CHAPTER XVI: MINISTRY OF RAILWAYS

Container Corporation of India Limited

16.1.1 Injudicious decision to take up an unprofitable business

The Company suffered a loss of Rs.30.37 crore by venturing into a cold chain business without requisite expertise and without mitigating perceived risks.

With a view to explore the possibility of expansion in the cold chain sector, Container Corporation of India Limited (Company) decided (March 2004) to enter into a Joint Venture and appointed consultants (SSKI Corporate Finance Private Limited (SSKI) and M/s. Deloitte Haskins & Sells) to assess the feasibility of the project. The Board of Directors (Board) noted (December 2004) that against the required return of 28 to 30 *per cent* on the equity, the project was expected to give a return of only 19.2 to 21.9 *per cent*. The (BOD) was also apprised of the following risks associated with the project:

- The Company had no expertise in trading business whereas this project involved entering into sourcing agreements with farmers/cooperatives for fruits which was quite different from the Company's core competence *i.e.*, rail haulage and container terminal management.

- Absence of firm tie-ups with state governments for procurement, collection, transportation and safeguarding needs of farmers.

- The business was exposed to demand risk, price risk and cost risk.

- Dependence on apples and a failure of apple crop in a particular year could adversely affect the operations of the Company.

Accordingly, the Company decided (December 2004) to abandon the project.
Subsequently, on request (March/July 2005) of Government of Haryana and Ministry of Commerce (GOI) for reconsideration of the project in the interest of farmers and consumers of agro products, the Company reviewed its earlier decision and decided (July 2005) to revive the project. The Company got fresh studies conducted by SSKI to revalidate the financial viability, assessing the risk factors and suggesting risk mitigation mechanisms. The report submitted (October 2005) by SSKI envisaged dealing by the Company in apples and mangoes initially and estimated Project IRR[♣] and Equity IRR as 25.7 *per cent* and 33.3 *per cent*, respectively. The BOD approved the proposal (October 2005) and a new subsidiary company namely Fresh & Healthy Enterprises Limited (FHEL), wholly owned by the Company, was incorporated in February 2006. The Project was commissioned (2006-07) at Rai, Sonepat (Haryana) at a total cost of Rs.81 crore.

[♣] ***Internal rate of return***

Audit observed that the Company embarked on this venture without mitigating the risks which led the Company to abandon this Project earlier as detailed below:

- The Company did not identify a suitable joint venture partner to mitigate the risk of lack of expertise and entered into this business all by itself.
- FHEL was solely dependent on apples instead of apples and mangoes as per the project report of the consultant.
- The return on equity in the project report was based on the projected margins of Rs.25.80 per Kg. (approximately) on apples. However, the Company failed to achieve the desired margin and consequently suffered loss right from its inception.

The Management stated (February 2009) that:-

- The Project was taken up as it was an important business opportunity in one of the priority sectors. The project is a diversification into fresh produce logistics which benefits millions of farmers/farms workers and consumers.
- They were compelled to sell most of the fruits through traditional mandis using the auction mode which was dependent upon the trust and goodwill of marketing associates. The price of apple was also dependent upon a number of factors and could vary from day to day.
- The Company was making all efforts required to improve its performance as a result of which it is expected that during 2008-09 there would be significant improvement in its financial performance.

The Ministry furnished (October 2009) a similar reply.

In this regard, Audit observes that:

- The Company had assessed that they did not have adequate expertise in trading perishable commodities which was different from its core competence area *viz*. rail haulage and container terminal management. Therefore, the Company should have entered into the project only after properly mitigating this risk possibly by joining a joint venture with a partner having adequate expertise in this area.
- The reply indicates that the Company did not appropriately mitigate the market and price risks assessed by it.
- The Company has incurred loss of Rs.12.05 crore during 2008-2009 even after taking steps to improve performance.

The projections of IRR did not materialise and the Company suffered a loss of Rs.30.37 crore during the period 2006-07 to 2008-09.

Thus, by venturing into a new area without having the requisite expertise in the field and without adequately mitigating the perceived risks the Company suffered losses amounting to Rs.30.37 crore.

Indian Railway Catering and Tourism Corporation Limited

16.2.1 Loss due to deficiency in agreement

IRCTC would lose revenue of Rs.7.63 crore due to non-inclusion of clause in the agreements for proportionate increase in concession fee with the increase in the passenger carrying capacity of trains as a result of increase in number of coaches.

Indian Railway Catering and Tourism Corporation Limited (IRCTC) manages catering services on running trains through private entrepreneurs appointed by bidding process. The bidders are required to offer lump sum concession fee to IRCTC for the tenure of licence. This concession fee is based on the passenger carrying capacity of trains. The capacity can increase due to:

- Increase in the frequency of trains, and
- Increase in the number of coaches in the trains.

Logically, the lump sum concession fee receivable by IRCTC should increase with the increase in passenger carrying capacity. Therefore, the agreements between IRCTC and caterers provide for *pro-rata* increase in the concession fee on account of increase in the frequency of trains. However, the agreements do not provide for such a hike in case of increase in the number of coaches in the trains. The agreements, thus, are deficient to that extent and do not safeguard the financial interests of IRCTC in the event of increase in the number of coaches.

Audit observed that the Indian Railways increased passenger carrying capacity (ranging from 6 *per cent* to 80 *per cent*) of five Rajdhani and five Shatabdi trains[1] by adding coaches with effect from 26 May 2007. In the absence of an enabling clause, IRCTC could not raise the concession fee on this account and hence would suffer a loss of revenue of Rs.7.63 crore[2] by the end of these contracts.

The Ministry mainly contended (October 2009) the following:-

[1] Bangalore Rajdhani (Train No 2429-30), Trivandrum Rajdhani (Train No.2431-32), Secunderabad Rajdhani (Train No. 2437-38), Jammu Rajdhani (Train No 2425-26) and Chennai Rajdhani (Train No 2433-34) and Kalka Shatabdi (Train No 2011-12), Amritsar Shatabdi (Train No. 2013-14), Lucknow Shatabdi (Train No 2003-04), Kalka Shatabdi (Train No2005-06), Amritsar Shatabdi (Train No. 2029-32)

[2] Proportionate concession fee recoverable on the basis of enhanced passenger carrying capacity of the trains for the period from May 2007 to the end of the contract period (ranging from August 2010 to October 2012) in respect of 10 catering contracts covering five Rajdhani and five Shatabdi trains.

- The coaches are attached/detached according to the volume of passenger traffic.
- Attachments/detachments were not related to concession fee and the caterers are paid on the basis of actual occupancy of the trains. In the event of enhancement/reduction of capacity, the concession fee remains static as the agreement provides that "the train may run with fewer/more number of coaches, frequency and timings were subject to change in future". Therefore, bidders take such eventualities/fluctuations into consideration while bidding.

The contention of the Ministry is not convincing as the ground realities were different as explained below:

- The increase in number of coaches, effective from May 2007, was a long term arrangement to augment the train capacity and not a temporary/seasonal stop-gap arrangement.
- The agreement has a provision which requires the caterers to proportionately increase the concession fee if the frequency of trains increases. This implies that the concession fee quoted by the caterers was based on the existing capacity and if the capacity increases, they would accordingly be paying more. This was also logical considering the fact that increased capacity of passengers would bring them increased business. However, the agreement was deficient as it did not take into account the increase in passenger capacity by way of permanent increase in the number of coaches.

Thus, IRCTC would lose revenue of Rs.7.63 crore by the end of these contracts. As capacity enhancement through increase in number of coaches is not ruled out in future, it is recommended that IRCTC removes the existing deficiency in the agreement so that its financial interests get protected in future.

16.2.2 Loss of revenue due to imprudent renewal of licences

The Company would suffer a loss of revenue of Rs.5.96 crore due to renewal of catering licences at lower rates ignoring the receipt of higher rates through competitive bidding on the same/similar routes.

Indian Railway Catering and Tourism Corporation Limited (Company) provides catering and on board services on Indian Railway trains through various licencees appointed by bidding process.

The Catering Licensing Policy of the Company provided (March 2002) that the licence would normally be awarded for a period of five years to the highest bidder and was not renewable unless specifically provided in the agreement. The agreements entered into with the licencees provided for renewal of licence for further five years at the sole discretion of the Company. On renewal of licence, licence fee was to be increased on the basis of actual Sales Turnover subject to a minimum increase of 10 *per cent* of the prevailing licence fee.

Audit observed that though the Company had received a licence fee ranging from Rs.0.65 crore to Rs.1.11 crore for two trains on two routes[1] through competitive bidding (October 2005 and December 2006), it did not invite fresh bids for other two trains on the same/similar routes[2] after expiry of the term of their agreements and extended their agreements (April 2008 and June 2008) for another term by increasing licence fees nominally[3]. Consequently, the Company lost an opportunity to earn an additional revenue estimated at Rs.5.96 crore[4] by renewal of licences instead of calling fresh bids.

The Management stated (July 2009) that:

- At the time of framing policy guidelines, the then Board of Directors (BOD) of IRCTC was of the view that tenure of licences awarded as per Company's Catering Policy 2002 should be for 10 years.
- The agreement contained a one time renewal clause as part of terms and conditions.

The reply of the Management is not convincing as:

- There were no recorded minutes to support that the BOD was of the view that tenure of licences awarded should be 10 years.
- As per renewal clause, the licence could be renewed for another term of five years at the sole discretion of the Company. Therefore, the Company was under no obligation to renew the licences after expiry of five years particularly when the bidding yielded much higher revenue than renewal.

The Company would thus lose additional revenue estimated at Rs.5.96 crore over the five years term of the licences (commencing from February 2008 to June 2008). The Company should ensure that in future the licences are renewed only after considering the financial interests of the Company.

The matter was reported to the Ministry in August 2009; their reply was awaited (November 2009).

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[1] ***Pune-Howrah and Chennai-Coimbatore***

[2] ***Pune-Howrah and Chennai-Coimbatore***

[3] ***Rs.16.33 lakh to Rs.17.96 lakh for train No. 2129/30 and Rs.5.5. lakh to Rs.6.05 lakh for train No. 2679/80***

[4] ***Difference in the licence fee obtained through competitive bids on similar/same routes and licence fees obtained through renewal of licences calculated over the five year term of the licences commencing from February 2008 to June 2008. The loss would be more if the seating capacity of the trains is considered because the seating capacity was higher in trains where the licences were renewed as compared to the trains where licences were awarded after competitive bidding.***