

# CENTRE FOR JOINT WARFARE STUDIES



## CENJOWS

### THE CONTOURS OF CORPORATISATION OF THE OFB

By

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*The secret of change is to focus all your energy not on fighting the old but on building the new. - Socrates*

#### **Winds of Change**

The announcement of the relief package by the Hon'ble Prime Minister on 14 May 2020 was followed by certain specifics by the Hon'ble Finance Minister on 16 May 2020. In it, she mentioned that the Govt of India had decided to go ahead with the corporatisation of the Ordnance Factory Board and that a detailed roadmap for the same was being drawn up. This announcement was welcomed in many quarters, none more so than amongst the users. However, to a lesser extent, it was met with some skepticism and cynicism, especially amongst the trade unions. The question on everyone's lips was how this transformation was going to be managed and what it actually entails. To this end, various views have been articulated in the print media, on television news channels and on social media. This paper attempts to understand the contours of this transformation and the shape of a corporatised OFB.

## **Structure**

From what is available in the public domain and without getting into much detail, it appears likely that at the apex level ie at the Board level, the OFB Board could be given a status of Maharatna PSU. It will perhaps be the holding company with freedom to reorganise the factories and establishments under its control. A major restructuring of sorts would have to be undertaken with consultants with the aim being to make the organisation function like any successful corporation. To this end, the OFB Corporation would get dispensation independent of Ministry of Defence (MoD) to forge partnerships with the Private Sector as per the policy approved by the MoD. For this, the OFB Corporation could be allowed to form joint ventures with 49% equity of the Govt of India. This is not to be confused with the FDI cap for Defence Production under the automatic route which has been increased from the present 49% to 74%. This will encourage foreign companies to invest in India and will help the OFB Corporation in forging long term relationships with such companies.

It is envisaged that the Chairman OFB Corporation would be given suitable representation in Defence Procurement Board. He is already a member in the Defence Production Board. With the heft that he carries, he is bound to be major player in shaping the defence production philosophy. The OFB Corporation is also likely to have the mandate to foray into allied areas such as the manufacture of equipment to meet the requirements of the Internal Security establishments. This will lead to greater diversification of their products and, if steered properly, can even help it to capture a significant slice of this market.

## **Ownership**

Once the OFB forms a corporation, the existing assets in the form of plant and machinery, real estate, buildings, etc would be owned by the OFB Corporation. If this be so, it would also have the necessary powers to make use of these assets for business purposes including lease for joint ventures (JVs) or fully owned subsidiaries, etc. If corporatisation is to be taken to its logical conclusion, then the OFB Corporation would be free to offer ESOPs to its employees as well as to the Members on its Board.

## **Production/Purchase Orders from the MoD**

For the OFB Corporation to stand on its own feet, production/purchase orders on nomination basis for the products in the current portfolio of OFB, as being done at present will have to continue for the time being. Subsequently, it is envisaged that the OFB Corporation will continue to get the orders from the Services on nomination basis for new products whenever it is earmarked as

the designated production agency for development and production of such new products. Also what appears to be a slightly tilted playing field is that in 'Make Category' projects and 'Buy and Make Category', a special preference 15 % above L1 price would be given to it. The preferential treatment of giving orders to the OFB Corporation at 15 % additional price over the L-1 vendor should be restricted to a maximum of 50% of the quantity sanctioned in the AoN so as not to deny the legitimate share to the L-1 vendor.

If this be so, then the pricing mechanism that the new corporation would use to ensure that it can make cost effective products would need to be spelt out. If this Corporation is to get assured orders on a 'Nomination Basis' as hitherto, then it would not be any different from the present OFB regime. One can understand this hand holding for the initial 3-5 years of the formation of the OFB Corporation, but for it to get nominated orders at a price determined by this newly formed corporation in perpetuity, defeats the very purpose of corporatisation of the OFB. Besides it will become a major disincentive for the other manufacturers.

### **Internal Pricing and Orders**

That the OFB Corporation would decide the price and quantity for orders to be placed on various Ordnance Factories and on vendors as per requirement and delivery, is a given. This functional freedom to operate would indeed empower the Corporation with sufficient flexibility and resilience.

### **Finance & Funding**

The working capital for the new corporation for the next five years or so is likely to be provided by DDP by creating a onetime corpus. Capital investment for ongoing and sanctioned projects is also likely to be provided. This new corporation is also likely to be given funding from Technology Development Fund set up by the Govt. This is necessary in order that this new corporation be able to stand on its own feet. Also funds for the R&D needs may be provided by Govt for five years initially at the rate of 2-3% of the turnover of the OFB Corporation.

However, after the hand holding ceases, the OFB Corporation would have to manage like any other business house by going public, taking bank loans, et al. Govt long term research support to the OFB Corporation should be akin to the best practices globally. An imaginative road map has to be drawn ab initio that needs to be followed in letter and spirit to cater for the future.

## **Accounting & Audit**

The net worth of the OFB should be based on valuation on current market rates rather than on book value. This would help in framing JVs of higher values and will indicate the correct valuations. For audits, the OFB could take advice from the CAG to engage any auditing firm in addition to/in lieu of audit by CAG as per prevailing norms. The financial audit for the first five years should be done by the CAG. Later on it could be transferred to a Third Party Auditor, as mutually agreed to by the OFB and the CAG once the corporate financial system is firmly in place.

Also, thus far, being a purely Govt owned and managed entity, the OFB was not required to maintain a P&L (Profit & Loss) statement. However now as a corporate entity, it would become incumbent for it to do so. Besides, this new corporation should be subjected to the Performance Audit by the CAG at the end of the 2nd and 4th year of its formation, so as to closely assess its efficacy, as in past, many Performance Audits performed by the CAG on OFB have been critical of its functioning.

## **Procurement Procedures & Processes**

The OFB has its own procurement Manual and is not bound by the Defence Procurement Manual. This Manual will undergo a change in keeping with the new philosophy. The OFB would have to frame a new Manual suitably modifying its earlier one. This would need to include clauses for long term PPPs. The OFB would have to build Supply Chains taking into account its Long Term Partners.

## **HR and Service Conditions**

Presently, the recruitment in the Indian Ordnance Factories is done by the Union Public Service Commission (UPSC) based on the performance in the Engineering Services Examination (ESE) and the Civil Services Examination (CSE). While engineering posts are filled through the Engineering Services Examination, posts in the non-technical streams are filled through the Civil Services Examination. IOFS is the only cadre in which officials are selected by all four means - CSE, ESE, interviews and promotions..

In line with the corporatisation of the BSNL model, all existing officers and employees of the OFB organization would need be on deputation for five years to the OFB Corporation but without deputation allowance. Salaries and perks as per existing rules with increase in DA from time to time and 7<sup>th</sup> CPC recommendations would apply till the end of this period.

It is envisaged that all employees above the age of 50 would be given the VRS option. The VRS scheme should be funded by the Govt and made attractive. All vacancies caused by the VRS scheme could be filled by promotion of suitable personnel as well as direct recruitment from the corporate world and industry through 'walk in' interviews. Persons with experience from the Armed Forces and other Govt bodies should also be considered. This should be the norm for the shop floor management as well. The OFB Corporation is also likely to do away with the cadre of IDAS officers for its finance and accounting functions. They would be replaced by professionals selected by the Corporation.

Another important matter is that the HR policy and rules would not be controlled by DOPT. The OFB Corporation would need to make its own rules to promote excellence in system.

### **Budget and Salary**

The OFB Corporation will obviously be the controlling authority for the budget and administrative decisions for all the Ordnance Factory Units. However, it is likely that the salaries of all the employees will be provided by Government of India for next five years.

### **Liabilities**

Initially, the Govt of India would be taking on liabilities like pensions for the serving employees.. The writing off of the losses by the Govt should be for the first 2-3 years only. In case of losses, the Central Government would be supporting the OFB Corporation by way of loans and equity investments. The Government would also provide sovereign guarantee for raising of loans. However, what is most important would be the resolve of the Govt to ensure that there is no political interference whatsoever in its functioning.

### **Taxation and Pricing**

GST and corporate tax for any autonomous entity is a sine qua non. Norms applicable to Defence PSUs may be applied here too.

### **Preferential Allotment**

The OFB Corporation would likely be given preferential allotment of Land in the Defence/ Aerospace SEZs. It could also have the benefit of MSMEs for next five years and build a complete supporting ecosystem in this category.

## **Relationship with MoD & Functioning of the Board**

No proposal of the OFB Corporation would be required to be routed through DDP if the same is approved by the Board where the Ministry is represented. The Board must include independent professionals and technocrats especially from the fields of R & D, production and the Quality Management. **Most importantly, the Board must have a permanent representative of the user ie the DCOAS/MGO.**

The principle of empowerment requires that the OFB Corporation should be allowed to take decisions in a businesslike manner and be accountable for its performance. The MoD should therefore not interfere with functioning of the OFB Corporation. This is perhaps the most important aspect on which hinges the autonomy of the OFB Corporation.

## **OFB as a Corporate Entity**

The corporatisation of the OFB envisages that the OFB becomes a corporate entity much like any other corporation. It would be given a free hand to set up offices, factories and entities in India and abroad. It should have the power to create function specific subordinate corporations eg. a Marketing Corporation, an After Sales Service Corporation, etc. The possibility of having smaller cluster wise product oriented corporations also under the umbrella of the OFB Corporation could also be considered so that the parent organisation does not become too unwieldy.

The OFB Corporation should be given financial autonomy to fund start ups, undertake Mergers & Acquisitions as well as purchase of Intellectual Property Rights. This would also entail full financial powers for any business expenses for brand and image building through Corporate Social Responsibility/Marketing/Publicity. These powers to the OFB Corporation would be in line with that which are being exercised by other Govt of India Navratnas. However there would be certain exceptions for which prior approval from MoD would be required. These would need to be spelt out. The budgeting would continue to be through the budget of the MoD.

## **Crystal Ball Gazing**

With these far reaching proposals, the OFB is likely to witness a transformational change. However what is still unclear at this stage is how the OFB Corporation after five years of hand holding, will emerge as a financially self supporting organisation. At this stage it is felt that after monetising its resources, the OFB Corporation would be able to compete with industry albeit with the 15% pricing advantage clause.

The OFB Corporation will need to focus upon manufacturing and quality control (QC). Manufacturing has to evolve to Industry 4.0 standards and AI based QC systems must be adopted. Memoranda of Understanding (MoU) with top academic institutions for restructuring, reformation and R&D would need to be entered into.

Apart from producing war fighting materiel for the Indian Armed Forces, the OFB Corporation should be able to utilise its excess capacities for exports to friendly foreign countries. Corporatisation will provide it greater flexibility in acquisitions through their overseas assets abroad by forming strategic alliances with Indian and foreign partners.

The issues that the Indian Armed Forces, especially the Indian Army had with the OFB hitherto were primarily, exorbitant pricing, time overruns, failure to meet agreed upon targets and quality especially with respect to ammunition. The OFB Corporation must internalise the philosophy that it exists primarily to serve the user ie the Indian Armed Forces. All else is secondary. The MoD and the OFB must ensure that during the change over process, production and delivery schedules should not be compromised in any manner whatsoever.

It is expected that the corporatisation of the OFB which frees it from the confines of the Govt will enable it to address all these issues and that this new corporation will emerge as the lode star in the firmament of defence production in India and herald a new era of 'Atmanirbharta'.

**Disclaimer:** Views expressed are of the author and do not necessarily reflect the views of CENJOWS.