

## **REVIEW OF DISINVESTMENT POLICY**

The Chapter deals with the review of literature available on the disinvestment policy and impact of disinvestment on selected public sector undertakings. This chapter includes the review ten research papers, Five Committee reports, which were appointed by the Govt. of India specially to take over the Disinvestment process, five well reputed Journals and two books. This chapter is divided into four different parts i.e.

1. Review of Research paper
2. Review of Books
3. Review of Committees
4. Review of well reputed journals

### **Review Research Paper :**

**Dr.M.S. Smriti Khurasia** in her research paper titled "A positive aspect of Disinvestment of public sector in India" argued that the objective of disinvestment should be to benefit the public, the consumer and the investor, and at the same time, to improve competitiveness and eliminate monopoly. In this direction the former NDA Government made exerting efforts it has collected over Rs.14,000 crore by way of disinvestment proceeds. The Congress Party in its manifests (2004) has

clearly stated:"Disinvestment will not be resorted to merely to mop up resources to meet short term targets". Considering the pivotal role of PSUs, it would be better to turn some PSUs into venture capitalists. It would be better to strengthen PSUs in key areas, including infrastructure. The policy outlined in the Congress Manifests is an indication of Government has been criticized, that, it is over enthusiastic to privatize highly profitable PSUs.

The current policy of disinvestment should be continued and expanded. Loss making enterprises should be bundled along with profit making ones and the resulting packages should be sold to international as well as domestic investors. Hopelessly loss making institutions like NTC should be wound up. The policy for winding up such institutions should be accompanied by the adoption of 'Social Security' Act financed by payroll taxes, that will be used to provide unemployed people with bare necessities of life. Over all Government should be careful while disinvestment highly profitable PSUs, otherwise it will kill the goose which lays golden eggs.

**Mr.Sandeep Mathur** in his research paper entitled "Disinvestment of public sector in India said that Disinvestment is an effective instrument for restructuring of the PSUs. If this is not properly understood and effective and quick measures are not taken, then drain on the scare

budgetary resources will be such that sooner or later most of the undertakings will go bankrupt and there will be a dead weight of assets and unemployment for which it is not easy to find a satisfactory solution. The mechanism for easy to find a satisfactory solution. The mechanism for implementation and delinking of disinvestment from the budgetary needs, providing full autonomy including pricing, investment, employment and revamping the Voluntary Retirement Scheme (VRS) the setting up of Disinvestment Fund are most essential if the country is not to suffer the financial shortfalls with their consequential impact on the erosion of the net worth of the undertaking and increasing fiscal deficit in the central budget. At the same time, disinvestment policy should not ignore the employment needs of the country. It appears necessary that the Disinvestment Commission and the central government should be in view this threat and make serious efforts for reconciling disinvestment with social policy, especially employment policy.

**Ms.Ajanta Bose** tried to highlight in his research paper that, in India whatever the form of Government may be, both the public and the private sector are likely to survive together. But it is essential that, for their efficient running, neither should be over protected or discriminated against. There must be an atmosphere of healthy competition.

To accept much from privatization is such as atmosphere would be futile. Here induction of the concept would not solves the present problems of public sector. In our country, the concept of privatization can be adopted at a modest scale in the low priority activities and with poor ideological shift, the concept of privatization will be negotiable. The controversy regarding public V/s private sector should not be extended too far. The notice that there is fundamental incompatibility between public and private sector should be discarded. There should be consultation and understanding between the two so that the recourses of the nation are properly utilize for economic development.

It not only failed to produce surpluses which it was expected to generate for future growth, but the return of investment remained poor, the question that is examined is weather disinvestments and privatization can lead to better result.

**Dr.Richa Rai** explained the urgent need is to disband the Ministry of Disinvestment so that the process of privatization which is proving to be harmful to the national interest can be stopped. The public sector is becoming performance oriented, hence more powers need to be given to the MDs of PSUs in decision making and reduce their dependence on ministerial control.

Disinvestment in central public sector undertaking is being undertaken to bring down government equity in non-strategic PSUs to 26 percent to below in majority of cases. The strategic PSUs outside the ambit of disinvestment comprise those that are in the area of arms and ammunition, allied items of defense equipment, defense aircraft and warships, atomic energy and rail transport. The disinvestment ministry has also recently formulated guidelines for disinvestment of loss-making enterprises, employee, buyouts and disinvestment of natural resource companies. Further specific provisions to protect the service conditions of workers are incorporated in the Shareholders agreement with the strategic partner at the time of disinvestment. Lastly government is setting up the Disinvestment Proceeds Funds which will be used to meet expenditure on social and infrastructure sector, restructuring of PSUs retiring public debt and provision of a safety net for workers.

**Mrs. Neeta Deeparware** highlighted in her research paper that, The disinvestment process involves the sale of equity and bond capital invested by the Government in PSU's. Disinvestment is generally expected to achieve a greater inflow of private capital.

In the Budget Speech for 2002-03 it was started that the Govt. has completed strategic sale in 7 public sector companies and some hotel properties of Hotal Corporation of India (HCI) and India Tourism

Development Corporation (ITDC). In 2003-04 budget, the target for disinvestment was kept at Rs.14,500 crore. The Govt. was able to raise Rs.1,300 crore by making public offer in Maruti Udyog Limited and Hindustan Zinc Ltd. Total realisation of disinvestment during 2003-04 is likely to be Rs.150,126 crores.

Out of 222 State Level Public Enterprises (SLPE's) identified for disinvestment, 124 enterprises are initiated for disinvestment, 30 SLPE's have been privatised and 68 SLPE's have been closed down.

The total investment in Public Enterprises in India is of the order of about Rs.4,86,700 crore. Three-Fourths of this investment has been in heavy and basic industries.

Till March 2004 as against the target of Rs.91,500 crore, actual realisation has been of the order of Rs.44,908 crore.

**Dr.Bhartendu Singh** highlighted in his article that, the strategic sale which was started in the year 99-00, have been proved very successful as the prices realized through it have been very high. In the year 03-04 Disinvestments through public sale of share was predominant.

The disinvestment process which was started with the sale of shares in small lots in the year 1991-92 continued to be so up to 1999, when the focus was concentrated on strategic sales. The strategic sale was started in the financial year 1999-2000 which have been proved very

successful as the prices realized through it have been very high. In the year 2003-04 disinvestment through public sale of shares was predominant.

There is a long term strategy agenda for disinvestment so that every year change in policy may not hamper the progress of the disinvestment process. A proper model for pricing of share prices should be finalized for the purpose. A proper coordination between Department of Disinvestment and concerned Minister of Industry is strongly recommended. Loss making PSUs and PSUs earning compatibly pre profit should be divested first while "Navaratna / Mini-Navratna PSUs should not be offered for trade sale, rather disinvestment in such PUSs should be deferred.

**Ms.Navita Nathani said about the disinvestment that,** Most of the problems in public sector stem from the fact that it has been exposed to competition but without any of the relative decision making freedom and flexibility of private companies.

What needs to be done in a more systematic and vigorous manner by the Govt. is the marketing of the process to the private investors and those who are going to manage these organisation post disinvestment. Transparency in the process does not mean that you need not consult and talk to the investor high degree of mutual trust comes about only when

you sit across the table with the buyers and thrash out the issues. This means that Govt. has to position reform minded officers, equally important for the Govt. to examine the role to be played by the management of the unit being sold in the transaction. Another important issue is the fact that these transactions are really meant for long term value enhancement and not short term monetary gains. The expectation within the political groups have to be managed to be more realistic in the amount of money obtained from the deal.

According to her Disinvestment is a complex process involving strong stockholders with highly conflicting motives. Our economic and political condition is yet not conducive to such a process yet, things are moving at snail's pace. In fact the disinvestment target of Rs. 12000 crore for the year now seems all too distant. Finally it is clear that the ability to balance two things i.e. running business successfully and employees of disinvested firm receives fair deal will determine the success of exercise.

**Dr.S.K.Bajpayee** argued on the disinvestment that, the real issue is not whether to have total marketisation of the economy or fully state owned economy. This is an empty thought and no serious school of political economy would even today credibly argue for one or the other. Hence the basic question is that how to create the right balance between this dichotomy. PSEs have always been playing an important role of



Indian Economy for the battle of equity, social justice and democracy. PSEs particularly in social utility services like railways, post and telegraphs, telecommunication, water supply, power energy, are guided by a variety of considerations in determining cost and prices. Because of this the state may not raise the prices of these services even though costs may have risen, so it would not be appropriate to use profitability as criterion of their efficiency. Although the PSEs has given lower profitability as compare to the private sector but it would made a higher social rate of return by offering much better reward for labors in term of wages, salaries and other perquisites and providing services in cheaper rate in comparison with private sector enterprises. Therefore, instead of disinvestment rationalization of work force, professionalisation of management, improvement of business plan and adoption of corporate strategy will to free them from the clutches of politicians and bureaucrats would make PSEs more productive, much efficient and better competitive.

**Dr.Manohar Pandit opined in** his research paper entitled "No controversy or myth, Disinvestment is the only Reality & way forward for India" says that the initial need and compulsions of post independence era of 1950s might have justified the investment in public sector, the poor execution of the objectives and the policies by both the political and

bureaucratic leadership of the country has made it a bad dream, that should have ended much earlier. However since the nation awoke from its economic fallacies, only in the year 1991, caused by the jolt of economic disaster, we began thinking in this direction only lately and the process of disinvestment was initiated. Even a ministry with cabinet rank was constituted for disinvestment. As narrated above Government has no business interests and focus on real governance of the country. If we have to progress as a nation and secure our position on the league of nations, then we well have to invest in our people's education, health, nutrition and basic infrastructure. To do that, the resources will have to be withdrawn form PSUs through the process of Disinvestment. This will also turn the loss making or merely profit making PSUs into a commercial success stories, creating a win win situation for all.

**Dr.Harshvardhan Halve had his overview on disinvestment that,** the valuation of business entity is a balanced combination of Art and Science. There is no 'Surefire' way to value a company or a business entity. The bottom line is, of course, that the business is worth what a buyer is ready or willing or able to pay. So, the value of an entity finally by all practical means becomes the value as perceived by the involved parties. But there is always a method to arrive at a reasonable estimation about the value of an entity, more so considering the specific situations.

Sometimes, any one method may not be considered sufficient or may not be in a position to convincingly arrive at a reasonable value to satisfy either the seller or the prospective buyer. Therefore, it is not uncommon to value a PSU by a number of different methods or use an average (or more likely weighted average that gives more weight to some methods than others) of the various methods used. It is a very common happening for a buyer to ask for the 'Logic' behind an asking price. Having a good answer to that question always will enhance the chances of selling the PSUs for the desired price or the price, which will generate much less 'political dust' as is seen in most of the developing countries.

Valuation is always a complex issue and as a result, the government is required to move towards a transparent valuation process, which should have the acceptance of both the government and the public at large. On the other hand, for a buyer in real business world there is 'No risk' situation. The higher the perceived risk, the lower would be the value of business entity or the PSU. But the government can reduce the perceived risk of the buyer by giving him the correct information about the business entity on sale. Valuation thus is a complex exercise as different methods yield different 'values' spread over a large range. Different valuers may arrive at different values depending upon their perceptions of future scenario, expected rate of return, associated risks, etc. Valuation of

business also varies from time to time. The best way is to evolve a suitable integrated approach rather than taking average of values arrived at by adopting different methods. Transparency in valuations is a must so as to obviate co.

### **Review of Books**

Mr. Sudhir Naib in his book "Disinvestment in India" discussed about the Public Sector in India, Strategy for privatization. The effects of ownership & competition on efficiency, corporate response to economic reform Disinvestment in India, etc. out of which a brief review of main types of Disinvestment Method of Divestiture, criteria for selection of PSU's for Disinvestment and the procedure of Disinvestment are given.

### **Disinvestment:**

Disinvestment is one of the methods of privatization. Privatization is a broad term, which means the process of disengaging the state from those activities which are best done by private sector. It may involve Divestiture and Non- Divestiture option. Divestiture option involve transfer of ownerships rights from public to private sector, Where as Non- divestiture options involve management transfer and marketisation. Divestiture option may be preceded by Non- Divestiture techniques, which are usually aimed at improving the financial and/ or operational of the SOE's, thus increasing the potential sale value.

## **The main types of non-divestiture options are:**

### **(a) Restructuring:**

SOEs can reform through restructuring -organizational, financial and operational .The organizational restructuring may involve splitting of the SOE into smaller units, and labor rationalizations. The financial restructuring includes writing off excessive debts, and operational restructuring means infusion of new investment or technology into the SOE.

### **(b) Lease and management contracts:**

Leases and management contracts are arrangements whereby private sector management, technology and skills are provided under contract to SOE for an agreed period and compensation. These measures are more often used as temporary measure to bring an SOE to an acceptable level of performance. The basic differences between a lease and a management contract are the following.

- i) Under a lease, the lessee hires its personnel. However, under management contract the contractor may have wide power over existing personnel but they remain employees of the enterprise and are often subject to government pay scales and conditions.
- ii) A lease pays the state for the use of assets or facilities, whereas a management contractor is paid by the state for its management

or skills. The contractor has not financial exposure and receives his regardless of the profitability of the enterprise.

Another non-divestiture instrument is concession. A concession is a contractual agreement between the state and a private operator (called concessionaire) requiring the latter to operate a public service, such as power or water distribution system, for a specified period and at his own-risk. Unlike leases, the holder of a concession is responsible of capital expenditure and investments. One typical form of concession is build-operate-transfer (BOT) concession for private development of infrastructure.

### **(c) Contracting out**

In contracting out, a public authority contracts a private firm to perform some specific service in place of a public entity or in competition with it. Contracting out is a form of operating concession. It is particularly a success where the selected contractor has the equipment and know-how to provide the services or products and the contract specifies the performance required. However, there should be a designated agency to monitor the contract and receive complaints from the public.

**(d)Joint ventures:**

It is an association of two or more natural persons or legal entities (judicial persons) collaborating in an enterprise and sharing the risks and benefits of the joint venture. This partnership often involves a foreign partner who may provide capital and know-how. The motivation of the government in going for joint venture with foreign partner is access to foreign technology, capital management know-how and foreign partner's international distribution network which can facilitate access to new export markets.

Whereas non-divestiture options involve the transfer of operating or development rights, divestiture options involve the transfer of ownership rights from the public to the private sector.

**The principal methods of divestiture are:**

**a) Public offering of shares (full or partial):**

Under this transaction, the state sells to the general public all or large block of its stock in a wholly or partly owned SOE. Technically, this amounts to secondary distribution of existing government-held shares but is commonly handled largely as primary issue. A prospectus for the offering is prepared and normally the services of an investment bank as adviser are required. The bank or a syndicate may also underwrite the offering. The offering may be on a fixed price or on a

tender basis. The shares may be marketed internationally or only domestically.

The method is usually used for profitable, large-scale SOEs. If the SOE is not a strong performing firm, a public offering is possible only after it's restructuring and turn-around.

The advantages of public offering are that they permit widespread shareholding, normally characterized by openness and transparency. For these reasons it is politically more palatable. However, without strong equity markets, public offering will not generate much response.

It is a time consuming process and transaction cost is high (4 to 5 per cent). Precedent cases in public sector have been VSNL and MTNL.

**b) Direct private sale (full or partial):**

Under this method of divestiture, the state's share of a firm is sold directly to private buyers. No use is made of share offering or the services of financial intermediaries such as brokers, underwriters or other agents, and therefore the method has the advantage of lower flotation costs and greater speed. A direct sale can be carried out in two ways- one, through competitive bidding (direct sale by tender), and two, to a predetermined selected buyer).

One of the principal advantages of a private sale of shares is that the prospective owner is known in advance and can be evaluated on the



basis of his ability to bring in benefits such as management, technology, market access, etc. In many instance, the future success of the operation may be as important to the future success of the operation may be as important to governments as the proceeds from the sale. In some cases, a partial private sale may be a necessary first step to full privatization, as it brings in a leveraged party who is able to turn the SOE around so that it becomes attractive to investors. In India private placement of equity has been done in case of CONCOR and GAIL.

**c) New private investment in SOE:**

A government may wish to add more capital to an SOE and achieve this by opening equity ownership to the private sector. The main characteristic of such privatization method is that the state does not dispose of any of its existing equity in the SOE. Rather, it increases the equity and causes a dilution of the government's equity position. The resulting situation will be joint private/ government ownership of the enterprise. Normally, a new equity issue does not result in sales proceeds for the State (Vuylsteke 1988). It will be the preferred method, if the government's objective is both to reduce its proportionate share holding, and the enterprise is in needs of capital.

**d) Management/Employees buy-out:**

The term management buy-out (MBO) generally refers to the acquisitions of a controlling shareholding in a company by a group of managers. This may involve leveraged management buy-out (LMBO), wherein purchase is debt- financed and assets are used as security for it. However, where a large amount of debt is used, the enterprises are left very exposed to unfavorable changes, the macroeconomic environment. Therefore the experience quality and motivation of the management and workforce are critical to the success of management/employee buy-out.

**e) Liquidation – sale of SOE assets:**

In certain circumstance, the government may prefer to liquidate the SOE and sell their asset instead of selling it assets instead of selling is as an ongoing operation. It occurs mostly when it is more advantages for the state to sell individual assets instead of the entire enterprise. Liquidation has been used as a form of privatization in Poland particularly with shall and medium-sized firms.

**f) Fragmentation- Reorganization / break-up into components parts:**

This method involves breaking up or reorganization of an SOE into several separate entities. It also includes hiving off of some activities. This method permits piecemeal privatization and application of different method of privatization to different component parts, thereby maximizing

the overall process. It is applicable where SOE incorporates too many activities that, in the aggregate, are not attractive to potential investor. Also, the state may wish to sell only certain components of the SOE while retaining others. Another reason for fragmenting an SOE may be that it is a monopoly and the government may fragment it into separate enterprises to create competition, e.g. electricity generation and distribution. Once an SOE has been broken up into component parts, further privatization method can be applied, viz., private sale, sale of assets, MBO, etc.

**g) Public auctions:**

Public auctions are predominantly used for small or medium-sized SOEs, which do not require technology transfers or other special inputs. It provides for open competitive bidding, which makes the process transparent. The process is also comparatively fast. One drawback of this technique is the inability to impose conditions of sale.

**h) Mass privatization:**

Mass privatization (also called voucher or coupon privatization) has been widely used in the countries in transition of Central and Eastern Europe. Mass privatization is based on the population-wide distribution of vouchers or certificates free of charge or for a nominal fee. Usually, these vouchers are distributed to all adult citizens.

The main advantage of mass privatization is the rapid transfer of ownership from the State to individual shareholders. Consequently, it encourages popular support for the privatization process and contributes to the building of the necessary board-based consensus for privatization. On the other hand, the principal argument against mass privatization is that it does not, in itself, result in improved economic efficiency. This is due to several reasons. First, widely dispersed ownership may result in ineffective control of the privatized enterprises, especially when the key actors lack the necessary experience and skills for enterprise management in a commercial market context. Furthermore, it does not address the real problems facing PSEs such as under-capitalization, huge indebtedness and poor management. Another problem is that the transfer of ownership without any provisions for fostering competition or without adequate regulation merely transforms State-run monopolies into private companies.

**A criterion for Selection of PSU's for Disinvestment:**

**a) Comparative advantage criteria:**

Ramanadham (1984, 1989, 1991a, 1991b) advocates that where a public enterprise loses its comparative advantage, it is preferable to privatize it. As long as public enterprise is a superior means of making a contribution to the national well being, it should be preferred to other

forms; but when it has a comparative disadvantage in this respect, it should be reorganized in to a private enterprise.

The comparative advantage is to be measured in terms of the commercial returns, social returns and a desired trade-off between them. The social-financial return combination would be dissimilar among different enterprises or sectors, and hence the concept of comparative advantage has to be addressed in an enterprise-specific and time-specific manner. As these conditions change in the course of time, private enterprise may be to gain an edge over public enterprise, not necessarily because it is intrinsically more efficient, but because of two other reasons. First, the social returns element in the comparative advantage of a public enterprise generally weakens over time in several sectors of activity. Second, public enterprise, as an institution, is exposed to certain intrinsic costs, which can be a constant drag on its performance. There is undue focus on mistakes, resulting in 'play safe' syndrome by managers who avoid taking risk. In a public enterprise loss of comparative advantage is not necessarily synonymous with inefficiency. The situation may have arisen from certain macro changes in the national economic circumstances and from changes in the scales of social preferences.

**b) Economic criteria:**

According to this, the criterion for divestiture is net economic yield generated by the enterprise as state-owned entity and as privatized entity. Two distinct elements affect this difference: the transfer of funds from the private sector to the public sector in connection with purchase of enterprise and the transfer of productive facilities from the public sector to the private sector.

Jones et al. (1990) have suggested a model to answer which enterprises should be disinvested. According to this, an asset should be sold only if the seller is better off after the sale, i.e. the change in welfare ( $\Delta W$ ) is positive. If the government behaves as a private seller, then this would simply require that the sale price exceed the value of the future-earning stream foregone, i.e.

$$\text{Sell if } \Delta W = W - V_{sg} > 0$$

Where  $\Delta W$  = Change in welfare.

$Z$  = Price at which sale executed.

$V_{sg}$  = Social value under continued government option.

The value to society under public operation is the present value of expected net benefits accruing to society as a whole from the continued public operation of the enterprise. As the government is concerned about overall welfare of society, it must also consider the firm's performance

after sale ( $V_{sg}$ ), i.e. social value under private operation. The social value under private operation is the present value of expected net benefits accruing to society as a whole from the private operation of enterprise.

Another consideration is the impact of transferring funds from private to public hands in case of divestiture. One impact may be ‘crowding out’ of other capital needs in the private sector in the country. However, the government may use this income to retire some of its own debts, thereby releasing new funds to the private sector and thus could offset the crowding out effect.

Another impact which should be examined is how the sale proceeds are used. This depends on the difference between the private revenue multiplier ( $\lambda_p$ ) and government revenue multipliers ( $\lambda_g$ )<sup>4</sup>. Thus divestiture has both a behavioral impact (reflected in the  $V^{sp} - V_{sg}$  differential) and a fiscal impact (reflected in the  $\lambda_g - \lambda_p$  differential)

Keeping these parameters in view, the decision to sell becomes:

Self if,

$$\Delta W = V_{sp} - V_{sg} + (\lambda_g - \lambda_p)Z > 0$$

$$\text{Rearranging these terms, self if } Z > \frac{V_{sp} - V_{sg}}{\lambda_g - \lambda_p}$$

This means that whenever social welfare is higher under private ownership than public, and government revenue multiplier greater than private profit multiplier, the price is of no consequence, and the

government should be willing to pay the private sector to take over the enterprise. This might happen, if the enterprise which is loss making under government operation becomes viable under private ownership without large deleterious welfare effects on consumers or workers.

### **Decision Model for Deciding the Portfolio of Enterprises for Disinvestment**

Developing a pragmatic model for deciding the portfolio of SOEs whose shareholdings have to be divested is the most critical component of the divestment process. The model could take into account a host of factors, namely financial success, marketing structure, social obligations, classification of SOEs into certain cognate groups, etc. Venugopal et al. (1990) have suggested a 2x2 matrix for divestment of SOEs which takes into consideration factors such as the financial success and marketing structure. According to this model, financially successful SOEs operating in the competitive market are the most appropriate candidates for divestment. Coming to the financially successful non-competitive SOEs the matrix introduces the idea of breaking them eligible for finally off-loading to the private sector. The financially non-successful enterprise will first have to be transformed into financially viable units and subsequently privatized.



Sankar et al. (1989) has presented a 3x2 matrix for a divestment decision. SOEs are considered as high or low on three factors, namely social purpose, profitability and resource mobilization. According to this model, SOEs operating in competitive markets having low social purpose and also low resource mobilization are most suitable candidates for divestment.

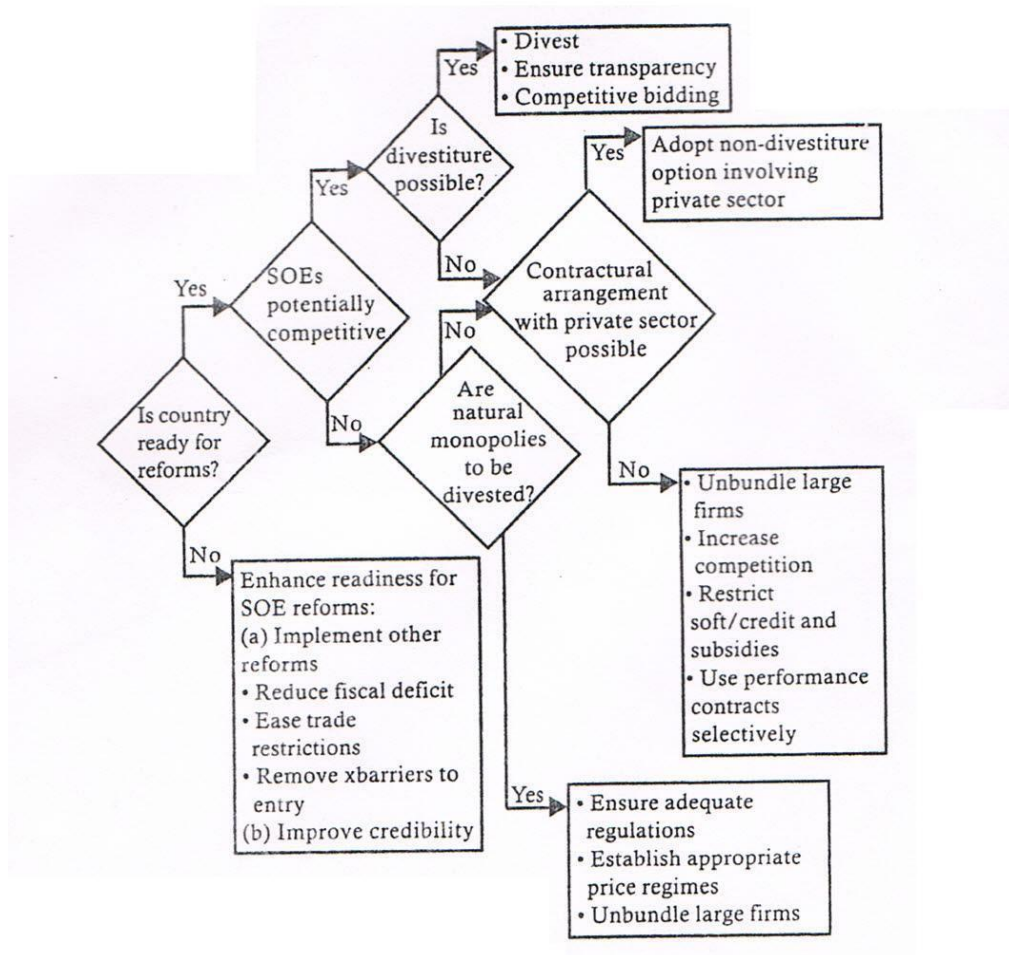
Kumar (1992) evolved a 3x2x2 matrix, which categorizes SOEs in terms of their being high or low with reference to market structure, efficiency and social obligations. The model suggests divestiture of enterprises, which are low in efficiency and social obligations. The detail of the model are given in the Table No. 2.1

**Table No. 2.1**  
**Privatization Options based on Market Structure,**  
**Efficiency and Social Obligations**

<b>Market Structure</b>	<b>Efficiency</b>	<b>Social Obligations/ Externalities</b>	<b>Portfolio of Privatization Options</b>
Competitive	High	Low	Create further competition by allowing private sector Units or by divestiture
Competitive	High	High	Non-divestiture options
			a) Management transfers b) Marketisation
Competitive	Low	Low	Divest

Competitive	Low	High	Non-divestiture options a) Dilution of equity b) Sub-contracting, etc c) Joint ventures marketisation
Monopoly	High	Low	Create competition by allowing Private Sector units and through exposure to international competition a) Increasing Scope for marketiation
Monopoly	Low	Low	Divest
Monopoly	Low	High	Create competition by splitting the enterprise in different units
Monopoly	High	High	Regulate with divestiture Options or encourage dilution of equity

## A DECISION TREE FOR DISINVESTMENT PROGRAMME



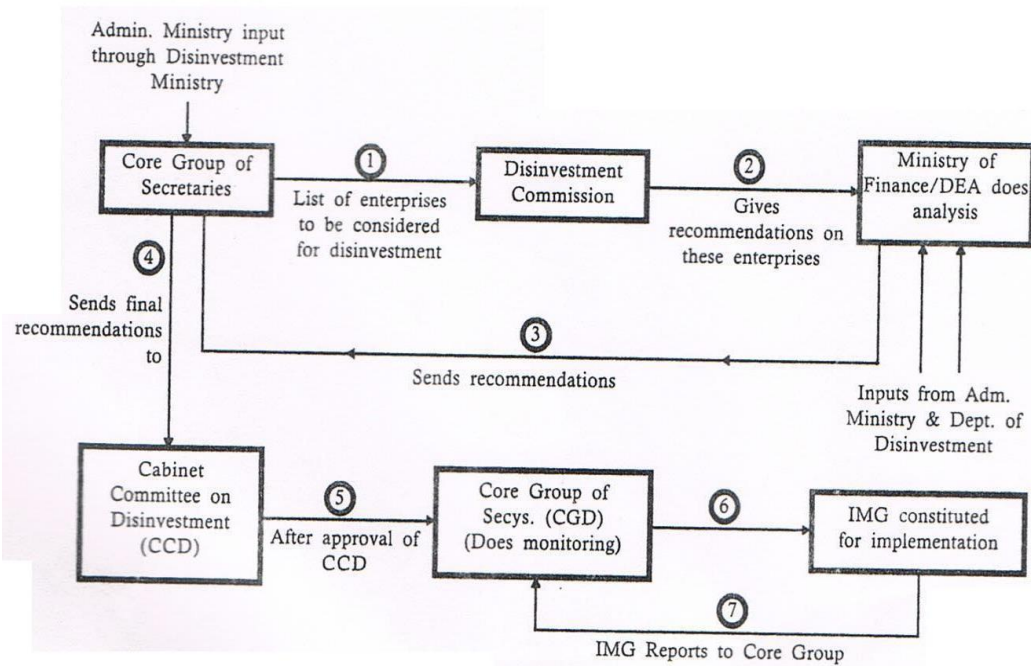
### **Procedure for Disinvestment:**

Ministry of Disinvestment, Govt. of India, headed by Mr. Arun Shouri and has office carry out the disinvestment in accordance with prescribed procedure with transparency. The procedure is:

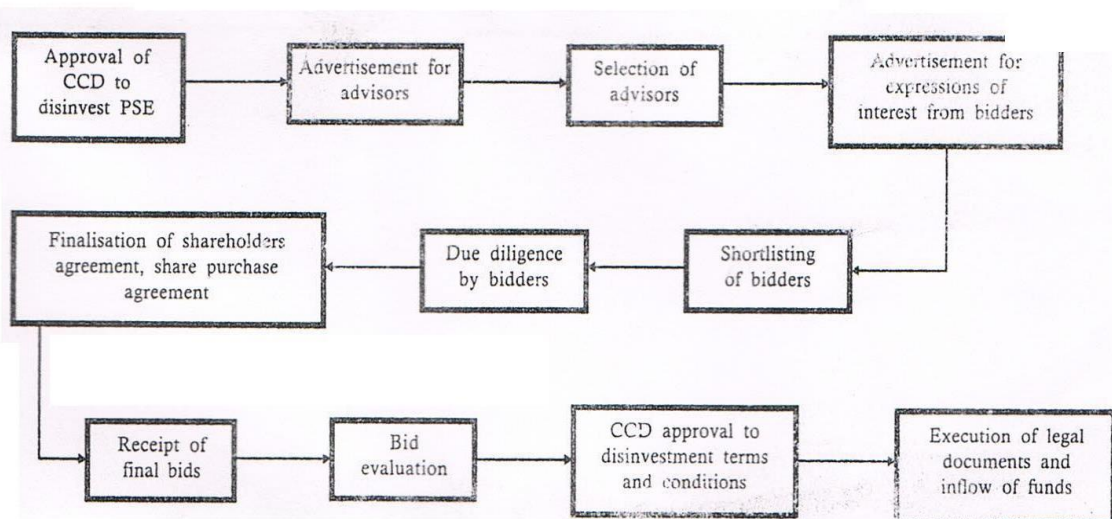
- a) proposal for disinvestment in any public unit, depending on the recommendations of the commission or in accordance with the declared disinvestment policy of the govt. placed before the Cabinet Committee on Disinvestment for consideration, b) after the clearance of the proposal, competitive bidding process will take place through the Advisor, c) After Expression of interest, advertisement through various media(newspaper, website etc.)the bidders are short listed based on objective screening considering the criteria or recruitment. d) The advisor prepare the information memorandum in consultation with the public units. e) both the agreement of share purchaser and share holder are prepared by the committees advisor with the help of legal Advisor. f) the prospective bidders can hold discussion with the committees advisor or govt for any clarification, g) task of valuation of public units are undertaken as per the standard national and international manner, h) after receiving the reaction from the bidders, both the Share Purchase Agreement (SPA) as well as Share Holder Agreement (SHA) are prepared. After the approval from the Law Ministry, are approved by the Govt. Then eventually they are sent to the bidders for final bidding. i) After examination, analysis and evaluation, the recommendation of the inter Ministerial Group of

Secretaries on Disinvestment, whose recommendation are place before the Cabinet Committee on Disinvestment for final decision regarding the selection of the strategic partner, signed both the agreement of SPA and SHA, j) the traction mentioned in (i) are carried through host of the Ministries and Department like, Finance Dept. of Public Enterprises controlling PSU's Dept of Company Affairs and Dept. of Legal Affairs etc. k) After the completion of the transaction all the document sent to cabinet Advisory Commission of India, it will go to parliament and releasing to the general public.

## FLOW DIAGRAM OF DISINVESTMENT PROCEDURE



## FLOW CHART OF STRATEGIC SALE



## **Review of Committee Reports:**

Since 1991 Government of India appointed various committees to institutionalize the Disinvestment process a brief overview of these committees are given below.

### **Krishnamurthy Committee:**

This was the first committee constituted by the Chandrashekhar government. While presenting the interim budget for the year 1991-92 declare disinvestment up to 20 percent of the government equity in the selected PSE's in favor of the public sector institutional investors. The objective of the disinvestment was to board-base equity, improve management, enhance availability of resources for these PSE's and yield resources for the exchequer. Later, the Industrial Policy Statement of 24 July 1991 stated that the government would divest part of its holdings in selected PSE's but did not place any cap on the extent of disinvestment. Nor did it restrict disinvestment in favor of any particular class of investors. The objective for disinvestment was to provide further market discipline to the performance of public undertakings.

In the budget speech of 1991-92, the Congress government reiterated the cap of 20% for disinvestment but the eligible investors were to consist of mutual funds, investment institutions in the public sector, and the workers in these firms. The objectives were modified as being the

rising of resources, encouraging wider public participation and promoting greater accountability.

To institutionalize the disinvestment process the govt. had constituted a committee in February 1992 under V. Krishnamurthy, the then Member, and Planning Commission. The terms of reference of the committee were to devise criteria for selection of the PSE's for disinvestment during 1992-93, and to advice on limits on the percentage of equality to be disinvested in respect of such PSE's. It was also to suggest the target clientele, make suggestion on the modus operandi of disinvestment and lay down the criteria for valuation of equality shares of such PSE's.

In short the Public Sector Undertakings in India faced the following changes under this committee :

- 1) Disinvestment took place in twenty four selected Public Sector Undertaking.
- 2) Up to 20 percent of Government equally were allotted to Minimal funds, Investments Institutions in the public sector and the workers in Public Sector Undertaking

**Rangarajan committee:**

The govt. reconstituted the committee in November 1992 with Dr. C. Rangarajan, then the Member, Planning Commission as Chairman and



Dr. Y. Venugopal Reddy as Member Secretary. The Committee gave its report on 20 April, 1993

The Committee took upon itself to indicate the objectives sought to be achieved through disinvestment in public sector equity. According to it, the objectives were:

- (a) To mop up resources of non-inflationary character to meet the budgetary needs which include requirements of developmental activities and social obligations?
- (b) To sub serve, in the medium term, the overall fiscal objective of gradually reducing the fiscal deficit and bringing about a positive overall impact on future liabilities and income flows to Government.
- (c) To improve the overall economic efficiency by bringing about a more competitive atmosphere with emphasis on the cost and quality of product and service to the customers of public sector enterprise.
- (d) To enhance the efficiency of individual enterprises by imparting a new dynamism in the management of these enterprises through diversification of ownership and control as also larger and freer access to the expanding capital markets in India.
- (e) To realign the extent of ownership, control and regulation in different activities consistent with the technological needs and developments in Industrial Policy"

The committee did not suggest any criteria for selection of enterprises for disinvestment on the ground that the financial year 1992-93 was about to end. Regarding level of disinvestment, it recommended that the percentage of equity to be divested could be up to 49% for industries explicitly reserved for the public sector. In exceptional cases, such as the enterprises which had dominant market share or where separate identity had to be maintain for strategic reasons, the target public ownership level could be kept at 29%, i.e., disinvestment could take place to the extent of 74% . In all other cases, it recommended 100% disinvestment of govt. stake. Holding of 51% or more equality by the govt. was recommended only for six schedule industries: coal and lignite; mineral oils; arms, ammunition and defense equipment; atomic energy; radioactive minerals; and railway transport. It also suggested creating market friendly image for concerned PSE's among investing public, and evaluating the need for a regulatory commission. The committee suggested that 10% of proceeds be given to the PSE concerned for meeting its expansion / rationalization needs. Another important recommendation of the committee was that foreign investor might not be allowed to buy more than 24% of equity except strategic alliance on terms approved by the govt. The committee suggested a separate apex agency for designing and implementing disinvestment.

However, no action was taken on the report as political consensus about disinvestment to such an extent was lacking. Under this commission partial divestiture was undertaken in a piecemeal manner. It appears that the sole aim was to get revenue from disinvestment without following any objectives seriously.

In short the Public Sector Undertakings in India faced the following changes under this committee:

- 1) Industries explicitly reserved for the public sector were disinvested up to 49 percent.
- 2) 74 percent of enterprises having dominant market share or separate entity were also disinvested.
- 3) All other (Excluding the above) public sector undertakings were disinvested up to 100 percent.
- 4) 10 percent of Disinvestment proceeds were spend to the public sector undertakings concerned for meeting its expansion or rationalization needs.

The committee never allowed the foreign investors to buy more than 24 percent of equity except in case of strategic alliance on terms and conditions approved by the government

**Ramakrishna Committee:**

This committee was constituted by the United Front government in 1996, in its Common Minimum Programme stated its policy as being to carefully examine the public sector in non-core strategic areas and to set up a Disinvestment Commission for advising on the disinvestment related matters. However, no disinvestment objective was mentioned in the policy statement.

The government constituted public Sector Disinvestment Commission under G.V. Ramakrishna on 23 August 1996 for a period of three years with the main objective of preparing an over-all long-term disinvestment programme for public sector undertakings referred to the Commission. This inter-alia included determining the extent of disinvestment, selecting financial advisers to facilitate the disinvestment process, supervising the over-all sale process and taking decisions on instruments, pricing, timing, monitoring the disinvestment process and advising the government on possible capital restructuring to ensure maximum realization through disinvestment.

By December 1997, the disinvestment commission had given six reports which included specific recommendations in respect of 34 enterprises. The commission showed concern about slow progress in implementation of its recommendations and it was particularly critical of

the government's going ahead with strategic sales leading to joint ventures in some PSEs not referred to the commission.

Presumably, the government did not like the criticism as it axed the powers of the commission in January 1998. It replaced the existing terms of reference with a revised terms of reference, which stated that the role and function of the commission would be to advise the government on disinvestment in those public sector units that are referred to it by the government. The final decision of the recommendation of the disinvestment commission with the government. This amendment diluted the role of the commission considerably as it removed the overall monitoring and supervisory functions from its ambit.

In all, the government referred 72 PSU's to the commission. Out of these eight PSU's were withdrawn. Out of the remaining 64 enterprises, six enterprises were already under reference to BIFR and the commission did not examine them. Thus, the commission was left with 58 enterprises. It submitted its recommendation for all these enterprises in 12 reports. The recommendations indicated a shift from partial disinvestment, which had taken place so far, to strategic sale with transfer of management. The last report of commission came in August 1999 and the commission itself lapsed on 30 November 1999.

In short the Public Sector Undertakings in India faced the following changes under this committee:

- 1) Public sector Disinvestment commission was constituted on August 23<sup>rd</sup> 1996 for a period of three years with the main objective of preparing an overall long-term Disinvestment programme for public sector undertaking.
- 2) The Disinvestment commission had given six reports which included specific recommendations in respect of 34 enterprises, showing the concern about slow progress in implementation of its recommendations and it was particularly critical of the Governments going a head with strategic sales leading to joint ventures in same. PSUs which are not referred to the commission. Obviously the Government not like the criticism as it axed the powers of the commission in January 1998.
- 3) The decision in regard to the percentage of Disinvestment was changed. The non strategic PSEs were privatized through gradual disinvestment or strategic sale.

### **Review of the Recommendations of the Disinvestment commission**

The Disinvestment Commission did not take an ideological approach to disinvestment. It examined each PSE and classified it *as* strategic or non-strategic. According to the commission, strategic units

are those engaged in defense and security-related production. *In* such units, government holding could be maintained at 100 per cent. The non-strategic PSEs were classified as either core or non-core. The classification of PSE in core or non-core was made by taking into account the structure of the industry, the competitiveness of the market in which it operates, its market share and the public purpose (if any) served by it.

The commission opined that core group is that which *is* capital or technology intensive and there is a tendency towards an oligopolistic market structure. Examples of such cases according to the commission were telecom, power generation and transmission, petroleum exploration and refining industries. The commission felt that in such areas presence of public sector will be necessary for sometime as a countervailing force and recommended disinvestment up to 49 per cent in core area for the time being. According to the commission, non-core PSEs were in areas where private investments have grown considerably and markets are fully contestable. For non-core PSEs, the commission was of the view that it would be desirable to disinvest up to 74 per cent or more. Withdrawal from non-core sectors was indicated on considerations of a long-term efficient use of capital, growing financial in viability and the compulsions for these PSEs to operate in an increasingly competitive environment.

The commission arranged to have diagnostic studies through professional consultancy firms of the referred PSEs. The commission stated that its recommendations were based on expert commercial evaluation of each PSE, market structure in the industry, potential commercial viability of the undertaking, discussions with top management and the concerned Ministries.

With this framework in place, out of the total 58 PSEs examined by it, the commission categorized 14 PSEs in core group and 44 in non-core group. It may be noted that even in the same industry segment, viz., petroleum, steel, minerals and metals, transportation services and industrial development technical consultancy services, enterprises have been categorized in both core and non-core categories, depending upon the characteristics of a particular enterprise.

However, the classification of enterprises in core and non-core is not relevant now as the government classified PSEs into strategic and non-strategic categories in March 1999. According to this classification, strategic PSEs exist only in areas of defense, atomic energy and railway transport.

The subtle difference between strategic sale and trade sale is that whereas in the former some percentage is retained by government, in the latter 100 per cent is sold. The recommendation for deferment in



disinvestment was mainly to allow for proper regulatory structure to come first.

In the 1998-99 budget, the BJP government decided to bring down government shareholding in the PSEs to 26 per cent in the generality of cases, (thus facilitating ownership changes, as was recommended by the Disinvestment Commission). It however, stated that the government would retain majority holdings in PSEs involving strategic considerations and that the interests of the workers would be protected in all cases.

On 16 March 1999, the government classified the PSEs into strategic and non-strategic areas for the purpose of disinvestment. It was decided that the strategic PSEs would be those in the areas of arms and ammunitions and the allied items of defense equipment, defense aircrafts and warships; atomic energy (except in the areas related to the generation of nuclear power and applications of radiation and radio-isotopes to agriculture, medicine and non-strategic industries); and railway transport. All other PSEs were to be considered non-strategic. For the non-strategic PSEs, it was however decided that the dilution of government stake to 26 per cent would not be automatic and the manner and pace of doing so would be worked out on a case-to-case basis. A decision in regard to the percentage of disinvestment would depend on two factors, viz., first, whether the industrial sector requires the presence of the public sector as

a countervailing force to prevent concentration of power in private hands, and second, whether the industrial sector requires a regulatory mechanism to protect the consumer interests before privatization. In 1999-2000, the government stated that its policy would be to strengthen strategic PSEs, privatize non-strategic PSEs through gradual disinvestment or strategic sale and devise viable rehabilitation strategies for weak units. For the first time, the expression 'privatization' was used instead of disinvestment.

**Department of disinvestment Commission:**

The government formed the Department of Disinvestment on 10 December 1999, which was to act as a nodal agency for disinvestment and to have a systematic policy approach towards disinvestment. In a significant decision, the government announced in the budget of 2000-2001 that it was prepared to reduce its stake in the non-strategic PSEs to even below 26 per cent if necessary. It further stated closure of those PSEs which cannot be revived. The emphasis remained on strategic sales. The budget statement for the year stated that entire proceeds from disinvestment would be deployed in social sector, restructuring of PSEs and retirement of public debt.

In short the Public Sector Undertakings in India faced the following changes under this committee:

- 1) All the public sector undertakings which cannot be reviewed were closed.
- 2) Disinvestment proceeds were deployed in social sector restructuring of PSUs and for the retirement of public Debt

**Patil Commission:**

The government reconstituted the Disinvestment commission in July 2001 for a period of two years under the chairmanship of Dr R.H. Patil. The commission has four other part- time members and one member secretary. The government decided to refer all ‘non-strategic’ PSEs including subsidiaries (excluding IOC, ONGC, and GAIL ) to the Disinvestment Commissions for it to priorities, examine and make recommendations taking into consideration the existing policy as articulated on 16 March 1999 and the budget speeches of the Finance Minister from time to time. The reconstituted commission has submitted six reports till March 2003. In these reports, fresh recommendations have been made for 17 PSEs and review recommendations for four PSEs. The commission recommended strategic sale in case of eight PSEs and sale of entire government stake or closure in six PSEs out of the 17 freshly examined PSEs.

In short the Public Sector Undertakings in India faced the following changes under this committee:

- 1) To priorities examine and make recommendation reconstituted Disinvestment Commission came in July 2001.
- 2) Through strategic sale mode eight PSUs were Disinvested

### **Enterprises under Study by Disinvestment Commission**

#### **Name of Public Sector Enterprise**

- Balmer and Lawrie Co. Ltd.
- Bharat Heavy Plates and Vessels Ltd. (BHPV)
- Bharat Ophthalmic Glass Ltd. (BOGL)
- Bharat Petroleum Company Ltd. (BPCL)
- Braithwaite and Co. Ltd.
- Bum Standard Company Limited (BSCL)
- Central Inland Water Transport Corporation Ltd. (CIWTC)
- Engineering Projects (India) Ltd. (EPIL)
- Engineers India Ltd. (EIL)
- Fertilizers and Chemicals (Travancore) Limited (FACT)
- Hindustan Copper Ltd. (HCL)
- Hindustan Organic Chemicals Ltd. (HOCL)
- Hindustan Paper Corporation Ltd.
- Hindustan Petroleum Co. Ltd. (HPCL)
- Hindustan Salts Ltd. (HSL)
- Hotel Corporation of India Ltd. (HCIL)
- Indian Medicines Pharmaceuticals Corporation Ltd. (MPCL)
- Indian Tourism Development Corporation (ITDC)

- Instrumentation Ltd. (IL)
- Madras Fertilizers Ltd. (MFL)
- Manganese Ore India Ltd.
- Maruti Udyog Limited (MUL)
- MECON Ltd.
- Minerals and Metals Trading Corporation of India Ltd. (MMTC)
- MSTC Ltd. (MSTC)
- National Aluminium Company Ltd. (NALCO)
- National Building Construction Corporation Ltd. (NBCC)
- National Fertilizers Ltd. (NFL)
- National Instruments Ltd. (NIL) NEPA Ltd.
- Rashtriya Chemicals and Fertilizers Ltd. (RCFL)
- Shipping Corporation of India Ltd. (SCI)
- Sponge Iron India Ltd. (SIIL)
- State Trading Corporation (STC)
- Tungabhadra Steel Product Ltd.
- Tyre Corporation of India Ltd.

Source: Ministry of Disinvestment website

## **Review of well Reputed Journals:**

**Economic & Political Weekly**, one of the reputed Journal, research article appears in the issue, May 29, 2004 published showing "How to disinvest & to whom". It explains, Disinvestment could be by way of retail sale or through sale of equity to public financial institutions or through sale of large chunks of equity to strategic partners who would then take over the management of the PSU. Should the government still retain ownership by limiting disinvestment to less than 50 per cent or should it merely retain its strategic role by limiting disinvestment to less than 75 per cent? When disinvestment was started, the intention was to farm out shares in 'non-strategic' PSUs to public financial institutions. Later, the policy shifted towards selling majority shareholding in non-strategic PSUs and then to strategic sale in selected PSUs. The government announced its intention to bring down its equity to 26 percent or less around the time when the newly created disinvestment ministry started becoming fully operative. The words 'strategic sales' and 'strategic investors' used by the FM in 2001-02 sounded more like clichés than any meaningful expression of a well thought out intention.

**Mrs. K.T. Geeta**, viewed that Public sector units in India are frequently saddled with a host of non commercial goals – employment generation, income redistribution, promotion of socialism, etc.

Privatization often results in increased efficiency, as organizations goal are better defined and non-commercial goals are sidelined. Private management will produce significant improvements; boosting the efficiency and quality of services and activities. In the functions that are privatized, it is hoped that the profit seeking behavior of new, private sector managers will lead to cost-cutting and greater attention to customer satisfaction.

This newfound faith in privatization is only a part of the global economic phenomenon of the 1990s. Throughout the world, governments are turning over to private manager's control of everything from electrical utilities to prisons, from railways to education. Developing countries like Argentina and Mexico have been quick to adopt the privatization policy, sometimes as a matter of political and economic ideology, other times simply to raise revenue. Over the next decade, privatization is to be at the tope of the economic agenda of the liberated countries in Eastern Europe as well. Czechoslovakia, Hungary and Poland are all committed to privatization and have been worked out the details. As for India, through criticism is inevitable, it should not become a cause for inaction as delay carries its own price. Privatization, by exposing our industries, both in private and public sector, to global competition and technological innovations, can provide an excellent means to consolidated gains in industrialization of the last few decades.

**Ms.Susheela Subramania** Editor of Southern Economist, published her article regarding "The Agony and Ecstasy of Disinvestment" in Southern Economics – Vol. 35. she highlighted on the ASU's that, 246 central PSUs are making losses. Others like ONGC, IOC, OIL etc. show profits despite higher production cost mainly because they are able to more than fully offset the later by increase in the administered prices. Experts argue that if the PSUs had been given the option to invest the divided money paid to the government for expanding operation, the additional investments would have yielded returns – which in any case would have gone to government. It is also felt that the government should utilize the funds raised through disinvestment scheme to retire old debts as there has been a phenomenal increase in the interest burden on government debts. Presently, the government is borrowing at a rate of around Rs.3, 000 crore a month. This has increased the interest burden which is already the biggest drain.

Significantly, PSUs feel that there should be a parallel process of disinvestment of the financial institution holdings in the private sector firms also along with disinvestment of the PSUs. This will enable the financial institutions to use the resources raised by them from disinvestment to finance their purchase of government equity that is disinvested from the PSUs. This parallel process could contribute for the development of the Indian corporate sector.



**Ms. D.S. Vishwanath** in his Articles, entitled "PSUs – Is it an Opportunity" gives few suggestions to overcome the challenges. He tried to suggest some remedies to overcome the problems, I.e,

1. As CEO accept the job gracefully.
2. Be bold, brave & courageous. Face pressure, threat etc.
3. Empower executives & workmen.
4. Build second line in all areas.
5. Apply the principle of Sama, Dana Bedha and Dhanda.
6. Efforts to remove mental blocks at all levels.
7. Have official commercial attitude.
8. Effective MIS (Management Information System).
9. Exchange and provide information i.e. Transparency.
10. Development of Cost centre Concept & Profit centre approach.
11. Continuous analysis about Budgets, Budgetary Control, BEP, Funds flow & cash flow in consultation with departmental heads.
12. Exposure of people to different trends in business.
13. Development of marketing attitude at all levels and divisions in the organization.
14. Respond to technology changes & technology up gradation. But only if it enables more supplies & bring more returns to the organization.
15. Use pencils & not pens.

16. Decisions only in the interest of the organization.
17. Belongingness to work with passion.
18. Let democracy be prevailed only in the interest of the organization and objectives of the Government.
19. Need not oblige to everybody for every thing but tell obligingly to every one.
20. Be offensive as regards marketing and productivity. Be defensive as regards other areas.
21. Foremost thing needed is consolidation, which is a Prime Concern in the era of LPG. and 22. Hard work is the only way for survival. With this one may decide whether PSU is an opportunity or otherwise.

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