

# Implementation of VRS in India

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## Executive Summary

In today's Indian business environment, inter-organization rivalry has become intense. Most of the organizations in the erstwhile protected business environment had focused on production volumes, not necessarily on productivity. Consequently, they often got overstaffed as they tried to neutralize the adverse impact of absenteeism and unionization on production volumes by hiring new staff. Organizations are now exposed to the inevitability of improving productivity in order to survive in the competitive environment. Many of them have taken recourse to Voluntary Retirement Schemes (VRS) to reduce the employee strength. This paper examines different types of VRS offered by organizations in the year 1999-2000 in India. It also examines the effect of VRS on the profitability of these organizations.

The authors adopted two approaches to the study. In the first phase, they collected the details of VRS that were announced by organizations in India in the year 1999-2000 and examined the performance implications of these schemes after a time lag of two years. They gathered 30 such responses in total and did a content analysis of these schemes.

In the second phase of the study, the authors met managers in four organizations which were selected based on their willingness to discuss about the schemes. Having discussed with the managers, the employees, and the union leaders in these organizations, they developed detailed cases. These cases provided an insight about various qualitative issues relating to VRS. The discussion with managers in the companies showed that managers spent substantial time to decide the following characteristics of VRS:

- duration of VRS
- eligibility for VRS
- discretions with managers
- compensation

The authors considered PAT/Total assets as a measure of success of implementation of VRS as, conceptually, VRS should result in improvement in PAT owing to reduction in labour expenses. Further, in the gap of two years after VRS, there would be no expenditure on scheme-related payments as in the first year. It should inflate the change in PAT. Hence, lack of gain in PAT/Total assets would be a clear signal of decline of financial performance of the organization in the post-VRS phase.

The study reveals that:

- There is no fixed pattern of VRS among organizations and even the implementation of VRS differs significantly between organizations.
- The design of schemes that target older employees and remain conservative to work out compensation to employees should be encouraged.
- The schemes that are kept open for appropriate period of time seem to be more effective.
- The success of VRS significantly depends on how the scheme is implemented and the perception of the persons opting for VRS and the survivors.
- Factors contributing to the success of VRS are effective communication, building trust among employees about procedural justice, and involvement of multiple stakeholders. ✓

## KEY WORDS

**Liberalization**  
**Stakeholder**  
**Productivity**  
**Surplus Manpower**  
**Restructuring**

The liberalization policy, declared in 1991 by the Government of India, exposed the Indian organizations to global competitive pressures and opportunities. Prior to liberalization, Indian organizations were neither encouraged nor equipped to compete with international giants in the industry. They were enjoying seller's market in most of the industries. The business environment was tightly controlled by the government and carried low incentives to achieve efficiency. Consequently, most of the organizations in India had focused on production volumes, not necessarily on productivity. In their zest to achieve volumes, they tried to neutralize the adverse impact of absenteeism and unionization on production by hiring new staff. Hence, they were often overstaffed.

Liberalization intensified competition and organizations had to find ways to improve productivity of their operations. To reduce the cost of products and improve their quality, it almost became mandatory for organizations to acquire latest technology and techniques and rationalize management systems. Rationalization of management systems and adoption of new technologies led to identification of surplus manpower in these organizations. While it is conceptually possible to argue that the level of activity could be expanded to absorb the surplus manpower, it was difficult in the intensified competitive environment. Hence, organizations had to find ways to get rid of surplus manpower to improve productivity and stay competitive in the market.

The existing labour laws in India prevent employers from terminating the services of the employees easily. According to Section 25(O) of Industrial Disputes Act, 1947, employers are required to take prior permission of the appropriate government for retrenchment of workers where the number of employees is 100 or more. Such permission is rarely granted in India due to socio-political considerations. Organizations have responded to this difficulty through Voluntary Retirement Schemes (VRS). Socially, the implementation of VRS in India carries many concerns. In a country characterized by one of the highest unemployment rates in the world, employment is also a status symbol in the society. In one of the organizations in the state of Bihar, employees frequently stated:

... Loss of job also creates problems in the marriage of children. The families of prospective fiancée of our children resist such marriages as our unemployment adversely affects the joint family income.

Politically, the union leaders seem to have accepted the ground realities of VRS. The managements of organizations frequently respond to the resistance to VRS from unions by creating a perception of possible dissolution of the organization. The government has supported VRS by exempting income tax on the money received as VRS compensation up to Rs 0.5 million.

Internally, the schemes envisage that unproductive employees would leave the organization voluntarily if compensated adequately for job loss. The success of VRS depends on its ability to attract larger number of targeted employees to accept the scheme at the least cost to the organization and its least negative influence on retained manpower (Zamutto and Cameron, 1985). Some studies (Zamutto and Cameron, 1985) indicate that people who carry high self-efficacy have high propensity of leaving the organization while the under productive employees may stay longer with the organization. It is likely to create difficulties to achieve higher performance in the organization.

These varied concerns make the managers, academicians, and researchers wonder how to make VRS effective in organizations. This paper examines the characteristics of VRS and factors that influence their effectiveness in India. Box 1 explains the methodology.

## WHY VRS?

There are several reasons for organizations to introduce VRS. The most common among them are to:

- improve efficiency
- respond to decline in sales and increase in cost
- reduce overhead costs
- protect long-term interests of the organization
- achieve technological advancement that reduces the requirement for manpower
- restructure the organization.

All the organizations stated more than one objective for VRS.

**Improving efficiency:** Twenty organizations stated that they were not able to survive in the global business environment and were unable to face fierce competition without improving their efficiency. Reduction of employees and wage bill was one of the measures taken to attain these objectives. Results indicated that only five of them improved their performance.

**Responding to decline in sales and increase in cost:** Seven organizations stated that they were offering VRS because business had become unviable due to decline in sales and

## Box 1: Methodology

We adopted two approaches to the study. In the first phase, we collected the details of VRS that were announced by organizations in India in the year 1999-2000. We chose the year 1999-2000 to examine the performance implications of these schemes after a time lag of two years. We collected 30 such responses in total and did a content analysis of these schemes. The profiles of organizations are shown in Table A.

**Table A: The Profile of Organizations (N=30)**

|                                      |                  |
|--------------------------------------|------------------|
| Average age of organizations         | 53.83 years      |
| Average turnover (2000-2001)         | Rs 531.3 million |
| Average PAT/Total assets (1999-2000) | 7.05%            |
| Average PAT/Total assets (2000-2001) | 5.90%            |

In the second phase of the study, we met managers in four organizations. These organizations were selected based on their willingness to discuss about the schemes. Having discussed with the managers, employees, and union leaders in these organizations, we developed detailed cases. These cases provided an insight about various qualitative issues relating to VRS.

As the thrust of VRS has been on productivity improvement, performance was measured on Profit After Tax (PAT)/Total assets. Though, ideally, PAT per employee would have provided labour productivity, we could not choose that measure in the absence of data from many organizations relating to number of employees at different times in these organizations.

Conceptually, VRS should result into improvement in PAT owing to reduction in labour expenses. Hence PAT/Total assets should improve after implementation of VRS. Further, the gap of two years after VRS, there would be no expenditure on scheme-related payments as in the first year. It should inflate the change in PAT. Hence, lack of gain in PAT/Total assets would be a clear signal of decline of financial performance of the organization in the post-VRS phase.

increase in cost. Only two of them improved their performance.

**Reducing overhead costs:** Only two of the 13 organizations that stated this objective improved their performance.

All three above stated objectives were reactions to the changes in external environment through VRS. Most of these organizations responded through VRS once they got into a difficult situation. Their VRS was frequently not coupled with strategic reorientation. Consequently, these organizations were unable to improve their performance after VRS.

**Protecting long-term interests of the organization:** The organizations that took a long-term view of VRS and coupled it with strategic change management initiatives have performed better. Two of the three organizations that stated the purpose of VRS to serve the long-term interest of the organization improved their performance after VRS.

**Achieving technological advancement:** Three organizations stated advancement of technology as a reason for manpower reduction. None of them could improve performance. This result is to be taken with care as inadequate project implementation could have led to decline in performance.

**Restructuring the organization:** Restructuring was cited as a reason for downsizing in five organizations. This is in line with the literature (Freeman, 1994) that major hierarchical changes drive downsizing. However, such firms are frequently unable to anticipate appropriate structure to improve their performance in a dynamic

business environment. Consequently, only one of these five organizations improved its performance.

A careful examination of the VRS objectives shows that organizations that had improved their performance were candid in their communication with employees. The preamble of the VRS of one of the organizations, which improved its performance, reads as follows:

The organization wishes to bring to the notice of workmen/members of staff that the manufacturing cost including wages is increasing substantially and affecting organization's competitiveness. You must be aware that a number of small scale industries have bloomed in similar product lines and are out-pricing us with lower overheads and labour costs. Further, with technological advancement in our area of business, modern office equipment like computers and photocopiers are replacing our conventional products like carbon paper, stencils, duplicating inks, etc. Also, 90 per cent of similar stationery manufacturing industries have closed down. Most of our organizations worldwide have closed down. Adding to all these, changes in government and their policies related to our industry have hampered our business competitiveness substantially. As a result, the organization's profit margins are under heavy pressure. Therefore, we have to optimize productivity. In view of the excellent employee-employer relations we have, we are pleased to announce a generous VRS. It is hoped

that workmen/members of staff will carefully go through this and take advantage of the same, as it is in mutual interests of employees and management.

Another organization stated its objective as follows: Since the last couple of years, our organization is experiencing intense competition from the unorganized sector on the one hand and adverse effect of globalization on the other. This has caused serious threats to the very existence of the organization. With a view to consolidate our position in the market, it is necessary to synergize and rationalize our operations. This will improve overall efficiency and profitability of the organization. Due to increasing employee cost from year to year and with a view to enable such a reduction in manpower, the following VRS is offered to our employees.

These organizations had been communicating with the employees the need for VRS even before the formal announcement. Employees in these organizations genuinely believed that there was no alternative to manpower reduction in the organization. Such communication also created a perception of possibility of difficult time ahead among the survivors. It compelled them to work harder to retain their jobs which resulted in improved productivity.

### PERFORMANCE OF FIRMS IN DIFFERENT SECTORS AFTER IMPLEMENTING VRS

Table 1 shows the performance of organizations after implementation of VRS in different sectors. Only one of the six organizations from electric and engineering sectors improved its performance. Among the five organizations from the services sector, none improved its productivity after VRS. Commitment and competencies of employees are vital to succeed in service sector. VRS, if not implemented carefully, does have the potential of adversely influencing the commitment and competencies of retained employees.

Two of the five organizations from the drugs and pharmaceutical sector showed improved performance after VRS. Similarly, only one of the four organizations from chemicals and dyes/paints sector reported improved profit after VRS. None of the three organizations from petrochemicals/fertilizer improved its performance after VRS. One of the two organizations from steel industry improved its performance. These results show that

**Table 1: Sectors of Organizations (N=30)**

| Group                               | Total Number of Organizations | Number of Organizations Improving Performance After VRS |
|-------------------------------------|-------------------------------|---|
| <b>Sector</b>                       |                               |   |
| Electric and engineering services*  | 6                             | 1   |
| Drugs and pharmaceuticals           | 5                             | 0   |
| Chemicals & dyes/Paints             | 5                             | 2   |
| Pesticides/Agrochemical/Fertilizers | 4                             | 1   |
| Diversified                         | 3                             | 0   |
| Steel                               | 3                             | 1   |
| Textiles                            | 2                             | 1   |
| Automobile                          | 1                             | 1   |
| <b>Ownership</b>                    |                               |   |
| Private (Indian)                    | 17                            | 4   |
| Multinational organizations         | 11                            | 3   |
| Government                          | 2                             | 0   |

\*Includes banking and financial organizations.

organizations in most of the sectors of economy performed worse after VRS. Services and engineering firms seem to be the worst performers after VRS.

Seventeen of the 30 organizations (57%) in this study belonged to the private sector. We found that only four of them improved their performance after VRS. There were 11 multinational organizations. Only three of them improved their performance after VRS. The pattern suggests that firm-ownership did not influence the success of VRS.

### FEATURES OF VRS

Our discussion with managers in the companies showed that they spent substantial time to decide on the following characteristics of VRS:

- duration of VRS
- eligibility for VRS
- discretion to managers
- compensation.

**Duration of VRS:** The organizations that kept the scheme open for less than 15 days did not show any improvement in their performance. Organizations with short duration got little time to execute their plans effectively. It provided little time to persuade employees to accept VRS. Three of the nine organizations that kept the scheme open for one to three months improved their performance. The average duration of the scheme where performance improved was about two months (59 days) and the average duration where performance deteriorated was about three months (86 days).

Our result shows that successful organizations kept

the scheme open for nearly two months. It provided them enough time to implement the scheme and, therefore, they had been successful in retaining the critical talent needed for the success of the organization. Because of the availability of time, even employees got time to think and take appropriate decision. Such organizations laid more thrust on communication and maintaining trust with the employees rather than going in for 'surgical manpower reduction.' The fairness and proactive communication in the whole process helped the managers to get actively involved in the scheme implementation. It reduced the feeling of guilt among the managers and survivors. They took responsibility to work to improve the profitability of the business.

The average duration of ineffective VRS was nearly three months. Longer duration brings in complacency in the early stage of scheme implementation. It becomes difficult for organizations to generate adequate enthusiasm at later stages. Hence, schemes of very short duration and long durations are likely to be less successful than schemes that remain open for moderate period of time.

In an organization where one author visited and asked about the introduction of the scheme, the HR manager stated:

We first communicated the need for VRS to the unions in the monthly meetings in which our Managing Director, all the managers, and union leaders were present. We explained the deteriorating condition of the organization to the unions with the help of factual data on hand. This helped us remove the unnecessary obstacles in implementation of the VRS and we could also get cooperation of the employees.

**Eligibility for VRS:** There were two main criteria, i.e., the tenure in the organization and age to decide suitability for the scheme. The tenure criteria varied from zero to 15 years of service in the sample. The mean tenure criterion was 9.7 years. There was no significant difference between mean tenure between organizations that improved their performance after VRS and those that did not.

The minimum age criteria varied from 30 years to 59 years in the organizations. Nearly 80 per cent of organizations in the sample specified 40 years as the minimum age to decide about the suitability for VRS. Age also failed to effectively differentiate between successful and not-successful organizations. The mean of the age criteria among organizations that improved

their performance after VRS was 42.9 years while the same among those that did not improve was 39.5 years. The difference between two was insignificant.

**Discretion to managers:** Certain organizations gave discretion to managers to accept or reject VRS applications and to withdraw the scheme.

**Discretion of management to accept or reject the VRS application:** Managements retained this discretion so that they could retain people with appropriate skills. Table 2 shows the number of organizations that kept the discretion of accepting or rejecting the VRS application of

**Table 2: Discretion of Management to Accept or Reject VRS Application**

| Management Discretion | Number of Organizations | Number of Organizations Improving Performance After VRS |
|-----------------------|-------------------------|---|
| Who retained it       | 18                      | 4   |
| Who did not retain it | 12                      | 3   |

an employee.

Almost all the organizations wanted their crucial manpower to stay back, yet only 60 per cent of the organizations retained the discretion of accepting the application. Though the organizations that retained this discretion performed marginally better, they had to use discretion carefully. Perception of unfair application of judgment may lead to negative impact on the success of the schemes.

**Discretion of management to withdraw the scheme before the declared date:** Managers considered it as an important parameter in the design of VRS schemes. However, the study does not show a significant impact of this discretion on the success of the scheme, as most of the organizations that retained such discretion were not able to use it owing to difficult and volatile conditions of downsizing.

**Compensation:** All the schemes in the study had a mention of two decisions relating to compensation to retiring employees under VRS:

- upper limit of the amount of compensation
- criteria to calculate the compensation.

**Upper limit of the amount of compensation:** It is an important issue in the design of VRS. To decide the upper limit, managers considered primarily the paying capacity of the organization, regional and industry practices, and attractiveness of the scheme for the target employee population. Six of the 30 organizations in the sample did not provide for upper limit. They were open to pay any amount, calculated as per the pre-set formula. Only one

of these six improved its performance after VRS.

The remaining 24 organizations in the sample had the upper bound ranging between Rs 60,000 to Rs 5,00,000. Out of them, 11 organizations had the upper bound in the range between Rs 400,000 and Rs 500,000. Only two of these 11 organizations improved their performance. The results indicate that higher amount under VRS, thus making the scheme more attractive, does not ensure the success of VRS. Simultaneously, very low amount may also lead to non-acceptance of VRS.

**Criteria to calculate the compensation:** All the organizations in the study had formulae to compute compensation under VRS. One of the common methods to make the scheme attractive has been to compensate employees for their remaining period of service. Only one of the ten organizations in the sample that offered 100 per cent of current salary for every remaining period of service to its employees improved its performance after VRS. Frequently, such attractive schemes attracted competent employees to VRS. They could seek jobs in other organizations after accepting VRS.

A comparison of criteria for calculating the compensation between successful VRS and failed VRS indicates that unsuccessful VRS provided for better compensation for retiring employees based on remaining years of service (Table 3). On the contrary, successful VRS provided for better compensation for retiring employees based on completed years of service. Such VRS provision

**Table 3: Average Number of Days for Each Year to Compute Compensation Under VRS**

| Years of Service in the Organization | Organizations that Improved their Performance | Organizations that Deteriorated in their Performance |
|--------------------------------------|---|--|
| Years already served                 | 52.5  | 42.4   |
| Remaining years to retire            | 62.5  | 86.0   |

made the scheme more attractive for older employees.

Non-monetary help was an important concern in one of the successful organizations. When one of the authors interviewed a HR manager in an organization, which improved its performance, he stated,

The amount of compensation does not matter as much as the way of presenting the whole package. You have to convince an employee that the organization really needs to reduce manpower and it could not compensate more for VRS. Secondly, you need to help him with expert advice for the investment of the VR compensation as most of these people are

unaware of such investment opportunities.

Table 4 shows other benefits given by the organizations under VRS. It is found from the study that almost all the organizations stated that the retiring employees would be eligible for retirement benefits like provident fund, gratuity, bonus, and encashment of privilege leave. Nearly one third of the organizations also allowed medical facility to retired employees under VRS. One organization allowed the housing facility for the retired employees under the scheme.

**Table 4: Other Benefits Under VRS**

| Type of Compensation *   | No of Organizations |
|--|---------------------|
| Ex-gratia ceiling of salary for 120 months                               | 1                   |
| Ex-gratia ceiling of salary for 95 months                                | 1                   |
| Ex-gratia ceiling of salary for 84 months                                | 1                   |
| Ex-gratia ceiling of salary for 68 months                                | 1                   |
| Bonus  | 10                  |
| Notice pay   | 2                   |
| Leave travel allowances  | 9                   |
| Encashment of sick leave   | 5                   |
| Encashment of casual leave   | 4                   |
| Medical benefits and insurance   | 11                  |
| Housing  | 1                   |
| Housing loan outstanding allowed to be carried forward at the concession | 2                   |
| Long service benefits  | 4                   |
| Next-of-kin-benefit  | 1                   |
| Early bird prizes (cash)   | 1                   |
| Subsidized power in the organization housing                             | 1                   |
| Other items (gift)   | 1                   |
| Training for wards   | 1                   |
| Deduction from VRS compensation  | 1                   |
| Settling allowance   | 1                   |

## IMPLEMENTATION OF VRS

We had extensive discussions with senior managers, employees, union leaders, and civil authorities in four organizations which had improved their performance significantly and had achieved significant manpower reduction through VRS. The key characteristics of VRS implementation in these four cases are:

- Transparent and proactive communication of managerial intent to reduce manpower.
- Active exploration of other alternatives to manpower reduction by managers.
- Involvement of multiple stakeholders in VRS implementation process.
- Developing trust among employees regarding fairness, honesty, and commitment of managers towards organization and its employees.

**Transparent and proactive communication:** In all the four cases, the CEOs and other senior managers communicated with employees well before the announcement of VRS regarding the health of the organization

and the need for manpower reduction. The CEO in one of the organizations stated:

I had a meeting with all the heads of functions in which we collectively decided to remain honest and transparent to our employees about our intent to overcome difficult times. Slowly, union leaders, government authorities, and workers realized that there was no option other than VRS. We could effectively reduce more than 60 per cent of our workforce without attractive payments. We could not pay well as we lacked financial resources. However, we remain in touch with our retired employees through our welfare schemes for them like health, education, housing, etc.

The CEO of another organization stated:

I hired an independent agency of repute to assess the manpower requirement for my organization. We were making losses and there was no way that I could afford extra manpower. The report of the agency was widely shared among all and managers were convinced at all levels to identify surplus manpower in their workplaces.

Such communication improved the authenticity of managerial communication. It also prepared employees prior to the announcement of schemes. These schemes did not come as a surprise to them. Employees who were willing to accept VRS had developed plans for their activities for their post-retirement phase.

**Active exploration of other alternatives:** In all the four cases, attempts had been made to explore the possibilities of expansion of activities of the organization to retain the employees productively. In one of the organizations, nearly five new products were developed and launched to retain employees. One of the directors of the organization said,

We were making huge losses but were willing to invest in new product development so that we could survive in the competitive environment without reducing our manpower. However, none of our new product launches was effective and we had no option but to reduce our recurring expenses on employees through VRS.

**Involvement of multiple stakeholders in VRS implementation process:** In all the cases, management communicated extensively with other agencies like government authorities, trade union leaders, and civil authorities. This communication was helpful to overcome

difficulties of VRS implementation. One of the CEOs of the organizations stated:

We did not have funds to meet VRS obligations. In such difficult times, banks helped us on assurance of the government who is the owner of the organization.

In all four cases, the organizations belonged to either a large business house or the government. The owners of the organizations supported the managerial initiatives of manpower reduction to enhance the performance of the organizations.

In another case, the management sought government's permission to close the plant after convincing them that there was no other alternative to closure. Such grant of permission by the government left no option to the workers than to accept the VRS or else get retrenched. The organization could effectively reduce more than 60 per cent workforce. The organization tried to provide alternative employment by hiring the services of potentially capable, voluntarily retired employees in activities like transportation, maintenance, etc. The organization also provided for health, vocational training, free education for children, and housing facility for voluntarily retired employees. In this organization, there was very little feeling of guilt among the retained employees though the cash payment to voluntarily retired employees was one of the lowest by an organization in India in the recent past.

**Developing trust among employees regarding fairness, honesty, and commitment:** In all the four cases, clear guidelines were issued to decide the acceptance of application for voluntary retirement. In one of the organizations, all employees of one plant were targeted. The plant was to be closed down. In the second case, all the low performers in the organization were identified to accept VRS. The CEO of the organization stated:

I believe in Selective Retirement Scheme (SRS) and not in VRS. We could identify all the low performers and trouble creators in the organization who were later targeted in our VRS.

In another organization, all the employees who met age and minimum service conditions were open to seek VRS. The implementation of these different criteria was extremely honest that helped to build confidence among employees regarding the fairness of the scheme.

## CONCLUSIONS

The study was conducted with an objective of

understanding the characteristics of VRS and factors that influence their effectiveness in India. The study attempted to find relationship between the contents of the VRS of the organizations and improvement in their performance.

It is found that no 'fixed' pattern has evolved for VRS among Indian organizations. All the organizations had some unique characteristics in their VRS. No specific sector of organizations has fully benefited from VRS. The ownership of the organization did not differentiate in the success of VRS.

Organizations that unequivocally stated their objectives of VRS performed better than others. These organizations laid emphasis on communicating the actual situation to their employees even before going for manpower reduction. This helped them to build trust among the employees opting for VRS and the survivors who perceived the process to be transparent. It also reduced the 'guilt' perception among survivors.

The study found that the organizations that kept their scheme open for shorter period (e.g. one day to 15 days) showed decline in their performance. As the time period for the scheme increased, the organizations showed improvement. However, when the time period increased very high (e.g. more than three months) their performance again declined. This shows that the organizations that kept their scheme open for appropriate time got a chance to plan their scheme and remain focused and could implement the scheme successfully.

According to the study, organizations that offered VRS to younger and less experienced employees showed decline in their performance while those that offered to the older employees had better chances of improving performance.

All the organizations in the study calculated the compensation in different manner. Effective organizations had a thrust on completed years of service to calculate compensation while the ineffective organizations were found to have higher thrust on remaining years of service to calculate compensation under VRS.

The study shows that if VRS is to be successful, it has

to be adequately planned. The organizations should be clear in their objectives of offering VRS and they should explicitly mention these objectives in their schemes. They should make the scheme as transparent as possible and be open for any communication and clarifications to make the employees develop trust. They should keep the scheme open for appropriate time so that the organizations as well as the employees get enough time to take this crucial decision. The organizations should carefully target persons for VRS. They should be careful that the crucial manpower required for running the organization is not allowed to go out. The compensation criteria for VRS should be decided according to the targeted population.

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*All you need in this life is ignorance and confidence; then success is sure.*

*Mark Twain*