

Corporate Governance of State-Owned Enterprises: The Case of BSNL

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A missing element in the reform process in India is the restructuring of the incumbent state-controlled monopoly operator prior to or simultaneously with the opening up of the sector to competition. This places the state-owned operator at a serious disadvantage relative to competitors. This has been the case with Air India/ Indian Airlines with adverse consequences. This paper argues that Bharat Sanchar Nigam Limited/Mahanagar Telephone Nigam Limited may be headed in the same direction. The restructuring of the state-owned enterprises must begin at the top with a complete reorientation of the corporate governance mechanism which establishes the relationship between the government and the enterprise. With the growth of private operators in these sectors the state-owned enterprises are no longer of strategic importance to the government for sector development or providing "universal service". To the extent privatisation is not feasible or desirable at least in the short run, the corporate governance mechanism should be designed around the objective of growth and efficiency as in the case of private enterprises.

Bharat Sanchar Nigam Ltd (BSNL) may become the latest casualty of economic reform and liberalisation which does not include restructuring of the incumbent state monopoly.¹ While the telecom sector was opened up to competition in the early 1990s, the Department of Telecommunications Services (DTS) was corporatised into BSNL only in 2000. Even after corporatisation there has been no attempt to put in place suitable corporate governance mechanisms consistent with the new industry structure characterised by fierce competition. Even the absorption of the Indian Telecom Service (ITS) officers, who constitute the top management of BSNL but are formally employees of the Department of Telecommunications (DOT), is yet to be completed. This is unfortunate since corporate governance determines the quality of the most crucial decisions that a firm faces – corporate strategy, top management recruitment, compensation policy and major investment decisions.

Recent studies have highlighted the role of corporate governance for firm valuation. In the private sector a distinction is made in the role of corporate governance on the basis of the nature of ownership and management control. In the US and UK, where ownership is relatively diffused, corporate governance is aimed at ensuring that managers do not pursue private interests at the expense of the interests of the firm. In addition managers are also supposed to be disciplined by the market for corporate control in the form of takeovers and proxy contests.

In most other countries where ownership is usually concentrated and management is controlled by the concentrated owner, the role of corporate governance is to protect the interest of minority shareholders and other stakeholders. Alternatively, this can be seen as protecting the firm from the controlling shareholder pursuing private objectives. With concentrated ownership the disciplining effect of the market for corporate control is largely absent. In both cases the board is required to play a major role. Of course, there has been continuing scepticism about the ability of boards to perform the assigned function in the presence of a dominant management or a controlling shareholder.

The nature of the corporate governance problem of a state-owned enterprise (SOE) is more complicated because of the ambiguity about ownership. While the government may be compared to a controlling shareholder, the government itself is an agent of the citizens of the country who are the ultimate owners with diffused shareholding. Hence there is a need not only to ensure that managers work in the interest of the firm, as in the case of diffused share ownership, but also to protect the firm from the

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government pursuing political and populist agenda at the expense of the firm. In addition, if there are minority private shareholders then there is the additional problem of their expropriation by the government.

Unlike a widely held corporation in the private sector, an SOE generally cannot have its board changed via a takeover or proxy contest, and most cannot go bankrupt. The absence of potential takeovers and proxy contests reduces the incentives of board members and managers to maximise the value of the company, and the lack of bankruptcy can introduce a soft budget constraint, which reduces pressure to contain costs. Hence, two of the most important checks on underperformance are absent.

The government has never declared its long-term policy for BSNL. Occasionally there have been proposals to merge BSNL and Mahanagar Telephone Nigam Limited (MTNL); a 10% initial public offering (IPO) for BSNL; and a holding company for BSNL and MTNL. However, none of these alternatives or any combination have been pursued with any seriousness. This paper argues that there is a need and an opportunity to resolve the corporate governance problems at BSNL and allow it to compete and grow along with the private operators. The need arises from the continuing deterioration in the performance of BSNL. The opportunity arises from the fact that BSNL is no longer of strategic importance for the government.

Therefore, the role of the government should be restricted to that of a financial investor. The experience of numerous SOEs indicates that cosmetic changes such as sale of a minority government stake or a small public issue are unlikely to be effective. Given the obstacles to privatisation there is a need for a fundamental change in the way the government exercises its control over BSNL. The government should seriously consider moving SOEs such as BSNL (and Air India) to the finance ministry which would treat them as purely financial investments of the government.

The paper is organised as follows: Section 1 provides a brief background to the restructuring of the DOT and the emergence of BSNL. Section 2 presents an overall assessment of the performance of BSNL, especially in the last four years when there has been a deterioration in performance. Section 3 looks at some recent corporate governance initiatives taken by the department of public enterprises. Section 4 provides the basic requirements for a well functioning corporate governance structure for BSNL. Section 5 concludes.

1 Background to BSNL

Until the mid-1980s, the telecommunications industry in India was a monopoly, functioning as a department of the government. Faced with rapidly increasing demands for telecommunications services and equipment, the government commenced a reorganisation of the telecommunications industry. MTNL, a government company, was established in 1986 to provide telephone and telex services under a non-exclusive license in the two largest metropolitan cities of Delhi and Mumbai. Videsh Sanchar Nigam Limited (VSNL) was also established in the same year to provide international telecommunications services. The DOT retained responsibility for providing all other telecommunications

services throughout India. The Telecom Commission was established in 1989 as an executive body under the ministry of communications to formulate policy for approval of the government and implement the government's policy in matters concerning telecommunications.

Since 1992, as part of its general policy of gradually reducing its holding in public sector enterprises, the Indian government sold a portion of its equity holdings in MTNL and VSNL to certain mutual funds, banks and financial institutions controlled by the government. MTNL made a global depository receipt (GDR) offering in 1997, in which the government sold 6.3% of the outstanding equity shares. The government's stake in MTNL is currently at 56.25%. In 1997 and 1999, it sold additional equity shares of VSNL in the form of GDRs, thereby reducing its equity interest in the company to 51%. In February 2002, it further divested an additional 25% interest in VSNL to the Tata Group through a competitive bidding process, thereby retaining a 26.13% stake.

In October 1999, the DOT was bifurcated into two departments: the DOT as the licensor and policymaker, and the DTS as the service provider (SP). DTS was corporatised in October 2000, as a new entity BSNL, which provides telecommunications services in the entire country except in Delhi and Mumbai, where MTNL continues to be the government-controlled SP.

DTS was issued a licence in February 2000 for the operation of Cellular Mobile Telephone Service (CMTS) in the country. CMTS was launched by BSNL throughout the country on a commercial basis only in October 2002. By then the country's cellular subscriber base had reached about 9 million.

2 Performance of BSNL and MTNL

In the pecking order of Indian SOEs, while MTNL is a navaratna, BSNL is only a mini ratna. MTNL is listed domestically and its American depository receipts (ADR) is listed on the New York Stock Exchange. Government holding in MTNL is 56.2% as against 100% in the case of BSNL. However, both BSNL and MTNL have shown poor performance in recent years in the face of private sector competition.

BSNL Performance: BSNL has been experiencing a steady decline in revenues and profits over the last three years. According to recent media reports based on 2008-09 financial results, Bharti Airtel has overtaken BSNL as the largest telecom operator in terms of revenues.

BSNL can be considered to have incurred operating losses during 2007-08. During that year its "profit before tax" at Rs 4,452 crore was less than its "other income" of Rs 5,694 crore, consisting mainly of interest on cash balances.

The combined wireless (Global System for Mobile (GSM) plus Code Division Multiple Access (CDMA)) market share of BSNL and MTNL has dropped from 21% in March 2005 to 14.5% in

Table 1: Income and Profits of BSNL (Rs crore)

Year Ended March 31	2008	2007	2006
Income from services	32,360	34,616	36,139
Other income	5,694	5,099	4,038
Total revenue	38,053	39,715	40,177
Expenditure	33,636	31,466	31,907
Profit before taxation	4,452	8,154	8,447
Profit for the year after taxation	3,009	7,806	8,940

Source: BSNL annual reports.

December 2008. The share of BSNL alone has dropped from about 20% in March 2006 to 13.3% in December 2008.

Table 2: Wireless Market Share of BSNL and MTNL (Million)

Wireless Subscribers	December 2008	March 2008	March 2007	March 2006	March 2005
MTNL	4.19	3.53	2.94	2.05	1.08
BSNL	46.23	40.79	30.98	17.65	9.9
Total PSU	50.42	44.32	33.92	19.7	10.98
Total market	346.89	261.07	165.11	90.14	52.22
% share PSU	14.53	16.98	20.54	21.85	21.03
% BSNL	13.33	15.62	18.76	19.58	18.96

Source: The Indian Telecom Services Performance Indicators, various periods, Telecom Regulatory Authority of India (TRAI).

Not only has the market share been declining but BSNL's subscribers have a lower average revenue per user (ARPU) than the average subscriber of private sector operators. During the quarter October-December 2008 the blended ARPU of BSNL/MTNL wireless subscribers was Rs 195 per month as against Rs 225 for private SPs. This difference is more striking for postpaid subscribers who have a higher ARPU than prepaid subscribers.

Table 3: Average Revenue per User (per Month) for October-December 2008

Rs Per Month Per Subscriber	Postpaid	Prepaid	Blended ARPU
All India	559	192	225
All private SPs	615	196	225
BSNL/MTNL	382	173	195

Source: The Indian Telecom Services Performance Indicators, October-December 2008, TRAI.

BSNL's wireline subscribers have dropped from 37.51 million in March 2006 to 29.5 million in December 2008, a decline of about 21%. During the same period, BSNL's wireline revenue has dropped from Rs 32,355 crore during 2005-06 to Rs 23,716 crore during 2007-08, a decline of about 30%.

Table 4: Wireline Subscribers of BSNL and MTNL (Millions)

	December 2008	March 2008	March 2007	March 2006	March 2005
BSNL	29.5	31.55	33.74	37.51	37.04
MTNL	3.53	3.68	3.73	3.87	4.06
Total (all operators)	37.9	39.42	40.75	50.18	46.19

Source: The Indian Telecom Services Performance Indicators, various periods, TRAI.

The growth in wireless revenue has not been enough to offset the decline in wireline revenue so that overall income from services has declined from Rs 36,139 crore during 2005-06 to Rs 32,360 crore in 2007-08.

BSNL has the leading position in internet and broadband. As of December 2008, BSNL accounted for approximately half of both the 12.85 million internet connections and 5.52 million broadband connections. There was an additional 101 million of wireless internet connections for which the break-up by operators is not

Table 5: Income and Profits of MTNL

	2007-08	2006-07	2005-06	2004-05
Basic telephone	3,338	3,764	4,688	5,142
Cellular	836	762	573	274
WLL	88	84	67	104
Other services	460	300	233	62
Income from services	4,722	4,909	5,561	5,582
Other income	607	674	530	492
Total income	5,330	5,583	6,091	6,074
Profit before tax	632	793	671	1,216
Net profit	407	466	578	948
Prior period adj	(180)	(216)	(3)	9
Net profit after adj	587	682	580	939

Source: MTNL annual reports.

available. During the year 2008 the number of internet connections increased by about 20%, the number of broadband connections by about 75%, and the number of wireless internet connections by about 100%. BSNL's income from broadband was about Rs 900 crore during 2008.

MTNL Performance: MTNL's total income and net profits have been declining over the last four years.

In the case of wireless, in Delhi MTNL has the lowest market share in terms of subscribers, revenues and outgoing minutes of use (MOU). In Mumbai it has the lowest market share in terms of revenues and outgoing MOU.

Therefore, significant but not controlling non-public shareholding, the Navaratna status and the enhanced autonomy that is supposed to come with it does not seem to have helped MTNL in its performance. This implies that an IPO or minority stake sale by itself is unlikely to be effective in improving or maintaining performance.

Table 6: MTNL Wireless Market Shares (in %)

Service Provider	Market Shares Based on		
	Subscribers Base	Revenue	O/G MOU
Delhi			
Bharti	23	33	27
Tata	21	13	22
Hutch	19	26	20
Reliance	15	11	15
IDEA	12	11	11
MTNL	10	7	6
Mumbai			
Vodafone	25	37	27
Reliance	21	14	19
Bharti	17	21	25
MTNL	14	9	7
Tata	13	11	12
BPL	10	9	8

Data is for quarter ending June 2008.

Source: TRAI Consultation paper on "Lock-in Period for Promoter's Equity and Other Related Issues for United Access Services Licensees (UASL)", 9 January 2009.

Employees: Table 7 shows the employee strength and employee costs as percentage of income for BSNL, MTNL and the largest private operator, Bharti.

Employee costs as a percentage of income are significantly higher for both BSNL and MTNL. This could

Table 7: Number of Employees and Expenses (Rs crore)

31 March 2008	BSNL	MTNL	Bharti
Income from services	32,360	4,722	25,665
Employees' remuneration and benefits	8,809	1,643	1,334
% of income	27	35	5
No of employees	3,20,506	47,422	25,543

Source: Annual reports.

partly be attributed to the large wireline network operated by BSNL and MTNL and extensive outsourcing by Bharti. However, it could also be the result of surplus employees inherited from the period of government ownership. According to a newspaper² report, S D Saxena, the then director of finance in BSNL, is reported to have said, "We are taking outsourced managed services in international markets in a big way. We have the expertise to manage an operator's network. This way we will not only earn additional revenues but also deploy our large experienced workforce to the optimum." This may imply that the current workforce is not fully employed.

During the year ended 31 March 2005, MTNL implemented a voluntary retirement scheme (VRS) for executive as well as non-executive employees. Under the scheme, the eligible employees were given an option to voluntarily take retirement from service and make their choice within the specified period of time. The scheme provided for ex gratia payments to eligible employees opting for voluntary retirement based on the respective employee's

salary and term of employment. As of 31 March 2007, a total of 3,947 employees retired under this scheme. There have been no such initiatives in BSNL so far.

Corporate Governance Problems at BSNL

BSNL's equipment procurement experience highlights its corporate governance problems. Report No 10 of the Comptroller and Auditor General (CAG) of India for the year ending March 2006 describes in detail the delay in finalisation of tender for phase-v of IMPCS project.³

In November 2004, the minister for communications and information technology outlined the vision statement that the country's overall telecom network (landlines, wireless in local loop (WLL) and CMTS) capacity would be increased to 2,500 lakh lines by December 2007 in which BSNL and MTNL were expected to have a 50% share. To achieve this target, the BSNL board approved (January 2005) procurement of 641 lakh lines of CMTS under phase-v of the IMPCS project. An audit scrutiny of the records revealed that there were delays at every stage of finalisation of the tender.

January 2005 – A committee constituted to formulate the expansion strategy reassessed the proposed procurement and recommended (June 2005) tendering for procurement of 400 lakh lines of CMTS with a quantity variation of up to 50%.

July 2005 – In order to give impetus to the government's proposed policy for indigenous manufacture of telecom equipment, the board revised its procurement policy to purchase telecom equipment under any tender in two phases. In the first phase, vendors would supply 50% of the total tendered equipment. In the second phase, the remaining equipment should have 20% indigenous value addition.

August 2005 – The minister directed BSNL to tender for 600 lakh lines of CMTS with a quantity variation of up to 50%. In the first phase, vendors should supply 33% (instead of 50%) of the tendered equipment and the remaining tendered equipment in the second phase must have 30% (instead of 20%) indigenous value addition.

November 2005 – The BSNL board approved issue of open tender at the national level for three zones, i.e., north, east and south for procurement of 450 lakh lines and reserved the balance of 150 lakh lines of CMTS equipment for west zone for Indian Telephone Industries (ITI).

December 2005/January 2006 – The government nominee director suggested reconsideration of the modalities of issuing the above tender and the board constituted a committee of experts to vet the tender document.

March 2006 – Based on the recommendations of the committee of experts, the board approved the tender for inviting bids for procurement of 455 lakh lines of CMTS for the three zones from registered Indian companies and 180 lakh lines for the west zone were reserved for ITI. The eligibility criteria fixed for the bidders required that either they should already have manufacturing facilities in India for the core equipment to be supplied or they/their parent companies should create the infrastructure within six months from the date of issue of the purchase order for the first phase.

June 2006 – The tender was opened and the process of selection of bidders for placement of purchase orders had not been completed as of September 2006.

The audit report concluded by observing that although BSNL had a standardised procurement policy and had adequate experience in procurement of GSM equipment since 2001, there were inordinate delays in finalisation of the tender during 2005-06 as explained above. The audit further noticed (October 2006) that between January 2005 and October 2006, the total addition of GSM subscribers by private operators was 381 lakh (excluding Delhi and Mumbai where BSNL does not operate) and BSNL lost this opportunity due to delays in the tendering process. Similar delays and court challenges seem to be going on in the case of the current BSNL tender.

One formal statement of the corporate governance issues is available in Form 20 F for the year 2007-08 submitted by MTNL to the Securities and Exchange Commission. These problems may be more severe in the case of BSNL given that it is 100% owned by the government.

The section on "Risks Relating to Our Business" states:

If the president of India does not allow us to make capital expenditures pursuant to our business plan, we may be unable to compete effectively or maintain profitability. Government formalities, including requirements that many of our purchases be made through a competitive bidding process, often cause delays in our equipment and product procurement; these delays can place us at a disadvantage relative to private sector competitors.

The section on "Government of India as Regulator" states:

All appointments to our board of directors must first be recommended by the Public Enterprises Selection Board, a government agency, and its recommendations are reviewed by the government of India, although until recently all appointments to our board have been recommended only by the government of India.

The section on "Employees" states:

As a public sector enterprise, we abide by general DOR and Department of Public Sector Enterprises personnel policies, which, among other things, limit our ability to reduce employment levels and control the amount of salaries and other remuneration that we may pay to our employees. Our employee productivity measured by access lines in service per employee has been increasing steadily but remains significantly lower than the Asian and global averages.

3 Corporate Governance of SOEs in India

In India, a number of bodies oversee the SOEs. The department of public enterprises issues guidelines on governance related issues, including board appointments, appointments of other personnel, wages and salaries. The central vigilance commissioner (CVC) issues guidelines on conduct, disciplinary cases, investigations and related issues. Departmental enterprises are subject to a special additional audit by the CAG. The Central Bureau of Investigation assumes jurisdiction over the employees and board members. The Planning Commission has a role in planning and project proposals. The public enterprise selection board recommends and selects potential SOE board members. Finally, it is the various ministries that exercise ownership rights and set policy objectives (sometimes together with the legislature). The ministries

make the final choice for certain board members and the chief executive – through which they exert substantial influence – and can also issue directives to and veto major decisions of SOE boards (World Bank 2006).

According to the chairman and managing director of a leading SOE, such pervasive government control and interference prevents the top management from performing its normal duties and responsibilities.⁴

In the wake of liberalisation and globalisation of the Indian economy there has been a broad consensus on the need to empower SOEs with greater financial and operational powers. The government introduced the concept of Navaratna and Miniratna in July and October 1997 which provided for delegation of powers related to capital expenditure, formation of joint ventures/subsidiaries/strategic alliances and implementation of human resource development policies including VRS. Later, certain powers for incurring capital expenditure were also delegated to other profit-making SOEs. Professionals were inducted in the boards of directors and audit committees were also set up. However, these initial measures have not been adequate to enable SOEs' management to reform and restructure their organisations to meet the challenges of an increasingly competitive environment.

This is borne out by the comments of the prime minister, who expressed his views on corporate governance of SOEs in India while releasing the book *The Indian CEO: A Portrait of Excellence* on 18 July 2007:⁵

While granting full operational autonomy to public sector enterprises, to enable them to compete and succeed in the global market, the concerned Ministries have a responsibility for ensuring that they follow good corporate governance practices. There is often the complaint that Ministries in fact encourage the opposite! Such instances should be brought to light and corrective action taken.

He also expressed his concern about the lack of authority of chief executive officers (CEOs) of SOEs.⁶

Finally, he made it clear that parliamentary accountability should not degenerate into either ministerial or political interference in day to day management of enterprises, or bureaucratic stranglehold on managerial decision-making.

Sengupta Committee Recommendations

In 2004, the Ministry of Heavy Industries and Public Enterprises set up an "Ad hoc Group of Experts on the Empowerment of the Central Public Sector Enterprises" (CPSE) under Arjun Sengupta. The Sengupta Committee (2005) report points to the crucial role of corporate governance for efficiency and growth of the public enterprises. The committee went on to make several important and specific recommendations which highlight the problems with the existing system:

- (1) The ministry should not give instruction directly or indirectly to the management. It should be the responsibility of the concerned board of directors. The views of the ministry should be communicated to the board through government directors.
- (2) If the ministry considers it necessary to issue mandatory instruction to a CPSE, the same must be given in the form of a presidential directive. The issuance of such presidential directives should have the approval of the cabinet.

(3) There should be a negative list of areas which must be kept away from the intervention of the government (except for respective jurisdiction of the CAG and CVC).

(4) The current restrictions regarding capital expenditures, joint ventures, etc, need to be done away with. Such decisions should be left entirely to the board of directors.

These recommendations highlight the fact that while SOEs may have been granted some measure of autonomy through the Navaratna status and the system of MOUs, they continue to be subject to government interference.

Article 12 of the Constitution

The Sengupta Committee also examined the applicability of Article 12 of the Constitution to SOEs. Although Article 12 does not explicitly provide that SOEs fall within the definition of the "State", they still are deemed as being included in the category "other authorities" and therefore, covered under the definition of "State" as pronounced by different courts including the apex court.

According to the committee:

This negation of the essential distinction between government per se and public enterprise has led to a situation where any aggrieved employee or contractor can move the court against the Management of public enterprises calling in question individual actions or decisions in the same way as against the State. This would seem to imply that government enterprises can function only as government departments and in accordance with the modalities, procedures and styles similar to government administration. This impedes decision-making in CPSEs, particularly in the competitive environment in the wake of liberalisation/globalisation. Indeed, it is precisely because business cannot be run efficiently in the normal governmental style and in accordance with government procedures that public enterprises have been organised in the corporate form.

It was brought to the notice of the committee that the matter was considered by the committee of secretaries in 1987. That committee referred it to the Ministry of Law requesting it to examine the possibility of inserting a clause exempting SOEs from Article 12. The Ministry of Law placed the issue before the Law Commission which looked into various possibilities but could not find a solution. In its 145th report submitted in 1992, the Law Commission concluded as follows:

Having regard to the Preamble and total philosophy of the Constitution, even if such an amendment is made, some of the problems experienced by the public sector undertakings would still survive under the ordinary law. In particular, judicial intervention in the form of injunctions issued under the ordinary law cannot be ruled out, even after the suggested amendment.

It is highly doubtful whether, in the light of the theory of non-amenability of the basic features of the Constitution as at present recognised, such an amendment will pass muster on the Constitution level.

While taking note of the deliberations on the subject in the past, the Sengupta Committee concluded:

The far-reaching mandatory legal implications of Article 12 inhibit the functioning of CPSEs as commercial entities like similar companies in the private sector. In consideration of the foregoing position, the Group recommends that this issue could be revisited by the policymakers at an appropriate time in future.

In spite of the reservations expressed by the Law Ministry it is worthwhile pursuing this matter to work out a solution which

relieves the SOEs of the burden of complying with Article 12 of the Constitution.

Guidelines on Corporate Governance

The department of public enterprises issued "Guidelines on Corporate Governance for Central Public Sector Enterprises" in June 2007. The guidelines cover issues such as composition of board of directors, setting up and deciding the role and powers of audit committees, issues relating to subsidiary companies, disclosures, accounting standards, risk management, and compliance.

The guidelines seek to address the failure of the functioning of the corporate governance system in terms of the role and functioning of government directors. In the annexure on the guidelines on composition of board of directors, the report highlights the following on the role of government directors:

He should be allowed to function freely and use his own judgment without any formalised briefing by the Ministry before a Board meeting with discretion whether to seek a briefing or make a report. The Government Director should identify himself with the objects and goals of the enterprise, engage in joint thinking on equal terms and not assume a superior status, he should not reserve his position on matters before the Board, however, others on the Board should not expect him to commit the Government in respect of matters which require to be referred to the Government.

In all subsequent examination of the Board approved proposals, his role should be mainly elucidatory and he should not sit in judgment over the Board. Reference to the Ministry for approval, sanction, etc, should be addressed to the Government representative on the Board whose responsibility should be to process the matter and obtain the necessary Government approval promptly.

The guidelines also require that there should be a clear demarcation of powers of decision-making between the board and the government. It highlights the fact that while such requirements exist on paper they are often subverted by the administrative ministries.

The Economic and Administrative Reform Commission (EARC) has recommended that there should be clarity in regard to the powers of decision-making of the Board and those, which are reserved for the Government. In this context, they have mentioned that while on paper and in the Articles of Company such clarity exists, in a very large number of cases, informal advice amounting virtually to a directive percolates from the administrative Ministries to the public enterprises. In consequence, the Government Directors on Boards also tend to be used or considered to be acting as channels of informal control by the Ministry. Since functional autonomy of these enterprises is essential for their good performance, there should be no vagueness about the areas on which the Boards can take decisions and those in which it must seek prior Governmental approval.

According to recent newspaper reports, officials of administrative ministries may be taking advantage of their positions to obtain perquisites from SOEs. According to a letter issued by the Prime Minister's Office (PMO):⁷

Permitting some ministries to obtain such facilities from CPSEs is problematic. They tend to become perks that other ministries do not have. This also creates a perverse incentive for officers to prefer ministries with CPSEs. Apart from this being unfair and inefficient, it has the potential to compromise the independence of the government direction.

Public Sector Executive Pay

In a competitive environment the role of executive compensation, especially its relationship to performance, is critical. The

Second Pay Revision Committee (2nd PRC 2008), headed by Justice M Jagannadha Rao, submitted its report to the government in May 2008. The recommendations were considered by the government and orders for pay revision of executives and non-unionised supervisors of CPSEs have been issued. The implementation of pay revision has been linked to the SOEs being able to afford the revised pay scheme. A novel feature of the recommendation is a performance linked component of pay. The performance related pay has been directly linked to the profits of the firm.

More important than the specific pay recommendations, the committee pleaded for a radical change in the manner in which SOE salaries are fixed. The committee stated that "It is absolutely necessary that the remuneration levels are cut off from the umbilical chord that traditionally ties public sector salary level with government salary level." With regard to future revisions in pay the committee stated:

We would like to see that we are the last such committee for deliberating on the remuneration structure in the public sector as a whole and that hereafter no such committee will be necessary. Revision can be considered by the Board of Directors and the concerned Ministry as and when necessary on the basis of the economic situation and the nature of the concerned industry.

The committee felt that the current classification of CPSEs into four broad classes for pay fixation purposes should be discontinued:

Finally, we feel that time has come when we should no longer look at all these CPSEs spreading over a vast spectrum with a common approach. If one industry is different from another and has its own peculiar problem, it is neither possible nor desirable that the concerned CPSEs should continue to be treated together just because they are government owned. The concerned Ministries might well follow different approaches specific to the particular industry. Eventually, the Board of Directors of the company should be the agency primarily responsible for fixing up remuneration of officers. Only the emoluments of the Chairman & Managing Director should be settled by the Ministry discharging its role as the shareholders of the company. We are, thus, advocating a complete shift of paradigm and a complete change in the environment different from what has been prevailing hitherto. We even feel that some of the recommendations that we are making should have come about much earlier.

The overall picture that emerges is that the administrative ministry exercises significant formal and, more so, informal control over SOEs. This not only renders the top management of SOEs ineffective but also dilutes the accountability of management for firm performance. The administrative ministry cannot hold the SOE management accountable for performance since management does not have adequate control over the organisation and its decisions. Of course, management can also take shelter behind "government interference" to avoid taking responsibility for poor performance.

4 Restructuring the Corporate Governance of BSNL

With almost two decades of telecom sector reforms there is little justification for continuing government ownership and control of BSNL. Traditionally, government ownership and control have been justified on the basis of developing the telecom sector and extending coverage to underserved and unserved areas. However, with telecom sector reforms both these roles can also be played by numerous private sector operators.

BSNL: No Longer of Strategic Importance

While BSNL is the only significant wireline operator, wireline now accounts for only 10% of its total subscriber base. Of course, BSNL accounts for almost all of the 10.6 million rural wireline subscribers and half a million village public telephones as of end December 2008. However, rural wireline subscribers have declined from 14.7 million in March 2006 to 10.7 million in December 2008. In addition, the total rural wireless subscriber base stood at 93 million, with BSNL accounting for only 16 million.

Table 8: Wireline Subscribers (millions)

	Urban	Rural	Total
December 2008	27.22	10.68	37.90
March 2008	27.78	11.64	39.42
March 2007	28.19	12.56	40.75
March 2006	35.49	14.68	50.18
March 2005	32.74	13.45	46.20

Source: The Indian Telecom Services Performance Indicators, various issues, TRAI.

Table 9: Wireless Rural Subscribers (millions) as on December 2008

Wireless Group	Total Subscribers	Rural Subscribers	Rural Subscribers (Percentage of Total)	Market Share of Rural Subscribers %
Bharti	85.65	26.10	30.48	28.02
Reliance	61.35	12.28	20.01	13.18
Vodafone	60.93	19.19	31.49	20.60
BSNL	46.23	16.29	35.24	17.49
Idea	34.21	11.57	33.82	12.42
Total (including others)	288.37	85.43	29.63	91.71
Total (all operators)	346.89	93.15	26.85	100.00

Source: The Indian Telecom Services Performance Indicators, October-December 2008, TRAI.

BSNL has a dominant position in internet and broadband provision because of its dominant fixed line position. TRAI has recommended unbundling of the local loop but the government has not implemented this recommendation yet.

Even the access deficit charge (ADC) regime has been phased out and the Telecom Disputes Settlement and Appellate Tribunal (TDSAT) has rejected challenges to this decision by BSNL. In fact, the TDSAT questioned the very basis of BSNL's decision to subsidise rural subscribers through the ADC, in the absence of any explicit policy directive by the government.

Hence BSNL is no longer of strategic importance in the same way as it used to be prior to the telecom sector reforms. In fact, continued government ownership and control restricts BSNL from competing fully with the private sector and is contrary to the avowed government policy of a level playing field and providing universal access through the Universal Service Fund.

Performance Evaluation and Incentives

Improvement in performance will require an arms-length relationship between BSNL and the government on the basis of clearly defined performance parameters with incentives and penalties for top management. In the absence of a robust performance evaluation it is difficult, if not impossible, to provide incentives or delegate autonomy to SOEs. A World Bank (1998) study of performance contracts found that most contracts seemed to fail on three important counts – information, incentives and commitment.

Information for Setting of Targets: Managers were able to use their information advantage to negotiate targets that were either difficult for outsiders to evaluate or easy for the firm to achieve. Performance is hard to evaluate, for example, when there are

many targets or when targets change frequently. The managers' information advantage was compounded by governments' failure to give the bureaucrats (who were responsible for negotiating the contracts and evaluating results), the power, resources, and status they needed to face enterprise managers on a level playing field. Managers were thus able to negotiate targets that they could achieve without making additional efforts to improve productivity.

Incentives and Penalties: The incentives provided under the contracts failed to motivate managers. The first study found that only two of the 12 contracts paid a bonus or punished underachievement. And the second study, in China, found that the incentive (wage increases linked to profits) was set too low to motivate improvements in most of the firms and was aimed only at workers.

Commitment to Enforce: The governments' commitment to enforce the contracts was not credible. All the contracts lacked neutral, third-party enforcement mechanisms, and governments often renege on their promises.

These problems should not be serious in the case of BSNL. The telecom sector is competitive with a highly developed market for telecom services, telecom equipment and other inputs. Performance could be easily benchmarked to other private sector operators. BSNL is no longer the dominant incumbent, and in some ways is disadvantaged against the private players due to government control. It also does not need to fulfil any social obligations. It may, therefore, be possible to arrive at purely commercial performance parameters benchmarked against a large number of private operators. The 2nd PRC report provides a starting point for structuring top management remuneration.

Controlling Government Agency for SOEs

An important question in the corporate governance of SOEs is the specific department/ministry through which the government exercises its ownership rights. There are three models of organising the SOE government relationship: the decentralised or sector model, the dual model and the centralised model (World Bank 2008).

In the decentralised model, SOEs are under the responsibility of relevant sector ministries. The main advantage and rationale for a decentralised organisation is the availability of sector expertise. The main drawbacks are the difficulty in clearly separating the ownership function from the regulatory role and the risks of governmental interference in day to day operational functions.

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In the dual model the responsibility is shared between the sector ministry and a “central” or “common” ministry, usually the finance ministry or the treasury. This is still adopted in many Organisation for Economic Cooperation and Development (OECD) countries, including Greece, Italy, Korea and New Zealand. The main disadvantage of the dual model is that the sharing of responsibilities between the two ministries may be unclear resulting in either over or under monitoring of the SOE.

Finally, in the centralised model the ownership responsibility is concentrated under one main ministry. Most SOEs are put under the responsibility of one ministry or agency, usually the ministry of finance or the ministry of industry. In a few cases a specific agency has been established, which is more or less autonomous, and usually reporting to the ministry of finance. The main advantage of the centralised model is the clear line of accountability from the SOE to the government. This arrangement also allows specialisation in the task of exercising the government’s ownership function.

The OECD’s recommended model is for a centralised ownership function, to be exercised by an independent agency. China appears to be following the centralised approach with a single agency called the State-owned Assets Supervision and Administration Commission of the State Council (SASAC).

The government should consider moving SOEs, such as BSNL which do not have any government mandated social or sector development obligations, from the control of the sector ministries, to the finance ministry or a single agency. This will ensure that

they receive real autonomy and are able to compete on an equal footing with the private sector companies.

5 Conclusions

Economic reforms and liberalisation have converted BSNL and MTNL from state-owned monopolies to players in a highly competitive market with no social or other non-commercial objectives. They will have to be run like other private sector telecom companies if they are to survive and prosper. The government’s existing Navaratna policy, where limited autonomy is granted on the basis of size, profitability and a nominal listing, is not appropriate for SOEs competing fiercely with the private sector. These firms need autonomy not because they are making profits on the basis of their monopoly position but because they have to compete on an equal footing with the private sector.

All parts of the government, starting from the prime minister and extending to various government committees, recognise the need for autonomy with appropriate corporate governance. The key requirement is a competent board with adequate powers. The role of the board is likely to be more crucial than even in the case of private companies. Given the historical legacy, this will require a complete break from the current system of SOEs being controlled by sector ministries. The control will have to pass on to either an independent agency or in the interim to the finance ministry. In the absence of corporate governance changes, the only alternative will be privatisation.

NOTES

- 1 Air India appears to have already suffered this fate.
- 2 *Business Line*, 20 May 2007.
- 3 BSNL IMPCS is a pilot project in the field of cellular telephony to provide GSM-based mobile services to its subscribers in the states of Bihar, West Bengal and Tamil Nadu.
- 4 Arun Balakrishnan, Chairman and Managing Director, Hindustan Petroleum Corporation Limited, “Network on Corporate Governance of State-Owned Enterprises in Asia”, New Delhi, 25-26 June 2008, Organisation for Economic Cooperation and Development and Government of India. According to him, “The state-owned enterprises have to work under the aegis of the state, as the state is the majority shareholder. The key question is the parameters of the ownership and review function, composition and empowerment of the boards. The responsibility of complying with the requirements of multiple layers of authority can be quite onerous and time-consuming. In fact effectiveness of the CEO of a state-owned enterprise may lie overwhelmingly in managing the relations with various arms of the government.”
- 5 Web site of the PMO.
- 6 “I do note with concern the observation in the book that ‘although the best public enterprise Chiefs excel at empowering their people, they themselves are currently largely disempowered by the Government’. This must change and we must all create an environment that is conducive to this change being brought about sooner than later.”
- 7 “Can’t Milk Your PSUs Anymore Babus Told”, *Indian Express*, 21 September 2009.

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