

**Press Release**

**Report of CAG on “Competitiveness of BHEL in Emerging Markets” presented in Parliament;**

**Major audit findings show inadequacy of efforts for diversification, inadequate efforts for increasing competitiveness, and improper management of receivables**

Report of Comptroller and Auditor General (CAG) of India on “Competitiveness of BHEL in Emerging Markets” (Audit Report No. 29 of 2017) was presented in Parliament today.

Bharat Heavy Electricals Limited (BHEL) is the largest engineering and manufacturing company engaged in design, engineering, manufacture, construction, testing, commissioning and servicing of a wide range of products and services for the core sectors of the economy. As the decade ending 2010 posed challenges to BHEL in the form of climate change, increased competition and squeezed delivery schedules with emergence of new competitors, BHEL’s turnover declined sharply after 2012-13 and the Company reported a loss for the first time in 2015-16. Keeping in view the significance of competitiveness of BHEL in evolving scenario, the performance audit on ‘Competitiveness of BHEL in Emerging Markets’ was carried out.

**Major audit findings**

**Inadequacy of efforts for diversification**

Power sector continued to account for the bulk (76.46 to 80.83 *per cent*) of BHEL’s turnover during 2011-12 to 2015-16. As BHEL had not effectively diversified into new/less operated business areas, both turnover and profitability declined sharply with slowdown in power sector. BHEL’s turnover which was ₹49510 crore in 2011-12 declined to ₹ 26587 crore in 2015-16; while profits of ₹7400 crore in 2011-12 turned into a loss of ₹ 913 crore in 2015-16. (Para 3.3.1)

BHEL had fixed Strategic Plan targets for the period 2012-17 with focus on diversification and innovation. However, BHEL did not set year wise milestones for implementation of the envisaged strategies. BHEL could not achieve any of the strategic plan targets till 2015-16 and shortfall ranged between 23.33 and 113.91 *per cent* against specific goals. (Para 1.3)

BHEL could not bridge the technology gap in the core power sector; in particular, Circulating Fluidized Bed Combustion, Gas Turbine, Dry Type Transformers and 500 MVA Inter Connecting Transformers. BHEL could not avail of the opportunities in the 765 kV segment of Gas Insulated Substations which was being increasingly adopted

to reduce Right of Way requirement for transmission lines and overcome constraints in availability of land for substations. (Para 4.2.1)

### **Inadequate efforts for increasing competitiveness**

Though BHEL had quoted below production cost in 13 cases, 11 of them were being executed with profit margins. In case of other nine orders, the ordered prices were above production cost by 0.57 to 18.59 *per cent*, yet the projects were being implemented with higher profit margins. This indicates that costing data used by the manufacturing units/regional offices of BHEL for bidding was not reflective of actual position and the prices quoted by BHEL in case of lost tenders could have been further rationalized which in turn would have enhanced the competitiveness of BHEL

(Para 5.2.1)

BHEL could not secure any of the four tenders (involving TG component) finalised against competition during 2015-16. BHEL's quoted prices in these tenders were 4.36 to 73.85 *per cent* higher than L1 prices. (Para 5.5.1)

Rationalisation of manpower according to level of operation was essential to maintain margin, competitiveness and business growth as manpower constituted significant component of Company's expenses. Despite slowdown in power sector since 2010-11 and dampening investment sentiments, BHEL inducted 9346 employees in the calendar years 2011 and 2012 against retirement of 5844 employees during this period. As a result, the percentage of employee cost to turnover increased consistently from 11.04 *per cent* in 2011-12 to 20.84 *per cent* in 2015-16. (Para 5.5.3)

There was no improvement in the performance of BHEL in project erection as per customer surveys carried out over the period 2012 to 2014. In respect of 24 out of 25 sub-activities of 'project installation and management' function, BHEL's scores were less than those of its competitors. BHEL did not carry out customer surveys after 2014. (Para 5.7.2)

BHEL could not complete any of the projects selected for performance audit within scheduled completion time. All 53 selected projects were commissioned with delays of three to 84 months. As a result, customers withheld ₹1966.07 crore towards liquidated damages against 37 of these projects. (Para 6.1.2)

### **Management of receivables**

Contracts entered into by BHEL with eight private project developers provided that payments shall be released to BHEL through Letter of Credit (LC). It was, however, observed that BHEL did not ensure compliance of this contract provision and not only initiated supplies without establishment of LC but also continued supplying material even after recurrent failures of private developers. All eight projects were subsequently declared 'on hold' and outstanding dues under these projects accumulated to ₹2660.77 crore. Besides, inventory relating to these projects worth ₹458.51 crore is lying at different BHEL units. (Para 7.4.1)

Orders secured by BHEL for execution of power projects provided for release of the final 5 to 10 *per cent* of contract amount upon successful completion of Performance Guarantee (PG) tests and completion of pending works/punch points. It was, therefore, imperative that BHEL conduct PG tests immediately after commissioning and clear the punch point at the earliest. However, out of 52 units of 29 thermal power projects commissioned during 2011-16, PG tests of only 18 units were completed up to July 2016 after considerable delays of seven to 50 months' post commissioning. PG tests in respect of the remaining 34 units were yet to be completed though two to 70 months had elapsed up to July 2016 since their commissioning. Contracts for execution of power projects provided for completion of facilities within three months of commissioning of last unit. However, punch points/pending works were not cleared by BHEL till 31 March 2016, even in respect of projects commissioned as back as in 2006-07. Loss of interest on outstanding dues which could not be realised on account of delay in completion of PG tests and clearing pending works/punch points worked out to ₹1457.11 crore. (Para 7.4.5)

### **Recommendations:**

Based on the audit findings discussed in the Report, the following recommendations are made for enhancing competitiveness of BHEL in emerging markets

- (i) BHEL needs to develop its own products that excel over competitors through R&D initiatives. Expeditious efforts should also be made to forge technological tie ups in new business areas.
- (ii) 'One BHEL' ERP system should be implemented expeditiously for processes and systems improvement and better coordination between units of BHEL.
- (iii) More orders need to be finalised by BHEL through open tender system. Purchase Indent to Purchase Order cycle time should be reduced to ensure competitive and timely procurement of inputs.
- (iv) Action plans need to be developed and implemented by BHEL within stipulated timeframe to address its weak areas vis-à-vis competitors as identified during customer surveys and as per reports of task forces constituted in this regard.
- (v) Quality controls at both BHEL manufacturing units and vendors' works may be made more effective to avoid failure of equipment during commissioning and warranty period.
- (vi) To safeguard BHEL's financial interest, dispatches, particularly to private parties, should be made against establishment of Letter of Credit. Completion of PG tests immediately after commissioning and completion of balance punch points in a time bound manner in close coordination with customers' needs to be ensured.
- (vii) Revenue billing and debtor management systems need to be strengthened and made more effective to ensure timely billing and collection of revenue.

The above recommendations were discussed in the Exit Conference held in June 2017 and the Ministry/BHEL noted the recommendations for necessary action.