DISINVESTMENT- AN ECONOMIC COMPULSION FOR INDIA

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Disinvestment is a compulsory tool to boost the economy of any developing country. It generates revenue not only to reduce fiscal deficit of the country, but also to deploy in social sector for welfare activities. Credit also goes to it for improvement in efficiency and abilities of public organisations. India being a developing country needs huge resources for its developmental efforts. Disinvestment is necessary here not only to come-out of present fiscal deficit but also to suck excess liquidity from the economy to check the inflation. Therefore, it has become an economic compulsion for India to drive its economy on this fluent path.

In past years, most of our PSUs had shown a negative rate of return on capital employed. In relation to the capital employed, the levels of profits were too low. Inefficient PSUs were continuing to be a drag on the Government's resources. Many undertakings traditionally established as pillars of growth became a burden on the economy. The national gross domestic product and gross national savings were also getting adversely affected by low returns from PSUs. About 10 to 15 % of the total gross domestic savings were getting reduced on account of low savings from PSUs.

On other hand, the Indian economy passing through increasing fiscal deficit, high inflation rate (still 6.46% in Sep. 2013) and deterioration of balance of payment, led to adoption of this new approach in 1991. Disinvestment of PSUs has been one of the major policy measures adopted by the government of India so far. The government has set Rs. 40,000 crore disinvestment target for this current financial year although the first 5 months it has been able to collect Rs. 1300 crores divesting its stakes in PSUs. CIL (Coal India Ltd.) will be the single largest disinvestment for the year 2013-14.

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Disinvestment is good up to a certain limit. It generates huge funds as a revenue source which could be deployed in social sector, given as subsidies, reduce fiscal deficit & create good corporate governance but up to a certain level. Because, above that level, it diverts economy towards private-monopoly, from state-monopoly which may be harmful for the country.

The two-decade old disinvestment story of the country does not provide unambiguous results vis-a-vis to its objectives. While disinvestment has provided solid results so far as resource generation is concerned, the results in terms of efficiency are mixed. So, there is a need to revisit the subject and plug some of the remaining loopholes in it, to robust the disinvestment policies in of our country.

In this line, the present paper will assess the disinvestment efforts of government, evaluate the impact of such efforts on the PSUs, as well as, on the Indian economy, and also suggest the measures for further effective disinvestment programs.

Introduction

Disinvestment can be defined as the action of an organisation/ government selling or liquidating an asset or subsidiary. It is also referred to as 'divestment' or 'divestiture.' In most contexts, disinvestment typically refers to sale of a government-owned enterprise, partly or fully. A company or government organisation typically disinvests an asset either as a strategic move or for raising resources to meet general/ specific needs.

In past years, most of our PSUs had shown a negative rate of return on capital employed. In relation to the capital employed, the levels of profits were too low. Inefficient PSUs were continuing to be a drag on the Government's resources. Many undertakings traditionally established as pillars of growth became a burden on the economy. In relation to the capital employed, the levels of profits were too low. Of the various factors responsible for low profits in the PSUs, the following were identified as particularly important:

- Price policy of PSUs

- Under–utilisation of capacity
- Problems related to planning and construction of projects
- Problems of labour, personnel and management
- Lack of autonomy

The Indian economy was passing through increasing fiscal deficit, high inflation rate and deterioration of balance of payment. National gross domestic product and gross national savings were also getting adversely affected by low returns from PSUs. About 10 to 15 % of the total gross domestic savings were getting reduced on account of low savings from PSUs.

Hence, the need for the Government to get rid of these units and to concentrate on core activities was identified. The Government also took a view that it should move out of non-core businesses, especially the ones where the private sector had now entered in a significant way. Finally, disinvestment was also seen by the Government to raise funds for meeting general/specific needs. In this direction, the Government adopted the 'Disinvestment Policy', in 1991. This was identified as an active tool to reduce the burden of financing the PSUs.

Objectives of Disinvestment

Disinvestment is a compulsory tool to boost the economy of any developing country. It generates revenue not only to reduce fiscal deficit of the country, but also to deploy in social sector for welfare activities. Credit also goes to it for improvement in efficiency and abilities of public organisations. India being a developing country needs huge resources for its developmental efforts. Disinvestment is necessary here not only to come-out of present fiscal deficit but also to suck excess liquidity from the economy to check the inflation. Therefore, it has become an economic compulsion for India to drive its economy on this fluent path. The following main objectives of disinvestment:

- Reducing the increasing fiscal deficit
- For repaying Government debt
- To reduce the financial burden of Government

- To improve public finances
- To fund for economic growth
- Financing large-scale infrastructure development
- For social programs like health and education
- To depoliticise non-essential services
- To encourage wider share of ownership
- To introduce, competition and market discipline
- For investing in the economy to encourage spending

Disinvestment also assumes significance due to the prevalence of an increasingly competitive environment, which makes it difficult for many PSUs to operate profitably. This leads to a rapid erosion of value of the public assets making it critical to disinvest early to realise a high value. If the disinvestment process is designed appropriately, it can lead to dispersed share ownership amongst crores of households with enormous economic and political consequences. It would help in sharing the benefits of disinvestment with the people of India; improve the stake in the functioning of the country as seen by households.

Disinvestment of PSUs has been one of the major policy measures adopted by the government of India so far. Disinvestment could be the vehicle through which we make progress on the important problems of corporate governance in the country. This would pave the way for a further flowering of widely-held, professionally managed companies in the years to come. PSUs which turn into private, widely-held, professionally managed companies could perform a valuable role in economic policy.

The common perception about the effectiveness of divestment lies in the belief that institutional selling of a certain stock lowers its market value. Therefore, the company's net worth becomes devalued and the owners of the company may lose substantial paper assets. In addition, institutional divestment may encourage other investors to sell their stocks for fear of lower prices, which in turn lowers prices even further. Finally, lower stock price limits a corporation's ability to sell a portion of their stocks in order to raise funds to expand the business.

Disinvestment in India

In a mixed economy like India, historically the public sector had been assigned an important role. However, in the year 1991 the national economic policy underwent a radical transformation. The new policy of liberalisation, privatisation and globalisation de-emphasised the role of public sector in nation's economy. But the balance sheets of Indian PSUs were in a mess. Huge amount of public money was invested into various PSUs. The economy was further exasperated through the excessive borrowings every year and the resultant interest burden. Inefficient PSUs were largely responsible for the macroeconomic crisis India faced in 1980's a phenomenon that spilled over into balance of payments crisis in 1990.

Privatisation in India generally goes by the name of disinvestment or disinvestment of equity. Disinvestment here is a wider term extending from dilution of the stake of government to a level where there is no change in control to dilution that results in the transfer of management. The policy of promoting PSUs took a paradigm shift with the announcement of industrial policy on July 24th 1991, in which the central government expressed its intention to bring the private sector participation through a system of disinvestment of PSUs, except in arms and ammunitions and allied item on defense equipment, atomic energy and minerals.

It is contented that functioning of many PSUs has been characterized by low productivity, unsatisfactory quality of goods, excessive manpower utilization, inadequate human resource development and low rate of return on capital for instance between 1980 and 2002, the average rate of return on capital employed by PSU's was about 3.4% as against the average cost of borrowing, which was 8.66%. This pushed the government to adopt a new strategy keeping in line with the global trends to reform and improve PSU's performance.

The new disinvestment policy has been articulated in the recent President's addresses to joint sessions of parliament and the finance minister's recent parliament budget speeches. The salient features of the policy are:

- Citizens have every right to own part of the shares of Public Sector Undertakings,
- Public Sector Undertakings are the wealth of the Nation and this wealth should rest in the hands of the people,
- While pursuing disinvestment, Government has to retain majority shareholding, i.e. at least 51% and management control of the Public Sector Undertakings.

Government's Efforts for Disinvestment

The process of disinvestment gained actual momentum after interim budget of 1991-92. The cabinet meeting of 16th march 1999 classified the PSU into strategic (defense, atomic energy, railways)) and non- strategic. In the non strategic sector, the government stake was to be reduced by 26%. The 2001-02 union budget listed entries purposes for which the proceeds from public sector disinvestment will be used the following are the proposed way which disinvestment proceeds are to be used:

a) Re-structuring assistance to PSUs.
b) Creating safety net for workers
c) Reducing debt burden.
d) To make additional budgetary support for plans, primarily the social and infrastructural sectors.

It was in August 1996 government established a disinvestment commission initially for a duration of three years to advise it on all aspects relating to public sector disinvestment. The main terms of reference were:

- to draw a comprehensive overall long-term disinvestment programme with in 5-10 years for PSU referred to it by the core group comprising secretaries of selected Ministries,
- to determine the extent of disinvestment in each PSU,
- to patronize the PSUs referred to it by the core group in terms of the overall disinvestment programme,
- to recommend the preferred mode(s) of disinvestment for each of identified PSUs,

- to supervise the overall sale process and decisions on instrument, pricing, timing etc. as appropriate,
- to monitor the progress of disinvestment process and take necessary steps and to advise government on possible capital restructuring of the enterprises by marginal investments if required, so as to ensure enhanced realization through disinvestment.

The Department of Disinvestment was set up as a separate Department on 10 December 1999 and was later renamed as Ministry of Disinvestment from 6 September 2001. From 27 May 2004, the Department of Disinvestment is one of the Departments under the Ministry of Finance. As per the present Allocation of Business rules, the mandate of the Department is as follows:

- All matters relating to disinvestment of Central Government equity from Central Public Sector Enterprises (CPSEs).
- All matters relating to sale of Central Government equity through offer for sale or private placement in the erstwhile CPSEs.
- Decisions on the recommendations of the Disinvestment Commission on the modalities of Disinvestment, including restructuring.
- Implementation of disinvestment decisions, including appointment of advisers, pricing of shares, and other terms and conditions of disinvestment.
- Disinvestment Commission.
- CPSEs for purposes of disinvestment of Government equity only.
- Financial Policy in regard to the utilization of the proceeds of disinvestment channelized into the National Investment Fund.

Government disinvested its stake in nine PSUs namely, Modern Food Industries Limited (MFIL), Bharat Aluminium Company Limited (BALCO), Hindustan Teleprinter Limited (HTL), Computer Maintenance Corporation (CMC), Hindustan Zinc Limited (HZL), Videsh Sanchar Nigam Limited (VSNL), Indo Burma Petroleum Limited (IBP), Indian Petrochemicals Corporations Limited (IPCL) and Pradeep Phosphates Limited (PPL) between 1999-2000 and 2002-2003 through the strategic sale route in which block of shares along with the management control passed on to the strategic partner, except in the case of IBP where the control was passed on to another PSU namely the Indian Oil Corporation Limited (IOC).

Government realised disinvestment proceeds of Rs. 47,671.62 crore during 1991-2005, which included Rs. 36,007.20 crore from the sale of minority shares in 43 PSUs during this period and Rs. 1317.23 crore during 2000-01 from the sale majority shares of Kochi Refineries Limited (KRL), Chennai Petroleum Corporation Limited (CPCL) and Bongaigaon Refineries and Petrochemicals Limited (BRPL) to sister PSUs.

Subsequently, Government adopted the strategic sale route for disinvesting equity in the PSUs during the period from 1999-2004. Government privatised 11 PSUs and 22 hotel properties of HCI and ITDC through the strategic sale route and realized Rs. 10,347.19 crore. Of the total proceeds of Rs. 36007.20 crore, Government realised Rs. 15,205.35 crore in 2004-05 by disinvesting minority shareholding through market sale route, either including through IPO.

Central Public Sector Undertakings (CPSUs) constitute 15.07% and 15.39% of the total market capitalisation of companies listed at BSE and NSE respectively (as on 31 October 2013). As on 31 October 2013, the 50 CPSUs were listed on the stock exchanges, contributed about 15% of the total market capitalization (table 1).

Unfazed by the ongoing economic turmoil and weak market conditions, the government is confident of meeting the Rs. 40,000 crore disinvestment target set for the current financial year (table 2), although the first 5 months it has been able to collect as Rs. 1300 crore disinvesting its stake in small PSUs Neyveli Lignite Corporation (NLC), State Trading Corporation (STC), Metals and Minerals Trading Corporation of India (MMTC), India Tourism Development Corporation (ITDC).

Table No. 1:

Market Capitalisation of Listed CPSUs, as on 31 October 2013

Company	Market Capitalisation (Rs.crore)
Oil & Natural Gas Corp. Ltd.	2,50,846.97
Coal India Ltd.	1,81,500.73
NTPC Ltd.	1,22,610.06
NMDC Ltd.	55,149.20
Indian Oil Corp. Ltd.	49,044.64
Power Grid Corp. of India Ltd.	46,829.67
Bharat Heavy Electricals Ltd.	46,614.54
GAIL (India) Ltd.	44,758.23
Oil India Ltd.	28,301.48
Bharat Petroleum Corp. Ltd.	25,998.49

Source: *http://www.divest.nic.in*

A senior finance ministry official has stated that disinvestment in Coal India Limited (CIL) is on track which alone will help raise Rs.20,000 crore. The government currently owns 90% in CIL and has a plan to divest 10% stake in the company that boasts of a huge cash balance about Rs.60,000 crore. CIL will be the single largest disinvestment for the government in 2013-14.

Table No. 2:

Summary of Receipts from Disinvestment: 1991-92 to Till Date

As on 13.08.2013 (Rs. in crore)

Year	Budgeted Receipt	Total Receipts	Transactions
1991-92	2,500.00	3,037.74	Minority shares sold in Dec, 1991 and Feb, 1992 by auction method in bundles of 'very good', 'good' & 'average' companies
1992-93	2,500.00	1,912.51	Shares sold separately for each company by auction method.
1993-94	3,500.00	-	Equity of 6 companies sold by auction method but proceeds received in 94-95.
1994-95	4,000.00	4,843.10	Shares sold by auction method.

1995-96	7,000.00	168.48	Shares sold by auction method.
1996-97	5,000.00	379.67	GDR -VSNL
1997-98	4,800.00	910.00	GDR -MTNL
1998-99	5,000.00	5,371.11	GDR-VSNL; Domestic offerings of CONCOR and GAIL; Cross purchase by 3 Oil sector companies i.e. GAIL, ONGC and IOC.
1999-00	10,000.00	1,860.14	GDR-GAIL; Domestic offering of VSNL; capital reduction and dividend from BALCO; Strategic sale of MFIL.
2000-01	10,000.00	1,871.26	Sale of KRL, CPCL and BRPL to CPSEs; Strategic sale of BALCO and LJMC.
2001-02	12,000.00	5,657.69	Strategic sale of CMC, HTL, VSNL, IBP, PPL, hotel properties of ITDC and HCI, slump sale of Hotel Centaur Juhu Beach, Mumbai and leasing of Ashok Bangalore; Special dividend from VSNL, STC and MMTC; sale of shares to VSNL employees.
2002-03	12,000.00	3,347.98	Strategic sale of HZL, IPCL, hotel properties of ITDC, slump sale of Centaur Hotel Mumbai Airport, Mumbai; Premium for renunciation of rights issue in favour of SMC ; Put Option of MFIL; Sale of shares to employees of HZL and CMC.
2003-04	14,500.00	15,547.41	Strategic sale of JCL; Call Option of HZL; Offer for Sale of MUL, IBP, IPCL, CMC, DCI, GAIL and ONGC; Sale of shares of ICI Ltd.
2004-05	4,000.00	2,764.87	Offer for Sale of NTPC and spill over of ONGC; sale of shares to IPCL employees.
2005-06	No target	1,569.68	Sale of MUL shares to Indian public sector financial institutions & banks and employees
2006-07	No target	-	-
2007-08	No target fixed	4,181.39	Sale of MUL (Rs.2366.94 cr) shares to public sector financial institutions, public sector banks and Indian mutual funds and sale of PGCIL (Rs.994.82 cr) and REC (Rs.819.63 cr) shares through Offer for Sale.
2008-09	No target	-	-
2009-10	No target fixed	23,552.93	(Rs.2012.85 - NHPC, Rs.2247.05 - OIL and NTPC - 8480.098, REC Rs.882.52, Rs.9330.42 NMDC,)
2010-11	40,000.00	22,144.21	Rs.1062.74 SJVN, EIL 959.65, COAL INDIA 15199.44 CR; PGCIL 3721.17; MOIL 618.75; SCI 582.45
2011-12	40,000.00	13,894.05	Rs.1144.55 PFC,Rs. 12749.5 ONGC
2012-13	30,000.0	23,956.06	Rs. 124.97 NBCC,Rs. 807.03 HCL, Rs. 5973.27 NMDC,

	0		Rs. 3141 OIL, Rs. 11456.78 NTPC, Rs. 310.15 RCF,Rs.627.84 NALCO, Rs. 1514.50 SAIL
2013-14	40,000.00	1,325.27	Rs. 571.71 MMTC. Rs. 259.56 HCL, Rs.101.08 NFL, Rs. 30.17 ITDC, Rs.4.54 STC, Rs.358.21 NLC
Total		**1,38,295.54**	

Source: *http://www.divest.nic.in/SummarySale.asp*

Effects of Disinvestment

Disinvestment receipts figure shows huge receipts from disinvestment of central PSUs over Rs.1.38 lakh crore have been raised from disinvestment in the period 1991-2013. The pattern of disinvestment receipt is highly uneven with receipts being as high as Rs. 15,547.41 crore in 2003-04, Rs. 23,552.93 crore in 2009-10, Rs. 22,144.21crore in 2010-11, Rs. 13,894.05 crore in 2011-12, Rs. 23,956.06 crore in 2012-13, in the last 22 years. This is probably because a case by case approach to privatisation has been followed.

Improvement in the performance of PSUs had been observed, immediately after adopting economic reforms. The table no. 3 shows how the performance of public sector in India was improved after we initiated economic reforms. It was perhaps because economic reforms create a better environment even for the public sector to perform.

Table No. 3:

Change in Performance of PSUs after Initiation of New Economic Reform

Status no: of Public Sector Units	1990-1991	1998-1999
Profit asking units	37	127
Loss making units	151	106
No profit/ loss making units	48	2
Total no. of units	236	235

Source: *Public Enterprises Survey Vol., 01 of 1991-92 & 1998-99, Dept. of Public Enterprises, Govt. of India, New Delhi.*

When we consider the impact of the modest PSUs disinvestment efforts of the early 1990s, we can easily find that public firm's performance and productivity were improved. Even with such partial privatization, the levels and the growth rates of profitability, labour- productivity and investment spending improved significantly. Thus, the efficiency gains from privatisation are likely to be large. As per the Public Enterprise Survey (2010-11) there were 62 loss making PSUs exemplified by Air India, BSNL, MTNL, ITI, etc., incurring loss of Rs. 21,693 crore annually. We can think about the direct impact upon GDP simply because of improvements in value added by 290 central PSUs was Rs. 2.8 trillion which is about 10% of GDP. Amongst these 290 are many companies with negative value added, i.e. GDP would go up more if these Companies ceased to exists. Each 1% of efficiency gain is roughly worth a GDP flow of Rs. 28 billion per year.

Disinvestment could be the vehicle through which we make progress on the important problems of corporate governance in the country. This would pave the way for further flowering of widely-held, professionally managed companies in the years to come. PSUs which turn into private, companies could perform a valuable role in economic policy. The fiscal impact of disinvestment will operate primarily through the increase in GDP growth and tax revenue that disinvestment yields, and through disinvestment proceeds.

The disinvestment of PSUs is criticised for several reasons, as well. Selling of profit making and dividend paying PSU would result in loss of regular source of income to the government. There would be chances of assest stripping by the strategic partner most of the PSUs have valuable assets in the PSUs have a valuable assets in the shape of plant and machinery, land and buildings etc. It may be possible that the strategic partner may very well dispose of these assets make money leaving the PSUs as a sick enterprise the Government policy or disinvestment includes the disposal of both profit making as well as potentially viable PSUs.

Strategic sale despite being a financially prudent method of divesting loss making PSU have not been favoured in India in recent years, mainly because of the low level formal employment in the country which stands at less than 3% of the total population. Since the PSUs are over-manned, the strategic sales have caused diminution of jobs in the first 3 years of privatization which has made it difficult to sustain public support, even if these effects are in short term.

The valuation system of PSU for disinvestment is not full proof and lacks necessary transparency. The Centaur hotel in Mumbai, which was sold to Mr. Batra for Rs. 83 crores in August 2002 was resold to Sahara Group in 2002 for Rs. 115 crores providing the former a return of 135% on investment. Zurari Maroc which took over loss of the fertilizer unit was more than Rs. 25 crores per month more than double of what government claimed at the time of disinvestment. Zurari Maroc is now asking for Rs. 152 crores as compensation from government.

Conclusion

About two-decade old disinvestment story of the country does not provide unambiguous results vis-a-vis to its objectives. While disinvestment has provided solid results so far as resource generation is concerned, the results in terms of efficiency are mixed. Though, disinvestment is good, but up to a certain limit. After this limit it diverts economy, from state-monopoly to private-monopoly which may be harmful for the country. So, there is a need to revisit the subject and plug some of the remaining loopholes in it, to robust the disinvestment policies in of our country.

In order that disinvestment becomes a more dependable source of receipts to the government, there is need for a rule based approach as opposed to the case by case approach being followed now. To enable that, the government may determine that its shareholding in non strategic PSUs would be brought down to 26%.

The most important reason to disinvest is to increase the productivity. It can be achieved even by partial privatisation and by listing of unlisted profit making PSUs. For chronically loss making PSUs the government needs to undertake strategic sales, so as to put underutilised labour and capital to productive use. The fiscal impact of disinvestment will operate primarily through the increase in GDP growth and tax revenue that disinvestment yields, and not through disinvestment proceeds.

In order to get better returns, the government should also try to include strategic sales of PSUs in its arsenal of disinvestment methods so that small loss making enterprises and large ones like Air India may be sold through this method to prevent their continues deleterious impact on fiscal resources. Shunning strategic sales would mean that the government would continue to subsidies many PSUs in future years as there are no takers for loss making PSUs.

Instead of outright sales of public sector units, the government can also appoint a partner who has commendable track record for managing similar business. The government can shift its policy prescription from strategic sales to strategic alliance, Instead of outright sales of ITDC hotels, the government should have gone for strategic alliance with other leading hotel chains.

Though, there are some adverse impacts of disinvestment, yet it has become compulsory today. it not only generates huge funds as a revenue source which could be deployed in social sector, but also reduces fiscal deficit, encourage wider share of ownership, fund for economic growth and create good corporate governance. Certainly, now it has become economic compulsion for India.

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