as compared with RS191 million in the 1983 financial year. During this period the grade accomplishment of the unit is as follows:

- A grade 7 times
- B grade 2 times
- C grade 1 time

For illustration purposes, let us look at the year 1987-88, where the unit has achieved the profit target but after was awarded a grade 'B' after evaluation.

At the beginning of the year the Pak-Saudi management was asked to submit their proposals and plans for the year. the main features of the Pak-Saudi proposal/budget are summarised as follows:

(Rs in millions)

Description	Budget 1987-88	Last year 1986-87
♦ Net sales	1,290	1,197
♦ Cost of sales	833	692
♦ Gross profit	457	505
♦ Financial expenses	49	66
♦ Profit before tax	392	426

♦ Labour cost	44	39
♦ No. of employees	900	868
♦ Sales volume(urea)	580,00	568,000
♦ Production volume	560,000	587,000
♦ Operating days	320	324
♦ Down time	46	41

The main features of physical cost-consumption ratios were as follows:

Cost-Consumption Ratios

Description	Budget	Last year
♦ Natural gas MBTU/ton	36.01	33.2
♦ Labour cost expenses (Rs in million)	44	39
♦ Financial expenses (Rs in million)	49	49

This proposal/budget was scrutinised in the light of EAC's database, in order to determine the optimal targets for the year (annex). While scrutinising the targets, there were various considerations:

- What was the original objective, designed capacity and expected profit of the unit?
- What has been the performance of the enterprise in the past years?
- What is the achievement level of similar industrial units in other selected developing and developed countries?
- What are the standards achieved by similar industrial units in other selected developing and developed countries?

- What financial and physical constraints are expected to be experienced by an enterprise during the year?

- What is the macro-economic environment which is going to influence the demand and supply position of the inputs and outputs of the enterprise?

Development of Targets

After a detailed examination, EAC's comments and basis of negotiations were worked out. EAC comments on the Pak-Saudi proposal were as follows:

- production in budget decrease by 4.8 per cent;

- operating days reduced from 324 to 320;

- production per day reduced from 1812 tons to 1750 tons;

- sales value increased by 2.1 per cent (also using inventory);

- average monthly salary/employee increase by 9.7 per cent;

- no increase in price of urea;

- price of natural gas increase by 31.7 per cent;

9. Other income decrease from Rs40.5 million to Rs16.0 million due to decline in interest income.

The principles on which the targets are set by the Experts Advisory Cell are:

- Efficient target setting should be carried out in a participatory process. Without this approach, targets tend to take the form of formal directives which are often overtly accepted and covertly resisted.

- Targets should be explicit and clear-cut.

- Targets should be neither too low nor too high. This could give the wrong signals to the managers.

- Each enterprise must be looked at in its own, unique environment.

- Targets for incentives should ensure that the generation of a surplus is worth significantly more than distribution by way of bonus.

- Targets must take into account the social tasks which enterprises are invariably asked to carry out.

After a detailed negotiation which was based on an increase in sales and the conservation of major costs, i.e. energy, raw material, labour and financial charges, a new bottom-line profit was worked out (details in annex).

Profit (Rs in millions)

	Wts	A	B	C	D	E
1. Profitability	0.60	25.02	24.43	23.84	23.48	23.14
2. Physical production (thousand tons)	0.10	580	575	570	565	560
3. Physical energy consumption		424	414	404	398	392
4. Cost of production per ton	0.30	1408.73	1415.26	1421.91	1428.66	1435.55

In order to ensure strict cost conservation, the targets are generally constrained by physical consumption rations in four areas, i.e. raw materials, energy, financial charges and labour. However, in view of the specific production and cost pattern of Pak-Saudi, two costs names natural gas consumption per unit or area production and cost of labour was constrained to Rs33.7 and Rs44.4 million respectively. The two costs were assigned weights as .5 and .25 respectively.

After signing its agreement of targets, the management of the unit is left on its own to make efforts to achieve the given targets. EAC started to monitor the performance during the year so that the ministry can keep a watch on the performance of the unit and take corrective action where it is required. The performance of the unit against the EAC-established targets is monitored through a computerised information system on a monthly basis. It is also examined on a periodic basis in the performance review meetings. The meetings are chaired by the Secretary, Ministry of Production and comprise chief executive officers of units. The review meetings discuss not only the bottom line target achievement but also discuss the cash flow, manpower productivity, production facilities, material utilisation, energy conservation, etc. The bottom line variance is split into the following areas and the reasons for the position are explained:

- sales volume variance;
- raw material purchase price variance;
- raw material usage variance;
- output price variance;
- trend in inventories;
- trend in production.

The objective of the review meetings is to identify areas which are creating problems in achieving targets and to ascertain whether government can come to the assistance of the enterprise. The review meetings ensure that the enterprise management continue to make efforts to achieve agreed targets. In sum, the targets assist the decision-makers in assessing the unit performance against an established and agreed standard and help managers, if need be, to achieve them.

Actual Achievement Versus Targets

At the end of the year, for the purpose of evaluating the performance of the unit, specially designed diagnostics formats are sent to the unit, so that the detailed information on the factors affecting the performance of the company during the year can be made available to EAC. The idea is to ensure the company is evaluated in the light of the specific controllable factors influencing its performance. At the end of the year based, on the audited accounts and diagnostic formats, the unit's achievement is compared with the original targets.

Criteria	Weight	A	B	C	D	E
Profit before tax (Rs in million)		424.13	414.13	404.13	398.13	392.30
Profitability (%)	0.60	25.02	24.43	23.84	23.48	23.14

Criteria	Weight	A	B	C	D	E
Physical Production (000 m. ton)	0.10	580	575	570	565	560
Cost of production (per ton)	0.30	1408.73	1415.26	1421.91	1428.66	1435.55

The actual achievement of the company against targets is worked out as follows:

Criteria	Actual Achievement	Raw	Weight Score	Weighted	Score Achieved
Profitability (%) PBTX divided by total assets	25.39	1(A)	0.6	(1x.6)	0.6
Physical production (000 m. ton)	580.62	1(A)	0.1	(1x0.1)	0.1
Cost of Production	1416	2(B)	0.3	(2x0.3)	0.6
				Sub total	**1.3**

Evaluation of cost targets

Description	Wt.	Target	Actual	Add back for exceeding target limitations
Raw material Natural Gas (MBTU/Ton)	0.50	33.70	34.36	0.50
Labour Cost (Rs in million)	0.25	42.418	47.531	0.25
				.75

Final score	
Score achieved against profit, production and cost/ton target=	1.30
Score achieved against cost target	.75
TOTAL:	**2.05**

The composite score of Pak-Saudi in terms of profit, production and unit cost works out to 1.3, which would place it in A grade. However, when we take into account the cost constraints the unit has exceeded both in natural gas consumption and labour cost. An addition of their weight, i.e. .75 brings the total score to 2.05. On a scale of 1 to 5 (1 'A' excellent performance; 5 or E, inadequate performance), the company's total score worked out to 2.05 which leads it to grade 'B' and an entitlement of two months' bonus.

Part Three

Effectiveness of the Signalling System

The signalling system was conceived and set up in the government policy environment which placed emphasis on improving PIEs' performance with the assistance of efficient management systems. The signalling system was part of the attempt at the systematisation of management of PIEs. How far this system has been successful in attaining its objectives, requires an in-depth analysis which is beyond the scope of this study.[3] If profit alone is any indicator, the trend of aggregate shows a continuous profit rise (annex). This, indeed, is a result of a number of factors. However, the following manifestations are indicative of the system's achievements:

- managers' attitude towards the system;
- attainment of grades and trend in profitability;
- how far this system has assisted in systematising the management of PIEs.

Managers' attitude to the system

A preliminary survey of the managers' attitude towards the signalling system indicates that it has at least been able to draw their attention to operational efficiency. The CEOs of PIEs are conscious, to say the least, of the year-end evaluation and grading which makes them accountable for their performance. Indeed, the reaction of PIE managers ranges from positive support to scepticism to strong opposition to the system. The reaction of managers to this system divided them into two classes:

[3] For a detailed account of this subject see Jones, L.P. and Mehdi, I. "Signalling System for Public Enterprises in Pakistan". August, 1986.

- managers who are favourably inclined towards this system; and
- managers who are sceptical towards this system.

Managers reacting positively

The reasons for some managers supporting the system are as follows:

- Managers whose units have been generating profit for a number of years had grievances that there was no method and system of acknowledging their achievements. The issue had become important since the workers' bonus was to a large extent determined by the profit-earned performance of the unit and they were getting away with as much as ten bonuses. As a consequence, managers at the junior level were often getting less financial emoluments than some workers. The incentive system provided a method of rewarding bonuses to the officers in profit-earning units.

- Managers of some units, especially those where prices were fixed, found a way of demonstrating their good performance. For instance, in the case of a petroleum unit, in the past their managers had argued that their unit was working at a high level of efficiency. However, the conventional performance indicators i.e., profit, could not demonstrate this as the unit was allowed a fixed return on equity irrespective of its performance. The Stock Exchanges and Chambers of Commerce, while identifying the best companies of the year, ignored this unit since their primary criterion of evaluation was the maximisation of profit. EAC's performance evaluation system initially faced the same problem. However, the Cell, in its efforts to motivate management to improve productivity, evolved a set of criteria of evaluation which, along with targets to maximise profitability (by reducing assets, i.e. inventory and receivables, etc.), assigned weights to conservation of costs. The manager of this unit found a way to demonstrate his achievements. In fact, its chief executive suggested to the representative of the Chambers of Commerce and Stock Exchange that his unit's performance should be evaluated and seen with reference to EAC's evaluation system.

- Generally, it was experienced that the managers of process industries were more enthusiastic to the system than those in the batch industries. One of the reasons for this was that most of the process industries sell in a supply constraint situation where they aim at maximisation of production. As against this, batch processing industries, i.e. engineering sector units etc., are operating in a competitive environment where performance is largely determined by the market. Since marketing is one of the weakest areas of public sector managers, the managers of these units generally felt uneasy and uncertain while negotiating the target for sales. However, among these units those with a profit-making record found the evaluation system helpful.

4. Reaction towards the system was also very largely dependent on the personality of the managers. Managers who had drive and ambition and endeavoured to establish their goodwill in the market, showed their enthusiasm towards the system. However, these managers were also the most difficult ones with whom to negotiate targets.

Results Produced by the System

The setting up of the incentive-linked performance evaluation system has been an extremely fruitful experience. Although the actual system is quite different from that originally envisaged, the system evolved by the Experts Advisory Cell has proved to be a good starting-point. The system has produced the following positive results:

- The system helps to clarify the perception of managers of their objectives.

- The targets negotiated by the Experts Advisory Cell provide a bench-mark to the Ministry of Production for effective control of the performance of operating units. In the periodic review meetings, the decision-makers, i.e. the Minister and Secretary, use the well-thought out and negotiated targets for effectively monitoring, controlling and regulating the units' performance.

- In-depth ex-post-facto evaluation of operating units has identified a number of problems and shortcomings in the management of our units. A continuous decline in performance, reflected by the consistent low grades of units, indicates the need for a detailed study of the units' problems and prospects, and to identify the requirement of structural changes, such as, mergers, disinvestments, liquidations or diversifications, etc.

- The evaluation system has also highlighted some major shortcomings in the public enterprises management. For instance, it was realised that public enterprise managements should have long-term corporate plans. Consequently, the Experts Advisory Cell initiated a programme to launch a project to install a corporate planning system in the public sector which is now fully operational.

- Finally, the system has created a spirit of improving performance. The incentive to improve varies according to the quality of management. Enterprising and aggressive managements have taken the results of the system much more seriously than others.

Annex I

PROFIT BEFORE TAX AND GRADE ACHIEVED

(Rs in million)

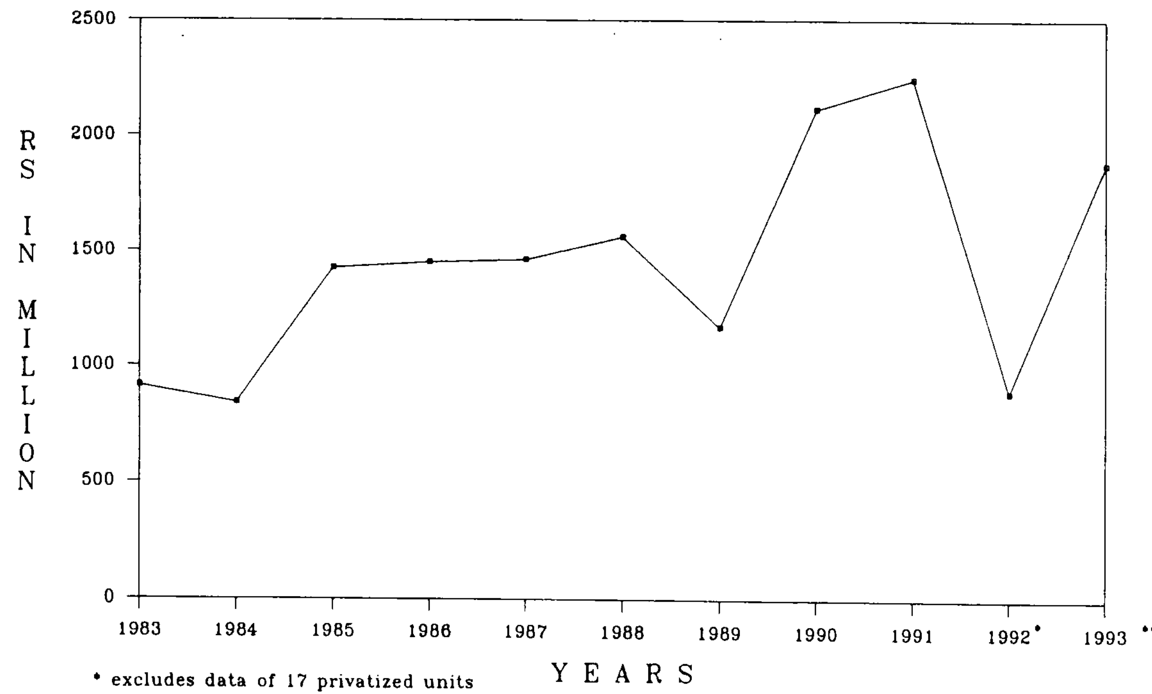
Year	PAK SAUDI	
	PBTX/(Loss)	Grade Achieved
1983-84	191	A
1984-85	197	A
1985-86	234	C
1986-87	570	A
1987-88	468	B
1988-89	446	A
1989-90	588	A
1990-91	894	B
1991-92	826	A
1992-93	826	A

Annex II

PHYSICAL DATA

Description	83-84	84-85	85-86	86-87	87-88	88-89	89-90	90-91	91-92	92-93
Capacity utilization (%)	104	105	95	108	104	104	106	100	101	92
Production (000 tons)	582	587	528	600	581	585	590	559	562	512
Sales volume of urea (tons)	544	561	578	599	570	588	624	579	552	537
Plant Oper. (No. of days)	320	330	303	330	324	323	328	302	306	290
Production per day (tons)	1819	1779	1743	1818	1791	-	1836	1851	1837	1768

PRETAX PROFIT
(EXCLUDING PAKISTAN STEEL)



* excludes data of 17 privatized units
** excludes data of 28 privatized units

IV

Performance Contracts: A Case Study of the Steel Authority of India

Introduction

The Steel Authority of India (SAIL) is the fifth largest public sector company in India with an investment of Rs.63 billion. It has a production capacity of over 10 million tonnes of steel; a turnover of Rs.101 billion and has under it four integrated steel plants set up as fresh investments by the Government of India between the 1950s and 1970s, and two old plants acquired as sick plants from the private sector. It is a company registered under the Indian Companies Act. The Government recently divested five per cent of its equity to financial institutions and the public.

SAIL started as a unitary board-managed company in 1950 when it was known as Hindustan Steels Limited. It became a holding company in the 1970s when the number of plants under it increased and reverted back being a unitary board-managed company with individual plants functioning as divisions. The two, acquired sick plants were kept as subsidiaries along with two other subsidiaries. The company presently has 190,629 employees.

Although there is one steel plant run by TATAs in the private sector, once it was decided in the 1950s to set up steel plants in the public sector exclusively, no other private competition was allowed until 1991, when the policy changed. The steel sector was under an administered price regime until the end of 1991 when controls on steel prices were lifted.

It is intended to show through this study how the Indian policy of performance contracting evolved and how it was possible to prepare this steel giant for the liberalised ambience of the 1990s through the instrument of PCs, or MOUs (Memorandum of Understanding) as they are known in India. Since this was the first PSE to attempt the MOU, the experience gained from it became extremely useful in applying it to other PSEs.

Before we take up the actual case study, it would be useful to consider the background of how the Indian policy came to be adopted and how it developed. This will also highlight how the efforts on the part of SAIL to stay out of the system initially, actually showed the merit of the system finally adopted, as compared to the French system.

Introduction and Evolution of MOUs in India

Performance contracts for Public Sector Units are known as MOUs in India. The MOU (The Memorandum of Understanding) is rooted in an evaluation system which not only looks at performance comprehensively, i.e. at both commercial and non-commercial criteria of performance in their static and dynamic aspects, but also ensures and forces improvement of performance of managements and industries by making the autonomy and accountability aspects clearer and more transparent. It is an annual document which is an intrinsic part of a long-term corporate plan in which the Government (represented by the Secretary in the line ministry) and the public enterprise represented by its CEO lay down their mutual obligations and responsibilities based on the missions and objectives of the public investment and after mutual negotiations. The idea is to choose appropriate criteria, assign mutually acceptable priorities to them and decide at the beginning of the year how the achievement of targets (and deviations therefrom) will be evaluated. The crux of the evaluation system is to set the evaluation parameters in advance and before the actual performance is delivered. Further, the process of negotiation is assisted by an objective third body which finally evaluates the performance and brings greater objectivity into the system.

The importance of introducing MOUs was first realised and recommended by a Committee to Review the Policy for the Public Enterprises: (Arjun Sengupta Committee) which submitted its Report in 1985. The Committee was appointed to suggest ways of improving public sector performance, perception of which was universally negative in India. The Committee concluded that an MOU was the best form of interface between the Government and the PSE management and this would ensure operational autonomy for the public enterprise managements with corresponding accountability for results, thereby reducing day-to-day Government interventions. While making the suggestion for the introduction of MOUs, the aforesaid Committee had the French "Performance Contract" system in mind, but in view of the inadequacies of that system in the Indian context, the Korean form of "Signalling System" was adopted with suitable modifications from 1969 to 1990 on the basis of the recommendations made by the Suresh Kumar Committee of the Department of Public Enterprises.

The first set of MOUs in India were signed for the year 1967/68. These MOUs were closer to the French system and did not contain either criteria weights or criteria values. As a result, it was not possible to evaluate the performance of MOU-signing enterprises. The change from the French to the Signalling System in 1969 enabled an objective performance evaluation of MOU-signing public enterprises for the first time. This change will be highlighted in this study.

MOU System as Currently Implemented in India

The MOU system has the following elements:

Corporate Mission

Every enterprise must have a corporate mission which is a succinct statement of its reason for existence and addresses the question regarding what business the enterprise is engaged in and, in effect is the superordinate objective of the enterprise.

Corporate Objectives

The corporate objectives stem from the corporate mission and are inter-linked with one another. Stated objectives relate to *what* an enterprise is expected to do. The *how* relates to the strategy for achievement of the objectives and the two are often confused in the MOUs. Objectives are required to be quantified and given a time horizon. Further, it is considered desirable that:

- Objectives covering the key performance area of an enterprise should be few in number and capture performance, both financial and social, adequately.

- Areas which are not in the main line of business should be excluded, but the balance sheet may reflect their costs.

- Objectives should preferably relate to outcomes rather than processes.

- Objectives should be listed according to the priority attached to their attainment by the owner. The Memorandum of Association (MOA) should be used in culling out the objectives. In cases where the MOA does not refer to any social obligations, these should not figure in the objectives.

Performance Criteria

The corporate objectives must have performance indicators, called performance criteria in the MOU system. Looking at the performance criteria differently, they reflect the key performance areas of an enterprise. By implication, performance criteria and key performance areas are inter-related. The performance criterion must have a specific measure which is both objective and growth-oriented. The selection of a proper performance criterion is as important as the selection of an appropriate measure. For instance there is very little point in measuring R&D performance in terms of funds utilised unless a nexus between the two has already been established. Further it is considered desirable that:

- Performance criteria, like corporate objectives, should be limited.
- There should be a congruence between objectives and performance criteria.
- There should not be any duplication in the selection of performance criteria.
- Selected performance criteria should be measurable and their evaluation method predetermined and laid down in the MOU.

Criteria Targets

A performance criterion has five levels of targeting, ranging from 'excellent' to 'poor' with 'very good', 'good' and 'average', as the three intervening levels. The Performance Budget and/or Plan Targets are required to be placed under the 'very good' column and not 'excellent', in order to ensure continuous effort on the part of the enterprise to really strive for 'excellence'.

Criteria Weights

A performance criterion is assigned a weight (on a scale ranging from 0 to 1) in such a manner such that the sum of the weights of all the criteria add up to 1. The weight attached to a particular criterion depends on the subjective assessment of its relative importance by the owner.

Composite Score

A composite score of performance from 1 (excellent) to 5 (poor) is computed by evaluating the actual achievement with reference to the targets set on a 5-point scale and determining their weighted average on the basis of weights assigned to each criterion.

Evaluation Mechanism of MOU, HPC & ATF

The real and unique feature of the Indian system is the institutional arrangement for evaluation of the contract by an objective third body consisting of a High Power Committee headed by the head of service in India and assisted by an ad hoc body of experts outside the Government called ATF (Ad Hoc Task Force) who bring to bear on the system an objectivity which is generally not available in the normal governmental set- up. This is the significant departure from all traditional methods of evaluation which are internal to the Governments.

A copy of the checklist giving guidelines for drawing up MOU is attached as Annex I.

SAIL MOUs 1987-94

Steel Authority of India Limited (SAIL) was the first of the public sectors which signed a MOU with the Government of India in 1967-68. Since then, SAIL has signed a MOU with the Government every year. There have been gradual changes in the structure of the MOU document due to changes in environment and government policies.

MOUs 1987-88 and 1988-89

These were the very first years when the Korean type of contract had not been adopted. Hence they were more in the nature of a performance information system, more useful to the Board of the company than the owner, i.e. the Government. It will be seen that no mission was defined and that there was no agreement as to the manner of evaluation. However, Government did grant some delegation of powers which were not available to other PSUs.

Further, the obligations of SAIL and Government were defined clearly in the document. It had the following characteristics:

- Focus on production, product-mix, techno-economic parameters, financial performance, equipment availability, project milestones, investment approvals by government, ensuring infrastructural support of coal and power.

  The relative importance of each parameter on percentage weightage basis was not spelt out at that time.

- It helped SAIL to define plant-wise performance criteria and to fix accountability for attaining the specified objectives.

  Therefore, it remained an internal control document, which made little impact on PSU-Government interface or on existing traditional methods of evaluation which were quite clearly found to be inadequate for the Government to extract enhanced performance from PSUs. Performance could neither be rated nor compared in any acceptable manner.

MOUs of SAIL after 1988-89

In 1988/89, the Korean system was adopted, but SAIL showed initial reluctance to conform to the new system because they felt that time and labour spent by them in developing their MOUs would be a waste and, perhaps, there was some reluctance on their part to be exposed to some kind of inter-firm comparison. The composite score under the newly introduced system made such a comparison possible. In this, they even got the support of their line ministry. However, the High Power Committee gave them a directive to conform. This not only had a decisive impact on many reluctant PSUs and their line ministries but also, as subsequent events proved, made them really strive hard for "excellence". In the case of SAIL, it also prepared them for the Liberalisation, which has taken away their protection. These aspects clearly emerge from their MOUs.

The evaluation parameters and evaluation sheet from 1989 to 90 to 1993 to 1994 is attached as Annex II. This makes it possible to appreciate the nature of the document, the nature of negotiations to draft the document and its adherence to the checklist and above all the quality of the third party supervision.

It will be noticed that the mission had been clearly stated and that the criteria had been clearly developed and fine-tuned over a period. Also, the priority of each criterion is assigned a weight, and the performance to be achieved is put on a five-point scale. Since there are bound to be variations in achieving targets, to eliminate subjectivity in evaluating variations, they are negotiated in advance. This is the crux of the system, especially since negotiations are supervised by an outside third body which ensures objectivity of evaluation; prevents forcing down of targets on managers, and ensures that there is no collusion.

MOU 1989-90

As compared to previous years, weightages of important criteria were spelt out. These were crucial changes which transformed the quality of the document. It was now more meaningful to both parties since the expected performance was made absolutely transparent. The focus was on:

- production of crude steel 60% WT
- gross margin/capital employed 15% WT
- project Schedule 10% WT
- customer satisfaction 15% WT

As seen here, there is high focus on production. This is typical of the public sector all over, especially in controlled regimes. However, introduction of "customer satisfaction" gave the first signal towards a market orientation which could lead to rationalisation of the production itself. In other words, the Government desired that the activities of this PSU should be increasingly market-driven and not plan-driven.

SAIL was evaluated under the new system and, for the first time, it got a composite score of 2.31 and a "Good" rating.

MOU 1990-91

In this document the focus was on:

	Parameter	Weightage
(i)	Production weightage	27.5%
(ii)	Projects including R & D	15%
(iii)	Gross Margin/Capital Employed	12.5%
(iv)	Customer Satisfaction	10%
(v)	% Tested in Saleable Steel	15%
(vi)	Sp. Energy Consumption (Cost reduction measure)	10%
(vii)	HRD Areas	10%

Production still remained highest in priority but with a much lower weightage. A shift was made to cost control and cost reduction under Government direction. HRD was added as a new criterion.

The performance of SAIL was evaluated at the end of the year. The composite score was 1.98, which means 'Very Good'. It meant that SAIL was improving on its record of the previous year.

MOU 1991-92

	Parameters	Weightage
(i)	production weightage	25%
(ii)	project including R & D	15%
(iii)	cost control measure (incl. sp. energy consumption inventory reduction)	25%
(iv)	gross margin/capital employed	15%
(v)	customer satisfaction	10%
(vi)	HRD area	10%

The focus on production was declining (in 1989/90 – 60%, 1990/91 – 27.5%, and 1991/92 – 25%) and the cost control measure to improve financial performance was being given utmost importance, to the extent of 25% in 1991/92.

The performance of SAIL, evaluated at the end of year, was 1.59 which was 'Very Good' on the 5-point scale but bordering on an 'Excellent' rating (1.5 and below is rated 'Excellent').

MOU 1992-93

Parameters chosen were predominantly on profit and profit-related parameters in the following manner:

	Parameters	Weightage
i)	production	15%
ii)	profit & profit-related parameters	50%
iii)	HRD Areas	15%
iv)	project, including R & D	10%
v)	customer satisfaction and commercial parameters	10%

In 1992-93, there was a clear focus on profit generation with weightage as high 50 per cent. This was a deliberate government policy to make PSEs behave commercially in order to give a better return to the nation. The high weightage to profit meant that without a good commercial performance, no PSE could get a high performance score or rating. The national policy of reducing the burden of PSEs on the budget was thus given a concrete shape.

Performance was rated 1.36, which is 'Excellent' on 5-point scale. SAIL was able to meet the desire of the owner at an excellent level of performance.

MOU 1993-94

In order to ensure the timely completion of modernisation, focus was given to the Milestone Performance Index of projects. The weightage is 19 per cent (inclusive of R&D projects). Production weightage is 14 per cent and financial performance weightage is 50 per cent. The focus now is in the following order:

- financial performance;
- projects;
- production.

The provisional score is estimated at 1.36, which gives them an 'Excellent' rating.

An Overview of MOU Document of SAIL

- There has been a shift from no *evaluation* to *production*-oriented evaluation to *finance*-oriented evaluation.

- SAIL reacted to a competitive environment simulated through the MOU process before liberalisation and hence finds itself in a strong position to compete globally.

Since 1989-90, when SAIL has been evaluated, the performance of the MOU composite score, which shows a Net Profit and Gross Margin to Capital Employed (the two major financial parameters), and production of Saleable Steel is as follows:

Year	**MOU Composite Score**	**Net Profit**	**Gross Margin/ CE**	**Prod. of Sal. Steel (MT)**
1989-90	2.31	224.96	15.83	7.063
1990-91	1.98	248.26	16.75	7.365
1991-92	1.59	367.30	19.71	8.029
1992-93	1.36	423.40	20.58	8.335

As seen, there is steady improvement in the MOU Composite Score, financial performance of SAIL, as well as production. This proves the general point that the composite score is a very good and eminently adequate indicator of performance in its totality and it is able to capture all elements of performance expected from a PSE (and not only financial performance.) One can, however, make an MOU evaluation criterion finance-oriented if that is the most important public purpose, as is the situation in India today.

There is as yet no specific central incentive scheme of monetary return in India; but a scheme has already been prepared and is being considered for approval by government. In the meantime, non-monetary awards, such as the Prime Minister's certificate of 'excellence', are being given. SAIL has still to receive its first certificate for its 1992/93 performance.

There is no legal basis for these "PCs" in India. That is why they are called MOUs. However, as yet there has been no case of difference between the PSE and the Ministry which could not be resolved by the High Power Committee.

Procedure followed in SAIL for drawing up MOUs

In SAIL, The vice-chairman is responsible for formulation of MOUs. The vice-chairman is assisted by a group of executives with multi-disciplinary backgrounds.

The draft MOU, drawn up with the help of functional directorates, is discussed in a meeting presided over by the chairman where other directors and chief executives and senior officers are present.

The draft MOU is sent to the Ministry of Steel (MOS) where it is analysed and discussed by SAIL and MOS before sending it to the Department of Public Enterprises which services the High Power Committee.

The Ad Hoc Task Force bridges the gap between MOS and SAIL in terms of technical competency and the findings of the document. The revised draft MOU document is sent for the approval of the High Power Committee and then signed by the chairman and the secretary (Steel).

The performance is discussed at board level every month, at minister's level in each quarter and at end of the year at SAIL, MOS and DPE level.

MOU and SAIL

MOU justifies the choice of the right key performance areas in the case of SAIL, since it becomes the basis of Annual Performance Plans which are more detailed documents signed between the chairman of the company and the chief executive of plants/units. These APPs are further analysed and a detailed microplan for each shop is prepared with detailed activities, responsibilities and time-frame which helps in attaining objectives-fulfilment, which in turn helps in obtaining key performance areas for MOU.

The above is the general procedure followed in all PSEs in India generally, with marginal modification. Currently about 125 MOUs are signed every year in India.

Lessons of Experience

The initial problem centred around the procedure for evaluating the initial efforts made by SAIL, ONGC & BEHL, three of the biggest PSEs of India. The MOUs were based on the French System and were more in the nature of creating a performance information system rather than a performance evaluation system. It was virtually impossible to be objective because any variation could be subjectively judged by the evaluator unless there was prior mutual agreement on the manner of judging variations. Nor did this result in conferment of any greater autonomy on the managers. At that time, we were looking at the South Korean signalling system which had the added features of prior agreement on criteria for judgement and an agreement as to how to evaluate variation by having a rating system for levels of performance. We were then able to show, based on a theoretical exercise for the same MOU, that the exact performance of a PSE could be evaluated in terms of a rating or a number, which would be both fair to the manager as well as to the owner because of a prior agreement on both the level of performance and the variation from targets. A prior agreement as to the importance of criteria for the achievement of objectives was therefore the crux of the system and crucial for the enhancement of its performance.

The second most important issue was who should evaluate. Initially, it was assumed that the secretary of the department/s signing the MOU would also evaluate it (because he was traditionally doing it, and traditionally wore many hats). It was with some difficulty that we were able to convince the Government that the signatory to the contract should not also be allowed to evaluate it. This is how the High Power Committee and Ad Hoc Task Force work became empowered to look into the functioning of ministries/ departments in respect of the MOU. This was a great victory for the reformists of the system since it was an implied acceptance that line ministries in administrative charge of PSE should also be up for evaluation if they play a role in the contract, and that too by a third party.

Implementation of the Indian Government policy in regard to performance contracts is indeed a saga in managing change in an extremely complex and vast administrative and corporate structure. One had to fight deep-rooted mindsets and a control system which was both rigid and arrogant and also chary of relaxing or loosening any of its controls. It is for this reason that, whatever has been achieved in this area in the last five to six years, which is not inconsiderable, it is indeed a tribute to dedicated work and patient plodding of a few who were entrusted with the task, for they were taking on a frozen civil service behaviour pattern. But above all, given the general environment of a controlled regime, to introduce reforms to the controllers and to make them conform to them was due to the fact that the Prime Minister was himself behind the reforms, rather than the work of any individual. The late Mr Rajiv Gandhi was positively behind the system (and he actually participated in SAIL's first MOU negotiations) and so was Shri V P. Singh. Shri Chandersekhar was not there long enough to be assessed, but Shri P. V. Narasimha Rao actually adopted this as part of the New Industrial Policy, which is in itself a tribute to the system being valid in all situations.

These three aspects are being highlighted because not only are they important but they emerged as most important lessons in the development of MOU of SAIL. The study therefore brings into focus the step by step development of MOU policy itself in India. We can now say that the policy has stabilised in a manner that enables us to look clearly at performance and its enhancement critically and transparently through the MOU document. It is for this reason that the MOU (or PC) can now be a basic instrument which can help not only the privatisation process of a PSE by making the performance and its process transparent to any investors.

ANNEX I

Checklist for drafting Memorandum of Understanding (MOU) for the year 1994-95, MOU Division, Department of Public Enterprises

A **Memorandum of Understanding** (MOU) is a freely negotiated performance agreement between Government as owners of public enterprises and the public sector enterprises (PSEs). It should clearly specify the intentions, obligations and the mutual responsibilities of the two parties. Contents of the MOU may be divided into the following two parts;

Part I		**Mission & Objectives of the PSE**
Part II	**(A)**	**Commitments of the PSE**
		Criteria for Performance evaluation, Criteria Weights, Performance Targets (Criteria Values) to be indicated on a 5-point scale.
	(B)	**Delegation of Powers and Assistance from the Government**
	(C)	**Frequency of Monitoring and Information Flow**

While drawing up or examining a particular MOU, please check the following:

Part I Mission & Objectives of the PSE

1. Does it contain a clear statement of board approval Mission and Objectives?

2. Are the objectives related to the mission of the Organisation?

3. Have these objectives been listed according to the priorities? List the priorities for the year clearly.

4. Do these objectives cover:

   (a) Both quantitative, as well as the qualitative aspects of the PSEs performance?

(b) Commercial and non-commercial aspects of the PSEs operation?

(c) Static as well as Dynamic aspects of the PSEs operation?

5. Are these objectives in conformity with the Corporate Plan of the PSE?

6. Are these objectives too many in number? If so, reduce the number to a manageable size.

7. Do these objectives contradict one another? If so, eliminate the contradictions or highlight the trade-offs.

Part II. A. Commitments of the PSE

A.1 **Performance Criteria and Criteria Weights**

8. Do the performance criteria cover the priority objectives as stated in Part I?

9. Have these criteria been defined clearly?

10. Only key performance criteria with reference tot he enterprise's business operations should form part of MOU.

11. The aim should be to include outcome objectives (that which measure end results) rather than process objectives (that which measure the means).

12. Please ensure that, wherever relevant, the MOU should contain criteria measuring PSEs performance with respect to 'Project Implementation' and 'Foreign Exchange Saving/Earnings'.

13. Is there any duplication in the criteria listed in the MOU? If so, is it avoidable or is it intended to serve a special purpose (e.g. to emphasise or highlight an important aspect of enterprise performance)?

14. Do the weights assigned to the criteria correspond with the stated priorities in the objectives? Do they reflect the perceived relative importance of the various criteria in the judgement of the PSE/Ministry?

15. Do the criteria listed in the MOU cover important qualitative aspects of enterprise performance? Have these criteria been translated into measurable quantitative indicators? If this is no feasible in certain cases (these should be few), does the MOU lay down a methodology for the

evaluation of performance with reference to such indicators?

16. Have the indicators measuring qualitative aspect of enterprise performance been given due relative weightage depending upon the nature of the activities of PSEs?

17. Do not include any 'social (or, non-commercial) obligation' unless it has been case on the PSE by the Government (Statutory obligations, or voluntary actions by the PSE in the interest of good industrial or neighbourhood relations do not qualify for inclusion).

A.2 **Criteria Values and Targets**

18. Is the target setting realistic and growth oriented?

19. Are the MOU targets identical with Plan and Budgetary Targets?

20. For qualitative indicators, the targets for each of the points on the 5-point scale should be indicated in the performance matrix itself.

21. The methodology adopted for fixing targets for qualitative parameters to be annexed.

22. The Ministry/Departments budget and MOU targets should synchronise as both the documents are required to be placed in the Parliament around the same time and variation, if any, could lead to serious consequences. For other targets not found in the Ministry/Departments budget the source should be the Performance/Capital/Revenue Budget(s) of the PSE. For those targets which cannot be located in either the Ministry's or PSE's documents, then the source basis of the same should be given in the MOU itself.

23. BE 93-94 (not RE 93-94) and BE 94-95 figures for various performance criteria are to be indicated in the performance matrix itself as separate columns.

24. The source for these figures should be mentioned in the MOU as follows. BE 93-94 and BE 94-95 figures for various performance criteria if taken from Ministry/Department Budget to be termed as BE (M/D) and if taken from the PSE Budget to be termed as BE (PSE). Those which are not from either documents to be pointed out clearly by marking them a * sign.

25. BE 94-95 figure with respect to each of the performance indicators is the

basic target and should be placed in 'very good' column, i.e. under point '2' on the 5-point scale. Under no circumstances BE 94-95 figure is to be placed in the 'Excellent' column (i.e. column I).

26. Even the placement of the basic target in the 'very good' column is based on the assumption that it represents an improvement over previous year's BE figures (i.e. BE 1993-94). Where this is not the case, the basic target, even if it is in conformity with the BE 1994-95 figure, should be placed in column 3 of the 5-point scale (i.e. the 'good' column), unless there are special reasons (recorded in the MOU) warranting its placement in column 2.

27. The difference in target values between 'Excellent' and 'Very Good'; 'Very Good' and 'Good'; 'Good' and 'Fair'; 'Fair' and 'Poor' columns should be uniform. Undue advantage should not be permitted to be derived by keeping a relatively lower margin between excellent and very good columns on the pleas that it is more difficult to achieve anything beyond very good. On the other hand, the gap between 'Very Good' and 'Good', 'Fair' and 'Poor' should not be too steep.

If the difference is not uniform between various point on the 5-point scale, then standard deviation for the variable in question should be mentioned clearly in the footnotes and the deviations should be related to the standard deviation.

28. Does the MOU contain the past five years' performance data on criteria included in the MOU?

29. Following note to be put beneath the performance matrix:

"Normal variations/escalations in inputs have been taken into account while working out MOU targets".

30. For financial ratios clearly indicate if average, opening or closing capital employed/net worth is taken for computation.

31. All financial performance parameters to conform to DPE definitions given in 'Public Enterprises Survey'.

32. 50% weight in the MOU for the year 1994-95 has to be given to the following two financial criteria:

Gross Margin	-	20%	<u>This guideline is sacrosanct.</u>
Net Profit/Capital Employed	-	30%	

Weightage for all other indicators including other financial parameters like turnover, cost reduction, etc., should be accommodated within .the remaining 50%.

33. In addition, each MOU must include the following criteria:

	Criteria	Weight	1	2	3	4	5
			Excellent	Very Good	Good	Average	Poor
1	Timely submission if Draft MOU for 1995-96 after due discussion with admin. department	2%	Before 8 Dec. 1994	15 Dec. 1994	22 Dec. 1994	29 Dec. 1994	5 Jan. 1994
2	Timely submission of Performance Evaluation Report (composite score) for the 1993-94 MOUs on the basis of the provisional data	1%	Before 30 April 1994	2 May 1994	4 May 1994	6 May 1994	8 May 1994

Part II. B. The Government's Responsibility

35. Are the responsibilities of the Government stipulated in this section confined to those few which are directly related to the 1994-95 performance targets undertaken by the PSEs in the MOU?

36. Is the delegation of power asked for relevant and related to agreed performance targets?

Part II. C. Modality for Monitoring the MOU

37. Is the modality of information flow and the frequency of monitoring clearly mentioned in the MOU?

38. Is the MOU precise, clear and simple?

For further details and clarifications, please write to the following:

Economic Adviser
DEPARTMENT OF PUBLIC ENTERPRISES
Ministry of Industry
Government of India
Lok Udyog Bhavan
14 CGO Complex
Lodi Road
New Delhi 110003
Fax: 436-2646

ANNEX II

Memorandum of Understanding between the Ministry of Steel and the Steel Authority of India Limited (SAIL), 1993-94

1. **Mission**

"To be a leading Company in the Iron and Steel business and sustain growth through internal generation of resources."

2. **Long-term Objectives**

The long-term objectives of SAIL are:

2.1 To harness market potential in a competitive environment through dedicated customer service and continuously enhancing quality levels.

2.2 To supply quality steels at internationally competitive prices and become a leading exporter.

2.3 Through increasing production, to become one of the largest steel producers int he world and to continue to be a leading supplier of iron and steel in India.

2.4 To maintain and promote a committed and motivated workforce.

2.5 To acknowledge responsibility towards maintaining ecological balance and effectuate schemes that would help preserve the natural environment.

3. **Commitment by SAIL**

During 1993-94, SAIL undertakes to fulfil the following commitments:

3.1 For ensuring excellence in customer service at the same time maintaining high level of efficiency in its marketing operations, greater emphasis will be laid on customer satisfaction. For this SAIL commits to produce 87.5% of standard tested steel of total saleable steel.

3.2 SAIL commits itself to attain the following financial objectives:

3.2.1 Financial Results of SAIL (Sales Turnover, Gross Margin, Net Profit and Net Profit to Capital Employed) as per details given in Annex I (A) and Financial Results of IISCO as per Annex I (B).

3.2.2 SAIL, in the year 1993-94, commits to produce 8,600 million tonnes of Saleable Steel. Plant-wise targets for Capacity Utilisation and Production are listed at Annex II.

3.2.3 SAIL commits to export 3,500,000 tonnes of saleable steel.

The above STATIC performance indices as mentioned above will measure results achieved in 1993-94.

3.3 In addition, SAIL commits itself to four DYNAMIC efficiency parameters where the efforts are being put in now but the results will be evident only in the years to come.

3.3.1 SAIL has drawn out a detailed training plan which emphasise improvements in the quality of training. The Percentage of Employees trained will be 30% during 1993-94.

3.3.2 SAIL will also continue to give utmost importance to employees participation at grassroots level through Quality Circles (QC). QC project completion will be to the extent of 1200.

3.3.3 The major project milestones for SAIL plants during 1993-94 will be as per Annex 3 and Milestone Performance Index (MPI) will be calculated as per Annex 5.

3.3.4 SAIL's Research and Development Group commits to complete the projects listed in Annex 4 during 1993-94. These projects would ensure improvements in productivity and quality of process and product and performance will be calculated as per Annex 5.

4. **Commitment by MOS**

To ensure that SAIL can achieve the targets set for 1993-94 and meet its project milestones on time. The Ministry of Steel commits itself to the following:

4.1 Investment/Modernisation proposals for SAIL plants and Indian Iron and Steel Company will be cleared as per the timetable in Annex 6.

4.2 The Ministry of Steel will ensure adequate availability of coal, power and railway wagons as given in Annexes 7A, 7B and 7C.

In the event of shortfall in the availability of coal, power and railway movement, the requirements of which are given in Annexes 7A, 7B and 7C, SAIL's production will reduce by a corresponding amount and quality of operations will be affected. A shortfall of 100,000 tonnes of coking coal results in a loss of about 80,000 tonnes of crude steel and correspondingly 64,000 tonnes of saleable steel. In addition, erratic supplies, gradewise, necessitate frequent changes in coal blend which adversely affect the productivity of Blast Furnaces. An increase of 1% in ash content of coking coal causes a loss of 3 - 3.5% in productivity of blast furnaces.

4.3 Ministry of Steel will assist SAIL in getting 'Environmental Clearance' from the Department of Environment for all those projects which have met all required information needs, within three months of submission of proposal to the Department of Environment.

5. **DELEGATION OF POWERS**

Ministry of Steel will assist SAIL to obtain additional delegations to attain its long and short term objectives as specified in the MOU during the course of the year. These are given in Annex 8.

6. The weightage and scales given in Annex 9 will form the guiding principles for evaluating the overall performance of SAIL.

7. **JOINT REVIEW**

7.1 To achieve the objectives of the MOU, the evaluation system adopted to review fulfilment of obligations on both sides shall be through a joint review meeting structured as follows:-

i) By regular review at Board level of SAIL.

ii) By quarterly review at SAIL and Ministry of Steel level.

M.R.R. Nair
Chairman
Steel Authority of India Limited

V. Krishnan
Secretary
Ministry of Steel

Delegations sought by SAIL, to be pursued by the Ministry of Steel

The Ministry of Steel will assist SAIL to obtain additional delegations to attain its long and short term objectives as specified in MOU for following during the course of year:

(i) To commission feasibility reports by Indian consultants; and upto Rs. 50 Lakhs in foreign exchange, if done by foreign consultant.

(ii) To commission DPRs upto Rs. 5 crores by Indian consultants and upto 1 crore in foreign exchange, if done by foreign consultant provided the project/scheme stands incorporated in the Plan, Annual Plan Budget and Capital Budget of SAIL and there is a feasibility report of approved by the competent authority preceding the decision to commission the DPR.

(iii) To incur expenditure upto Rs.5 crores on preparatory work for each project approved by SAIL Board and pending Government's approval, provided it is financed through SAIL's internal resources.

(iv) To sanction expenditure on projects upto Rs.100 crores in respect of new investments provided the projects are included in the approved plan and will be financed by internal resources (present delegation is Rs. 50 crores).

(v) To sanction expenditure on replacement and renewal of assets due to normal wear and tear for an amount upto Rs.200 crores (present delegation is Rs.100 crores).

(vi) SAIL should have freedom of chartering vessels directly against its import and export contract instead of routing through Ministry of Surface Transport.

(vii) SAIL should have freedom to go to joint venture as provided in the Articles of Association.

ANNEX II cont'd

Criteria	Units	Wts. in %	Criteria Value (*)				
			1	2	3	4	5
STATIC EFFICIENCY PARAMETERS 1. % Tested in Saleable Steel	%	7.5	88	87.5	87	86.5	86
2. Exports of Steel	'000T	2.5	375	350	325	300	275
Profit and profit related factors: 3. Production (saleable steel)	Mt.	14	8.64	8.60	8.3	8.0	7.7
4. Net Profit/Capital Employed	%	30	1.4	1.2	(-)0.2	(-)1.7	(-)3.2
5. Gross Margin	Rs. (Cr.)	20	1760	1740	1600	1450	1300
DYNAMIC EFFICIENCY PARAMETERS 6. No. of training of Employees	%	2.5	31	30	29	28	27
7. Quality Circles	Nos.	2.5	1245	1200	1155	1110	1065
8. Milestone Performance Index (MPI)	%	14	100	95	90	85	80
9. Research & Develpment Projects completed	%	4	100	95	90	85	80
10. Timely submission of Draft MOU for 1994-95 after due discussion with admin.dept.	Date	2	Before 8 Dec. 1993	15 Dec. 1993	22 Dec. 1993	29 Dec. 1993	5 Jan. 1994
11. Timely submission of Performance Evaluation Report (Composite Score) for 1992-93 MOU on the basis of provisional data	Date	1	Before 30 April 1993	2 May 1993	4 May 1993	6 May 1993	8 May 1993

(*) 1- Excellent, 2-Very Good, 3-Good, 4-Fair, 5-Poor

ANNEX II cont'd

	1993-94	1992-93	1991-92	1990-91	1989-90
Saleable Steel Production (MT)	8.600	8.216	8.029	7.365	7.063
Percentage tested in Sal. Steel	87.5	87.0	88.1	83.8	85.8
Gross Margin/ Capital Employed (%)	1.2*	16.5	19.71	16.8	15.8
Gross Margin (Crores)	1740	1562	1503	1210.73	1062.97
No. of Quality Circle	1200	1175	1190	1025	739
Percentage of Employees Trained	30.0	29.5	47.2	27.0	26.0

*Net Profit/Capital Employed

V

Performance Contracts in Bangladesh: A Case Study

A Brief History of Public Enterprises in Bangladesh

The history of public enterprises in Bangladesh dates back to colonial days when the country inherited some of its public enterprises(PEs). During the Pakistan regime, the East Pakistan Industrial Development Corporation (EPIDC) was the main vehicle of industrial development in the then East Pakistan, and the country inherited most of its undertakings from that period. In the post-liberation period of 1971, private sector industries faced a major setback due to the mass exodus of non-Bengali owners and managers. In order to fill this vacuum, the President's Order No. 1 of 1972, The Bangladesh (Taking Over of Control and Management of Industrial and Commercial Concerns) Order, 1972 was promulgated and all abandoned properties, including 725 industrial and commercial units, were brought under government control and management.

The nationalisation policy immediately changed the nature and scope of public enterprises. The expanded participation of the state in economic development envisaged in the First Five-Year Plan (FFYP) of Bangladesh implied a greater role for PEs and was used as a tool for rapid economic development. Due to a number of contradictions, the nationalisation policy adopted by the Government faced opposition right from the beginning. First, due to lack of political commitment from the ruling party, the policy did not yield the desired results. Secondly, the planners entrusted with the policy-making had little belief in and commitment to the programmes as they themselves were motivated towards the capitalistic environment.[1]

Policy conflict, poor management of the nationalisation process and poor enterprise management brought public enterprises under serious attack by the opponents. In the initial years, the Government's announced priority to make abandoned public enterprises subject to public operation and accountability, did not receive due consideration. Priority was given to the introduction of management systems in an environment where public enterprises were faced with resource constraints. Most of the public enterprises also suffered from a lack of accounting, stores, purchasing and other basic functional systems. The people entrusted with the management of

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1 Rashid, M. H. "Public Enterprises in Bangladesh: A Survey", Bangladesh Journal of Public Administration Vol-I No. 1, January, 1988.

public enterprises, with little industrial and business experience, were confronted with great problems of management of the nationalised industries. Moreover, these industries were used for patronage of party workers, resulting in excess employment, wastage and other inefficiencies. The move towards disinvestment of public enterprises began in 1982 and a number of steps were also taken to boost the private sector. The measures included gradual disinvestment of smaller public sector enterprises; initiation of a capital market; simplification of investment and loan sanction procedures; concessionery import duties and protection through tariff structures, etc.

In order to enlarge the scope of private investment, the New Industrial Policy (NIP) of June, 1982 was issued and it limited the scope of the public sector to six basic heavy and strategic industries: defence; atomic energy; air transport; telecommunication; electricity generation and distribution and mechanised extraction of forests. Subsequently, in the Industrial Policy of 1986, security printing and minting was added to the reserved list. In the Industrial Policy of 1991, these seven sectors continued to be reserved to the public sector, while the rest were opened to private investment. The policy airmed to improve the efficiency of the public sector corporations.

Over the last few years, there has been a complete reversal of the development strategy from an overwhelming reliance on the public sector to a supportive role for private sector investments. However, despite all efforts towards denationalisation, public sector enterprises have maintained their importance in the economic development of the country.

Economic Significance of Public Enterprises in Bangladesh

In Bangladesh public enterprises play a vital role in the national economy. The public enterprises sector is small compared with many other countries, and in the last few years has become smaller. A recent estimate shows that it employed less than 1 per cent of the labour force and accounted for 3.6 per cent of Gross Domestic Product (GDP) in 1992-93. However, the sector is rather more important to the investment account and to the balance of payments account. Non-financial PEs absorbed 22 per cent of national investment in 1992-93. Though much slimmed down by disinvestment, public corporations remain dominant. As at December 1993, there were a total of 223 enterprises under the government control.

The performance of public enterprises has generally been poor and, except for a few, most of them have incurred losses over the past years. Until the end of the 1992-93 financial year, the cumulative losses of non-financial public enterprises were US$443 million. In 1992-93, the non-financial public enterprises generated revenue of US$3.3 billion by employing US$10.8 billion worth of fixed assets.

This implied that a mere 5 per cent increase in efficiency can generate additional revenue of US$170 million (Tk.6.8 billion) which is 10 per cent of the annual development budget of the country. The reasons for poor performance were traced to the multiple objectives, the lack of operational autonomy and multiple principals to whom they are accountable.

The PE Mission and Objectives

There is no well-defined corporate mission for the public enterprises in Bangladesh. However, the Bangladesh Industrial Enterprises (Nationalisation) Order 1972 that brought all enterprises under government ownership and control, has laid down the objectives as: "control, co-ordination and supervision of the enterprises placed under them and establishment and development of new industrial enterprises". Although there was no separate mission for each public enterprise, these objectives can indicate the PE mission in general. The objectives of the enterprises were, however, defined by the Government in the guidelines issued in 1976 at section 3 (3) as follows:

- to operate on commercial consideration, having due regard to national interests, in the most efficient and economic manner within the policy framework and guidelines prescribed in the rules and regulations;

- to strive continuously to improve its performance and attain better results;

- to earn additional revenue for government;

- to earn more foreign exchange at minimum sacrifice (for export-oriented enterprises);

Since the above guidelines did not define 'commercial consideration', 'national interest', and 'performance', the above objectives were interpreted variously by different agencies and bodies of government. The objective behind the creation of public enterprises was to run them efficiently and effectively for the greater interest of the state. Although social benefit is the main objective behind the creation of public enterprises, in order to yield social benefit, the enterprise has to survive commercially. Hence, running the public enterprises commercially to earn profit has become the primary objective.

The Performance Contract and its Evolution in Bangladesh

In Bangladesh, the Performance Contract system was initiated for a limited number of PEs on an experimental basis, with the expectation that after it proved to be effective, it would be applied to all public enterprises. They are drawn up annually on the basis of negotiation between the enterprise and government (Ministry of Finance) and in collaboration with the corporation head office and the administrative ministry.

Realising the significance of the public enterprise performance on the economy, the Ministry of Finance sought ways to improve the performance of the public enterprises. At the request of the Government, UNDP sent an expert in 1982 to look into the problem, and he suggested the setting up of a Cell for financial MIS of public enterprises. The Ministry of Finance felt that this alone could not solve the problems because they were deeper than that. The problems were more to do with management and ways of improving the management of public enterprises should therfore be sought. In 1984, the Government of Bangladesh, through the Ministry of Finance, launched a UNDP-supported project named "Development of Performance Evaluation and Financial Management Information Systems for Autonomous Bodies" with the following terms of reference:

(i) to develop an MIS for financial management, budgetary control and macro-economic policy formulation by the Ministry of Finance, the Ministry of Industries, the Planning Commission and others; and

(ii) to conduct an overview study to identify the constraints on public enterprise performance and make the necessary recommendations.

The basic objectives behind the overview study were to identify the weaknesses of public enterprise performance and make recommendations for their resolution. The study team of senior officials of the project visited Pakistan, India and South Korea to look into the problems of PE management and how they are resolved in those countries. Encouragement by the Performance Contract system implemented by Korea and the Signalling System in Pakistan, it was felt that merely copying the systems of other countries would not help, as the solution to the problems commonly faced by most countries may not necessarily be common, due to the diversity in corporate culture, style of management and socio-economic background.

Characterisitics of Performance Contracts in Bangladesh

Why Performance Contract?

Public enterprises in Bangladesh, as in most other countries, are hybrid organisations created to serve social and commercial goals. The expectation was that they, as a separate legal entity, would perform efficiently like private organisations, the benefits of which would be utilised to achieve the social goals. This has resulted in a policy conflict as to the operation of PEs. Private organisations are believed to do things, but not always the right things. The Government, on the other hand, do the right things but do not always always do them right. PEs were expected to do the 'right things' and to do 'things right'. Managerial accountability and autonomy were the pre-requisites to getting 'things right' and doing the 'right things' respectively. Government's reliance on legal devices – by making them a separate legal entity – was supposed to be the solution to the problem of autonomy and accountability. Although there were legal provisions to ensure that PEs promote 'public interest', this has proved to be difficult in practice. Politicians and bureaucrats retained control even on day-to-day operational matters. This has often resulted in incongruent action in the name of public interest. PE managers could cover up some of their inefficiencies in the name of such interference. Such a situation has necessitated the search for improved methods of PE management that can take these deficiencies into account.

As is the practice in PEs, autonomy was not given to the degree it should have been, and yet efforts were being made to establish accountability. This resulted in more 'quantity' of control by the government by interfering in each stage of its operation rather than waiting for the results (i.e. 'quality'). In other words, government should try to control by results than by process. Governments trying to improve the performance of PEs often look at the reforms involving reduction of quantity of control, hoping that these alone can solve the problem. Although it is necessary to reduce the quantity of control by allowing autonomy, it is not easy to raise the quality unless due accountability is established. Hence autonomy and accountability should be increased simultaneously.

In trying to raise the quality of control, governments find two kinds of barriers: technical and organisational. Technical barriers include:

(i) finding the ideal performance criteria for PEs – as profitability, which has reasonably been the measure of performance of private firms, is not regarded as the desired criterion in the case of PEs;

(ii) distinguishing the management performance from PE performance;

(iii) balancing short-term goals with the long-term results – as it is easier to improve the short-term results at the cost of long-term and there is always the problem of balancing the two.

Organisational barriers that arise in PEs are:

(i) difficulty in setting the right targets as PEs have more expertise and information than government controllers;

(ii) due to conflicting values arising out of three different groups working together, i.e. professional managers, bureaucrats and politicians, it is difficult to provide PEs with a clear set of goals and targets; and

(iii) co-ordinating for controlling PEs by results is a problem as government is one of the loosely coupled organisations.

In view of the above, it is argued that quality of control can be improved by implementing the performance contract system. It has been proved that through performance contracts, accountability and autonomy can be established better by taking these barriers into account.

Institutional Arrangements for Designing, Monitoring & Evaluation of Performance Contracts

Any institutional arrangement for designing the performance contract system is dependent on the environmental conditions in which the contract will operate. As such the control hierarchy of public enterprises in Bangladesh is presented in Figure 1.

The responsibility for overall supervision and management of most public enterprises in Bangladesh is vested in the parent organisation known as the corporation. Corporations are created by statute to look after the management of a number of enterprises placed under them. Depending upon the nature of the operation, each ministry has a number of corporations under its control and each corporation in turn has a number of public enterprises under its supervision. There are fifteen controlling ministries under which there are 39 corporations. Although PEs are directly responsible to the parent ministry, they are also indirectly responsible to at least two or three other ministries for social development purposes. For example, the Planning Ministry, as the national planner, provides all long- and short-term development plans and PEs have to execute their plans in accordance with those. The Ministry of Finance, as the custodian of national exchequer, absorbs the financial surpluses or losses of the PEs. As a result, all the PEs are under the direct budgetary control of the Ministry of Finance. Above all, the President's secretariat may also look after the activities of the ministries. In addition to the hierarchical control shown in Figure 1, PEs are also given instructions from the President's Secretariat[2] and controlling ministries directly.

[2]When the performance contract was planned and designed there was a presidential form of government in the country and the President was the chief executive. Recently, the parliamentary form of government has been adopted and the Prime Minister looks after all the ministries directly.

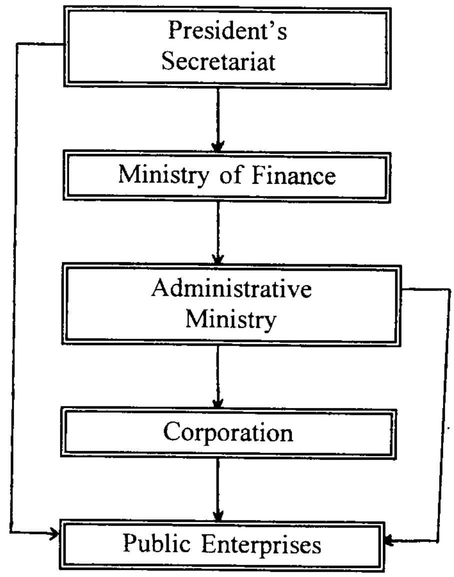


Figure-1 : Control Structure of PEs

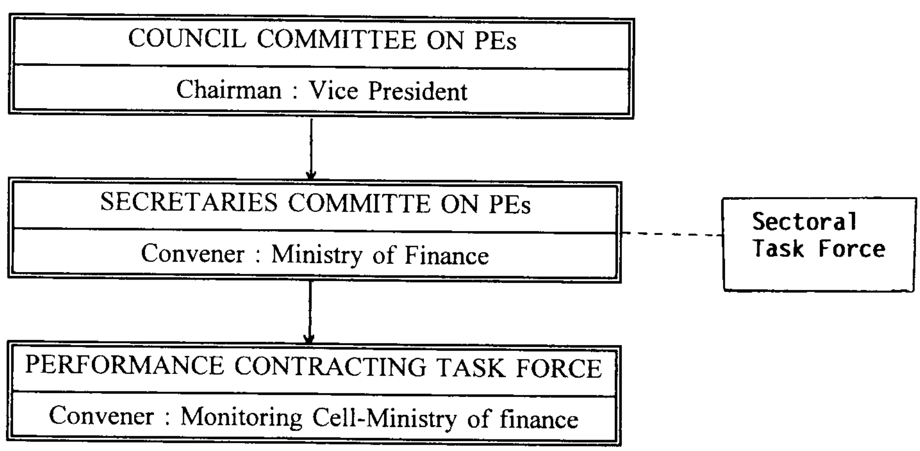


Figure-2 : Institutional Arrangement for Performance Contract

In view of the above control structure of PEs, the institutional structure planned for the implementation of performance contracts is shown in Figure 2. It was felt that, as in South Korea, the involvement of high-powered policy-making bodies might help to make the implementation much more practical and effective. Accordingly, the role of the three principal bodies were incorporated into the whole process. In 1986, the Council for Public Corporations (CPC) was formed to look after PE activities, and although the President was made the chairman of the Council, in view of President's engagements, the Vice-President was made the chairman of the CPC. Although there was provision for a Secretaries Committee under the structure, the committee was virtually non-functional. The CPC secretariat used to forward cases to the CPC. There was also provision for several high-powered technical Task Forces to assist the Secretariat Committee.

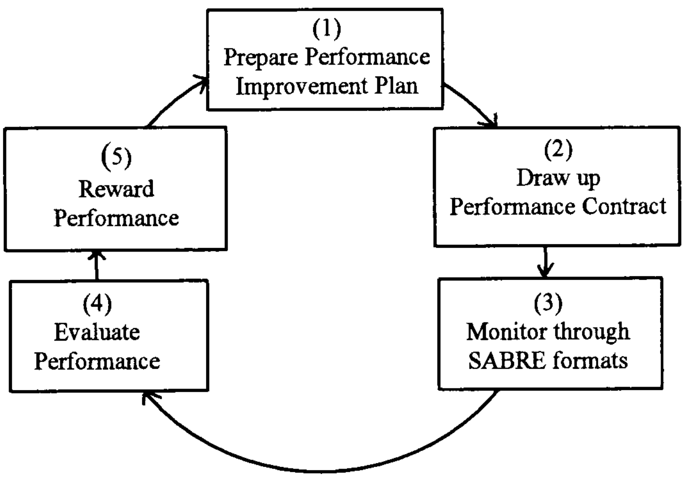
By notification, five sectoral task forces were also formed for Civil Aviation; Industries; Transport; Energy; and Utility sectors to formulate sectoral goals and objectives and to look after the technical aspects of the performance of PEs under the respective sectors. The task force included representatives from public enterprise, controlling ministries, the Finance Ministry, the Planning Ministry, the Establishment Ministry, other related ministries whose involvement would affect the performance of the PEs under the Contract, and other experts in the field. The task force was to formulate clearer objectives for PEs, prepare guidelines for achieving the objectives through performance contracts, and provide expert services for monitoring and evaluation of PEs. Before the arrangements could be made fully operational, CPC was rendered inactive as a result of the change of government in 1990. No decision has yet been taken for overseeing the performance of PEs. The Ministry of Finance as an initiator of the contracts is still continuing with them. The Monitoring Cell remains the nucleus of all performance contracting and monitoring activities.

The Performance Contracting Process

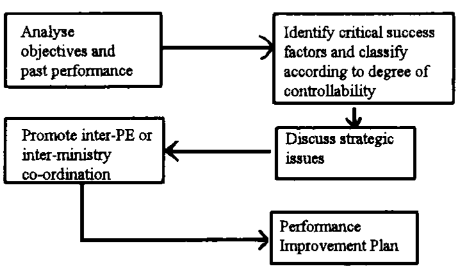
Five stages are involved in the performance contracting process as per the cycle shown in Figure 3. The first two steps of the cycle – preparing a Performance Improvement Plan and drawing up the Performance Contract – are the planning activities which are carried out prior to the start of the financial year. They are the most difficult steps in the process, taking up most of the total effort expended by all parties in the entire cycle. Once they are carried out, the remaining steps are easy to execute. The third step – Monitoring Performance – is carried out during the financial year on a quarterly basis through the Monitoring Cell of Finance Ministry. The fourth step – Evaluating Performance – commences shortly after the end of the financial year and requires more technical expertise. The last step – Rewarding Performance – is quite straightforward if the evaluation has been completed and the reward system is well defined. Each of these steps also involves

Figure - 3

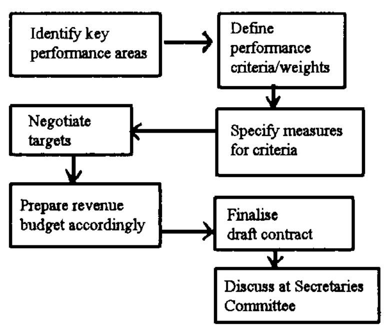
PERFORMANCE CONTRACTING CYCLE



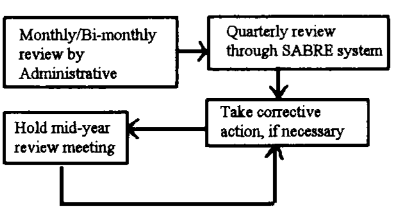
Step 1: Prepare Performance Improvement Plan



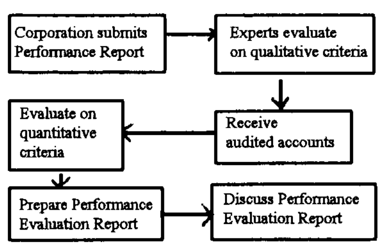
Step 2: Draw Up Performance Contracts



Step 3: Monitor through SABRE formats



Step 4: Evaluate Performance



Source: Ramamurti's Report

a number of sub-steps, the descriptions of which are furnished in Appendix A. As the PEs are directly controlled by the corporations and the controlling ministry, the parties to the contract are:

(i) enterprise;
(ii) corporation;
(iii) controlling ministry; and
(iv) monitoring cell, Ministry of Finance.

As mentioned above, the sectoral task force was supposed to do the first stage of the contracting cycle. Since the it is not operational, a team of experts from the Monitoring Cell of the Finance Ministry visits the enterprise, studies its objectives and past performance and involves key enterprise personnel in identifying the critical success factors and classifying them according to degree of controllability and their contribution in the overall performance of the enterprise. After the initial work is done, the performance criteria, weights and targets are negotiated with the enterprise personnel, including the corporation, and the controlling ministry officials who also remain present and provide their input. Thereafter, the contract is finalised and is put before the Secretaries Committee. As the Secretaries Committee is not functional, the Finance Ministry and controlling ministry approve them for implementation. In the absence of requisite support from the highest authority, no formal signing of the contract takes place.

According to the plan, the contracting cycle should take two and half years from initiation to final evaluation. The following activities are involved. The first year is the preparatory year. Issuing guidelines, constitution of the task force, in-depth review and analysis of past performance by the technical team, preparation of draft Performance Improvement Plan, discussion of Performance Improvement Plan and deriving the performance critera and weights, and finalising targets and budgets etc. are done during the first year. During the contract year, the progress of the contracts is monitored and during the last half-year preparation, submission, evaluation and approval of the performance evaluation reports are required.

Performance Criteria and Targets

The criteria and targets are mutually negotiated with the enterprise management and Monitoring Cell officials. For example, all the departmental heads are given the assignment to identify the key success factors of the organisation as well as the probable role of the department in achieving success. The departmental head in turn has the opportunity of discussing with his staff, before finally coming up with suggestions for the achievement of relevant success levels. In the joint meeting of the PE, the corporation, the controlling ministry and the Finance Ministry, the identified critical success factors or performance criteria are discussed at length. It requires a series of meetings to reach agreement on the criteria and targets for the contract. After the contract is finalised, all who were involved in the target setting process have a mutual obligation to co-ordinate and co-operate to achieve the targets.

The assumptions made while fixing performance targets are:

- the enterprise, after affecting the contract, would be left free of all interference from bureaucrats and politicians, other than the periodic monitoring of performance;

- the enterprise performance and management performance would be evaluated on the basis of annual targets, and management would be made accountable for their performance;

- the performance would be linked to reward and punishment so that is adequate motivation;

- for the factors beyond the control of management, the corporation, ministry or other involved agency would co-ordinate and co-operate to achieve the targets; and

- while evaluating, appropriate allowance should be given to any deviation of performance arising out of unforeseen factors or due to factors beyond the control of management.

There is no expressed provision for dispute handling or arbitration in the contract. While experimenting with the contracts, no remarkable dispute has so far arisen. As the contracts were implemented on an experimental basis and since the performance results were not linked to incentives, no such dispute has yet been mentioned . However, possible disputes may arise:

- in finalising the criteria and fixing weight to it; and

- in evaluating the performance when the targets could not be achieved due to certain government decision/interference.

The former could be resolved through mutual discussion with the finalising authority, i.e. the Monitoring Cell. In the case of the latter, the disputes may be resolved by giving due allowance while evaluating the relevant criteria. In any of the situations, the highest authority's approval must be treated as final.

Evaluation Criteria

The criteria are fixed well in advance. They are quite elaborate and are based on various dimensions of performance. Each criterion is evaluated on a five-point scale or grades (A to E). The entitlement to the grades is dependent on the achievement of the target set against the criteria. In other words, for each criterion, five target ranges are fixed and at the end of the year, the actual performance data are fitted into the corresponding target grade. As mentioned before, each performance criterion has some weight, depending on its importance in the overall performance of the enterprise. Based on the grades of individual criterion and weight composite, this grade is computed. The points awarded for each of the grades is shown below. For example, if increase of sales is one of the evaluation criteria and its weightage is fixed at 4 per cent, the points for actual sales performance of 1.5 million tonnes would be calculated as below:

Sales Targets (M. Ton)	Target Grades	Achieved Grade	Points
2.00 - 1.76	A		1.00
1.75 - 1.51	B		0.95
1.50 - 1.26	C	C	0.90
1.25 - 1.01	D		0.85
1.00 - 0.75	E		0.80

(Points for composite index = 4 x 0.90 - 3.6)

The points calculated for each of the criteria, as shown above, are added together to calculate the composite index. Normally, each contract contains 10 to 15 criteria based on which the composite index is computed. The key criteria, along with weights of a textile mill, are shown below:

Evaluation Criteria	**Weight**
1. Production	20%
2. Sales	17%
3. Profitability	15%
4. Labour Productivity	7%
5. Labour Absenteeism	4%
6. Reduction of Idle Time	4%
7. Reduction of Inventory	10%
8. Reduction of Wastage	7%
9. Promote Production of domestic Cotton	5%
10. Use of Domestic Spares	7%
11. Training and Human Resource Development	4%
Total	**100%**

An Overview of the Contracts in Force

Performance contracting, though tried in different countries of the world, did not yield the desired results. The effectiveness of the system depends on the country's socio-cultural background, its importance to the government, its structure and process, management background and a host of other factors. In Bangladesh, a number of attempts have been undertaken in the past to improve the performance of PEs but most of them failed either due to implementation problems or due to lack of proper support from the top to implement it. The consultants prepared high-quality reports but no action was taken on most of them.

Although the contracts are designed to be developed by the corporations, in view of the technical know-how required in developing the contract it was felt that a number of PEs would be used as experiments from different sectors and thereafter, the corporations would be able to develop them by themselves. Accordingly, it was decided to extend the contract to fertiliser, paper, cement, heavy engineering, light engineering, textiles, jute, road transport, water transport, public utilities and gas sectors. The first contract was developed and tried in 1986. Subsequently, each year a number of contracts were added to extend the coverage, and by 1992, a total of 21 contracts were developed and implemented on an experimental basis. Consequent upon the government decision to liquidate one of the PEs, the contract for that PE was dropped. The enterprises that are brought under the contract and their performance grade since initiation are shown in Annex A.

The recent wave of privatisation has also made some inroads into Bangladesh. As part of recent economic reform measures which were requested by donors, emphasis is now more on privatisation of PEs than any other reform measures. As such, the Government's attention on improvement of PEs is no longer there. For the time being, the status quo is being maintained with the 20 contracts that have been introduced so far and they are renewed annually.

Review of a Contract in Force – Zia Fertilizer Co. Ltd. (ZFCL)

Background

The Zia Fertiliser Co. Ltd. produces ammonia and urea. The decision to set up a petro-chemical complex with the financial assistance of the World Bank was first taken in 1969/70 but consequent upon political disturbance in the period pre- and post-liberation, the construction work began in 1976 and was scheduled to be completed in December 1978. Due to installation problems, it could not be completed until October 1980. The plant started trial production in December 1981 and commercial production in June 1983. Until 1 December 1983, the factory was an independent company, after which it was brought under the control of the Bangladesh Chemical Industries Corporation (BCIC).

The plant has the capacity for producing 930m. tons of ammonia and 1600m. tons of urea per day (528,000m.tons urea per annum) by using natural gas as the feed stock collected through a 12" transmission line from the gas field situated at 20 km distance. The plant has its own power plant run by steam. The requirement for water is met up by refining river water from the adjacent Meghna river. The plant had a total of 1,238 employees as at 31 January 1990, out of which 380,415 and 443 were officers, staff and workers respectively. There were also about 180 daily casual workers.

The plant has a board of directors consisting of seven part-time members and the chairman of the corporation is head of the board. There are two government-nominated directors on the board, one from the controlling ministry and the other from the finance ministry. Other directors are nominated from the other units of the corporation. The managing director is the chief executive of the factory. The factory is one of the five fertiliser factories that BCIC is currently managing.

The past performance of the factory was not satisfactory. Due to a delay in the implementation of the project, the cost overshot by about 70 per cent. Moreover, there were some technical problems which affected capacity utilisation adversely. Over the last six years the factory's average capacity utilisation was 79 per cent (see Annex B). From the experience gained in other urea fertiliser factories, capacity utilisation of such a factory is expected to be well above 95 per cent.

Constraints on Improved Performance

(i) *Factors within the control of management*

The factory needs preventive maintenance once a year. The time required for such maintenance is around 60 days and the shut-down affects production considerably during the period.

Earlier, the factory used to sell the fertiliser to the government central distribution agency, the Bangladesh Agricultural Development Corporation (BADC). Consequent upon privatisation of all the fertiliser marketing operations, individual factories now have the responsibility for marketing and distribution. During lean seasons (monsoon), fertiliser sales are sluggish and at times excessive stock would force the factory to cut down production.

The factory needs a substantial quantity of various imported chemicals and spares, and because of poor inventory management, production was interrupted due to nonavailability of the desired chemicals and spares. On the other hand, a huge quantity of spares and chemicals is also lying in stock, some of which are obsolete, causing financial loss to the factory.

The selling price for fertiliser in the country is controlled by government – in order to ensure supply at a reasonable price to the farmers. Increase of input cost, spares price, inefficient use of raw materials, and excessive manpower have all caused production costs to rise year after year.

Urea being the chemical fertiliser has standard quality requirements. Any deviation from the quality standard would affect the agricultural production badly. The maintenance of the standard quality with Nitrogen 46.1 per cent, moisture 0.3 per cent and Biorate 0.9 per cent is of prime importance.

Industry recycling of wasted feed stock and utilities like steam and water can help reduce the energy cost considerably. As the plant is on the bank of river, it disposes of most of its waste chemicals in the river, which is dangerous to the environment. Adequate treatment is essential before disposal of toxic wastes.

ii) ***Factors beyond the control of management***

The factory sometimes suffered from an inadequate supply of gas from the gas field, causing the pressure in the pipeline to drop. As a result, the production level had to be reduced and this seriously affected productivity.

The price of the gas consumed by the factory, both as the feed stock and as utilities, is controlled by government. The selling price of urea is also controlled by government. In a situation where both the input and output are controlled, the management has limited option for increasing profitability.

In view of the increase in the costs of gas, imported chemicals, spares and manpower, the operating cost of the factory is increasing year after year. Though efficient use of inputs and the utilisation of capacity has direct influence on cost of the product, there is a certain limit for improvement in those areas.

Performance Criteria, Targets & Weights

In view of ZFCL's constraints discussed above, fifteen performance areas were identified; ten are commercial and these were considered to be essential for the survival and growth of the enterprise. Of these, reduction of due time for repair and maintenance, utilisation of capacity, sales, efficient uses of inputs, reduction of inventory and profitability are the key ones and they constitute 87 per cent of the total criteria in terms of weight.

The non-commercial criteria constitute 13 per cent of the total criteria and include maintenance of quality standard (so that the agricultural production is not affected), increased use of locally produced spares, human resource development and utilisation of the technical assistance programme etc. Six out of the fifteen criteria are dynamic efficiency indicators and these are: quality control; use of locally manufactured spares; training programme; utilisation of technical assistance programme; expansion of capacity and use of computer.

Out of the fifteen criteria, only three are qualitative and the rest are quantitative. In the case of qualitative criteria, no target is fixed. A short write-up explaining the progress of the activities is provided on all such qualitative criteria, based on which the evaluation grades are awarded. The detailed criteria, weights and actual performance data against the criteria for last five years is shown in Table 1. The details of the range of targets for each of the performance criteria and actual results for the last three performance contract years (1990-91, 1991-92 and 1992-93) are shown in Annexes C, D and E.

Evaluation of Performance Contracts so far

ZFCL's Performance

As may be seen from the historical performance data of ZFCL (Table 1 and Annexes C to E), overall production performance has increased gradually and capacity utilisation has reached 100 per cent. The turnaround time for maintenance has almost halved. The use of natural gas for the production of a ton of urea has declined from 37.01 MCF in 1989-90 to 30.12 MCF in 1992-93, which is a remarkable improvement over previous years. Labour productivity has increased from 29.61 ton per man-month (in 1989-90) to 36.48 in 1992-93. The manufacture of spare parts in its own workshop and in BCIC workshops has also increased. There are some fluctuations in the case of sales and the manpower development (training) area. The composite grade achieved in 1990-91 was 'C' and it had improved to 'A' in the following two years (details in Annxes D and E). All these indicators reflect the better performance of the company during the performance contracting period.

The performance of other contracts

As already mentioned, a total of twenty contracts were tried in Bangladesh over the last eight years. Out of these, one is for the last eight years two are for the last six years; one is for the last five years; six are for the last four years; and the remaining ten are for the last three years. The performance of PEs under the contract over past years was not satisfactory as a whole as most of them earned 'B'

TABLE 1: PERFORMANCE OF ZIA FERTILISER CO.LTD.

SI No	PERFORMANCE CRITERIA	UNIT	ACTUAL				
			1988-89	1989-90	1990-91	1991-92	1992-93
1	AVAILABILITY OF RAW MATERIALS	(%)	100	100	100	100	100
2	INCREASE IN PRODUCTIVITY:						
	2.1 Stream Days	Days	384.60	381.07	395.00	398.00	337.00
	2.2 Capacity Utilisation	(%)	85.16	84.71	90	90.37	100
3	MAINTENANCE PROGRAMMES:						
	3.1 Turnaround time (overhauling)	Days	56	-	53	35	-
	3.2 Preventive Maintenance				Qualitative		
4	INCREASE OF SALES	(%)	106.24	86.36	104.65	103.02	100.00
5	INVENTORY CONTROL:						
	5.1 Reduction in total inventory	(% of Assets)	7.60	7.41	8.13	7.13	7.33
	5.2 Sale of Obsolete inventory	GkTk	65.63	32.99	146.20	115.18	60.00
6	PROFIT MAXIMISATION	GkTk	4831	4443	3100	3394	5166
7	ECONOMIC USE OF RAW MATERIALS:						
	7.1 Natural Gas	MCF/Ton	13.99	37.01	37.91	33.71	30.00
	7.2 Steam	Ton/Ton	5	5.48	5.93	5.67	5.83
	7.3 Cooling Water	Ton/Ton	5.36	5.74	5.43	5.57	5.62
	7.4 Electricity	Kw Hr/Ton	308.81	306	314.60	194.31	190.00
	7.5 Chemicals	Tk/Ton	61	74	83	89	67.73
	7.6 Spares & Others	Tk/Ton	50	67	63	63	90.00
8	QUALITY CONTROL:						
	8.1 Actual Humidity	(%)	0.34	0.38	0.40	0.38	0.37
	8.2 Biorate	(%)	0.39	0.93	0.94	0.93	0.93
9	LABOUR PRODUCTIVITY	MT/M-month	35.27	39.61	30.50	33.36	36.48
10	MANUFACTURING OF SPARE PARTS:						
	10.1 In Own Workshop	GkTk	5	11.61	10.56	8.03	13.69
	10.2 Sub-contracting with BCIC	GkTk	-	3.50	6.44	30.75	33.00
11	TRAINING PROGRAMME	Man-month	131.08	133	61	370.60	397
12	USE OF COMPUTER	(%)			35	45	50
13	UTILISATION OF TECHNICAL ASSISTANCE	Man-month	13.00	9.00	10.00	13.00	8.00
14	30% PLANT CAPACITY INCREASE	"				Qualitative	
15	RE-USE OF WASTE MATERIALS	"				Qualitative	
16	RESEARCH & DEVELOPMENT	"				Qualitative	
17	COMPOSITE GRADE ACHIEVED				C	A	A

and 'C' grades (Annex A). With the exception of one PE, no consistent improvement of performance could be observed. In view of certain limitations the contracts are facing, one can not be sure of the success of the contracts. Even if an enterprise performs worse, the result cannot be attributed solely to the management or to the performance contract. It can also be the other way around. What is more important is the trend of performance when the uncontrollable variables remain more or less the same. Most of the PEs performing badly do so for a number of reasons which are beyond the PE and management control. Wide adoption of the system through total commitment of all the government machinery would yield some better results. The limitations which the contracts are facing are discussed in the following section.

Strengths and Weaknesses of the Contract

The strengths of the PC developed in Bangladesh are:

- It is the most systematic management control tool for achieving the goals and objectives of PEs. In an environment where responsibility for jobs is shifted and delayed, the PC outlines more clearly the responsibility among the personnel who are involved in the decision-making and implementation process.

- In view of the multiple control hierarchy and multiple objectives of the PEs, the PC can measure performance in quantitative terms; identify the reasons for poor performance, and make owners aware of the performance in a better way.

- The whole process of identifying the critical success factors; formulating performance improvement plan; selecting performance criteria; determining weight, and fixing targets, is participatory and this motivated the management team to achieve the targets.

- Bureaucratic and political interference by politicians and bureaucrats is made much more difficult because any interference is reflected clearly in the evaluation report.

The weaknesses of the system are:

- The system requires granting greater autonomy to the PE management which bureaucrats and policy-makers in the government are not willing to do. They have the inherent tendency of retaining control over PE by process rather than by results which is affecting implementation of contracts.

- The contract is skills-intensive and time-consuming. In a situation where most of the PE management, as well as the ministry personnel, are not educated in business/commercial management, it is difficult to develop and implement the contracts. The time and technical manpower required to develop a contract is substantial and the number of contracts that can be developed by the Monitoring Cell in a year is limited. In view of the technicalities involved, it is also not possible to sub-contract out.

- The institutional set-up designed for implementation of the contracts has also not yet been finally adopted by the government. Well-articulated institutional arrangements are the pre-requisite for the implementation of the system.

- Lack of political commitment is the greatest limitation of the system. Unless the highest authority of government is serious about the PE performance improvement, it would be difficult to reap the benefits as there may always be conflicting interest among different ministry officials.

- The lack of clarity of PE goals and objectives is affecting the development of the performance criteria. The task force designed for the purpose could have formulated well thought-out goals and objectives for each PE, but it is no longer in existence.

- In Bangladesh, the chief executive of the enterprise management and the officials at the controlling ministry and other related ministries are changed frequently. Such frequent transfers allow little opportunity to develop the skills required for understanding and implementing such contracts. Moreover, once the contract is developed and initiated by one set of officers, a new officer may never see the contracts in the same way.

- The most important element of performance contract is the Performance Incentive System. Unless the performance is linked to the performance-based incentive/punishment system, it will not work effectively. The contracts in Bangladesh cannot yet be linked with the incentive system and, as a result, due motivation is being gradually lost.

- Most policy-makers at the top echelon of government are not aware of the outcome of performance contracts. It is difficult to implement such a system where most of the top policy-makers are not convinced about its expected results.

Lessons Learned

In Bangladesh, the experiment of design, development and implementation of performance contracts is the first action-research project of its kind. The main purpose of the experiment was to ascertain whether the methodology that proved most effective in other countries could be implemented in Bangladesh and if so, in what shape. The experimental application of the system in 20 PEs over last eight years has revealed the following:

- In a situation where political linkage of the ruling party flows to the PE managers, staff unions and down to the labour leaders, the implementation of a goal-oriented performance scheme is a difficult task. Especially in a corporate culture where workers, employees and officers all have the tendency to gain more through political linkages rather than by working hard, it is difficult to earn confidence for such systems. As is the practice in most cases, even if the management or corporation refuses to accede to the illogical demands of the unions, they bring them about by the politicians through their linkage – proving that the management function most ineffective.

- The institutional structure planned for implementing contracts could not establish its due footing. In the absence of any clear decision from the controlling ministry, other ministries and corporation officials involved in the process were not sufficiently enthusiastic. The Cell had limited manpower, both in terms of number and skill to handle a large number of contracts. The task force planned for developing the goals, objectives and strategy with the help of technocrats could not function.

- In the absence of appropriate institutional support, the Monitoring Cell of the finance ministry had to take up the role of supreme authority for implementing/applying the contracts. The finance ministry being in a parallel position with other ministries, did not have the full authority to instruct the supervising ministries. Whatever support it had was by virtue of its authority to approve the PE annual budgets. At present there are about 223 non-financial PEs and the quantum of time and resources required to finalise the contracts, within the capacity of limited Monitoring Cell officials, is merely inadequate to bring all the PEs under the coverage of the performance contract within any given time-frame. At the initial stage, the contracts were developed under the direct assistance from qualified consultants and technical body (task force) formed for the purpose. In subsequent contracts, adequate time and technical services could not be provided to the extent needed. This resulted in some cases in relatively poor quality contracts.

- As the contracts are technical in nature, and the personnel implementing them are of limited management qualifications and background, the fewer the number of criteria, the less complicated the exercise will be.

- Trade unions for the labour and clerical employees are one of the major hindrances to the successful implementation of the contract. As was done in Singapore, the labour and staff leaders should be exposed/educated about the benefits of such system. If needed, representatives of those groups should be inducted in the development and implementation phase of the contracts.

- Any reform measure, to be effective, must have the acceptability of those involved in the implementation process. In an environment where the implementors are inadequately educated in the field of modern management techniques and are prone to controlling the PEs, the need for attitudinal change is of the utmost importance.

- The whole process of formulating clear goals and objectives; strategic planning; target setting, and the achievement of targets provided a better appreciation of the problem of PEs. This servesd as a good vehicle for management development by providing effective training to personnel who do not have the appropriate management background. The process of preparing the contract – through analysing, discussing and inter-organisational communication, was as valuable as the end product of the exercise (i.e. the contract).

- If any of the parties involved in the contract is displaying goal-incongruent behaviour, the whole exercise becomes ineffective. To cite an example, one of the contracts handled by the Monitoring Cell was involved in a second PE which was the sole purchaser of its output. Due to the conflicting interests of some of the senior officials in the second PE, the management of both the PEs could not be brought to agree on this criterion and on account of the conflict, the contract was abandoned.

Recommendations and Conclusions

Performance Contract designed and tried out in Bangladesh has a number of positive dimensions. Despite its limitations, it is believed that committed implementation can provide some useful results which might be difficult to achieve through other, alternative arrangements. The following recommendations could improve the present system:

- PEs are currently being run without any clear direction, and this affects their performance badly. There should be a clear policy decision on the future direction of PEs.

- Appropriate institutional structure should be created by activating the CPC under the leadership of the Prime Minister. The sectoral task forces should also be activated to implement the system.

- PEs may be classified for:

  i) immediate privatisation;

  ii) restructuring and privatisation; and

  iii) to be retained under the government control.

  Based on this classification, only the ones to be retained under government control should be brought under Performance Contracts.

- At the initial stage of contracts, the criteria and parameters should be kept as few as possible. Additional criteria may be added if the need arises.

- Appropriate training/exposure programmes are essential to change the attitude of civil servants and corporation officials towards the system, because they will be involved directly and indirectly in the process.

- In order to popularise the system, there may be a formal declaration of the performance results of the PEs by the highest authority, including the award for best performer.

- Frequent transfer of civil servants adversely affects the contracts. Before the performance contract for a PE is introduced, there should be a decision not to transfer the corporation and ministry executives for at least three years.

- It is imperative to create a culture where improved performance should be the only basis for performance-rating. Agreed consensus of all concerned and a systematic follow-up of the contracts can help establish the culture gradually.

ANNEX A

NAME OF PEs UNDER PERFORMANCE CONTRACT WITH COMPOSITE GRADES EARNED

	Name of PE	Evaluation Grades Earned						
		1986-87	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93
1	NORTH BENGAL PAPER MILLS	C	D	C	B	C	D	C
2	KARNAPHULI PAPER MILLS	-	-	-	-	B	B	C
3	CHATAK CEMENT CO.LTD	-	-	C	A	B	C	D
4	ZIA FERTILISER CO.LTD	-	-	-	-	C	A	A
5	MUBARAKGANJ SUGAR MILLS	-	-	B	C	B	C	C
6	NATIONAL TUBES LTD.	-	-	-	C	C	D	D
7	PROGOTI INDUSTRIES LTD.	-	-	-	-	C	C	C
8	EASTERN TUBES LTD.	-	-	-	-	-	C	B
9	BANGLADESH SHIPPING CORP.	-	-	-	-	-	C	D
10	DKAKA WASA	-	-	-	-	C	B	B
11	SUNDARBAN TEXTILE MILLS	-	-	-	-	C	D	E
12	TITAS GAS TRANSMISSION & DISTRIBUTION CO.	-	-	-	-	-	B	B
13	LATIF BAWANY JUTE MILLS	-	-	-	-	-	C	B
14	BANGLADESH POWER DEVELOPMENT BOARD	-	-	-	-	B	B	B
15	AHMED BAWANY TEXTILE MILLS	-	-	-	-	-	E	E
16	BANGLADESH HANDLOOM BOARD	-	-	-	-	-	B	B
17	BANGLADESH INLAND WATER TRANSPORT CORP.	-	-	-	-	-	C	C
18	BANGLADESH ROAD TRANSPORT CORP.	-	-	-	-	-	B	B
19	KAPTAI LAKE FISH DEVELOPMENT & MARKETING CENTER	-	-	-	-	-	B	B
20	SANGOO-MATAMUHURI PROJECT	-	-	-	-	-	D	C

ANNEX B

Key Performance Data of Zia Fertiliser Co.Ltd

Year	Production (M.Ton)	Capacity Utilisation	Sales (M.Ton)	Net Profit (Million Taka)
1981-82	62,455	11.84	61,009	Loss
1982-83	138,220	26.18	118,590	Loss
1983-84	379,039	71.79	378,792	76.77
1984-85	414,528	78.51	395,823	180.99
1985-86	425,329	80.55	417,677	261.58
1986-87	336,568	63.74	371,677	185.69
1987-88	493,695	93.50	471,618	389.26
1988-89	450,674	85.36	478,810	482.13
1989-90	447,295	84.71	388,500	444.23
1990-91	452,334	85.67	473,371	231.68
1991-92	476,600	90.27	491,000	229.45
1992-93	505,000	100.00	500,000	512.70

Zia Fertiliser Co. Ltd.
Evaluation of Performance for the Year 1990-91

Performance Criteria	Unit	TARGETS A	B	C	D	E	Actual Achieved	Grade Earned	Weight	Points Earned (Weight x Grade)
AVAILABILITY OF RAW MATERIALS	%	100	99.5	99.0	98.5	98.0	100	A	5%	5 X 1 = 5
INCREASE OF PRODUCTIVITY:										
Stream Days	Days	330	320	310	300	290	295	D	10%	10 x 0.8 = 8.5
Capacity Utilisation	%	95%	94%	93%	92%	91%	90%	E	10%	10 x 0.8 = 8
MAINTENANCE PROGRAMME:										
Preventive Repair				Qualitative				E	2.5%	2.5 x 0.8 = 2
Turnaround time (overhauling)	Days	30	35	40	45	50	52	E	5%	5 x 0.8 = 4
INCREASE OF SALES	% of Sales	100	98	95	92	90	105	A	15%	15 x 1 = 15
INVENTORY CONTROL:										
Reduction in inventory	% of assets	7.25	7.35	7.45	7.55	7.65	8.13	E	4%	2.5 x 0.8 = 2
Sale of obsolete inventory	Ml.Tk.	15.0	14.0	12.0	10.0	7.50	14.62	B	2.5%	2.5 x 0.95 = 2.38
PROFIT MAXIMISATION	Ml.Tk.	572	480	389	297	206	210	E	20%	20 x 0.8 = 16
ECONOMIC USE OF RAW MATERIALS:										
Natural Gas	MCF/Ton	34	34.5	35	35.5	36	37.9	E	1.5%	1.5 x 0.8 = 1.2
Steam	Ton/Ton of Urea	6.0	6.25	6.5	6.75	7.0	5.93	A	1%	1 x 1 = 1
Cooling Water	Ton/Ton of Urea	5.25	5.50	5.75	6.0	6.25	5.42	B	1%	1 x 0.95 = 0.95
Electricity	Kw hr/Ton of Urea	215	225	235	245	255	214.6	A	1%	1 x 1 = 1
Chemicals	Tk./Ton of Urea	90	95	100	105	110	83.0	A	1.5%	1.5 x 1 = 1.5
Spares and Others	Tk./Ton of Urea	90	95	100	105	110	63.0	A	1.5%	1.5 x 1 = 1.5
QUALITY CONTROL:										
Actual Humidity	%	0.30	0.35	0.40	0.45	0.50	0.40	C	2.5%	2.5 x 0.9 = 2.25
Biorate	%	0.90	1.00	1.10	1.20	1.30	0.94	B	2.5%	2.5 x 0.95 = 2.38
LABOUR PRODUCTIVITY	MT/Man-month	39	37	35	33	31	30.50	E	5%	5 x 0.8 = 4
SPARE PARTS MANUFACTURING:										
In Own Workshop	Mln.Tk.	0.5	0.4	0.35	0.3	0.25	1.6	A	2%	2 x 1 = 2
Sub-contracting with BCIC	Mln.Tk.	0.3	0.27	0.25	0.23	0.20	6.44	A	2%	2 x 1 = 2
TRAINING PROGRAMME	Man-month	200	175	150	125	100	61	E	1%	1 x 0.8 = 0.8
USE OF COMPUTER	(%)	95	90	85	80	75	25	E	2%	2 X 0.8 = 1.6
USE OF TECHNICAL ASSISTANCE	Man-month	10	12	14	16	18	10	A	1%	1 x 1 = 1
20% PLANT CAPACITY INCREASE				Qualitative				D	1%	1 x 0.8 = 0.8
RE-USE OF WASTE MATERIALS				Qualitative				D	1%	1 x 0.8 = 0.8
COMPOSITE GRADE ACHIEVED								C	100%	87.66

Zia Fertiliser Co. Ltd.
Evaluation of Performance for the Year 1991-92

Performance Criteria	Unit	TARGETS A	B	C	D	E	Actual Achieved	Grade Earned	Weight	Points Earned (Weight x Grade)
AVAILABILITY OF RAW MATERIALS	%	100	99.5	99.0	98.5	98.0	100	A	2%	2 X 1 = 2
INCREASE OF PRODUCTIVITY:										
Stream Days	Days	315	300	295	290	280	298	C	12.5%	12.5 x 0.9 = 11.25
Capacity Utilisation	%	90%	85%	80%	78%	75%	90%	A	10%	10 x 1 = 10
MAINTENANCE PROGRAMME:										
Preventive Repair				Qualitative				A	4%	4 x 1 = 4
Turnaround time (overhauling)	Days	35	40	42	45	50	35	A	5%	5 x 1 = 5
INCREASE OF SALES	% of Sales	100	95	93	90	85	103	A	15%	15 x 1 = 15
INVENTORY CONTROL:										
Reduction in inventory	% of assets	7.0	7.25	7.50	7.75	7.80	7.12	B	4%	4 x 0.95 = 3.8
Sale of obsolete inventory	Ml.Tk.	12.5	10.0	9.50	9.00	8.50	11.55	B	2.5%	2.5 x 0.95 = 2.38
PROFIT MAXIMISATION	Ml.Tk.	130	110	90	70	50	229.4	A	15%	15 x 1 = 15
ECONOMIC USE OF RAW MATERIALS:										
Natural Gas	MCF/Ton	33	35	36	37	38	32.7	A	3%	3 x 1 = 3
Steam	Ton/Ton of Urea	5.5	6.0	6.25	6.5	7.0	5.67	B	1%	1 x 0.95 = 0.95
Cooling Water	Ton/Ton of Urea	5.0	5.25	5.50	5.75	6.00	5.57	D	1%	1 x 0.85 = 0.85
Electricity	Kw hr/Ton of Urea	206	210	220	225	230	194.3	A	1%	1 x 1 = 1
Chemicals	Tk./Ton of Urea	80	85	90	95	100	89	C	2%	2 x 0.9 = 0.9
Spares and Others	Tk./Ton of Urea	90	95	100	105	110	63	A	2%	2 x 1 = 2
QUALITY CONTROL:										
Actual Humidity	%	0.30	0.35	0.38	0.39	0.40	0.38	C	2.5%	2.5 x 0.9 = 2.25
Biorate	%	0.90	1.00	1.10	1.20	1.30	0.92	A	2.5%	2.5 x 1 = 2.5
LABOUR PRODUCTIVITY	MT/Man-month	38	36	34	32	30	33.26	A	5%	5 x 1 = 5
SPARE PARTS MANUFACTURING:										
In Own Workshop	Mln.Tk.	1.0	0.8	0.7	0.6	0.5	0.8	B	2%	2 x 0.95 = 1.9
Sub-contracting with BCIC	Mln.Tk.	6.0	5.0	4.0	3.5	3.0	2.1	E	2.5%	2 x 0.8 = 1.6
TRAINING PROGRAMME	Man-month	250	225	200	175	150	270	A	1%	1 x 1 = 1
USE OF COMPUTER	(%)	80	75	70	60	50	45	E	2%	2 X 0.8 = 1.6
USE OF TECHNICAL ASSISTANCE	Man-month	14	15	16	17	18	12	A	1%	1 x 1 = 1
20% PLANT CAPACITY INCREASE				Qualitative				C	1%	1 x 0.9 = 0.9
RE-USE OF WASTE MATERIALS				Qualitative				A	1%	1 x 1 = 1
COMPOSITE GRADE ACHIEVED								A	100%	95.38

ANNEX E

Zia Fertiliser Co. Ltd.
Evaluation of Performance for the Year 1992-93

Performance Criteria	Unit	TARGETS A	B	C	D	E	Actual Achieved	Grade Earned	Weight	Points Earned (Weight x Grade)
AVAILABILITY OF RAW MATERIALS	%	100	99.5	99.0	98.5	98.0	100	A	4%	4 X 1 = 4
INCREASE OF PRODUCTIVITY:										
Stream Days	Days	312	310	300	295	290	337	A	15%	15 x 1 = 15
Capacity Utilisation	%	94%	92%	90%	88%	86%	100%	A	10%	10 x 1 = 10
MAINTENANCE PROGRAMME:										
Preventive Repair			Qualitative					B	4%	4 x 0.9 = 3.6
INCREASE OF SALES % of Sales	100	100	95	93	90	85	100	A	11%	11 x 1 = 11
INVENTORY CONTROL:										
Reduction in inventory	% of assets	7.0	7.25	7.50	7.75	7.80	7.23	B	7%	7 x 0.95 = 6.65
Sale of obsolete inventory	Ml.Tk.	10	9.5	9.00	8.50	8.00	6.00	E	4%	4 x 0.8 = 3.20
PROFIT MAXIMISATION	Ml.Tk.	250	220	200	180	160	516.6	A	10%	10 x 1 = 10
ECONOMIC USE OF RAW MATERIALS:										
Natural Gas	MCF/Ton	32	34	35	36	37	30.0	A	5%	5 x 1 = 5
Steam	Ton/Ton of Urea	5.5	6.0	6.25	6.5	7.0	5.83	A	2%	2 x 1 = 2
Cooling Water	Ton/Ton of Urea	5.0	5.50	5.75	6.00	6.50	5.62	B	2%	2 x 0.95 = 1.9
Electricity	Kw hr/Ton of Urea	206	210	215	220	225	190	A	2%	2 x 1 = 2
Chemicals	Tk./Ton of Urea	85	90	95	100	105	67.73	A	2.5%	2.5 x 1 = 2.5
Spares and Others	Tk./Ton of Urea	75	80	85	90	95	89.70	D	2.5%	2.5 x 0.8 = 2
QUALITY CONTROL:										
Actual Humidity	%	0.35	0.40	0.45	0.47	0.50	0.37	A	2.5%	2.5 x 1 = 2.5
Biorate	%	0.90	0.95	0.97	1.00	1.20	0.93	B	2.5%	2.5 x 0.95 = 2.38
LABOUR PRODUCTIVITY	MT/Man-month	35	34	33	32	31	36	A	5%	5 x 1 = 5
SPARE PARTS MANUFACTURING:										
In Own Workshop	Mln.Tk.	2.0	1.5	1.2	1.0	0.8	1.4	B	2.5%	2.5 x 0.95 = 2.38
Sub-contracting with BCIC	Mln.Tk.	1.5	1.2	1.0	0.8	0.6	2.2	A	2.5%	2.5 x 1 = 2.5
TRAINING PROGRAMME	Man-month	150	125	100	90	80	297	A	1%	1 x 1 = 1
USE OF COMPUTER	(%)	60	50	45	40	35	3550	B	1%	1 X 0.95 = 0.95
USE OF TECHNICAL ASSISTANCE	Man-month	8	10	11	12	13	8	A	1%	1 x 1 = 1
20% PLANT CAPACITY INCREASE			Qualitative					E	1%	1 x 0.8 = 0.8
RE-USE OF WASTE MATERIALS			Qualitative					A	1%	1 x 1 = 1
COMPOSITE GRADE ACHIEVED								A	100%	98.36

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