Chapter One

Introduction

1.1 Statement of the problem

The modern industrial organisation presents itself as a complex organism that continuously draws and redraws boundaries between firms and markets. While the invisible hand of the market dictates the form and structure of the market, firms are guided by a more visible hand of managerial intervention\(^1\). In a market economy, firms find themselves in an uphill task where it has to continuously negotiate its existence in the face of increasing competition and liberalisation.

Neoclassical economics defines production function for a firm by way of \( Q = f(K, L) \), where \( K \) is the capital in use, \( L \) is the labour employed and \( Q \) is the output. Profit and wages is determined by the marginal productivity of capital and labour respectively. In the era of rapid technological advancements, firms tend to reduce the labour employed so as to decrease production costs associated with running the firm. At the same time, there is the phenomenon of capital deepening that threatens to substitute labour. In a liberalised competitive economy, firms would invariably follow this direction which would lead to improved performance over time.

However, different firms have different size and productivity levels that it would use to move up the ladder. While large firms having a greater factor endowment find it easier to manipulate factor inputs towards a process of capital deepening, smaller firms struggle to keep pace with the existing units of inputs. Large firms follow a different growth trajectory as compared with its smaller counterparts. Amid this situation it is important to mention, there are specific touchpoints located internal and external to the firm which enables this kind of transition and growth. When external decisions would be related to matters of favourable government policies, macroeconomic environment, competition etc. internal policies of the firm would relate to the governance structures employed within. How does then a firm configure its settings in order to grow remains a moot point.

Against this backdrop of having variables both internal and external to the firm and also those related to the dynamics of factor inputs themselves, this study would look into measuring firm competitiveness. The analysis of firm competitiveness would also pave way for future firm behaviour. This study is based on the manufacturing sector of India. Within the manufacturing sector, it would look at the steel industry in particular which is considered as one of the rapidly growing industries of the country. Two firms would be taken up for analysis, which although belonging to the same industry and region would be different in terms of their size and output.

1.2 Background of the study

1.2.1 Employment Relations

There are two strands of economic thought that guides the understanding of relations emanating from employment—firstly, the neoclassical framework where the distinction between market and firms is hazy. Within this framework, firms or hierarchies are an extension to the same assumptions of the market albeit in a limiting manner, and secondly, the institutional economics perspective where internal and external labour market are clearly segregated. However, the primacy given to institutions working within these arrangements is what makes the institutional analysis different.

The study utilises the field of New Institutional Economics (NIE)\(^2\) which looks at firms from the perspective of having transaction costs associated with running the business\(^3\). Firms measure their sustenance in terms of their ability to economise on these transaction costs associated with exchanges. Questions related to make or buy dilemmas are central

\(^2\) The New Institutional Economics is differentiated from the Old Institutional Economics (OIE) on a variety of fronts. Apart from them following a historical trajectory of development with OIE preceding NIE, an important distinction between them is that while NIE looks to explain the institutional factors that are traditionally given in the neoclassical theory, OIE looks towards replacing it completely (Rutherford, 2001).

\(^3\) Institutional economics has been borne out of the critique of traditional rarefied economics. It was later that transactions costs as a unique foray was included as an important angle in this line of analysis. Interests in this discipline outlay Veblen’s Theory of Business Enterprise (1904), Wesley Mitchell’s work on business cycles, Adolf Berle’s combining of law and economics, all present the freshness in the institutional analysis. Although transaction costs as an instrument of analysis had been introduced by Commons (1931) in the old institutional economics tradition, it became explicit and ubiquitous only in the new institutional economic analysis.
to the issue\textsuperscript{4}. The new institutional economics found much of its reprise from the question of the division between internal and external contractual relations of the firm. While the external contractual relations have for a large part been addressed as part of understanding market, it is the intricacies of firm behaviour that has been the black box. Investigating the internal contractual relations, would throw light on the inner governance structures that has been obscure from economic analysis.

The essence of contractual relations gains a relational advantage when exchanges are limited within the precincts of the firm. Economising on these elements of contractual relationships involves stakeholders like the union and the rank and file of workers. In a transaction cost economising framework, the tussle between workers’ interests, pushing to move up the economic ladder, against the managerial push for lowering costs often gets vitriolic.

Therefore, defining employment relations in this regard is qualitatively different from the traditional definition of ‘industrial relations’. Kaufman (2008) makes it clear that, “to a large degree, most scholars regard trade unionism, collective bargaining and labor-management relations, and the national labor policy and labor law within which they are embedded, as the core subjects of the field [industrial relations]” [sic] (p. 31). With the decline in trade union density across the globe and shifting patterns of employment, there are also afterthoughts of having a broader and more nuanced idea of relooking at the subject. Differing kinds of employment relationships that capture non-unionised, part-time, casual, informal workers also needs to be recognised\textsuperscript{5}. By way of this, it would be more prudent to define relationships emanating from employment as an all encapsulating ‘employment relations’ rather than ‘industrial relations’. Further, this study also takes a breakaway from the traditional variables analysed in industrial relations and includes a study of both external as well as internal dynamics associated with the firm and hence in requirement of a newer term of employment relations.

\textsuperscript{4} See Coase’s “The Nature of the Firm” (1937).
1.2.2 Wages

Wages form the remuneration to labour. It is present in almost all types of modern employment scenarios. The magnitude of wages, in most cases might also be an important predictor to the kind of employment. Economists tend to explicate wages in terms of a real wage or the average wage level of an economy. The wage discounted by the cost of living would be the actual realisable, disposable income. Conventional neoclassical economic wisdom construes demand by the marginal productivity of that factor. As long as the factor input for production increases, the output also increases likewise up to the point where diminishing returns begins to take effect and thereby every increase in factor input diminishes the portion of the output. It would be irrational to increase the factor more and the remuneration of the factor is equated with the marginal product of the factor. Further, in elucidating the different actors in this process namely the workers and firm, it is assumed that they have their inherent preferences and choice sets which remain relatively unchanged over time. Parsons (1949) avers this to be the ‘utilitarian dilemma’ of the economic theory which presented a sense of randomness to it.

Although wages as a subject has had the prerogative of the economists, sociologists have had a fair share of its analysis. Parsons critique of the kind of analysis precisely brings out the lacunae in economic theorising. Labour as human beings emoting, displaying opportunistic behaviour, acting within the confines of their bounded rationality, could not simply be reduced to *homo economicus*. The “value problem” of market sociology in terms of aptly reckoning the value of any commodity or service in a range of different properties of the same commodity has the buyer of the commodity in a fix thereby distinguishing one product from the other remains important in correctly assessing its value. Value problem transposed in labour, increases the complexity of the analysis further. Distinguishing labour in terms of skills, preceding training undertaken becomes important. Wages in terms of remuneration for the value possessed by the labour become the determinants. Krishna and Paul GD (2013) tried to explain wages in terms of individual characteristics of the regular salaried workers in India. Human capital lends credence to the rise in wages however; wage disparity along dualistic identities of

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6 See Beckert (2009, p. 245).
sex, caste, place of origin etc also exists. Further, Human development index (HDI) directly related to wages makes for a case for greater push in investments on human development. Productivity enhancements by way of technological improvements also substantially relate to an increase in wages. Piore (1973) emphasised on-the-job trainings at the micro level as a replication of recognised practices which drew fixed customary rates of pay hence customs he reckoned to be an important sociological force explicating wages. Another example for this would be wage structures fixed through collective bargaining mechanisms are also institutionalised in the sense of being customary. Granovetter (1973, 1985) also provides evidence to the state of embeddedness of labour market and the under-utilisation of social institutions.

Wages for all practical reasons for our understanding has to do with the remuneration for the work done in exchange. This remuneration has two aspects to it- monetary and non-monetary. While the monetary aspect would deal exclusively with wages and all other payments done in a direct manner, the non-monetary would ascribe to all that is in terms of fringe benefits. Also, an analysis of value in terms of its use and exchange is provided following the Marxist line of thought.

### 1.2.2.1 Monetary remuneration

The report of the Fair Wages Committee has guided the fixation of wages in India. In so fixing the wage structure, a delicate balance between managing a sustained growth in the national income with formation of a more or less equitable society was desired. The concept of living wage, as directed in the most advanced economies, could not be directly replicated in the Indian system owing to the low levels of national income. Thereby, the committee thus came to the conclusion that a category of *minimum wage* would be most effective that would be alimentary as well as a means for further reproduction of the competence of the worker (Sarma, 1984). The wage structure is provided below.

a. Basic wage- Basic wages forms the most stable part of the wage structure and remains fixed for a reasonable period of time until some change is introduced. On

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7 The inclination for striking a balance may well could have been directed due to the socialist fervour of the Indian Constitution.
the other hand, the dearness allowance (DA) remains the part that keeps fluctuating with the change in the costs of living. In order to cater to the rising costs, the Gadgil Committee appointed in 1952, had recommended merger of the DA to the basic pay for the government employees. The Pay Commissions have successfully carried forward this element in the successive years and when DA compensation exceeded 50 per cent, half of it has been successfully merged with the basic pay and the remaining has been calculated as dearness allowance. This new pay would count as calculations for all further allowances.

b. Dearness allowance- It is an imperative part of the pay in India which attempts to neutralise the rise in the cost of living. The neutralisation can be of the tune of wholly or some part. In a Supreme Court judgment in 1956 concerning Clerks of Calcutta Tramways versus Calcutta Tramways Co. it was ruled that it was not mandatory to have a uniform neutralisation schemes for all classes of employees and while it was desirable to have a complete neutralisation scheme for lowest class of manual labourers such should not be the case in terms of other upper class employees. Also, 100 per cent neutralisation would have its direct impact on inflation. Majority of the decisions with regard to fixing the DA has been on the basis of employer’s ability to pay. At this point a cursory glance at the different structures of payment of DA in India would be instructive.

- The rate of payment which allows for a flat rate of fixing an amount that would be paid to all categories of the employees irrespective of their pay scales. Such flat rates would be out of tune with the ever changing index of the costs of living nevertheless it scores high in terms of the ease of handling it.
- The dearness allowance is linked to the consumer price index numbers which are publicly released by the government. This method is more adept in construing safety nets in line with actual price rises.
- Graduated scales of pay based on the segregation in terms of pay scales are the method of calculating DA payments. Workers belonging to the same pay scales would get the same fixed graduated scales of DA.

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8 See http://indiankanoon.org/doc/454450/.
c. Overtime payment- Working overtime is a means to achieve production targets, tackling absenteeism, breakdown of machines, future contingencies which requires management to compensate appropriately. This concept stems from having recognised hours of work in the first place. The Factories Act, 1948 defines that ‘where a worker works in a factory for more than nine hours in any day or for more than forty-eight hours in any week, he shall, in respect of overtime work, be entitled to wages at the rate of twice his ordinary rate of wages’. This provision is also repeated in the Minimum Wages Act, 1948.

d. Annual bonus- The Payment of Bonus Act, 1965 statutorily mandates the payment of bonus to employees of those firms which has twenty or more workers. A minimum bonus of 8.33 per cent of the salary/wage earned or Rupees hundred whichever is higher shall be payable under this Act. The maximum bonus to be allocated is fixed at twenty per cent of such salary/wage. The Act is mainly for the private sector units but also applicable to those public sector establishments which competes with the private sector and the income made thereof from such production or services is not less than twenty per cent of the gross income of the establishment for that particular accounting year.

e. Financial incentives- The incentive schemes vary from firm to firm and it depends on the ability of the management to pay. Some of such schemes can be housing allowances, gratuity, pension, contribution to provident fund, gratuity etc. Some of these existing incentives are backed statutorily by law.

1.2.2.2 Non-monetary remuneration

The non monetary remuneration of the employee consists of a basket of welfare and other services which are linked to employment. They usually are likely to be used by other members of the employee’s family members as well and it is quite likely that remunerations of such kind can ultimately be reduced in cash terms. The need for having such system in place emanates from the need to provide the employees to have a positive

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9 See http://dgfasli.nic.in/statutes1.htm.
10 See http://indiacode.nic.in/.
outlook towards their work and be motivated by the same. This part borrows much from the field of industrial and organisational psychology.

a. Fringe benefits- Fringe benefits relates to the non-pecuniary additional benefits that a worker receives for his work done. There are various forms of such benefits which include provision of living quarters, sick leave, vacations, transportation services, work clothes, medical benefits etc. Such bearings on the firm do however naturally increase the costs for the same and sometimes firms outsource such responsibilities to third party also.

b. Non-financial incentives- Incentives of the non-financial kinds are related to consolidation and providing a tighter grasp of the employee’s position of work. These incentives relate to being given leadership positions through designations, working conditions, nature of the job, privileges, development opportunities, job security etc.

It may be mentioned here that the above categorisation of remuneration in terms of monetary and non-monetary terms is only to get a clear understanding of the payments received by workers in cash and kind. Overlap of certain sections is bound to happen and it is imperative to mention here that it is used primarily on an analytical basis.

1.2.2.3 Value in use and value in exchange

Value forms a central concept of the Marxist line of enquiry. Through the explanation and thereby critique of the capitalist mode of production, Marx infused the idea of value in commodity production. Any commodity that is made through the work of human hands possesses intrinsic value in it. It is hence “crystals of . . . [the] social substance” of labour in them all (Marx, 2011, p. 4). Thereby any usage that happens of that particular commodity would have a use value for its creator. However, in a capitalist mode of production when people are divorced from their own means of subsistence, production of commodities happens for the sake of exchange of it. Now the producer of a commodity does not produce it for the usage of himself but for the usage of the market in which it

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12 The distinction between value in use and value in exchange was first put forwarded by Adam Smith in his The Wealth of Nations, first published in 1776 through the famous diamond-water paradox.
would be bought and sold. That although initially the value of abstract human labour imbibed in the commodity fetches use, it fails to get its desired returns on an exchange of the same.

This forms the fundamental contradiction between use value and exchange value of any commodity and since all commodities produced can be traced back to the work of human hands, all commodities invariably produces value. Therefore a commodity has both a use value and an exchange value. The nature of exchange value hence permits it to change continuously according to the demand and supply constraints of the market but use value remains fixed and grounded in the labour time required for its production.

This analysis is particularly important because of the development of systems of production in capitalism over time through standardisation processes which require lesser quantity of labour time for production and thereby diminishing value of the commodity being produced. Marx made it clear that any labour time that is measured in deriving the value of a commodity produced is through “homogenous human labour”, one that is defined in terms of average of the “labour-power of the society” (Marx, 2011, p. 5).

Assessing the internal exchanges that are likely to happen within the boundaries of the firm, discussions on wages and value form an important part to the background of the subject. Viewing this through the lens of new institutional economics framework would provide important lines of enquiry. With respect to the evolutionary perspective of the NIE, a critical period of liberalisation of the 1990s as an exogenous change is included in this respect. Liberalisation has been chosen to account for two changes- increased competition among firms and uncertainty of the future. The reason for this is the supposition that changes in contracts have been pervasive in this period. Also, how different firms having different backgrounds respond to a change in external environment is analysed.

1.3 Theoretical anchorage: A brief overview

This study finds its theoretical anchorage in two sources. The first is the new institutional economics and second is from a measure of global competitiveness. Initially assessments
of the two firms are done within the framework of new institutional economics, thereafter an index of Global competitiveness is used for characterising firm competitiveness.

1.3.1 New Institutional Economics

Institutional economics provides a lens of analysis of institutions that are pivotal in understanding the system of firm production. It goes beyond the scope of neoclassical economics which treats firms as a mere production function\(^{13}\). Coase (1937) brought the point home starkly when he questioned the mechanisms of market price in explicating the nature and organisation of a firm. He further goes on to suggest “. . . that the distinguishing mark of the firm is the supersession of the price mechanism” (ibid, p. 389).

For it lay that it is one thing to be governed by price mechanism of the factors related to the market and other to direct production in terms of matching the optimum outlay of requirements for the market.

The new institutional economics amalgamates literature from economic organisation and contract law. Three modes of economic organisation can be defined namely, market, hybrid and hierarchy each presenting their own distinct contractual relations. While markets represents the conventional neoclassical transactions that operates anonymously, however, guided by the invisible hand, governance structures in hierarchy are more attuned to the extension of these relations within the domain of a “visible hand of managerial direction\(^{14}\)” in the firm. Hierarchy or firms, for most part where the action lies, remains to a large extent less understood\(^{15}\). Transactions within this domain thus, become an important tool to assess these contractual relations and are the ultimate unit of analysis. An efficient system thereby thrives to reduce these transaction costs associated with economic exchanges. Understanding of these contractual relations through transactions that take place within a firm would be the criteria of evaluating the employment relations.

\(^{13}\) See Kaufman (2010).
\(^{14}\) See Chandler (1977, p. 286).
\(^{15}\) However as Chandler (1977, p. 285) avers “the modern industrial – the archetype of today’s giant corporation- resulted from the integration of the processes of mass production with those of mass distribution within a single business firm”.

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Further, transactions themselves are assessed in three critical ways which makes the governance patterns explicit- they are asset specificity, uncertainty and frequency (Williamson 1985, 2002).

- Asset specificity refers to the non-transferability of particular transactions due to their inherent contextual nature. Due to this reason there remains a high level of dependency in the relationship and in the event of premature termination of the relationship it hampers both parties (ibid., 1985). In the context of this study, human asset specificity i.e. particularly dealing with the specific and non-redeployable skill sets of the personnel of the firms is important among others16.

- For uncertainty, there exists no unique definition and various analysts have described it differently in different instances (Dequech, 2006). Important to mention here is Oliver Williamson’s categorisation of uncertainty broadly in terms of behavioural assumptions of institutional economics- bounded rationality and incompleteness of contracts which form a major segment of it. Bounded rationality conjures a complex decision making environment in the face of limited capabilities and information scenario. Also, the fact that contracts created ex ante would never be fully able to capture the future contingents made clear in the ex post stage of the contract augur the incompleteness of contracts. In another instance, Moriguchi (2000) mentions ‘unanticipated shocks’ as a key form of uncertainty, which alters equilibrium positions17.

- Frequency deals with the recurring nature of communication thereby determining the volume of transactions. The volume of transactions then determines the nature of the governance structures, whether specific or non-specific. Usually a low or less frequent kind of transactions would imply non-specific governance structures due to the high costs associated with it (Maher 1997).

This study would thus make headway towards understanding employment relations through the lens of new institutional economics. Transactions, particularly being assessed through the above parameters would be utilised in this regard.

16 See John and Weitz (1988).
17 This definition is in tandem with the non-ergodic world of Douglass North (1999).
1.3.2 Global Competitiveness

At a second level, this study also draws cues from the global competitiveness index (GCI) framework of the World Economic Forum (WEF). This framework is utilised for assessing various economies based on certain microeconomic and macroeconomic foundations. It uses twelve pillars to gauge at competitiveness of the various economies. Based on the assessment of these different pillars, economies are placed in different levels which can broadly be categorised into three- factor-driven, efficiency-driven and innovation-driven economies. Such a categorisation is important to understand the present situation of the country of analysis i.e. India. Further, it also reckons a globalised integrated world where competitiveness is not only based on the competencies inherent in any economy but also how others are placed in the competition.

This framework also provides a useful paradigm for framing a firm competitiveness index. This index draws its basis from having both macro as well as micro factors, within and outside the firm. The index would then rate firms at different stages of development. A summary of the process is depicted in figure 1.

![Figure 1: Theoretical process map](image)

1.4 Research Objectives

The objectives aimed to be achieved through this study are highlighted below:

i. To examine the institutional determinants of employment relations and firm competitiveness in the Indian steel industry.
ii. To analyse the changes in employment relations in the Indian steel industry in the wake of liberalisation.

iii. To explicate the differences in employment relations and firm competitiveness among firms in the Indian steel industry.

iv. To assess linkages between employment relations and firm competitiveness in the Indian steel industry.

1.5 Research Questions

The research questions presented below are congruous to the objectives of the study. They are as follows:

i. How do institutions determine employment relations of a firm?

ii. What factors define firm competitiveness in the Indian steel industry?

iii. What have been the changes in employment relations in the wake of liberalisation? How has been the response of the trade unions and workers towards these changes?

iv. How do differences in employment relations manifest among different firms in the Indian steel industry?

v. What factors determine differences in firm competitiveness among different firms in the Indian steel industry?

vi. What is the link between employment relations and firm competitiveness? How do employment relations contribute towards enhancing firm competitiveness and vice versa?

1.6 Rationale of the study

This study looks into the concepts of employment relations and competitiveness by focusing on the institutions that govern them. The Coasian framework of viewing transaction costs which forms the basis of new institutional analysis is the central tenet in the discussions. Although institutional studies of the theory of the firm has largely taken into consideration the decisions to ‘make-or-buy’ where conditions of asymmetrical information and bounded rationality are minimal, the present study goes on to analyse the specific transactions that take place concerning labour within firms. In this regard,
decisions of make-or-buy are transposed with decisions of hiring regular, contractual or even retrenchment of workers. Hence, these labour transactions constituting the make or buy decisions of the firms asks questions that relate to the amount, character and contract duration of labour that would be necessary for the firm in a competitive market environment. Issues of asymmetrical information, asymmetrical power and bounded rationality also comes into the picture. Also, these labour transactions finally define the employment relations of the firm.

By opening this set of lens in view of labour it is attempted to probe deeper into the most prized asset of any firm i.e. its human resources. In this case, relationship between management and the trade union transcends to the buyer supplier relations. Given the frequency of interactions between unions and management, this relationship is far more enduring, substantive and in need of attention. In a nutshell, the primary rationale of this research is to break the conceptual straitjacket of neoclassical economics in which labour is entwined and introduce a new lens through which labour can be analysed.

1.7 Research Design

The research design for the study follows a mixed methods approach. Within this approach a sequential transformative design has been utilised wherein both quantitative and qualitative data has been collected. The sequential procedure for the study involves firstly collecting data through secondary reports followed with qualitative data from the field (Creswell, 2009). The entire study has been guided by the perspective of the new institutional economics, most particularly the one dealing with transaction costs. Labour transactions is the central unit of analysis for this study.

The Indian steel industry was taken up for analysis. Within this industry two steel firms are selected. The choice of the steel firms is done on the basis of making a comparison between both wherein one belongs to a large steel firm and other is a medium sized firm. However, they both are leaders in their segments of steel production. They also belong to the same geographical location which makes it conducive for making a comparison between them.
The first phase of data collection involved the collection of secondary data from various sources on the internet like global competitiveness report, company reports, Government of India (GoI) ministry websites, EPW research foundation, National Sample survey (NSS) 68th round and Annual survey of industries (ASI). This was followed by primary data collection in the field. Primary data collection was done in two phases- the first happened during the period from April-August 2014 and the second phase data was collected from the field during April-July 2016. Triangulation was used to gather data in the form of semi-structured interviews and documents. The semi-structured interviews were guided by the secondary data collected in phase I. During this phase memos were also prepared through field notes. There were interviews of several key informants who helped plug in the gaps identified in data.

The sampling of the study was done taking into consideration the fact that only select few people had knowledge of the phenomenon being studied and thereby had knowledge of it. Hence, theoretical sampling was used for the study. Data collection and analysis were done in an alternate basis where the researcher collected data, analysed it and then further took them up in the form of questions that threw light on the phenomenon. This process was iterative in nature so as to increase clarity in the study. A total of thirty one semi-structured interviews were conducted.

The study makes use of literature so as to provide an anchor to the concepts of transactions to be used in the context of labour. Further, it aims to develop further on this concept of labour transactions so as to amalgamate the change in labour transactions in the event of uncertainty brought out by the liberalisation period. The study is hence descriptive as well as explanatory in its nature.

1.8 Chapter Scheme

The study has been categorised into eight chapters. The first chapter provides an introduction to the succeeding chapters. The second chapter deals with the review of literature where concepts of competitiveness, wages and its distribution are discussed on the pretext of an institutional analysis. Further this chapter also provides a background to the framework on which this study rests. Chapter three would provide a detailed
description of the methodology used in the study. Chapter four would provide for a country analysis of manufacturing at a global scale using the concept of the global competitiveness index. Chapter five would detail the industry level characteristics of the steel industry. Chapter six amalgamates literature and empirical observations from the field into a coherent whole and vouches for an explanation of the labour transactions. Chapter seven would bring about a ‘firm competitiveness index’ and the firms selected for the study are assessed within this fold. Finally chapter eight would sum up the study providing for a discussion and conclusion.