



CLAWS SEMINAR REPORT

AUGUST 2015

SEMINAR REPORT # 5

National Seminar on Capability Sustenance through Effective Revenue Procurement: Problems and Perspectives: 25 Aug 2015

Executive Summary

Introduction

1. The critical deficiency in ammunition has been adversely commented upon by the C&AG in their recent audit report. Lack of spares for the Air Defence Equipment, shortage of spares for maintenance and overhaul of both T 72 and T90 fleet or the recently scrapped tenders for Assault Rifles after four years of fruitless delay are indeed a cause for concern. The revenue supply chain consists of a number of stake holders viz the DDP, the Ord Fys, DPSUs, DGQA and the DRDO. MGOs branch and Ordnance Services Dte are the stakeholders in the Service HQ along with the PIFA (O) representing the integrated finance. In order to understand the nuances of shortfalls in revenue procurement, we Firstly need to look into our primary source of supply ie the Defence Industrial Base and analyse it both in terms of capacity and the capability for equipment sustenance. Secondly, we require to identify the impediments in procedural and policy functions that lead to delays, shortfalls and our inability

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to achieve the desired targets. Thirdly, there is another dimension that has been having a telling affect on our equipment sustenance and that is, management of revenue budget. Capital to revenue budget ratio in case of the Army stands at 80:20 which is a major cause of concern as 60 percent of the revenue component services the pay and allowances head. This leaves very little for procurement under the stores head which also caters for the budget of the OFB and DPSUs. This coupled with huge slippages and pending orders running into thousands of crs result in locking up a major part of Army's revenue budget in contractual liabilities.

2. A National seminar on “**Capability sustenance through effective revenue procurement: problems and perspectives**” was held on 25 Aug 2015. The major issues were:-
 - (a) **Defence Economics , Macro Aspects**
 - (b) **Critical Hollowness in the Army; causes and mitigation strategy**
 - (d) **Org restructuring for a more effective revenue procurement**
 - (e) **IFA System in Service HQ – An Appraisal**
 - (f) **Revenue Budget Management with special reference to stores budget; Challenges and way ahead**
 - (g) **Post Contract Management and Revenue Procurement ex import, Problem Areas and way ahead**

Key Recommendations

4. **Internal Processes and and Procedural Aspects**
 - **Organisational Structure for Management.** The structure for revenue management has to be inclusive of all the stakeholders . Officers from the three services , need to be integrated into the Department of Defence Production and also on the board of Ordnance Factories and the Def PSUs to ensure synergy of purpose and the requisite sense of urgency.
 - **Ensuring Accountability.** While guidelines for revenue procurement have been formulated and laid down in the DPM and various departmental procedures, accountability for delay in production and inability to meet quality parameters needs to be fixed amongst all players of the Defence Industrial Base.
 - **Product Pricing.** C&AG observed that OFys add 28% as overhead costs and in addition they have a captive client base with little competition. They have no incentive to achieve economies in production and reduction in cost of production. It is therefore imperative that products are competitively priced based on market rates.
 - **Corporate governance structure.** Def PSUs and Ord Fys must follow a corporate governance structure with greater functional and financial autonomy. The typical approach of working in

government departments as per convenience of effort and within own comfort zone needs to go.

- **Automation of Business Processes.** DDP, Defence Services, Ord Fys, Def PSUs and all other stakeholders need to automate their business processes and integrate with each other to ensure efficiency, greater asset visibility and transparency of functioning. Manual procedures lead to time delays and inhibit transparency and accountability.

5. Infrastructure

- **Modernise Capital Equipment.** Bulk of the equipment held by the Army is either in Obsolescence or the Obsolescent phase. This leads to non availability of OEM certified vendors for product support and hence intermittent measures have to be resorted to arrive at quick fix solutions. It is therefore imperative that an equipment is phased out as per its Product Cycle and new equipment inducted at the appropriate time
- **Production Capacity Augmentation.** There is a need for the Private Sector, Def PSUs and Ord FYs to augment their production capacity. They need to acquire niche technology, best practices and skill sets and also need to have 'ERP based' mechanism for real time monitoring.
- **Lifetime Support for Main Eqpt.** The Def PSUs and Ord Fys must ensure lifetime support of the main equipment through uninterrupted supply of spares manufactured on a three year roll on basis and should be accountable to its customers for the slippages and outstanding orders.
- **Public Private Partnership .** An institutionalised Public Private Partnership model between the Department of Defence Production (DDP) and the private sector must be established in order to propel government's indigenisation efforts through 'Make in India' and reduce reliance on ex import.

6. Financial Management Aspects.

- **Rationalisation of Advance Payments.** The system of payments for OFB is skewed against the Services as almost 95 percent advance payments have to be made to the OFB against any orders placed on them. This leads to lack of accountability and makes the OFB less responsive to the ultimate stake holders.
- **Involvement of Stakeholders in Policy Formulation.** Policies and procedures issued by the Defence Accounts Department (DAD) are issued without seeking adequate inputs from the Defence Services and in a non consultative manner. The Delegation of Financial Powers, Defence Services (DFPDS) 2015 being the latest such example. This needs to be remedied.
- **Attachment of IFA Cadres at Fd Units.** In the new policy on Delegation of Financial Powers DFPDS 2015 issued recently by the MoD (Finance), the **inherent** financial powers of military CFAs have been completely withdrawn. However financial powers right till the unit level have been enhanced and the role of the IFAs made inclusive in all procurements. Therefore IFAs need to have a deeper understanding of the Org structure and thus need to do attachments at the Field Units for better organizational comprehension.

- **Inclusion of FM in Courses of Instrs.** With exponential increase of Financial powers to unit Cos, revenue procurement at the ground level will be more unit centric. It is therefore mandatory that FM forms part of all basic and advanced course in the army

7. Procurement Ex Import

Reduction of Lead Time. It takes an average of 3 to 5 years for processing ex import indents. To reduce this time lag, it is important to automate all procurement processes and holistically adopt the method of E procurement

Life Time Buy of Spares. For all Obsolete and Obsolescent Equipment of Foreign origin, the sources of supply have drained out and it is extremely difficult to procure piece meal requirements for such equipment ex import. LTB of such spares needs to be considered on priority.

Indigenisation at Induction. Indigenisation of spares for a main equipment must be considered at the time of its induction and not during the last stage of its product cycle. With Make in India gaining momentum, this parameter needs to be included at the Contract Formulation stage itself.

Pre Despatch Inspection (PDI). The clause for PDI of revenue procurement needs to be included in all ex import contracts to cut down on the rejection of equipment/ spares post its arrival in India as bulk payment has to be released to the vendor at the time of dispatch from the host country and avoid arbitration.

General

1. The critical deficiency in ammunition has been adversely commented upon by the C&AG in their recent audit report. Lack of spares for the Air Defence Equipment, shortage of spares for maintenance and overhaul of both T 72 and T90 fleet or the recently scrapped tenders for Assault Rifles after four years of fruitless delay are indeed a cause for concern. The revenue supply chain consists of a number of stake holders viz the DDP, the Ord Fys, DPSUs, DGQA and the DRDO. MGOs branch and Ordnance Services Dte are the stakeholders in the Service HQ along with the PIFA (O) representing the integrated finance. In order to understand the nuances of shortfalls in revenue procurement, we Firstly need to look into our primary source of supply ie the Defence Industrial Base and analyse it both in terms of capacity and the capability for equipment sustenance. Secondly, we require to identify the impediments in procedural and policy functions that lead to delays, shortfalls and our inability to achieve the desired targets. Thirdly, there is another dimension that has been having a telling affect on our equipment sustenance and that is, management of revenue budget. Capital to revenue budget ratio in case of the Army stands at 80:20 which is a major cause of concern as 60 percent of the revenue component services the pay and allowances head. This leaves very little for procurement under the stores head which

also caters for the budget of the OFB and DPSUs. This coupled with huge slippages and pending orders running into thousands of crs result in locking up a major part of Army's revenue budget in contractual liabilities.

2. A National seminar on “**Capability sustenance through effective revenue procurement: problems and perspectives**” was held on 25 Aug 2015. The undermentioned major issues were covered .

Defence Economics , Macro Aspects.

3. Any consideration of a country's military capabilities or its military effectiveness must begin with an examination of the resources— financial, human, physical and technological that the national leadership makes available to its military organizations. These resources are clearly a function of the larger national-level assets possessed by a country. Probability, intensity and duration of war and military doctrine determines the need for financial resources. However, the following dilemma exists:-
 - (a) Does the military sector bring in inefficiency in the economy ?
 - (b) Military spending: does it lead to multiplier effect or under consumption elsewhere?
 - (c) What is the Damaging effect of military spending?
4. The Strategic Framework to overcome this dilemma should encompass the following :-
 - (a) Clear linkages to Government's strategic priorities and direction;
 - (b) Strategy-led policymaking and planning;
 - (c) Defined linkages between strategic intent and operational planning.
 - (d) Providing a shared, coherent basis for operational-level decision-making;
 - (e) A strategy-led capability planning process;
 - (f) Capability planning that is clearer to stakeholders, both within and external to Defence;
 - (g) Sound financial management practices where commitment of resources is aligned with strategic priorities.
 - (h) Guidance concerning strategic policy and planning development that allows staff to develop and position their work more effectively.

Critical Hollowness in the Army

5. The hollowness in revenue procurement for the purpose of capability sustenance is the direct result of our failure of not modernizing the forces in time. Over 60% of the equipment held by the Army is either in the Obsolete / Obsolescent stage. This reduces the availability of vendors, maintenance facilities and the requisite technology. Sustenance of equipment not only becomes difficult but also cost prohibitive. There is also a need to look at the sustenance and maintenance

of newly inducted equipment in a holistic manner. Procurement of any Capital equipment has to concurrently cater for its long term sustenance in terms of its repairs, technological upgradation and spares requirement. Internal processes and procedures have to ensure that the Defence Industrial Base(DIB) has adequate capacity to meet indented scales within the parameters of time, quality and reasonable pricing.

IFA System in Service HQ – An Appraisal.

6. The IFA advises the Executive Authorities on all financial matters within delegated financial powers. It is intricately involved in Financial Scrutiny of all proposals of provisioning and procurement, Participation in TPC/PNC/CNC, Critical performance appraisal of projects/schemes in financial & physical terms, Takes measures for achieving economy, cost effectiveness & better resource planning. Now with the Implementation of DFPDS 2015, the role has been changed from Advisory to Supervisory, and there is Infringement on executive decisions. In addition, the perennial problems of Iterative method of observations and Non uniform procedure in CsDA continue to remain. This poses pertinent questions of Measure of satisfaction among executives in regard to speedier disposal of procurement cases and the level of satisfaction with operations of IFA set up. In order to resolve these issues, there is a need to have closer IFA-CFA interface, build more reliance on E – Procurement, encourage deputation of qualified offrs to IFA and focus on Training of executives and finance officers. In addition, the IFA needs to have deeper understanding of the Org structure, bring about a change in Attitude, consider att of IFA cadres to Units in Fd and curb any malpractices at regional CDAs.

Revenue Budget Management with special reference to stores budget; Challenges and way ahead

7. If we analyse the revenue budget, some prominent issues that stand out are
 - (a) Allocation is not consistent with inflationary trends.
 - (b) Incr in scales of rations, MES maint & travel entitlements w/o any commensurate fin sp.
 - (c) Adverse impact of Govt policies like bulk FOL rates, decontrol of sugar etc within the FY.
 - (d) Exponential growth of ECHS from a budget of Rs 83 Cr in 2004-05 to Rs 2,670 Cr in 2015-16 (Avg growth of 35% per annum)
 - (e) Increased expenditure on Pay&Allowances adversely impacts the availability of Revenue Budget for sustenance & stores Budget Head. Add-on components to Army Budget which get higher annual increments and reduce availability to Army, like Cabinet Sectt (Salary), Units under HQ IDS,

Units under HQ SFC, Kendriya Sainik Boards, Sainik Schools, Cantt Bd Service Charges (DG DE), ECHS, DGOF.

8. In order to get a holistic picture of the management of revenue budget, we have to appreciate some of the major constraints that are faced in this context.

- (a) **Inadequate Budget Allotment** There is an overall Shortfall for Inflationary adjustment . All demands made by Defence Sector are not fully in conformity with resources available with the Government. This leads to addl voids in Capacity/Capability adding to the “Hollowness”. Reduced allocation of revenue requirements against projected requirement has a direct effect on operational preparedness. Capital acquisition gets priority without according due diligence to revenue procurement. This results in creation of cumulative deficiencies
- (b) **Long Gestation Period of Procurement.** Though DPM-2009 has a well laid out time frame, processing of procurement cases takes on an average two or three years. Delay results in depletion of operational availability of important equipment.
- (c) **Procurement Process.** It hinges on accuracy of requirement determination, speed in processing of financial sanctions, placement of orders and contract management . Delays in processing result in under-utilization of sanctioned budget.
- (d) **Ordnance Factories and Defence Public Sector Undertakings** . Stores which are in production line of OFs and DPSUs are required to be exclusively procured from them - Approximately 70–80 per cent . Capacity constraints result in causing slippages

9. **The Way Ahead.**

- (a) **Private Sector Participation.** MoD has to ensure greater collaboration between the Defence Procurement units and Private Sectors. Level playing field has to be ensured. Offset slippages due to OF and DPSU capacity through the private sector.
- (b) **Capacity Building of OFs and DPSU.** Reduce Hegemony. Incr Privatisation /Jt Ventures to complement the overall defence capacity in the country.
- (c) **Enhance Existing Vendor Base.** There is a requirement to have a central agency at HQ IDS for registering firms after due evaluation. E-registration is also a viable solution. This will pave the way for ensuring quality and efficient procurement
- (d) **Outsourcing /Third Party Logistics.** GoI has agreed on this in principle. Considering the funds that can be saved, work force that can be freed to train, proficient and skillful resources that can be used elsewhere, we should not drag our feet on this important issue
- (e) **Officers’ Tenure.** Need to ensure continuity of all stakeholders, especially at the working level to ensure effective procurement practices

- (f) **Supply Chain Mechanism and Inventory Management.** Informatics practices, Information Technology (IT) and Automation has to be adopted as well as updated on a regular basis
- (g) **Quality Imperatives of Defence Equipment.** Frequent rejection in inspection/ trials, upset the complete supply chain mechanism and hence stringent quality parameters have to be ensured at the manufacture stage itself.
- (h) **E-Procurement & E Concurrence.** It continues to remain limited in usage. It must be embraced in the correct perspective as it affords efficiency, competition, and transparency in procurement
- (j) **Multiple Verticals for Examination of Procurement Proposal.** Process of procurement has to pass through multiple agencies as laid down in DPM-2009 with primary aim of ensuring transparency. Any observation by any functionary in the vertical results in reverting the case-file back to the originator, thereby causing delay. Procurement Committee as per DFPDS 2015 is an apt step to overcome this lacuna.
- (k) **Rate Contract.** Director General of Supplies and Disposal (DGS&D) executes rate contract as per requirement of various departments of GoI. DGS&D is unable to cover the entire range of spares/stores required. This issue, if addressed appropriately, will yield rich dividends

Post Contract Management and Revenue Procurement ex import, Problem Areas and way ahead.

10. Procurement ex import, primarily suffers on account of :-

- (a) Huge delays in materialization of orders.
- (b) Lack of availability of spares
- (c) Inadequate maintenance support for old equipment,
- (d) Involvement of multiple agencies during the procurement process.
- (e) Slow pace of indigenization.
- (f) Non inclusion of product support clause in the original contract.
- (g) Lack of automation in the entire procurement process.

11. It is therefore imperative to focus on some important measures such as

- (a) Planning for indigenization at the time of procurement of the main equipment,
- (b) Adopt a holistic view on upgradations and obsolescence mgt
- (c) Explore options of Life Time Buy for equipment lacking product support
- (d) Lay impetus on automation and E procurement
- (e) DPM should be taken as a guideline and not a mandate as contracts for equipment with different countries has different peculiarities.

Key Recommendations

12. Internal Processes and Procedural Aspects

- (a) **Organisational Structure for Management.** The structure for revenue management has to be inclusive of all the stakeholders . Officers from the three services , need to be integrated into the Department of Defence Production and also on the board of Ordnance Factories and the Def PSUs to ensure synergy of purpose and the requisite sense of urgency.
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