Segregation of Ordnance Factories from being Departmental Units of the Army to Separate Manufacturing Units – An Analysis

Ms Somi Tandon, IDAS (Retd)@

01 Apr 1987 will remain a landmark date in the history of Defence Budgetary System. It may be recalled that until then the Ordnance Factories (OFs) had been in existence for nearly two centuries. They had, however, functioned as departmental units under the overall control of the Army. The system and procedures for various activities were well laid down and, by and large, these were followed by all concerned.

However, on 01 Apr 1987, this system underwent change and the Director General of Ordnance Factories (DGOF) budget was separated from the Army budget. What prompted the Government to bring about this landmark change in the functioning of OFs? The basic rationale was to bring in fiscal discipline both in the OFs (manufacturing units); and the Directorate General of Ordnance Services (DGOS), the prime procurement agency of the goods produced by the OFs. In the changed system OFs had to prepare pre-determined price list of all their products as against simply passing on the product cost much after manufacturing the entire lot of items taken up for production in a lot called 'Warrant'. The DGOS on the other hand had to ensure that they procured their yearly requirements within the stipulated amount in their budgetary allocation.

As a result, whatever the Army was procuring from their own OFs, considered as free issues to the Services till then, had to be henceforth procured from the DGOF at a predetermined 'price'. The DGOF now became a separate entity with its own budget, under separate Major Head 2079-DGOF. This will remain a

@**Ms Somi Tandon** joined Indian Defence and Accounts Service in 1967 and retired as the Secretary (Defence/Finance) in Jul 2005. Presently, she is working as a Consultant with Indira Gandhi National Centre for Arts and as an Independent External Monitor with the Ministry of Information and Broadcasting. She is also engaged in teaching underprivileged children to improve their learning capabilities.

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landmark event, as on that date the umbilical cord between OFs and the Army was severed. This gave birth to a new budgetary system for the OFs. From the concept of being owners of OFs, the Army and the OFs started to have a relationship of a ‘buyer’ and ‘seller’.

The objectives of the DGOF under the new defence budgetary system had to be redefined. The OFs which were earlier producing all the items for the Army had their own priorities. Like any other customer, the Army wanted to procure the best out of its own budgetary allocations. This required emphasis on getting the best value for money. The Army now had a choice in selecting the ‘party’, from whom to procure items that they needed. Earlier, the erstwhile British Indian Army had established OFs for producing and procuring arms, ammunition and equipment to meet all their requirements. They had never considered the idea of having a choice in the matter of buying these items from any other source except their own manufacturing units to fulfill their fast changing demands. Overnight the Army had now become the customer, and this changed the equation between the two. The issue under consideration now was: would this sudden change in relationship bring about a comprehensive change in the organisational work and culture of the OFs?

At that time, the DGOF had 39 OFs with a manpower of 1.7 lakh workers spread all over the Country. Even with the best of intentions, the process to disseminate the concept of new budgetary system took considerable time as it required educating and training officers and staff at various levels. This segregation of OFs from the Army involved adoption of a new budgetary system.

The new budgetary system had more than one variable; therefore, it needed precise understanding and workable linkages. The new system required periodic review of DGOF’s efficiency with reference to managing its ‘Net Budget’. This concept was something totally new to the organisation. The DGOF under its major head would get budgetary allocation under various minor heads to incur expenditure on producing the end product as well as intermediary products. Simultaneously, the DGOF had to sell its products to recover the cost of production from its buyers; primarily, the Army, Navy and the Air Force. Spare capacity was also to be utilised for meeting the requirements of Central Police

Forces (CPOs) and any other civilian organisations, in order to maintain the 'net budget' as provided for in the budget estimates. Here came the complication. While the OFs made all their investment in establishing plants and machinery, creating infrastructural facilities and engaged fixed civilian manpower through the Army's Budget till 01 Apr 1987; now suddenly, they had to ensure that their product prices were viable so that they could sell all that they produced and recover the cost which they had incurred to be able to manage 'Net Budget'.

While these developments were taking place in OFs to cope up with this paradigm shift, for the first time, the Services' own 'Budget Allocation for Modernisation' was categorised as 'Capital Budget' and the provision for other stores needed for normal maintenance and replacements was made under 'Revenue Stores Budget Head'. Specific ceiling in Stores Budget led to DGOS also becoming more cost conscious. Considering the limited allocation of their Stores Budget, they started going into the details of the product requirements and product prices. Even where indents were placed to cover four yearly requirements, the DGOS started taking a holistic review of Inventory Lists to determine whether it should continue with the indented items or go in for new products keeping in view the latest technology and fire power of the latest weaponry.

This resulted in large scale cancellation of indents, as all the indented items were not included in the Annual Production Programme in the Target Fixation Meeting between the DGOF and the DGOS. The DGOS justified its stand stating that their budget allocation was on an annual basis and total funds provided were so limited that they could neither entertain all the past indents nor place indents on a long term basis. Besides, the Army desired to have the best value for money within their allotted budget. This resulted in OFs facing severe criticism for unrealistic pricing of their products.

The interesting point was that while the products and the manufacturing units were the same (as they were prior to 01 Apr 1987), the change in the budgetary system brought about the relationship of 'buyer' and 'seller'. From being departmental units of the Army, OFs were made into separate manufacturing units. As a result, products which were earlier accepted as 'free issues' without any reservation, the reasonableness of their pricing was now being questioned. In a way these were interesting developments. The Army which had earlier never cared or inquired about the cost of the products which were manufactured in their own OFs, suddenly became cost conscious. Besides, there was a basic change in attitude. As a customer, the DGOS could look into the available alternatives and, therefore, could decide : how much to procure, from where and at what price? In a way this was a good development as they switched over to procuring the items within their budgetary allocation. This brought in an element of cost consciousness as well as some fiscal discipline as both the organisations had to manage within their available resources.

The major repercussion of this separation was that both were compelled to renew and overhaul their thinking process. They had a herculean task before them. They were required to determine the price of their products much in advance, taking due care of the anticipated inflation. They were also expected to keep the factories engaged in productive work. This would allow them to spread fixed overhead costs over a larger number of products to keep the pricing under control. Only this could have helped them to manage 'Net Budget', as catered for in the budgetary estimates.

The reality was so different since OFs did not produce consumer goods for which they could find an alternative market. The OFs capacities were created to meet the surge in 'war time requirements' of the Services. Some of these factories were set up more than a century ago when the infrastructural facilities were limited; hence, factories provided backward linkages. Right from melting of steel scrap, to producing the most sophisticated guns and tanks, had been the strength of these factories. These expensive sophisticated plants and machinery were neither needed nor considered cost effective for production of goods for the civil market. Hence, the scope to find alternative market to keep the factories loaded with work was an extremely difficult task.

With the short closure of indents or the indented items not being included in the Annual Production Programme, the situation faced by OFs was very peculiar, as a number of 'intermediate goods producing factories' (IGPFs) which supplied their product to the finishing factories had already produced the items which became their 'blocked inventory'. It raised a big question mark : what to do with this excess blocked inventory?

Top echelons of OFs were compelled to learn new lessons from these rapid developments. Instead of considering Indents as the basis for determining the production programme for each factory, inclusion of Indented Items in the firmed up Annual Production Programme by the DGOS was also to be taken as the basis to proceed with the production of items; whether these items were to be considered for production as 'inter factory demand' or the end product items? This exercise, no doubt led to forced reduction in the lead time for all stages of production from components to assemblies and then the end product. Sister factories producing inter-factory demands were also compelled to reduce their lead time to ensure that they would meet the requirement of connected factories but would not unnecessarily increase the inventory of finishing factory. This required close coordination to ensure that items produced by IGPFs should come to finishing factories within a fixed time schedule and limited to demands acceptable to the Services for the end product.

These conflicting issues and the DGOF's aim to manage within the 'Net Budget' required meticulous planning for determining the purchase budget for the OFs. It was made obligatory for each OF to prepare a detailed purchase budget and to spell out the material and components to be procured either from sister factory or from trade, after taking note of availability of each item and duly linking the same with the annual production targets. A culture, unknown to OFs became the order of the day as detailed scrutiny started being carried out for procuring all 'A' and 'B' category items so that, the IGPF and the finishing product factory could plan their production programme in a detailed manner and link their procurement plan with their monthly/quarterly production programme. No doubt, this required very close monitoring of availability of material for production as the cycling time for procurement had also to be shortened to meet the end production target.

The thrust given by the Army to make available the price list much before the target fixation meeting was no mean challenge for OFs who were used to passing over product cost to their customer. The repeated questioning of prices of the end product by the Army also brought in an entirely different approach in the annual accounts prepared by the factories. In spite of OFs being in existence for nearly two centuries, and there having been an elaborate system of preparation of annual accounts in each of the factories and consolidation thereof for the entire DGOF, the challenge of segregation of OFs revealed that these accounts complied with the statutory requirements but they rarely made use of the Management Information System. While there were wide variations in the year to year costs of the products, no analysis was available as to : why was this happening and the action to be taken to rectify the same?

Since the price list of Ordnance Factory Board (OFB) product had to be prepared before determining the quantity in the DGOS / DGOF Target Fixation, OFB had little option but to take this exercise seriously. To begin with, OFB could at best use the data available in the annual accounts for determining the price of any product. Since the cost of production as reflected in the accounts had lot of variations, a number of steps had to be taken to make annual accounts more reliable so that these could be used for determining the right price of the product for the ensuing financial year. This required not only continuous updating of the average cost of material used for production of items, but also ensuring that IGPFs close their Indents well in time to facilitate finishing factories to include updated cost of IGPFs products while determining the cost of finished product. This was a major step in bringing financial discipline in the IGPFs. It ensured the finishing factory to reflect updated cost of the product in the annual accounts which in turn facilitated them to work out next year's product price much more realistically.

The OFs were also compelled to take a genuine look at what they ought to produce in-house and what ought to be 'bought-out' items which were readily available in the market and did not involve any sophisticated technology. There was a famous case of a 'Tent Pin' which in 1990 was being manufactured at a cost of Rs 67 in the Gun and Carriage Factory; whereas the same was available in the market for Rs Seven only.

To get the OFs optimum work load, they had to produce items at 'a' cost instead of at 'any' cost. Besides, OFs learnt to diversify to the extent possible to get orders from customers other than Services, which included the CPOs and civil organisations. The large scale computerisation in OFs as well as the Controller of Finance and Accounts, facilitated generation of information much more quickly and accurately. This went a long way in carrying out the systemic changes that were called for to handle challenges that the organisation faced at that time. After a gap of three years or so, the DGOF did succeed in preparing a price list in advance of production for all major finished products to be supplied to the DGOS after taking note of updated production cost of components and materials supplied by the IGPFs.

In order to bring cost consciousness and efficiency in repair and manufacturing unit, it would be desirable to create similar self-accounting units within the Services. That would be a right step towards programme budgeting. It would require separate budget allocation for these units to meet all elements of cost whether that is for stores/material, manpower or overheads. Each of these repair/manufacturing units would need to determine 'assessed cost' prior to undertaking production work to ensure that they adhere to the quoted price. Variations in actual cost and predetermined price would need to be examined like any other similar units. To begin with, this may be a difficult exercise as was in the case of OFs but because of increased computerisation it should not be too difficult to start, as gains would far exceed the initial discomfort. All steps required to bring about financial discipline and cost consciousness will be in everybody's interest as allocations in the Defence Services Estimates would be put to better use.