

# Chapter-5

## TENDERING SYSTEM

### 5.1 Timeliness of procurement activities.

Timeliness of the procurement activities assumes a great significance as any delay in executing the Customer orders affects

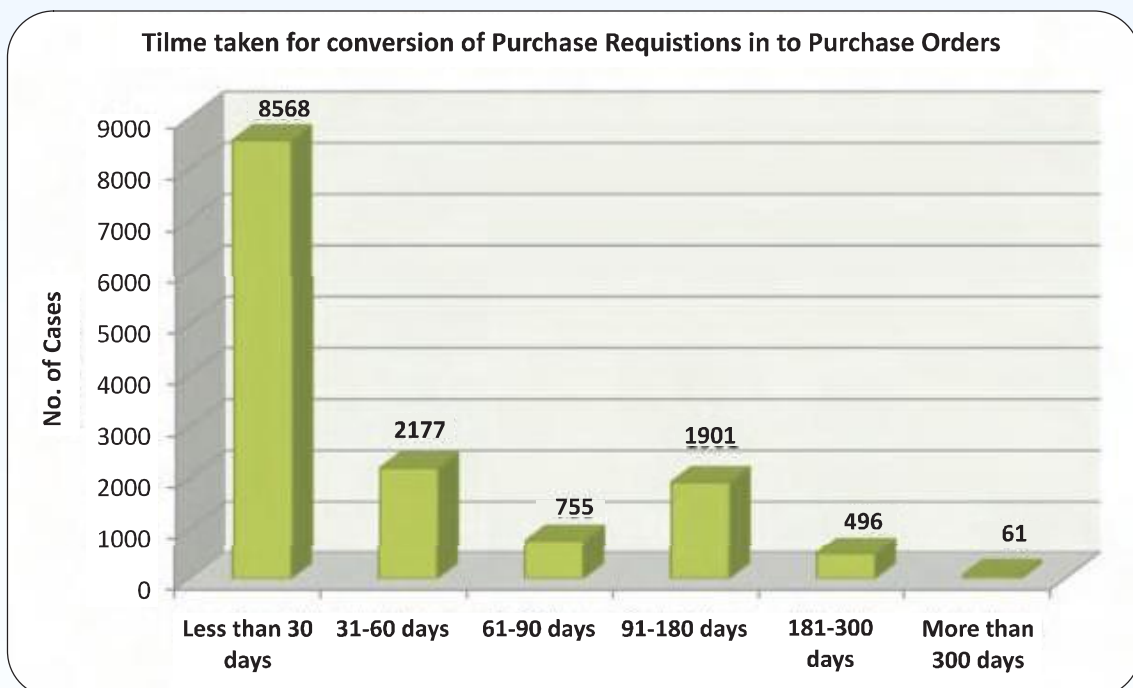
- The defence preparedness of the Nation,
- Goodwill of the customer, and
- Production schedule leading to levy of Liquidated Damages by the customer.

**Audit scrutiny revealed inordinate delays in various stages of the procurement process of the Company which are discussed below:**

#### 5.1.1. Delay in conversion of Purchase Requisitions into Purchase Orders

As per the Procedure, all the purchase requisition (PR) are to be converted into Purchase Orders within a period of 30 days (subsequently reduced to 21 days in the year 2009).

The graph below indicates the quantum of time taken by the company in sample cases:



Though almost in 62 per cent of cases, the Company adhered to the specified time schedule, in the remaining 38 per cent cases, the time taken in converting purchase requisitions into purchase orders ranged between 31 days to 300 days.

Further audit analysis indicated that the performance of

- *Navi Mumbai, Hyderabad and Pune* units was comparatively better as in **more than 75 per cent** cases, the PRs were converted within the specified time limit.
- Whereas *Panchkula, Machalipatnam, Bangalore and Kotdwara* units could convert **more than 60 to 75 percent** of the PRs into POs in 30 days time.
- ***Ghaziabad* and *Chennai* performance** was not encouraging as these could convert only **43 and 26 percent of PRs respectively** into purchase orders within the specified time limit (***Annexure-2***).

*The Management without analyzing the reasons for delays in each of the cases, attributed (December 2010) delays to: (i) low quantity PRs kept on hold for clubbing with subsequent PRs (ii) seeking the clarifications regarding drawing, technical specifications (iii) change in indenter's requirement (iv) SAP related problems and (v) re-tendering due to poor response, etc.*

The reply being general in nature is not acceptable as:

- (i) Clubbing of low quantity PRs with subsequent PRs and change in indenter's requirements lacks logic as these PRs were against the specific orders to be executed within the stipulated time.
- (ii) Requirements of the customer are to be frozen before issuing the PR.
- (iii) SAP ERP was implemented in October 2006 which should have been stabilized by this time.

Thus, the fact remains that the Company delayed the placement of purchase orders without any valid reasons which had a cascading impact on the timeliness of the overall completion of the projects which could be of strategic significance.

Viewing the overshooting of time lines in defence projects a matter of grave concern, the Ministry stated (March 2011) that the company has been advised to adhere to the timeliness.

#### **5.1.2. Absence of time line for various stages of procurement**

As discussed in the preceding paragraph, the PRs were to be converted to POs within 30 days (now reduced to 21 days). However, in order to ensure that the time schedule is adhered to, the Company had not stipulated any time limit for various stages involved in the process such as

- Indenting by the user department
- Verification of stock availability
- Finalization of drawings

- Request for Quotation and
- Tender evaluation etc.

The Management stated (December 2010) that time frame for each stage was practically not possible due to wide product range.

**However, the fact remains that adherence to the prescribed timeline for converting PRs into POs could be ensured only if the time line for each stage of the procurement process is fixed and monitored. Therefore, due to non-fixation of stage wise timeline, the Company could not achieve the target of converting the requisitions into purchase orders in the prescribed time.**

The Ministry stated (March 2001) that the Company has been advised to institutionalise a practical and reasonable time line for evaluating the critical activities involved in the procurement process.

### 5.1.3 Delay in releasing the Purchase Orders

In order to avoid any delay in executing the customer's order, the POs are to be issued as soon as the terms and conditions of the POs are finalized. Audit, however, observed that there were considerable delays in issuing the POs to the successful vendors.

The following table indicates the unit wise delays in issuance of POs.

**Table 5 - Delay in issuance of purchase orders**

| Unit/Range    | POs Examined | 1 to 10 days | 11 to 20 days | 21 to 30 days | 31 to 60 days | 61 to 90 days | 91 and above | Total Pos delayed | Delay % age |
|---------------|--------------|--------------|---------------|---------------|---------------|---------------|--------------|-------------------|-------------|
| Bangalore     | 511          | 128          | 39            | 24            | 24            | 11            | 6            | 232               | 45          |
| Chennai       | 66           | 22           | 8             | 8             | 1             | 2             | 6            | 47                | 71          |
| Machalipatnam | 35           | 14           | 3             | 2             | 3             | 1             | 4            | 27                | 77          |
| Navi-Mumbai   | 39           | 17           | 3             | 4             | 2             | 1             | 4            | 31                | 79          |
| Pune          | 35           | 18           | 5             | 0             | 2             | 1             | 2            | 28                | 80          |
| Ghaziabad     | 265          | 57           | 49            | 37            | 38            | 17            | 15           | 213               | 80          |
| Hyderabad     | 93           | 42           | 23            | 9             | 6             | 2             | 3            | 85                | 91          |
| Panchakula    | 133          | 29           | 30            | 14            | 18            | 7             | 4            | 102               | 77          |
| Kotdwara      | 95           | 13           | 24            | 13            | 21            | 6             | 4            | 81                | 85          |
| <b>Total</b>  | <b>1272</b>  | <b>340</b>   | <b>184</b>    | <b>111</b>    | <b>115</b>    | <b>48</b>     | <b>48</b>    | <b>846</b>        | <b>66</b>   |

It may be seen that out of a total of 1272 POs examined in Audit, in 846 POs (66 percent) there were delays in releasing the POs to the vendors. Audit also observed that except Bangalore unit, in every unit more than 70 per cent of the POs were released after delays.

Management replied (December 2010) that in some cases, delays could not be avoided for want of additional clarifications by Finance/Approving Authority, negotiations of payment terms, delivery schedule, and price and SAP problems.

The reply is not tenable as the POs are finalized only after firming up of terms and conditions and with the approval of competent authority. Moreover, delay in 66 per cent of the cases, is a matter of grave concern which needs to be urgently addressed.

This systematic lapse is corroborated by the fact that the Company has already incurred Liquidated Damages of ₹ 50.61 crore, ₹ 55.74 crore and ₹ 76.06 crore respectively during last three years 2007-08, 2008-09 and 2009-10

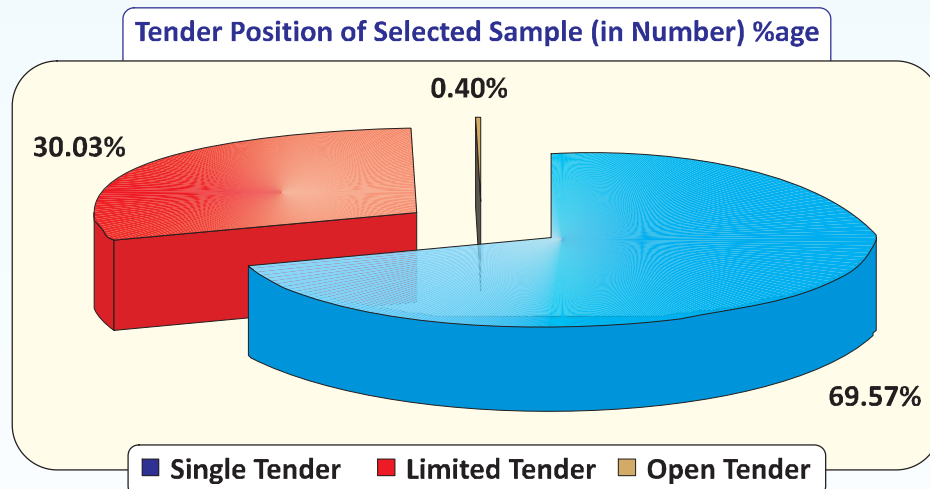
While emphasizing the need of systemic tightening of procedures, the Ministry stated (March 2011) that the company has been advised to prescribe a period of 15 days for issuance of purchase orders after finalization of the order.

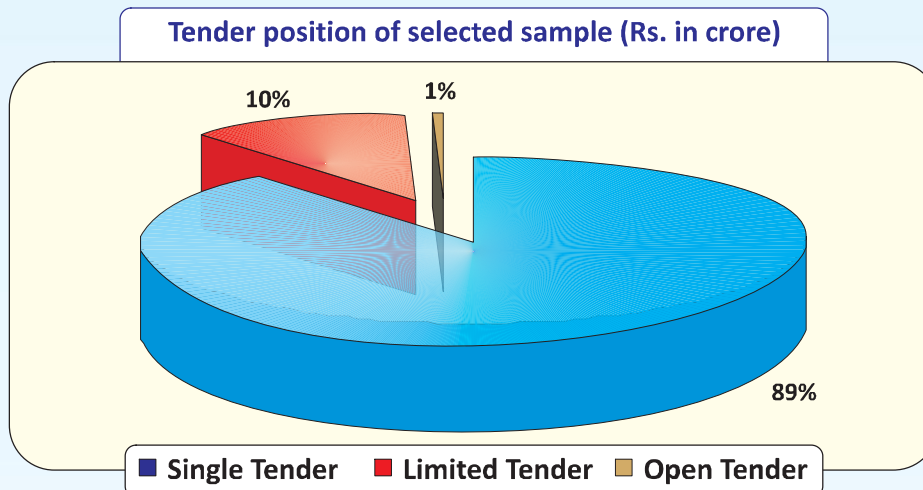
In sum, delays in procurement due to non fixation of prescribed time lines for various stages of procurement process, conversion of purchase requisition into purchase order and placement of purchase order after its finalization; may impact the overall completion schedule of the projects

## 5.2 Procurement by Single or limited tenders

The Purchase Procedure of the Company stipulates three types of tendering viz. open, limited and single for procurement of material and components.

The graphs and the table below give year wise break-up of the purchase orders placed by the Company during 2007-08 to 2009-10 through different types of tendering process.





**Table 6**

(₹ in crore)

| Mode of Tender | Years      |                |            |                |            |                | Total                   |                |            |
|----------------|------------|----------------|------------|----------------|------------|----------------|-------------------------|----------------|------------|
|                | 2007-08    |                | 2008-09    |                | 2009-10    |                | No. of POs              | Value          | Percentage |
|                | No. of POs | Value          | No. of POs | Value          | No. of POs | Value          |                         |                |            |
| Single Tender  | 231        | 1755.63        | 311        | 1404.21        | 293        | 1125.95        | 835 <sup>3</sup>        | 4285.79        | 88.65      |
| Limited Tender | 94         | 68.63          | 150        | 336.97         | 138        | 109.46         | 382                     | 515.06         | 10.65      |
| Open Tender    | 1          | 15.17          | 1          | 0.76           | 3          | 17.99          | 5                       | 33.92          | 0.70       |
| <b>Total</b>   | <b>326</b> | <b>1839.43</b> | <b>462</b> | <b>1741.94</b> | <b>434</b> | <b>1253.40</b> | <b>1222<sup>4</sup></b> | <b>4834.77</b> | <b>100</b> |

From the table, it is evident that the Company was mainly resorting to single tenders which constituted almost 90 percent of the total procurements and balance 10 percent through limited tenders. In fact, the percentage of procurement through open tenders was negligible. This was obviously due to the fact that the vendor base of the Company was very thin and for majority of the items (63 percent), it had only one or two vendors registered with it.

### 5.2.1. Single Tenders

As per the Purchase procedure, single tenders were to be invited:

- in case of propriety items,
- when specified source is indicated in the license / collaborator agreement/ customer requirement,
- for items procured on emergency basis which were to be regularized from authority one level higher by giving justification.

<sup>3</sup> Single tenders include 121 repeat orders for ₹ 142.31 crore.

<sup>4</sup> This excludes 50 cancelled POs

In all such cases, the Company was required to record the reasons for opting for single tenders.

Audit observed that though the Company was generally adhering to its laid down procedures, the following deviations required the attention of the Management:

- a) While resorting to single tendering, audit observed that for 17 POs valuing ₹ 350.89 crore, no such justification was found recorded.
- b) Despite the availability of multiple vendors, 19 POs valuing ₹ 373.05 crore were placed on single tender basis without exploring the competitive rates. In six such cases, the Company incurred an extra expenditure of ₹ 30.15 crore as the alternate sources on being contacted subsequently for part supplies were found cheaper (Annexure 3).

The Management accepted (December 2010) the fact that exploring alternate sources resulted in considerable savings.

- c) Company resorted to procure even non-standard items viz. heavy vehicle chassis, etc. valuing ₹ 5.94 crore on single tender basis despite multiple vendors existing for the items.
- d) The Company procured capital items (11 POs) valuing ₹ 12.46 crore on single tender basis without following the prescribed procedure of issuing market research enquiries to the manufacturers.

The Management stated (December 2010) that in the above cases, the single tendering was necessitated due to proprietary nature of items and specified customers requirements. It, however, assured to comply with the audit requirement in future.

The Ministry in its advisory issued to the Management stated (March 2011) that:

- propensity to procure on a single tender basis must be curbed.
- the option must be exercised only when other vendors are not able to supply as per the quality specifications and reasonable efforts have been made for procurements of items on a multi-vendor basis.
- any decision to go for a single vendor system of procurement, should be backed up by market intelligence, price-index and monitoring of prices on a continuous basis.
- the Company was being advised to carefully analyse all single vendor/ limited tender procurement cases and submit a detailed report to the Ministry .

The Ministry added (March 2011) that the company has to graduate towards a system for purchase on a competitive basis and such efforts must be institutionalized in a procurement system itself.

### 5.2.2 Limited Tender

The Purchase procedure of the Company defines 'limited tenders' as those addressed to all the parties which figured in the approved list of suppliers.

Audit observed that though there were poor responses from the vendors, there existed no system in the Company to insist on the vendors to either send the acknowledgement/ regret letter against the tender enquiry so as to ensure that all the approved vendors actually receive the tender enquiries.

However, audit observed that another Defence PSU i.e. HAL has a system of maintaining and filing the proof of dispatch of enquiries like postal/courier receipt in the respective purchase files.

The Management accepted (December, 2010) that acknowledgment from suppliers was not always received.

As the limited tender system involves only three or four suppliers, in order to have the participation of maximum number of the approved suppliers, it is prudent for the Company to devise a mechanism to ensure that the tender enquiries are received by them and that too in time.

The Ministry stated (March 2011) that Company has been advised to ensure acknowledgement from suppliers in limited tender cases.

## 5.3 Inspection of Material

As per the procedure, materials procured from preferred suppliers, whose products were quality tested by Electronic Components Standard organization (LCSO-military quality approval agency), are not normally subjected to detailed quality inspection. However, there would be visual inspection to confirm the receipt of correct material and quantity. Further, rejection of material, if any, has to be communicated to Purchase Department for liaison with the supplier for return or replacement.

Audit analysis revealed that:

- The Company did not prescribe any time limit for quality test / visual inspections unlike in HAL where the time limit of two weeks is prescribed. Thus, in the absence of any such norms, there were considerable delays in the inspections which ranged between 16 and 181 days in 7061 cases.
- As per the laid down procedure, the Company has to sort out the rejected cases within 120 days from the date of reporting. However rejection claims worth ₹ 11.43 crore were pending settlement for more than 120 days.

The Company needs to formulate a suitable mechanism to avoid these delays in order to achieve its production schedules.

While agreeing with audit , the Ministry stated (March 2011) that :

- unless the performance of an activity is measured, it can never be improved and for measurement of performance, it is essential to set evaluation norms for any activity.
- Undue delay of inspections amounts to stock out of material creation of artificial emergency leading to purchases which are at higher rates giving rise to all kind of undesirable activities.
- Company was being advised to study HAL system and find the feasibility of prescribing time limit for quality/tests/visual inspection.

#### 5.4 Cost reduction (CR) measures

Considering the increasing competitive environment for electronic products, the Company set up cost reduction task forces in all units with members from cross functional areas. The task forces in each unit identifies areas and sets targets for achieving cost reduction in each year viz., design change, indigenization, identifying alternate source and others.

The Company has estimated a saving of ` 398.23 crore, as a result of the efforts of its task forces. This amounts to a mere 2.72 per cent of the total value of production.

An analysis of the contribution towards cost reduction achieved during the period under review revealed the following:

- a) Indigenisation, which was supposed to be one of the major drivers of cost reduction, was not very successful as evident from the fact that the value of POs placed on foreign vendors increased from 48 per cent in 2007-08 to 68 per cent in 2009-10. Further as against ₹ 4186.66 crore procurement from domestic sources, the total imports/foreign procurement was ₹ 6262.41 crore during the period 2007-08 to 2009 -10.
- b) Cost reduction includes reduction due to price negotiation (₹ 155.80 crore during 2007-08 to 2009-10) with the vendors which in fact, is the normal phenomenon in any tendering process.

*The Management replied (December 2010) that saving was more as in a project running into multiple batches, the cost reduction was considered for the first batch of production only and in subsequent batches, only the incremental savings was being considered.*

The Ministry, however, stressed (March 2011) that with the opening of defence sector for private manufacturing and open competition, cost reduction can significantly affect the bottom-line of the company and therefore, it has to actively strive for cost reduction though efficient procurement process, reduction of overheads and increase thrust on Research & Development.

The Ministry further stated that the Government have announced a Defence Production Policy for building up a self-reliant Defence Production Base. As a follow up on the policy, Ordnance Factory Board and Defence PSUs have been advised to designate a nodal officer for each of their units who will be charged with the responsibility of enhancing the vendor base and increasing indigenous capability.



**5.5****Use of electronic technology in procurement**

Purchase Procedure of the Company provides that e-procurement is to be resorted to in stages for maintaining confidentiality and secrecy of the content of the data and information. The Company was yet to implement (December 2010) e-procurement for availing the benefits of price savings, process cost reduction and keeping up to date with global best practices.

Management informed (December 2010) that the implementation of e-procurement is being reviewed.

The Ministry stated (March 2011) that Company has been asked to introduce e-procurement within next 6 months.

New Delhi

Dated 28 April 2011



(SUNIL VERMA)

Deputy Comptroller and Auditor General  
and Chairman, Audit Board

Countersigned

New Delhi

Dated 28 April 2011



(VINOD RAI)

Comptroller and Auditor General of India