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INDIA:

**ORGANIZATIONAL TRANSFORMATION OF STATE OWNED
ENTERPRISES: CASE OF WEST BENGAL POWER SECTOR**

OUTCOMES FROM KNOWLEDGE SHARING WORKSHOPS

June 2009

Introduction

1. **Background:** The Indian state of West Bengal initiated a reform program for the power sector with a vision of creating operationally and financially viable power sector providing good quality power supply for social and economic growth of the state. West Bengal's sector turnaround story is dominated by an internal change-management process, rather than a top-down, policy-directed reform effort which has been more typical in many of the other states. West Bengal had been one of the lagging states of the country, which has been ruled by the communist party for the last three decades and has a history of active trade unions. In terms of key power sector parameters, the system demand is around 4500 MW, state utilities have around 25,000 employees and the average retail tariff is around 7.5 cents/ unit. Over the last 5 years, the sector has demonstrated an impressive turnaround in its financial performance, converting annual losses of USD 300 million in 2002 into a profit of USD 40 million in 2007. It is perhaps the only state in India (among the larger states), which does not get any revenue subsidy from the Government. The reform strategy of the state focuses on enhancing operational efficiency and customer service levels through governance reforms of state-owned enterprises. Sector restructuring has been undertaken by unbundling the sector into a separate generation, transmission and distribution. Benchmark competition occurs in the state because there are public (center and state) and private distribution and generation companies, with a promising power trading regime evolving.

2. The power sector reform program in the State has been designed and implemented by the Government of West Bengal (GoWB). The World Bank has been providing Non-lending Technical Assistance (NLTA), through a recipient executed DfID Trust Fund grant to GoWB), consisting of sharing national and international best practices on relevant aspects of sector reform, and assisting the state government in capacity building of the restructured utilities. The Project consists of the following parts:

- (i) Providing strategic and policy support for power sector reforms including compliance to the Electricity Act;
- (ii) Establishing a robust monitoring and evaluation framework in the Department of Power for monitoring, inter-alia, Power Sector Reform Program and its overall implementation, including compliance by various relevant entities to the Business Plan;
- (iii) Co-ordinating governance reforms related to the power sector in West Bengal including structural reconstitution of key entities and human resource development through skill assessment, training and performance linked incentives

. The capacity building program for the transmission and distribution utilities is being implemented, with financial support from DfID, in a phased manner over a period of three years. The capacity building exercise in generation utility is planned to be taken up shortly,

3. **Objectives of the note:** The power sector reform process/ path taken by West Bengal has a number of unique features like - use of extensive consultation process; use of governance initiatives for internal transformation of power utilities with an objective of attaining outcomes

of customer service orientation and sustainable operational efficiency of newly corporatized entities; and structure and sequencing of the reform program.

The objective of this note is to share the experience of West Bengal in improving the operational and financial performance of their power sector through a reform program with other states/ stakeholders in the country and initiate the dialogue on importance of organizational transformation required in state owned power sector companies.

Methodology

4. As a part of the NLTA, following activities were undertaken to share the experience of West Bengal :

- Organization of a National level experience sharing workshop on “*Power Sector Reform in States: West Bengal Experience and Stock taking of Distribution Reforms*” in Delhi (India) on July 24, 2008. The workshop was hosted by World Bank in cooperation with the Government of West Bengal (GoWB), Ministry of Power (Government of India), and the Planning Commission, and with financial support from AusAID. The workshop was attended by various stakeholders like state governments, regulatory commissions and utilities from seven states (Andhra Pradesh, Haryana, Kerala, Karnataka, Tamil Nadu, Uttar Pradesh and West Bengal), representatives from Government of India (Ministry of Power, Planning Commission and Finance Commission), Central Public Sector Undertakings (NTPC, POWERGRID), other organizations (TERI, PRAYAS, CPR, DFID and PwC) and representatives from print media.
- Organization of an International level experience sharing at the World Bank headquarters in Washington D.C. (USA) on October 1, 2008. The workshop was hosted by Energy Anchor and South Asia Energy Unit with financial support from AusAID. The workshop was attended by the Officials from Government of West Bengal, Power Utility in the State, Ministry of Power (Government of India) and number of Bank staff from different regions.

Outputs and Outcomes

5. Workshop agenda and the presentations from the two workshops are available in files. The conclusions from the two workshops are summarized below.

- (i) **A “One Size Fits All” approach does not work for sector reform** - Different sector restructuring models are working well in India (Andhra Pradesh/ Tamil Nadu/ West Bengal/ Delhi) while the same approaches are not working well at other places. There exist a number of circumstantial and historical aspects that need to be factored in while carrying through the process of restructuring and the solutions have to be located from within the sector and organization. Internal change management is a process which could be common but issues to be handled will vary for each state.
- (ii) **Use Sector Restructuring as a tool for organizational reform** – In the earlier reform model that was followed by the States, considerable time and energy was expended on developing the ‘right’ industry structure, within the several political, administrative and capacity-related constraints confronting the decision-makers. The results of these restructurings have been mixed. In addition, the limited pool of experienced managerial

resources in the public sector and State Governments has led to a struggle to find effective top managerial resources and give them a stable and predictable tenure to lead these companies. An important learning from the West Bengal experience is that for states that are debating sector restructuring, there is a need for less upheaval in sector structure, and more emphasis on internal organizational reforms - Unbundling should be used as an opportunity for initiating internal transformational change, rather than mere multiple transfer schemes and incomplete financial restructuring.

- (iii) **Successful demonstration assists in building credibility** - In West Bengal, Public Sector Enterprises (PSE) reforms were initiated during 2001-2005 by the Public Enterprises Department (PED) with financial support from the Department for International Development (DfID). The overall strategy for PSE restructuring included a measured beginning and creation of a justifiable, transparent, accountable and representative system of restructuring the enterprises. The employees and workers were extensively consulted during restructuring process and a strong Social Safety Net Program was designed and credibly implemented, ensuring the security and participation of workers which ended up being displaced. The benefit from PSE reforms, though small in magnitude relative to public utilities, demonstrated the government's seriousness about the overall performance of the state, which included a commitment to development, reforms and improved financial management, and a commitment to protecting the legitimate interests of labor. Successful implementation of PSE reform program and drawing the same political and bureaucratic team to power sector enhanced the credibility of individuals and the process. In addition, track record on operational improvements from 2000 onwards had been established through measures such as enactment and effective implementation of anti-theft legislation.
- (iv) **Realistic Business Plan** - States which undertook restructuring of their power sector earlier than West Bengal framed business plans which were over ambitious on assumptions for future tariff increases, T&D loss reduction and load growth, thus often failed to achieve the desired results. Unrealistic assumptions on achieving quick financial turnaround, given the political economy challenge of tariff revision, slow efficiency gains, and growth in subsidized sales (domestic and agriculture, which is largely unmetered also), led to repeated bail-outs from government later on. Learning from experience of other states, West Bengal has prepared a conservative business plan with assumptions of modest tariff increase, and conservative assumptions on revenue from trading and the reduction in consumer subsidies. The State Government also showed its commitment to the power sector reform effort by supporting the financial restructuring plan with a write-off of around USD 2,500 million of Government loans to the utilities. While quick turnaround may be an issue, the state has focused on achieving greater operational efficiency and enhanced customer levels that are feasible over the medium term.
- (v) **Participative Process across stakeholder groups** - A strong feature of the reform process in West Bengal has been the intensive and extensive consultation process followed at every stage that has contributed to the smooth implementation of the reform program. West Bengal's practice of soliciting and responding to employee feedback (verbal and written), across employee levels and at each critical milestone, has helped in strengthening the process. The Regulator and the different departments of the government

have been involved from the time of initiation of reform process. Another initiative has been operationalizing a team of change agents across important functions, from within the organization and across levels, to help in taking the reform process forward.

- (vi) **Individuals Matter** – Institutional building is a long term goal requiring stable and visionary management in the absence of which the whole process is still susceptible to non sustainability of short term gains. One of the key lessons of the West Bengal experience has been the emphasis of senior management (with tenures lasting around four years) on inculcating a sense of belongingness and professional pride in the employees of the state utilities. West Bengal recognizes succession planning as a risk for the long term sustainability of reforms and the capacity building exercise currently underway in the utilities is expected to set the stage for sustaining the reforms.
- (vii) **Picking battles judiciously** – There is a need to make distinction between “Desirable” Vs “Doable”. West Bengal has tried to make that trade-off by picking battles judiciously, progressing on reforms where there is consensus while deferring contentious issues to a later stage. For instance, the state managers have focused on strengthening corporate governance at the Board level of the unbundled entities rather than expending political capital on breaking up companies. Similarly, the state has used introduction of performance based incentive schemes in the companies as an integrated package with other difficult change measures like abolition of non-functional offices and outsourcing of operation of rural substations. In addition, the main focus of the current reform program has been on transmission and distribution leaving generation for next phase.
- (viii) **Evolutionary process, hence need for flexibility** – The process of undertaking change is “important end in itself”. The learning from the other states helped West Bengal in adopting a phased approach to restructuring of state power sector entities. The phased implementation of restructuring gave the state government and top management of the utilities enough time to implement the corporate governance and internal reform initiatives. It also provides enough opportunity and time to demonstrate the credibility of reforms and create a greater acceptance of the reform program amongst employees – for instance, in West Bengal case, the extensive stakeholder consultations and patient hearing of key staff issues such as staff terminal benefits, transfer of staff post restructuring needed time but helped in building trust and acceptability for reforms and restructuring. This approach has the desired flexibility for mid-course corrections if needed.
- (ix) **Controlling ideological aspects** – Politicians and consumers are often not necessarily concerned with the “much needed internal reforms” that are required in the utilities to sustain the program. Accordingly, the absence of big Ps - “Price” and “Privatization” are critical factors that helped in building wider political consensus and acceptability for internal reforms of organizations. In case of West Bengal, the improved financial viability helped in not looking at “substantial price increase” as an option adopted by many other reform states. In addition, senior management of the utility can play an important role in convincing political leadership how it can be a win-win situation in terms of controlling theft and reducing subsidy (credibility and convincing power of bureaucracy and senior management in achieving the same are essential attributes). For instance, in West Bengal, the sector had support on political front with a reasonable

degree of flexibility to allow going back to the leadership on what the sector required and what is the outcome given also the experience of PSE Phase I reform. The outcome of having a financially viable sector with better service delivery within a public set up has provided the authorizing environment from the political class.

- (x) **Improving Corporate Governance** - Poor governance in utilities is an essential priority area for ensuring sustainable results over a period of time. West Bengal's strategy to tackle this has been to focus on systemic approach that cannot be easily altered in long-term. The state is taking a technology driven outsourcing approach, including replacement or fixing of meters, as a third party validation against readings provided internally. This is supported by extensive monitoring and generation of exception reports to help sustain the efforts. The challenge facing the utility, as in most of the other utilities, is that the utility staff has high average age and is not computer literate and thus there is a need to build capacity in the utility.

With given political and social background, the strategy of West Bengal has been different from other states – in terms of being driven bottoms up through internal reforms and through focus on corporate governance measures at board level. To formalize and ensure corporate governance improvements, provisions for induction of independent directors were incorporated in the Articles of Association of the two restructured entities. The provisions for appointment of Directors, their tenure and remuneration, powers, duties, rights and liabilities, and process of appointment and removal were also incorporated in the Article of Association. West Bengal's approach model is based on continued public ownership of companies, with significant autonomy to boards of state power companies on all organizational matters.

The approach followed by West Bengal in professionalizing the board of companies through induction of independent directors may not yield the desired results in all cases unless there is a clear understanding within the utility head on the role for the independent directors and the expectations from them. For instance, West Bengal's perspective in taking this approach was to take time and find out relevant people who can bring value. The system has only been working for a limited time but has brought in a sea change in terms of the quality of the discussion, on presentation of information to facilitate decision making. A number of board committees with major representation from independent directors have been constituted with authority to take decisions up to a certain limit. Following this approach may have constraints in the current scenario where experienced people are retiring and availability is scarce.

- (xi) **Future Challenges/ Unfinished Agenda** - One of the key challenges/ unfinished agenda (apart from the reforms on the generation side) facing West Bengal is the low level of access in rural areas that has improved only marginally since onset of the power sector reforms. With improvements in access to electricity by urban population and West Bengal being a surplus power state, low levels of rural electrification can pose a threat to this success story. The state is taking steps under Rajiv Gandhi Grammen Vidyutikaran Yojana (RGGVY) to cope up with this lag and mobilization of Self Help Groups as franchisees in rural areas is also in process. The politics of power in West Bengal is on rural electrification and as a tool for industrialization, with the former becoming a huge

political agenda. States like Andhra Pradesh have managed it well by following a differentiated urban and rural strategy even in a politically charged atmosphere. In addition, the state now needs to focus on operational efficiency of existing state owned generating stations and timely completion of new generation capacity that is under commissioning. The Government of West Bengal has now initiated corporate governance and capacity building program for State owned Generation Company.

Annex 1: Ancillary Discussions

6. **National Level Workshop:** During the National level workshop, there was session devoted on sharing experience from other states on what else is working well and potential way forward on state distribution reforms. Distribution reform has been the nemesis of power sector and reforms of this sector would be critical for India's sustainable growth. The objective was to look at what innovative practices and ideas can be incorporated in the programs being pursued/ planned at national and state level so that reforms in this critical area are sustainable and able to deliver the intended objectives. Experiences were shared by Distribution utility in Maharashtra on introduction of pilot project for franchisee in an Urban area (Bhiwandi), which is the first case in India; by one of the distribution company in Karnataka on rural franchisees; and perspective from leading civil society player (PRAYAS) in power sector.

- *Urban Franchisee in Bhiwandi, Maharashtra:* Bhiwandi is a pilot project in the state of Maharashtra for introduction of franchisees at feeder level to improve distribution and service delivery levels. Bhiwandi model is a good example of large upfront investment where the responsibility is on the franchisee. The franchisee has carried out investment in strengthening the distribution infrastructure (adding new feeders, replacing/ revamping distribution transformers, installing capacitors, replacing meters, releasing new connections, strengthening LT lines etc.) that have helped in improving power availability and reliability and also led to significant reduction in Aggregate Technical and Commercial (AT&C) losses, which were more than 60% before the start of the pilot. The franchisee has also set up facilitation centres to improve communication with the consumers and hence, build confidence among them. The key success factor was the project area that was large enough for investments to be viable. In case of low investment requirement, management franchisee may turn out to be a better model.
- *Micro Feeder Franchisee in BESCOM, Karnataka:* The state of Karnataka has higher levels of rural demand for power as compared to West Bengal. There was a feeling among rural consumers that they were not being treated at par with urban consumers by the state distribution utility. To address these issues, BESCOM undertook reforms in distribution with objectives of provision of improved service delivery, adoption of best practices in construction of network, and optimum utilisation of available technical and human resources. From each village a Grama Vidyut Pratinidhi (GVP) was selected as Micro Feeder Franchisee to carry out various activities related to supply of electricity (like meter reading, billing, revenue collection, registering complaints, giving periodic feedback to the utility, etc) in area under a Gram Panchayat, which were also involved to make the whole exercise more credible. BESCOM trained the GVPs to address the requirements of the job. This resulted in provision of better services to the final consumers and has improved revenue collections for the utility.