Chapter-III

IMPACT OF PRIVATISATION, LIBERALISATION AND GLOBALISATION ON PUBLIC SECTOR IN INDIA

Privatization is a fuzzy concept. It covers a wide range of ideas, programmes and policies. In the broad sense of the term, privatisation is roll-back of the state in the lives and activities of citizen and strengthening the role of markets. In the narrow sense, privatisation is transfer of ownership from the public to the private sector, or transfer of control over assets or activities as in the case of privatization through leasing, where ownership is retained, leaving management of assets and activity to private parties.

It may be noted that privatization changes the role of the state, and not necessarily reduces it. The monitoring and regulation of the privatised system, discussed later, is a complex and difficult job. The state also has the onerous responsibility of ensuring that a meaningful competition prevails in the privatised sectors of the economy, and the vulnerable sections of the society are not unduly adversely affected.

In India, due to practical reasons, the government has consistently used the word 'disinvestment', even when it meant privatisation. Agencies set up for the purpose are entitled Disinvestment Commission and Department of Disinvestment. Some other countries have also avoided the word privatisation, which, for example, has been

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christened as 'prioritization' (Australia), 'industrial transition' (Bolivia), 'de-statization', (Brazil) popular capitalism' (Chile), 'economic democratisation' (Costa Rica), 'partners-in-developmen' (Egypt), 'disincorporation' (Mexico), 'assets sales programme' (New Zealand), 'people-ization' (Sri Lanka), 'transformation' (Thailand), 'restructuring' (Tunisia), and 'de-nationalisation' (UK)².

Privatisation is a word of recent origin and a phenomenon essentially of the 1980's. The term 'privatisation' was first used by Professor Peter Drucker in his book *The Age of Discontinuity* in 1969, with reference to divestiture by the government of PEs. Professor Drucker in his book *The New Realities* says that when the *Economist* reviewed the earlier book, "it derided the very thought as perfect nonsense and as something that could not possibly happen." Much has changed since then and the revolution started by the British Prime Minister Margaret Thatcher in 1980 has spread to many parts of the world, and several countries have privatised their public sector in a big way.

According to a 1992 policy brief of the Organisation for Economic Cooperation and Development (OECD), the strong influence exercised by the liberal thought led to idea of the transfer of property rights over a PE to the private sector as the be-all and end-all of privatisation³. On the basis of the postulate according to which the economic efficiency of an enterprise depends mainly on the nature of property rights, attention was mainly

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concentrated on the modalities for the transfer of public assets, the question of market structures and reinforcement of competition being considered as indirectly linked to the privatisation process. It was in this spirit that the privatisation programmes were launched in the developed countries. Privatisation was seen as a panacea making it possible in the short-term to ease the public finance crisis while at the same time having positive gains on the economic efficiency of the enterprises transferred to the private sector, the development of financial markets and income distribution\(^4\). The fall of the command economy in the former USSR and Eastern Europe provided a fillip to the privatisation drive. In the early 1990s, the former USSR and Eastern Europe became the testing ground for privatising on a massive scale. (Refer to privatisation in Russia and East Germany in chapter-19 on Privatisation Abroad). Even China *adopted policies* of liberalisation and privatisation in the name of "market socialism".

**REASONS OF PRIVATISATION**

(i) **Micro-level Considerations**

First, it is argued that private enterprise with accountability to shareholders and due to competitive atmosphere of the market economy can and often do improve performance\(^5\). Second, PEs in as much as they enjoy a monopolistic position and can have recourse to public resources, are not obliged to do well in the absence of a clearly defined index of


accountability which can be enforced strictly. Third, privatiation is also recommended on the ground that private enterprises are free from political interference at least in day-to-day operations, and also from bureaucratic redtapism in decision-making. Fourth, private enterprises are supposed to benefit more from the managerial skills and efficiency.

(ii) Macro-level Considerations

First, there is much ideological fight against the public sector. The US government's approach has always been to emphasise market-oriented economic policies. The ultra-rightist British government of Mrs. Thatcher was on a spree of denationalisation. This greatly pushed the idea of privatisation the world over. The pressure of the US government-controlled international financial institutions for privatisation is also relevant in this regard. PEs have not been able to perform well commercially, interalia, due to overloading of undefined and vague social objectives. There has also been an excessive political and bureaucratic intervention. PEs did not get the required guidance and support from the government due to the incompetence and short-range perspective of the latter. For example, the government is not unaware of the need to provide a stable and competent board of directors to its enterprises. But it has consistently and continuously failed to meet its obligations due to various avoidable reasons, including petty and personal considerations. All this naturally affects PE performance and reflects poorly on the PE concept. This is particularly true of state-level PEs in India.

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Determinants of Privatization

There is ample evidence to support the finding that privatisation has been heavily conditioned by one constraining factor or the other in the cross-section of countries in the developing world. Some of these are considered below.

1. Development planning. Basic limits to privatization comes from the kind of development planning in the country. Most developing countries have economic and social development plans - usually the five year plan. The essence of such plans is to inject in the economy forces of development that would not materialize if left to the market. Privatization, in the sense of commercialization, is obviously an opposite concept. If this should succeed, planning which introduces wide-ranging 'administered' interventions in economic development should be given up, or there should be material relaxations in its mandatoriness. Few governments in the developing world can ignore the imperatives of the objective of national wellbeing. And it would be necessary to devise techniques of subserving the objectives of planning, despite privatisation. This would not be easy but an attempt could be made so as to promote privatisation through appropriate non-divestiture options (see sub-heading "Privatisation through operational and organisational measures without loss of ownership", below). It is also possible that the divested enterprise is brought into a contractual relationship with the government in respect of the 'socially

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desired' input and output objectives. In other words, the cost involved of the non-market-oriented but socially desired activities would be met through the budget.

2. **Efficacy of private enterprise.** Divestitures tend to be under constraints where the private sector to which enterprises may be transferred exists but its efficiency is not demonstrably clear. The private sector depends on disproportionately large funding from financial institutions in the public sector. It derives profit more from protected markets than from technical efficiency. Management is not professional, by and large, and ownership is so family oriented that privatisation is nick-named in Nepal 'family-ization.'

The role of private enterprises in technology development has been relatively low. Tax evasions are substantial; and considerable sums of foreign exchange earnings are hidden away in foreign accounts. Further, the private sector is confined, by and large, to the categories of trade and secondary or light manufacturing industry, leaving the more basic, and slow and low yielding activities in the lap of the public sector.

3. **Overall economic policies.** Privatisation would have a limited chance of success, (i) unless the overall economic policies of the government are conducive to competition in input and output markets, (ii) unless there is adequate freedom for the entry and exit of foreign capital and for the conversion of the local currency into foreign (hard) currencies, and (iii) unless the financial institutions are so designed and regulated as to encourage economical financial management on the part of the enterprises.

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4. **Enterprise culture.** In countries long dominated by PE, e.g. east Europe and Russia, the enterprise culture that is appropriate to a market economy does not exist. Privatisation in such cases is likely to have limited success pending an attitudinal change among the major actors - the bureaucrats, the owners, the managers and the workers. There will be continuing need of an interface between the bureaucrats and the enterprise, but this has to be qualitatively very different from the command-type intervention of the PE and central planning era. 'Owners' as a class have to be born and lived. Managers whose focus was on meeting the commands from above have to learn to behave by market disciplines. And workers who have been generally characterised by poor Work ethics, have to change into partners in enterprise activity, willingly exposing themselves to the risks of the market.\(^\text{10}\)

5. **Policy statement.** Successful privatisation needs a clear statement of policy concerning privatisation. This simply does not exist in many countries, including India, UNDP's *Guidelines on Privatisation* (1991), indicated the following to be covered in the policy statement. (i) Brief review of the PE sector and its performance. (ii) Objectives of privatisation, (iii) Modality options, (iv) Criteria of the choice of privatisation candidates, (v) Macro implication - (a) the distributional consequences, (b) the impact on the exchequer, (c) compatibility with national development Strategy, and (d) relationship to policies administrative reform, liberalisation and deregulation. (vi) Efficiency capabilities of domestic private enterprise, (vii) Establishment of a high-level Privatisation Advisory

Body, (viii) Creation of a technical cell for privatisation with adequate resources, (ix) Publicity for privatisation decisions, and (x) Techniques of implementation.\(^{11}\)

6. **Sequencing.** Privatisation is not a one-day process. It takes years in terms of action and longer in terms of realising the objectives. A well-conceived sequencing helps privatisation as surely as an ill-conceived sequencing harm it. Sequencing is not to be understood in the limited sense of which enterprises to divest first and which next. It is much broader in connotation\(^{12}\). For instance, is a PE to be put through the ownership, organisational or operational option, with reference to immediate change, change in the short run and eventual change? It has to go further, specifying the precise technique in a given case. Among the available variety of full divestiture, partial divestiture and then public offer, private sale, employee buy-out, appropriate choice has to be articulated, though not too rigidly.

7. **Organisational structure.** For avoiding delays in transaction, the organisational structure should be free from 'internal conflicts'. Different ministries have afferent priorities: for example, the finance ministry needs quick and high divestiture incomes; the sectoral ministry is keen on appropriate restructuring of given enterprises; the labour ministry is interested in mini-mum lay-offs and prior-devised 'safety nets'; and the privatising department might feel pressured in favour of quick transactions. Conflicting


\(^{12}\) Ibid.,
interests could lead to confusion and adhoci sm, they might delay transactions; and powerful ministries might adopt uncompromising postures.

**Global Scenario**

These are both at the micro and macro levels\(^\text{13}\). The former would cover: (i) Profit, (ii) Cost, (iii) Price and consumer interest, (iv) Enterprise growth, and (v) Technology. The latter covers impacts on (i) Public exchequer, (ii) Employment, (iii) Development strategy, and (iv) Distributional structure.

**Micro-level impacts**

**Profit, cost and price.** The most important dimension of the micro impacts is the efficiency expected to be realised in the wake of privatisation. The simplest and most publicised result refers to the profit earnings of a privatised enterprise. Yet the question remains how efficient have the operations been? For, profit may arise even without efficiency being attained in several directions. The cost may not be low enough, but this does not worry the private owner if he can achieve the desired profit through a combination of other circumstances, including monopoly power and high prices. But it would be desirable for the owner himself to achieve high productivity in the use of resources - men, materials and machines\(^\text{14}\). The main question would then be to ensure whether

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improvements have been effected in these areas over the pre-privatisation levels. It must be necessary to establish that this happens in the interest of the nation and the consumer. There ought to be adequate competition in the sector of concerned activity for achieving the required degree of efficiency. If privatisation is mere a transfer of PE into a private monopoly (full or significant) the benefits attributable to privatisation would not be realised in terms of low prices and low costs. If there is no effective agency for controlling monopoly practices, the recorded profits cannot ipso facto be treated as an index of efficiency or gains.

**Enterprise growth.** The next dimension of micro impacts is the rate of growth which the privatised enterprise achieves from year to year. There is, of course, no reason why an enterprise should keep expanding; what matters to it is the rate of profit. If this is likely to be high without expansion beyond a certain point, the enterprise may decide not to expand. It might even restrict the output in an attempt to maximise its revenue\(^{15}\). Whether this is right from the national point of view would be a matter for consideration. The situation can also be on opposite lines. The privatised enterprise might decide to expand, even if at increasing cost. i.e., even at declining efficiency, as long as its market Control assures it a good profit. Such supra-optimal growth is not desirable from the national point of view.

The criterion to measure the impact of privatisation therefore has to be conceived in terms

of growth consistent with the economics of production, rather than of profit; potential in a
given market situation.

**Technology.** The last qualification to the profit index comes from the area of technology.
The profit rate might be indifferent to, and might not be the result of technological progress
or R & D efforts on the part of the enterprise. Once again, the assumption is that the free
market system is not effective enough to drive a technologically static enterprise out of the
field with the advent of a technologically dynamic enterprise\(^{16}\).

To sum up, the impacts of privatisation have to be visualised in terms, not of profit alone,
but of cost, price, consumer interest, growth, and technology. Not every one of them is
equally important in every case, but they have to be viewed for the sake of a balanced view
on the recorded post-privatisation profit.

**Macro Level Impacts**

Macro impacts are important for the economy as a whole and are linked with the country's
long-term interests. These are more relevant for countries with low income, large
population, considerable unemployment, and with wide income disparities.

**Public exchequer.** Regarding the first dimension of macro implications of privatisation,
the popular generalisation is that it improves the situation of the public exchequer. It
reduces the budget imbalance, and relieves the government of the need to find resources

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\(^{16}\) Richard L. Harris, “The Global Context of Contemporary Latin American Affairs”, in S. Halebsky and R. L. Harris (eds.), Capital,
Power, and Inequality in Latin America (Boulder: Westview Press, 1995), p. 279 and 80, as cited in Truman State University
(Marc Becker), web resource accessed March 21, 2006,
for investment in more desirable sectors. The primary issue here is whether the disinvested PE is a profit-making or a loss-making unit. In the latter case, the immediate effect of divestiture will be to relieve the government of the burden of subsidising the PE. This will be a recurring gain as well, assuming that the PE was a chronic drag on the budget and was likely to be so in the foreseeable future. If the divestiture price equals the government's investment in the enterprise, and if it is utilised for repaying a corresponding amount of public debt, the budget will save the debt-servicing charges and the relief mentioned just above would be realised. However, if the divestiture price is lower than the government's investment and the corresponding figure of public debt attributable to it, a portion of the debt continues after divestiture, and the budget continues to incur debt-servicing costs on it. This is the most likely possibility, because a losing PE often gets sold at a relatively low price. If, for any reasons, the divestiture brings a price higher than the investment and the corresponding figure of public debt, the budget gains from the transaction to that extent.

In case of a profit-making PE, divestiture saves the government debt-servicing costs but at the same time it foregoes profits that have been coming in. On the assumption that the profits have been higher than the debt-servicing costs, year by year, the budget sustains a net disadvantage\textsuperscript{17}.

**Employment.** The impact of privatisation on employment is most likely to be negative. Retrenchments may start before divestiture and continue thereafter. For an individual

privatised enterprise, labour economies, like any other kind of economies, are worth pursuing. But their impact, namely, an addition to the volume of unemployment is what the economy as a whole has to sustain. Payments for redundancies alone do not meet the situation\(^\text{18}\). There are many social and political implications of retrenchments due to privatisation.

**Development strategy** One of the serious concerns that privatisation can raise in many developing countries relates to the technological bias of industrial activity. It is well known that technology development, limited as it has been, has so far emerged from the efforts of PEs. We run the risk of a loss of initiative for R&D on the part of many privatised enterprises, whose immediate interest in profit lures them to choose technology option most economical to them in the short run. These can be either simple technologies or turn-ke, imports of technical knowhow. As such practices repeat themselves from year to year, the prospects of technology planning with an eye on long run and on national technological excellence can suffer. This requires cautious policy decisions on\(^\text{19}\) (i) whether to insist as a condition of divestiture that the new owner guarantee an agreed schedule of technology development, or (ii) whether the government can set up some national technology fund, built out of general or sectoral levies, so that, without reference to choice on the part of the


individual enterprises, the desired pattern of R & D expenditures can be made possible in
the economy as a whole or in specific sectors.

**Distributional structure.** Where a profitable PE is divested, the private sector owners
begin to enjoy the benefits of the profit incomes, minus the interest costs of capital, which
used to accrue to the public exchequer. Thus, there is a shift of benefits from the taxpayers
to the investors: If the cross-section of investors is richer than the average taxpayer, the
income redistribution effect is unfavorable. Additional receipts from tax on increased
private incomes, no doubt, flow in, but in the pre-privatisation era all profit incomes
flowed into the public exchequer or were retained in PEs. Where the PE is making losses,
the conclusion would be opposite. The taxpayer, who was bearing the burden of the loss,
will be relieved of it. To that extent there is an equitable distributional effect.

The conclusion concerning profitable enterprises rests on two assumptions. First, the
persons into whose hands the divested shares pass are, on average, far richer than the
average taxpayer. The second assumption is that the use of profit incomes at the discretion
of the new owners (in the private sector) is, on the whole, likely to be less equitable from
the distributional angle than if the same resources were in the hands of the government It
may however be said that budget measures are possible whereby the inequity of the income
shifts can be mallowed.

Regarding managerial compensation, there is a tendency for steep increases consequent on
privatisation. In an economy where income disparities are high, these increases are likely
to be resented on distributional grounds. In a country like India, where the public sector has
been relatively large and top salaries subdued, the new salary trends might appear to be
distasteful.

Social benefits. By placing the operations on a commercial footing, privatisation tends to
minimize, if not eliminate, the flow of the social benefits. As a result, some groups or
regions which were recipients of such benefits will suffer deprivation. If the divestiture
proceeds are utilized to improve the living conditions of the lower-income brackets, there
can be an ultimate good from the distributional angle. Provision of water, rural
electricity, free hospitals and primary education centers are examples of such
expenditure.

Methods of Privatization

A. Privatisation through Operational and Organisational Measures Without
Loss of Ownership

(I) Operational measures: Two of these are, measurement of performance against targets,
and nationalisation of government controls. These measures emphasise privatisation of
management as against privatisation of ownership.

The first measure is to operate PEs through definite targets, e.g., of profit, unit cost output,
and productivity, and measurement of performance based on such targets. The effort at
present is to achieve this objective through the Memorandum of Understanding (MOU),
which the central government enters into with many of its PEs every year. Here, at the

20 David Harvey, “Globalization in Question”, unpublished MS, Department of Geography and Environmental Engineering, The
beginning of the financial year, the government and PEs jointly lay down in detail what they expect mutually and the basis on which the performance would be judged. The process has been considered at some length in Appendix III. The system has failed to produce the required results mainly because of two reasons. First, PEs did not get any performance-related benefits, which is basic to the whole exercise of MOU, and second, it was found difficult to chastise the government for its failure to conform to its obligations mentioned in the MOU. It should be possible to implement the MOU scheme successfully for improving PE performance but the required political will seems to be lacking.

The second measure, namely, rationalisation of government controls has been considered above in chapters on Public Accountability, and Relationship with the Government. In brief, PEs suffer due to over-direction and over-control by the government, which is choking creativity of PE managements. The fact that PEs need autonomy to perform has been recognised repeatedly. The Industrial Policy Statement of July 1991, e.g., stated: "Government will ensure that the public sector is run on business lines as envisaged in the Industrial Policy Resolution of 1956" and "boards of public sector companies would be made more professional and given greater powers". The 1956 Resolution had mentioned that "public enterprises have to be judged by their total results and in their working they should have the largest possible measure of freedom". But this did not happen. There is a big gap between the promise and practice, and many PEs continue to complain about the unwarranted interference and demoralising overseeing by a number of agencies including

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\(^{21}\) Ibid.,
CAG, CVC, CBI, parliamentary committees and courts. The PE boards have also not been professionalised to the extent necessary.

As early as 1963, the Lok Sabha's resolution passed to establish the Parliament's Committee on Public Undertakings stated that the committee would examine PEs in the context of their autonomy and efficiency and ensure "whether their affairs are being managed in accordance with sound business principles and prudent commercial practices." But the directive of Parliament did not get the recognition it deserved. Thus, both the Executive and Legislative wings of the state are committed to full operational autonomy.

(ii) Organisational measures: Three of these are as under

(a) Introduction of competition and unbundling. Competition has been introduced for promoting efficiency and expansion of services in almost all areas of infrastructure in the country. Some examples.

Petroleum exploration: Many oil fields have been given for development to private parties. ONGC (40%), Enron (30%), and Reliance (30%) are, e.g., partners in an unincorporated joint venture to develop proven oil and gas fields at Panna, Mukta and Tapti. The oil and gas produced from these fields is sold to IOC and GAIL. Panna and Mukta, as per the Reliance Industries' annual report of 2000-01, were producing 29,000 barrels of crude oil and 2.5m. cubic meters of gas per day (Value Rs.2,800 crore during 2000-01). It was also stated that during the year, Reliance got 12 new exploration blocks through a process of competitive international bidding. To bring in more competition, foreign direct investment upto 100% is now allowed for exploration of small oil fields.

Ports: The government is expecting the private sector to bridge the 9* plan resource-gap of Rs.8,000 crore for developing ports and harbours. Till the end of fiscal 2000, 12 proposals
from the private sector involving an estimated investment of Rs.3,676 crore for the development of ports were approved. Foreign equity upto 100% is allowed in the construction of ports. A number of companies have developed their own captive port facilities, such as Essar, Reliance, L&T and Gujarat Ambuja Cement in Gujarat, and Nippon Denro Ispat and Finolex in Maharashtra.

**Airports:** The government policy of December 1997 recognised the need for participation of private parties (including foreign ones) for bridging the gap in resources as also to bring greater efficiency in management of airports. The policy also envisages long-term leasing of the airports. The Rs.230 crore Cochin International Airports Ltd. which became operational in 1997, has 49% private participation especially from NRI's of Kerala origin.

**Civil Aviation:** The Air Corporations Act, 1953 was repealed in 1994 ending the monopoly of Indian Airlines, Air-India, and Vayudoot, over scheduled air transport services. Six private operators who were hitherto operating as air taxis and had 25% share of air transport in the domestic market as on 31.3.1994, were granted status of scheduled airlines. During 1996-97, the government announced foreign equity in domestic airlines upto 40%. In 1999, two scheduled private airlines and 47 non-scheduled operators had 46.5% share of the domestic air traffic with them.

**Coal mining:** The government amended the Coal Mines (Nationalisation) Act of 1973 to enable private Indian companies to mine and explore coal and lignite in new areas. Foreign direct investment upto 74% is allowed for exploration or mining of coal and lignite for private consumption.
Insurance: The year 2000-01 saw the end of the public sector monopoly of the insurance business. Till February 2001, six private sector life insurance companies and four general insurance companies were in the field, mostly with foreign collaboration.

Unbundling: It is demerging an existing entity. In many states, the Electricity Boards have been divided into separate companies with reference to generation, transmission and distribution functions, for example, Andhra Pradesh now has six separate entities in place of the earlier monolithic A.P.State Electricity Board: A.P.Genco Ltd., A.P.Transco Ltd, and four distribution companies called Central Power Distribution Company Ltd. and three others - Northers. Southern and Eastern power Distribution companies. The unbundling can result in better control and accountability. It also helps in the privatisation process. In Orissa, e.g., where demerging like A.P. has taken place, the four distribution companies have been privatised to the extent of 51%, and the generating company to the extent of 49%.

Full divestiture

Here the whole of the enterprise is sold, among others, through a trade sale or a public offer of shares. The government policy is to sell upto 74% or go down further if necessary, except for PEs before the Board of Industrial and Financial Reconstruction (BIFR), which may be wound up. So far, no unit has been divested fully. Even in Modern Food Industries, a non-essential enterprise which was recommended for 100% sale by the Disinvestment Commission, the government has retained 26% equity to itself. The Disinvestment Commission has also not recommended 100% disinvestment in most cases. (Next chapter contains these recommendations in respect of PEs referred to the commission)
(b) Partial divestiture with majority being held by the government

The present policy is to avoid majority ownership being retained by the government except in a few cases considered strategic, e.g., ONGC, GAIL and oil companies.

(c) Partial divestiture with minority equity being retained by the government

So far, in a number of cases, as listed in annexure-I to the next chapter, partial disinvestment has been effected through public offering of shares and GDR issues. (The global depository receipts are issued to the investors abroad to raise funds and are convertible into equity as and when desired by the investor. The GDR is as good as issuing equity by a company). The present policy (2000.01) is to bring down the government's equity holding to 26% or less, where a PE is not considered strategic.

Disinvestment Techniques

1. Capital Markets

Public offer of shares of companies to be privatised can take many forms considered below.

a) Offer to public at a fixed price

Here the price is decided before the transaction. The government, e.g., disinvested one million shares of VSNL in 1998-99, @ Rs.750 per share, through an offer document. This method is transparent, relatively quick (3-4 months) and can ensure widespread shareholding. The method is suitable for profit-making companies with good prospects. The cost range is 4-5%, depending on the issue size and whether the issue has to be underwritten. The government has also to comply with the SEBI guidelines and stock
exchange requirements. The limitation here is dependence upon capital market conditions, and also that the price has to be at a discount to market/intrinsic price to ensure good response. This was the chosen method of privatisation in UK and many details of it are contained in the British experience of privatisation in chapter-19 on Privatisation Abroad.

(b) Offer to the public through book-building process

Here the offer document invites bids from interested parties, which are arranged from the highest to the lowest and allocations are made at a cut-off price. The bidders can acquire upto 85% of the shares offered, the balance of 15% are offered to retail investors at the cut-off price. The issue may be underwritten, if necessary. The method is suitable for profit-making companies with good intrinsic value and future prospects, in which institutional interest is expected to be substantial. This method is also transparent, relatively quick (2-3 months) though expensive with costs of 5-6%. There is no precedent of this method in the Indian public sector. In the private sector, Hughes Software Ltd. and HCL Technologies Ltd. are examples of use of this method.

(c) Secondary market operation

Here the government can dispose of its holdings of the companies whose shares are traded at the market price. The disinvestment has to be essentially on a wholesale basis, though retail investors can also purchase the shares. The sale price in this case would depend upon day-to-day market conditions and there is a possibility of price rigging. The advantages of this method are quickness with which the shares can be disposed of and its low cost as only the brokerage has to be paid. In case the amount of shares to be sold is large, the secondary market sales may lead to a crash in price and loss to the government, unless a large investor is having an eye on the company for acquiring the controlling interest, and is
ready to pay a good price. It may be noted that SEBI and stock exchange requirements for acquiring more than 20% equity in a company would have to be met by the investor. Where the sales involve only a limited amount, this can be a quick method for effecting privatisation. So far, this method has not been used.

(d) **International offering**

This is sale of depository receipts to international investors, essentially institutions; through a comprehensive offer document containing disclosures is per international standards. The published accounts have to be drawn in accordance with US Generally Accepted Accounting Practices (GAAP) and as per listing requirements of the concerned stock exchange\(^{22}\). The minimum sale price may be fixed by the disinvestor but the final pricing is obtained through bids from the investors. Allocutions are made to various bidders at the cut off price or at their bid prices. The issue is invariably underwritten. Only companies of international repute with good intrinsic value, good prospects and with actively traded share in the market go for this method of sale, which has been used in case of VSNL, MTNL and GAIL and a few other PEs, only for partial disinvestments not leading to privatisation. The transaction cost here is in the range of 4-5% depending on, the issue size, and the time involved 3-4 months. Such issues add to the prestige and visibility of the companies.

GDRs are issued by private companies to meet their financial requirements. But in case of PEs, they have mostly been used to disinvest the existing government equity in the company. For example, in 1996-97, 39 lakh shares of Rs.10 each in VSNL, out of the government's holding in the company, were sold through GDRs for Rs.370 crore. The government got this amount and reduced its slate in the equity of VSNL to the extent of Rs.3.9 crore.

(e) Private placement

Here the government disinvests a part of its holding (minority) in the domestic market to a set of institutional investors at a negotiated price arrived at through valuation, or price discovery through the book building process. An information memorandum is circulated among institutional investors who may carry out due diligence, that is, going into details of the working of the company for which full facility is provided to them. This method, for example, was used by the government in 1998-99 to sell Rs.9 crore of its equity holding (represented by 90 lakh shares of Rs.10 each), in the Container Corporation of India. The disinvestment gave the government Rs.221 crore for equity with a face value of Rs.9 crore. This method of disinvestment has to follow the conditions of sale of equity as laid down by SEBI and the stock exchange. It is suitable for listed companies with good intrinsic value and good prospects, but having low floating stocks and low volumes of business at the stock exchange. The transaction cost in this method is low and it is less time consuming (1-2 months). But it leads to concentration of equity in a few select hands, and may also not be considered transparent.

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23 Ibid.,
(f) **Auction**

This is of two types: in Dutch auction, allotments are made at a single price, and in French auction at the bid price\(^{24}\). The auction involves a set of institutional investors. The price is discovered through a bidding process. Allocations are made to all investors which are above the cut off price in case it is a Dutch auction, and at the bid price in case of French auction. The method is suitable for unlisted companies with good intrinsic value. It provides a transparent mechanism, is less time consuming and has low transaction cost. Its main disadvantage is that it does not ensure widespread shareholding. This method was used in the first nine rounds of disinvestment. The first few rounds of disinvestment were not for the public at large. For example, the notice inviting bids for the sale of 825 bundles of shares in 31 PEs in the first round was issued only to ten financial institutions and mutual funds. The offer from the highest bidder of each of the bundles was to be accepted. The bids were opened in the presence of the authorised representatives of the bidders and, after evaluation, bids for 406 bundles for a total value of Rs. 1,427 crore were accepted.

**Strategic Sale**

Here the government receives bids from the prospective buyers through ads. in newspaper/magazines and also with the help of a global advisor appointed for the purpose. Generally, the bids are invited for the sale of 51% or more of equity providing the buyer the right to manage. This method involves decisions on pre-qualification criteria, bid evaluation criteria, The bidding process and preparation of information memorandum to be made

available to pre-qualified buyers, based on which they carry out due diligence and mate
their bids. The bids are evaluated, negotiations take place with the bidders, leading to
signing of the sale agreement. The method results in obtaining a better sale price as the
purchaser pays a premium for his right to control the privatised firm, it also helps in getting
the technical, marketing, financial and managerial expertise of the buyer, and thus
increases the value of the residual share holding of the government. Its costs are low. The
method is not expected to take more than 6-10 months, but in practice could involve a
longer time, as happened in the sale of Balco and Modern Food Industries, discussed in
the next chapter.

Reduction in Equity

(a) Buy back of shares

Cash rich PEs can privatise themselves if the government agrees to sell its equity holding
beyond 49%, to them. The buy back can be at an agreed upon price between the PE and the
government25. This method improves earning per share of the company, it is low cost, and
relatively quick. Regulatory requirements however need to be met, e.g., the maximum
amount to be used for buy back cannot exceed 25% of the Companies paid-up capital plus
free reserves.

(b) Conversion of equity into another instrument

Here the government can be issued bonds or preference shares in place of its equity
holding. The main difference as compared to(a) above is that this method does not involve

25 Anthony Giddens, “Anthony Giddens on Globalization: Excerpts from a Keynote Address at the UNRISD Conference on
15, 1996/7, pp. 4-5, p. 5, as cited in M. Findlay, The Globalisation of Crime, Understanding Transitional Relationships in
any outgo of funds for the company. This method has all the benefits of (a) except that the majority equity continues with the government. For example, in 1998-99, the National Aluminium Co.Ltd. was permitted to convert more than Rs-600 crore of its equity into secured debentures, thus improving its earnings per share. It may be noted that servicing the equity is costlier than loans where the outgo as interest is deductible as an expense for tax purposes. The exercise did not result in any reduction in the percentage of equity held by the government, but it did increase the market value of the company's share, resulting in a better image of the company, and more sale value for the equity holdings of the government on privatisation.

**Trade Sale**

It is a 100% sale of a business or a division thereof by inviting bids. Here the government is not only interested in obtaining the maximum amount as sale proceeds but also in ensuring that the buyer does not strip the assets, close down the business and dismiss the employees. The agreement with the buyer would have clauses for this purpose. While effecting a trade sale, the financial strength, the credentials and capabilities of the prospective buyer are important considerations. For the Central Electronics Ltd., the Disinvestment Commission recommended a trade sale after hiving-off defence related operations.

**Asset Sale and Winding Up**

This is normally done for companies which are either sick or facing closure. The asset sale is normally done by open auction or by tender method. For the Rehabilitation Industries Corpn.Ltd., the Disinvestment Commission recommended discontinuance of all operations.

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26 Ibid.,
and sale of assets. For a company like Hindustan Vegetable Oil Corpn.Ltd., where services of all employees were terminated after due compensation, sale of assets becomes less difficult. Sick companies under SICA are wound up by BIFR and handed over to the official liquidator for realisation of dues and sale of assets.

**Management / Employee Buyout**

For smaller companies, particularly those that are highly dependent on their personnel, management / employee buyout can be a successful method of privatisation. Although most buyouts are led by management, active participation by the workforce is a pre-requisite for success. Even where the employees come forward to take over a unit, the importance of the management function does not get reduced. The management personnel for running the company could be from within or, if necessary, hired from outside. The employees as shareholders have a right to elect directors under the Companies Act. A company like Engineers India Ltd. where most employees (623 as on 31.3.2000) are knowledge workers, and which is a highly successful consultancy organisation, is a good case for employee buyout to the extent of 51% (The total equity, was Rs.56.16 crore as on 31.3.2000, and after-tax profit of the year - Rs.126 crore).

In Britain, take over of the National Freight Corporation (a PE) by the employees from their own resource (pension funds) and loans from banks proved a great success. In this
case, presently, most of the employees own the equity\textsuperscript{27}. An internal trust buys shares from the employee-owners, if they wanted to sell them. The purchase price of the share is fixed through an agreed formula taking into account the financial worth of the enterprise and its future earning power. Problems can arise when the shares turned into the internal trust exceed the demand for shares from other employees. In such a case, the employees may be allowed the freedom to sell their shares in the open market or to any one else.

**Demergers and Spinning off**

The basic concept here is to transfer a part of an existing PE into a new separate government company for the purpose of privatising that particular unit. For example, for the hotels owned by Indian Tourism Development Corpn., Disinvestment Commission recommended that the hotels at prime locations like Delhi and Bangalore be leased out to an established chain of hotels through a competitive bidding process, to take care of the problem of transfer of property in case of leasehold lands on which these hotels are located, and other hotels of the company be demerged into separate corporate identities and then sold. The spinning off, it may be noted, delinks the unit to be sold from a larger entity making the sale process easier. The new companies created are cmv for the purpose of facilitating transfer of shares to successful bidders.

**Regulation in Telecom Sector**

The telecom network in India, which is one of the largest in Asia, was wholly owned and operated by the public sector till 1992 when cellular mobile phones, radio paging, electronic mail, voice mail etc., characterised as value added services, were opened to the private sector. The National Telecom Policy of 1994 (NTP-94)\(^{28}\) opened up basic (fixed or wired) telephone services to competition and for complementing the efforts of the department of telecom (DOT) in regard to spread of services. The government agreed to permit upto 49% foreign equity participation in companies formed to provide basic telecom services. The government set up the Telecom Regulatory Authority of India (TRAI) in 1997 for regulating prices, ensuring technical compatibility among different service providers, fixation of interconnection and carriage charges, protection of consumer interest, facilitating competition, promoting efficiency, providing a level playing field to various operators, whether in the public or private sector, etc. It is hoped that the establishment of TRAI will promote an orderly and healthy growth of the telecom infrastructure in the country.

The NTP-1994 was revised as NTP-1999 in the light of developments in telecom and information technology leading to the convergence of computers, communication and broadcasting. The implementation of NTP-1994 brought forth many disputes between the operators before TRAI. Even the jurisdiction of TRAI came into question over disputes between the licenser and the operator. These developments led to restructuring of TRAI into a two-tiered body in the year 2000. Presently, TRAI consists of a chairperson and not

\(^{28}\) [www.trai.gov.in › Acts and Policies, 1994]
more than two whole-time and two part-time members, appointed by the government. It is mandatory for the government to obtain TRAI's recommendation in respect of matters dealing with the need and timing for introduction of new service providers and the terms and conditions of license to a service provider. A body called Telecom Disputes Settlement and Appellate Tribunal has also been set up to adjudicate any dispute between a licensor and licensee, between two or more providers, between a service provider and a group of consumers, and to hear and dispose of appeals against any decision or order of TRAI.

Insurance Sector

To protect the interests of holders of insurance policies and to regulate, promote and ensure orderly growth of the insurance industry, the Insurance Regulatory and Development Authority (IRDA) was established in April 2000 under an Act of Parliament. It consists of a chairman and not more than four whole-time and four part-time members appointed by the central government with five year tenure. If removed, the members shall be given a reasonable opportunity to be heard. IRDA grants registration to new Indian insurance companies, and lays down regulations for the conduct of insurance business, applicable to both the existing and new insurers. The authority sees to it that the customers' choices are respected and there is development of insurance market particularly in regard to socially weaker sections and the rural population. IRDA has also been given the powers to oversee the functioning of Insurance Ombudsman established under the Settlement of Public Grievance Scheme, 1998. So far, 12 Insurance Ombudsman have been established for
settlement of grievances of the insured. With the establishment of IRDA, the monopoly enjoyed by LIC, GIC and its subsidiaries has ceased to exist.

IRDA has nominated members of the Insurance Advisory Committee which considers drafts of regulations prepared by IRDA and approve them. The regulations, interalia, relate to (i) Registration of Indian insurance companies, (ii) Obligations of insurers to rural and social sectors, (iii) Assets, liabilities and solvency margins of insurers, (iv) investments by insurance companies, (v) Preparation of financial statements and auditors report of insurance companies, and (vi) Constitution of an investment committee to ensure transparency investment decisions and for regulating investments of funds.

By February 2001, IRDA had issued certificates of registration to six Indian insurance companies for life business, namely, (i) HDFC Standard Life Insurance Co.Ltd., (ii) ICICI Prudential Life Insurance Co.Ltd., (iii) Max New York Life Insurance Co.Ltd., (iv) Om Kotak Mahendra Life Insurance Co.Ltd., (v) Birla Sun Life Insurance Co.Ltd., and (iv) Tata AIG Life Insurance Co.Ltd. Four new general insurance companies are: (i) Royal Sundaram Alliance Insurance Ltd., (ii) Reliance General Insurance Co.Ltd., (iii) IFFCO-TOKIO General Insurance Co.Ltd, and (iv) Tata-AIG General Insurance Co.Ltd. The IRDA is a member of the International Association of Insurance Supervisors, and the regulations issued by it fall in line with those accepted universally as prudential regulations. New insurance companies have pledged themselves in regard to social obligation under section 32 B&C of the Insurance Act, 1938. IRDA has taken on itself the duty of regulating insurance intermediaries as well. Insurance agents are now granted
licence after a thorough practical training of 100 hours and after a successful completion of examination.

**Liberalization**

Liberalisation essentially involves a greater role for the market forces to the functioning of institutions. It is another name for *laissez-faire*, a 19th century doctrine which opposed government interference in economic affairs beyond the minimum necessary. It is presumed that the market is more effective than the government in achieving economic and social goals\(^{29}\). However, it may be noted that in a developing country like India with large scale poverty, the market system may not help a large chunk of the population because markets can bring equilibrium between demand (backed by purchasing power) and supply, and *not* a balance between need and supply.

This fact was recognised by Dr. Manmohan Singh, who helped in ushering the liberalisation process in the country. In his first budget speech of July 24, 1991 he remarked: "In highlighting the significance of reform, my purpose is not to give a fillip to mindless and heartless consumerism we have borrowed from the affluent societies of the west. We cannot afford it. In a society where we lack drinking water, education, health, shelter and other basic necessities, it would be tragic if our productive resources were to be devoted largely to the satisfaction of the need of a small minority." He went on to add that "a reformed price system can be a superior instrument of resource allocation than

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quantitative controls. But markets can only serve those who are part of the market system. A vast number of people in our country live on the edges of a subsistence economy. We need credible programmes of direct government intervention focusing on the needs of these people. We have the responsibility to provide them with quality social services such as education, health, safe drinking water and roads.

In the decade following the observation, precious little has been done for the have-nots as envisaged by the then finance minister, but "the mindless and heartless consumerism" is impacting us with full force. Psychologically exploitative ads. are seducing the consumer to buy, making the products marketed as his felt needs. Ads. are necessary to protect the consumers' right to know and choose. But highly exaggerated and nauseatingly repetitive ads. Confuse and bewilder the consumer. The public at large has to be saved from this ugly and wrong end of capitalism.

It may be rightly asked whether growing consumerism is adding to human happiness. It is well-known that the higher level of physical possessions does not necessarily make people happy, yet we are caught in the consumerist web, thanks to the massive and oppressive advertising by large and resourceful corporates. True, economic growth enlarges our choice. But aside from the fact that only those with money can choose, it may be asked whether choosing from scores of different models of vehicles, washing machines, TVs, etc is enrichment of life.
The opportunity to MNCs provided by liberalisation has, among others, two ominous fallouts. First, the small or medium producer is now confined to a local or niche market, if he can at all manage to have one, or he quietly goes out of the scene. Second, large MNCs fighting tooth and nail for the market share, pass on the cost to the voiceless consumer as, e.g., has happened in the case of the areated soft drinks\(^8\). All this is taken for granted in the name of liberalisation. The competition is being thwarterd because of the sheer strength and standing of the large corporation.

**Liberalisation in Practice**

1. Licensing: Virtual abolition of the requirements of industrial licensing. The dispensation till the end of the 80's, when a license was needed for most items of production, is now a thing of the past. The concept of monopoly involving limits on the assets of large industrial houses for permitting investment, does not exist any longer. Except for a shrinking number of items reserved for the small scale sector, the freedom for any one to produce is almost total.

2. Financing capital requirements: All controls and restrictions on raising capital within the country, and to a very great extent outside the country, have been done away. The institution of Controller of Capital Issues has been replaced by Securities and Exchange Board of India (SEBI) to protect the interest of me investors, and to ensure that the securities market grow and develop in a fair and orderly manner. For example, during 2000-01 the SEBI through Disclosure and Investor Protection Guidelines tightened the entry norms for initial public offers (IPOs).
One great benefit of liberalisation is the freedom to Indian corporates to raise equity abroad through the issue of Global Depository Receipts (GDRs) and American Depository Receipt (ADR). Since 1992-93, when this route for raising equity was opened, till 31.3.2000 a total of $ 7,574m. were secured by Indian companies. This is also a proof of the strength and standing of Indian business in the international capital markets. Indian corporates also have the freedom to borrow funds abroad. No approval is needed if the amount involved is $ 50m. or the money is raised to refinance an existing borrowing. In 1999-2000, the external commercial borrowings (ECBs) of Indian companies were $ 3,398m. A great advantage of raising funds abroad is that it provides a global perspective to Indian corporates on many dimensions of their business operations.

3. **Import-export:** Subject to a negative list, imports and exports are now free. The negative list is also being pruned from time to time. For example, in April 1998, 340 items of import were moved from the negative list to open general licence (OGL). In August 1998, all quantitative restrictions on imports of 2,300 items from SAARC countries were removed. A gradual reduction in customs duties is also taking place. For example, peak protective custom tariffs were brought down from 45 to 40% *tut valorem* in 1999-2000, and from 40 to 35% in 2000-01. Import of secondhand capital goods which are less than ten years old was permitted during 2000-01, without obtaining any licence.

4. **Foreign investments:** After liberalisation, foreign institutions, individuals and NRIs have got a lot of freedom to invest in business and / or in the capital market. Some examples. (i) **Foreign direct investment** (FDI) is now permitted through automatic route, without getting clearance from the Foreign Investment Promotion Board (FIPB), in all industries expect for a small negative list. There are limits to FDI in some cases, e.g., in the
insurance sector the foreign equity is allowed only up to 26%, and the investment needs licence from the Insurance Regulatory and Development Authority (IRDA). Till the end of 1999-2000, $15,354m. got invested in India through the FDI route. The amount may appear to be large, but is insignificant as compared to China where, according to the World Investment Report, 2000, FDI was $1,28,387m. in just three years - 1997 to 99. (ii) Portfolio investment: Foreign institutional investors (FIIs) can now invest in all securities traded on primary and secondary markets listed on Indian stock exchanges, if registered with SEBI, and have RBI's permission to do so. In 2000-01, FIIs' ceiling of investment in the equity of Indian companies was raised from 24% to 40%, subject to specific conditions. From 1.4.1992 to 12.7.2001, net aggregate investment by FIIs in the capital market was as much as $12,090m.

Globalization

Globalization has become a key word in economic debates. Telecommunication has meant the death of distance and this, combined with computers, has led to the birth of information technology, resulting in the world becoming borderless, so far as communication and information is concerned. For four decades after independence, we built heavy barriers to protect domestic industry. The Indian industry grew in an atmosphere where there was no competition from the rest of the world and it was a sellers' market. In 1991, we decided to change and plug into the global market. This was largely due to the financial crisis we had found ourselves in. There were also other developments like the collapse of the Soviet Union, which resulted in about
50 countries, which were earlier following communist philosophy, to adopt market-friendly economic policies. Simultaneously, the setting up of the World Trade Organisation, of which India is a member, supported globalisation.

Globalisation means world economic integration through free movement across national borders of: (i) Financial capital represented by investment in capital markets and money markets, (ii) Physical capital represented by plant and machinery, (iii) Technology, and (iv) Labour.

Today, Indian economy is open to foreign financial investments, imports of capital equipment, technology and personnel, in almost all sectors. In most cases, foreign investments to the extent of 100% can be made without any approval from the Foreign Investment Promotion Board, that is, under the automatic route. There are only a few exceptions, e.g., foreign investment in housing and real estate is not permitted except from NRIs. In a few cases, limits have been laid for foreign investments, e.g., (i) for trading and marketing of petroleum, a minimum 26% Indian equity is required, (ii) for hotels and tourism, the automatic route is available upto 51%, subject to certain conditions, and (iii) automatic approval is available only upto 74% for foreign direct investment in the advertising sector and for the exploration and mining of diamonds and precious stones.

Though globalisation meant free movement of goods, technology and financial capital, it was never extended to free movement of labour, which is in the interest of developing countries. When we agree for large reduction in import duties to facilitate larger exports by MNCs, we can also ask developed countries to increase the number of visas for skilled personnel from developing countries to seek jobs abroad. This did not happen. To this
extent, globalisation becomes one sided, and the concept of the world as a global village loses some meaning.

**Implications and Impact**

Globalisation is a double-edged sword. It provides opportunities and threats. The system should be managed in such a way as to gain more than lose, keeping both the short and long-term perspectives in view. MNCs involved in the production of consumer goods in the country can send back funds abroad on account of royalty for using the brand names and also dividends on their equity\(^{30}\). Many countries have prescribed that repatriation of funds in foreign exchange should be balanced by exports of the same amount. This compels the MNC to make India a base for its manufacture for exports. Unfortunately, we have been withdrawing the balancing obligations on MNCs even in the area of consumer goods.

Currency trading and currency speculation is a serious negative fallout of globalisation. Daily transactions of foreign exchange in global market are estimated at $1,500 billion. The Malaysian prime minister blamed currency traders for the South-East Asian financial crisis. He said: "We are told that we must open up, that trade and commerce must be totally free. Free for whom? For rouge speculators. For anarchists wanting to destroy weak

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countries in their crusade for open societies”. Here it may be noted that one of the reasons of the currency problem in South East Asia was that countries like Thailand and Malaysia became globalised a little too much for the good of their health. Unlike South-East Asian countries, currency speculation did not adversely affect our economy largely because the rupee is not fully convertible and also because of its comparative stability.

**Disinvestment**

The policy on 'Disinvestment' has evolved over the years. Disinvestment of Government equity in Central Public Sector Enterprises began in 1991-92. The chronology of evolution of the policy on disinvestment since 1991-92 is given in Annexure-11.

**Public Sector Disinvestment Commission**

The Ministry of Industry (Department of Public Enterprises) vide a resolution dated 23rd August, 1996, constituted a Public Sector Disinvestment Commission for a period of three years. The term of the Commission was further extended till 30th November, 1999. The Commission submitted its reports on 58 CPSEs. The Commission was reconstituted in July, 2001 for a period of two years. The term of this Commission was subsequently extended till October, 2004. The reconstituted Commission submitted its reports on 41 CPSEs, including review cases of earlier Commission's recommendations on 4 CPSEs. The term of the Commission expired on 31st October, 2004 and the Commission was wound up.

**Department of Disinvestment**

The Department of Disinvestment was set up vide Notification No. CD/551/99 dated 10.12.1999 as a separate Department from 6th September, 1999. It was later declared as
Ministry of Disinvestment from 6th September, 2001. From 27th May, 2004 the Department of Disinvestment became one of the Departments under the Ministry of Finance. The Department has been assigned the following work:

(a) All matters relating to disinvestment of Central Government equity from Central Public Sector Undertakings.

(b) Decision on the recommendations of the Disinvestment Commission on the modalities of disinvestment, including restructuring.

(c) Implementation on the disinvestment decisions, including appointment of advisers, pricing of shares and other terms and conditions of disinvestment.

(d) Disinvestment Commission.

(e) Central Public Sector Undertakings for purposes of disinvestment of Government equity only.

**NCMP and Disinvestment**

The National Common Minimum Programme (NCMP) outlines the present policy of the Government with respect to Central Public Sector Enterprises (CPSEs). The salient features of this policy are as follows:

(i) The Government is committed to a strong and effective public sector whose social objectives are met by its commercial functioning. But for this, there is need for selectivity and a strategic focus. The Government is pledged to devolve full managerial and commercial autonomy to successful, profit-making companies operating in a competitive environment.

(ii) Generally, profit-making companies will not be privatized. All privatizations will be considered on a transparent and consultative case-by-case basis. The Government will
retain existing "Navratna" companies in the public sector while these companies raise resources from the capital market. All efforts' will be made to modernize and restructure sick public sector companies and revive sick industry. The chronically loss-making companies will either be sold-off, or closed, after all the workers have got their legitimate dues 'and compensation. The Government will induct private industry to turn around companies that have potential for revival.

(iii) The Government believes that privatization should increase competition, not decrease it. It will not support the emergence of any monopoly that only restricts competition. It also believes that there must be a direct link between privatization and social needs, for example, the use of privatization revenues for designated social schemes. Public sector companies and nationalized banks will be encouraged to enter the capital market to raise resources and offer new investment avenues to retail investors.

Until 1999-2000, it was primarily the sale of minority shares of CPSEs in small lots. From 1999-2000 till 2003-04, the emphasis of disinvestment changed in favour of 'Strategic Sale'. Currently, the emphasis is on listing of currently unlisted profitable CPSEs (other than the Navratanas) each with a 'networth' in excess of Rs. 200 crore, through Initial Public Offering (IPO) either in conjunction with fresh equity issue by the CPSE concerned or independently by the Government, on a case by case basis, subject to the residual equity of the Government retaining at least 51% and the Government retaining management control of the CPSEs. It also involves sale of minority shareholding of the Government in listed, profitable CPSEs either in conjunction with a Public Issue of fresh equity by the CPSE concerned or independently by the Government, subject to the residual equity of the
Government being at least 51 % and the Government retaining management control of the CPSE.

**Disinvestment Decisions under Review**

On 6th July, 2006 the Government decided to keep all disinvestment decisions and proposals on hold, pending further review. CPSEs where disinvestment decisions will be/have been reviewed are mentioned below:

(i) *National Mineral Development Corporation Limited*

The Government had decided on 12th January, 2006 for disinvestment of 15% equity in National Mineral Development Corporation out of the Government's holding of 98.39% through the process of book building. Following the decision of 6th July, 2006 the process for implementation of the disinvestment decision has not been pursued further.

(ii) *Neyveli Lignite Corporation Limited*

The Government had decided on 22nd June, 2006 for disinvestment of 10% equity of Neyveli Lignite Corporation Ltd. out of Government's holding of 93.56% through the book building process. Following the decision of 6th July, 2006 the process for implementation of the disinvestment decision has not been pursued further.

(iii) *National Aluminium Company Limited*

The Government had decided on 22nd June, 2006 for disinvestment of 10% equity of National Aluminium Company Ltd. out of the Government's holding of 87.15% through the book building process. Following the decision of 6th July, 2006 the process for implementation of the disinvestment decision has not been pursued further.
(iv) **Power Finance Corporation Limited**

The Government had approved on 22nd December, 2005 an IPO by Power Finance Corporation Limited (PFC), consisting of fresh issue of 10 per cent of pre-issue paid up capital of the company and 'disinvestment' through a public offer (IPO) of 5 per cent of Government's shareholding in PFC. This was reviewed consequent to the decision of 6th July, 2006. Subsequently, on 23rd November, 2006, the Government approved an IPO by PFC consisting of a fresh issue of equity only, constituting 11.385% of pre-issue capital of PFC. The IPO of PFC was completed in February, 2007.

(v) **REC, NHPC and PGCIL**

The Government had approved on 23rd November, 2006, the proposals for fresh issue of 20 per cent of the pre-issue paid-up equity capital in Rural Electrification Corporation (REC) and fresh issue not exceeding 24 per cent of the Power Grid Corporation Limited's (PGCIL) paid-up equity capital in tranches, first tranche being limited to 10 per cent only through IPO. Subsequently, on 7th December, 2006, the Government approved the proposal of National Hydroelectric Power Corporation Limited (NHPC) for fresh issue not exceeding 24 per cent of the paid-up capital in one or more tranches. Thereafter, on 8th February 2007, the Government decided to piggy-back with an offer for sale of 10 per cent, 5 per cent and 5 per cent of the pre-issue paid-up equity of REC, PGCIL and NHPC respectively.

**National Investment Fund**

In pursuance of the decision dated 27th January, 2005 the Government has constituted a "National Investment Fund" (NIF) into which the proceeds from disinvestment of
Government equity in CPSEs would be channelised. NIF would be maintained outside the Consolidated Fund of India and would be professionally managed by selected Public Sector Mutual Funds for providing sustainable returns without depleting the corpus.

As high as 75 per cent of the annual income of NIF will be used to finance selected social sector schemes to promote education, health and employment. The residual 25 per cent of the annual income of NIF will be used to meet the capital investment requirements of profitable and revivable CPSEs.

**Revival and Restructuring of Loss Making CPSEs**

**Background**

Some of the Central Public Sector Enterprises (CPSEs) have been incurring losses continuously for the last several years. The accumulated losses in most of these cases have surpassed their net worth. Out of 217 operating CPSEs as on 31.3.2007, 59 incurred a net loss of Rs. 8223 crore during 2006-07. The accumulated losses in respect of 69 CPSEs have exceeded their respective net worth; although, some of them have turned around and recorded profit during the last one or two years.

Sickness in CPSEs has been the continuing concern of the Government. The reasons for sickness varies from enterprise to enterprise. In some cases, the cause of sickness is historical; textile companies which were taken over from the private sector on social consideration for protecting employment of workers in early seventies could not be modernized quickly. British India Corporation, Bird Jute & Exports and NTC belong to this group. Besides these textile companies, there are other enterprises as well which were
taken over from the private sector but could not be modernized. These include engineering and refractory enterprises such as Andrew Yule & Co, Bharat Wagons & Engineering, Biecco Lawrie, Praga Tools, Burn Standard, Braithwaith & Co., Richardsan and Crudass Ltd., drug companies like Bengal Chemicals & Pharmaceuticals Ltd., transportation/shipping companies like Hooghly Dock & Port Engineering Ltd., Central Inland Water Transport Corpn. and consumer goods companies like Tyre Corporation of India and Hooghly Printing Co. Ltd.

The other group of sick companies (other than taken over) are greenfield companies. These became sick on account of obsolete technology, high input cost, high overhead cost and the administrative price mechanism. These include fertilizer companies such as Fertilizer Corporation of India, Hindustan Fertilizer Corporation, Pyrites, Phosphates and Chemicals Ltd., chemicals and drugs companies like Indian Drugs & Pharmaceuticals Ltd., Hindustan Insecticides Ltd., and Hindustan Antibiotics Ltd. etc. Some companies have been set up for serving national objectives like the development of backward areas. The Nagaland Pulp & Paper Company Ltd., Manipur State Drugs & Pharmaceuticals Ltd., North Eastern Regional Agricultural Marketing Corporation Limited are examples of such enterprises. These companies have been suffering from losses from inception On account of inadequate infrastructure etc.

In addition to the above reasons, some common problems faced/ being faced by sick and loss making CPSEs include adverse market/ administrative prices, stiff competition, weak marketing strategies, low capacity utilization and high interest rates. Attempts have,
therefore, been made to overcome "sickness" in these CPSEs through various policy initiatives. The Statement on Industrial Policy (1991), the different Budget Speeches over the years and other policy pronouncements by the Government have addressed this issue from time to time.

**Strategies for revival/restructuring**

Some of the strategies for restructuring/revival of sick CPSEs include the following:

(i) **Financial restructuring:** Financial restructuring involves investment in CPSEs by the Government in the form of equity participation, providing loan (plan/non-plan) grants and/or write-off of past losses. Measures such as waiver of loan/interest/penal interest, conversion of loan into equity, conversion of interest including penal interest into loan, moratorium on payment of loan/interest, Government guarantee, sale of fixed assets including excess land, sacrifices by State Government, one-time settlement with banks/financial institutions, etc. are also taken to improve the financial strength of the company particularly in the case of sick and loss making enterprises.

(ii) **Business restructuring:** Business restructuring involves change of management, organizational restructuring, hiving off viable units from CPSEs for formation of separate company, closure of unviable units, formation of joint ventures by induction of partners capable of providing technical, financial and marketing inputs, change in product mix, improving marketing strategy, etc. are the steps taken under the business restructuring process as per need on case to case basis.

(iii) **Manpower rationalization:** Salaries and wages are often a major component of cost of an enterprise. In order to shed excess manpower, CPSEs have often resorted to *Voluntary Retirement Scheme* from time to time. In case of CPSEs found unviable and
where a decision has been taken to close the unit, it is the *Voluntary Separation Scheme* that is introduced. Retrenchment of employees is adopted only as the last resort and in exceptional circumstances.

Net loss in a company means excess of expenditure (including depreciation, interest, taxes, extra ordinary items, prior period adjustments but before providing appropriations to reserves) over operating income. If, however, the enterprise incurs 'cash loss', that is 'net loss' alongwith provision for depreciation', then it is usually considered a fit case for recommending closure.

**Sick Industrial Companies (Special Provisions) Act, 1985 (SICA)**

The CPSEs were brought under the purview of Sick Industrial Companies (Special Provision) Act, 1985 (SICA) which was subsequently amended in 1991 and made effective from 1992. Under the provisions of Sick Industrial Companies (Special Provisions) Act, 1985 (SICA), the industrial CPSEs whose accumulated losses are equal to or have exceeded their net worth, may be referred to the Board for Industrial and Financial Reconstruction (BIFR) which may either sanction suitable revival/rehabilitation schemes in case of enterprises which are viable or recommend winding up/closure in respect of enterprises considered unviable.

The process of revival/rehabilitation through the BIFR has, however, been very slow. The process of appointment of Official Liquidator (OL) for winding-up of CPSEs is also slow. The slow process of sanctioning of revival schemes has been on account of involvement of multiple agencies, delay in finalisation of revival schemes, lack of funds, lack of adequate
powers with BIFR, lack of proper monitoring of sanctioned revival schemes, delay in winding up of sick companies, etc.

Table 3.3 Highlights of Loss Making CPSEs

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<th>Years</th>
<th>Cases (no.)</th>
<th>Accumulated Net Losses (Rs. in crore)</th>
<th>Employees (no.)</th>
</tr>
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<tbody>
<tr>
<td>2002-</td>
<td>68048</td>
<td>-</td>
<td>631040</td>
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<tr>
<td>2003-</td>
<td>83</td>
<td>(-)3242</td>
<td>375587</td>
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<tr>
<td>2004-</td>
<td>81</td>
<td>13020</td>
<td>341053</td>
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<td>2005-</td>
<td>63</td>
<td>(-)16276</td>
<td>108931</td>
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<tr>
<td>2006-</td>
<td>59</td>
<td>9246</td>
<td>103599</td>
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</tbody>
</table>

Board for Reconstruction of Public Sector Enterprises (BRPSE)

The Government set up a Board for Reconstruction of Public Sector Enterprises (BRPSE)\(^{31}\) in December, 2004 to advise the Government inter alia on the measures to be taken to restructure/revive, both industrial and non-industrial CPSEs. The Board comprises a part-time Chairman, three part-time Non-Official Members and three part-time Official Members including Secretary, Department of Expenditure, Secretary, Department of Disinvestment and Secretary, Department of Public Enterprises(DPE). There is a full-time Secretary for BRPSE in the level/rank of Secretary / Additional Secretary to the Government of India.

\(^{31}\) dpe.nic.in/brpse
### STATUS OF CPSEs REGISTERED WITH BIFR AS ON 30.6.2007

<table>
<thead>
<tr>
<th>Case No. and</th>
<th>CPSE</th>
<th>Date of order</th>
</tr>
</thead>
<tbody>
<tr>
<td>of reference</td>
<td></td>
<td></td>
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<tr>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
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**Revival Scheme sanctioned**

<table>
<thead>
<tr>
<th>Case No.</th>
<th>CPSE</th>
<th>Date of order</th>
</tr>
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<tbody>
<tr>
<td>533/1992</td>
<td>Bengal Chemicals &amp; Pharmaceuticals Ltd., Kolkata (West Bengal)@</td>
<td>31.03.1995</td>
</tr>
<tr>
<td>534/1992</td>
<td>NTC (APKK&amp; Mahe) Ltd., Bangalore (Karnataka)@**</td>
<td>07.02.2002</td>
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<tr>
<td>535/1992</td>
<td>NTC (Gujarat) Ltd., Ahmedabad (Gujarat)@**</td>
<td>10.02.2002</td>
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<tr>
<td>536/1992</td>
<td>NTC (Maharashtra North) Ltd., Mumbai (Maharashtra)</td>
<td>01.10.2002</td>
</tr>
<tr>
<td>501/1993</td>
<td>NTC (MP) Ltd., Indore (Madhya Pradesh)@**</td>
<td>12.02.2002</td>
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<tr>
<td>503/1993</td>
<td>NTC (WB A B &amp; O) Lt. Kolkata (West Bengal)@**</td>
<td>05.02.2002</td>
</tr>
<tr>
<td>504/1993</td>
<td>NTC (UP) Ltd., Kanpur, (Uttar Pradesh)@*</td>
<td>05.02.2002</td>
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<td>505/1993</td>
<td>NTC (South Maharashtra) Ltd., Mumbai</td>
<td>01.10.2002</td>
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<td>501/1994</td>
<td>NTC (DPR) Ltd., New Delhi (Delhi)@**</td>
<td>22.02.2002</td>
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<td>501/1996</td>
<td>Cement Corporation of India Ltd., New Delhi (Delhi)</td>
<td>21.03.2006</td>
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<td>502/2000</td>
<td>Hindustan Salts Limited, Jaipur (Rajasthan)</td>
<td>22.8.2005</td>
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<tr>
<td>501/2000</td>
<td>Hindustan Insecticides Ltd., New Delhi (Delhi)</td>
<td>6.05.2006*</td>
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<tr>
<td>504/1998</td>
<td>Praga Tools Ltd., Secundrabad (Andhra Pradesh)@</td>
<td>29.03.2007</td>
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<td>501/1997</td>
<td>Hindustan Antibiotics Limited, Pune (Maharashtra)</td>
<td>.05.06.2007</td>
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</table>

**B. Winding up Recommended**

<table>
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<tr>
<th>Case No.</th>
<th>CPSE</th>
<th>Date of order</th>
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<tbody>
<tr>
<td>531/1992</td>
<td>National Instruments Ltd Kolkata (West Bengal)</td>
<td>01.10.2002</td>
</tr>
<tr>
<td>511/1992</td>
<td>Heavy Engineering Corpn. Ltd., Ranchi (Jharkhand)</td>
<td>06.07.2004</td>
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### Revival Proposals approved in respect of

<table>
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<tr>
<th>S</th>
<th>CPSE</th>
<th>Assisurime (Rs. in crores)</th>
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<tbody>
<tr>
<td></td>
<td></td>
<td>Cash#</td>
</tr>
<tr>
<td>1</td>
<td>Hindustan Salts Ltd.</td>
<td>4.28</td>
</tr>
<tr>
<td>2</td>
<td>NTC including its subsidiaries</td>
<td>39.23</td>
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<tr>
<td>3</td>
<td>Bridge &amp; Roof Co. (India) Ltd.</td>
<td>60.00</td>
</tr>
<tr>
<td>4</td>
<td>BBJ Construction Co. Ltd.</td>
<td>-</td>
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<tr>
<td>5</td>
<td>HMT Bearings Ltd.</td>
<td>7.40</td>
</tr>
<tr>
<td>6</td>
<td>Praga Tools Ltd.</td>
<td>5.00</td>
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<tr>
<td>7</td>
<td>Braithwaite &amp; Company Ltd.</td>
<td>4.00</td>
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<tr>
<td>8</td>
<td>British India Corporation Ltd.</td>
<td>47.35</td>
</tr>
<tr>
<td>9</td>
<td>Central Inland Water Transport Ltd.</td>
<td>102.00</td>
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<td>1</td>
<td>Hindustan Salts Ltd.</td>
<td>137.59</td>
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<td>2</td>
<td>HMT Salts Ltd.</td>
<td>250.00</td>
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<td>3</td>
<td>Fertilizers &amp; Chemicals</td>
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<td>Central Inland Water Transport Ltd.</td>
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<td>5</td>
<td>Hindustan Salts Ltd.</td>
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<td>6</td>
<td>Richardson &amp; Cruddas Ltd.</td>
<td>153.1</td>
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<tr>
<td>7</td>
<td>Hindustan Antibiotics Ltd.</td>
<td>104.6</td>
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<td>8</td>
<td>Hindustan Organic Chemicals Ltd.</td>
<td>6.02</td>
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<tr>
<td>9</td>
<td>Central Electronics Ltd.</td>
<td>-</td>
</tr>
<tr>
<td>10</td>
<td>Eastern Coal Fields Ltd.</td>
<td>-</td>
</tr>
<tr>
<td>11</td>
<td>Bharat Pumps and Compressors</td>
<td>3.37*</td>
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<td>12</td>
<td>Bengal Chemicals &amp;</td>
<td>207.19</td>
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<tr>
<td>13</td>
<td>HMT Machine Tools Ltd.</td>
<td>723.00</td>
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<td>14</td>
<td>MECON Ltd.</td>
<td>93.00**</td>
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<tr>
<td>15</td>
<td>Andrew Yule &amp; Co. Ltd.</td>
<td>-</td>
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<tr>
<td>16</td>
<td>Bharat Ophthalmic Glass Ltd.</td>
<td>9.80</td>
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<td>17</td>
<td>Hindustan Copper Ltd.</td>
<td>-</td>
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<td>18</td>
<td>Bharat Yantra Nigam Ltd.</td>
<td>3.82</td>
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<td></td>
<td>Total</td>
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</tbody>
</table>

#  Cash Assistance may involve budgetary support through equity/loan/grants
Non-cash Assistance may involve waiver of interest, penal interest, GOI loan, Guarantee fee, conversion of loan into equity/debentures etc.

**Summing Up**

Steep reduction in import duties, free import of goods and the declining value of the rupee has adversely affected the bottom line of Indian corporates. The depression at bourses linked to globalization, is also affecting companies in raising resources for growth. Indian companies are no match to foreign giants in terms of the investments they make and their capacity to survive. With deep pockets, MNCs have ability to operate at low margins or even losses for long periods to secure the market share, which in the due course can more than make up the shortfalls of the earlier period. The quality and appeal of foreign brands also adversely affect Indian firms, which are slowly but surely losing their market share in favour of MNCs, in many areas. High technology, access to global sourcing and distribution partners of MNCs are additional threats, which may lead to takeover of Indian firms or shifting management control to the foreign partners, as has happened in some cases.

Though there is no option but to integrate with the global system, the speed and direction of integration should be constantly overseen and regulated carefully. Developed countries are exploiting the situation based on their strength, resources and experience, at the cost of developing countries, and this needs to be guarded against. WTO rules should be used for our benefit. For example, these rules frown upon subsidies, but subsidy for R&D and for backward area development is permissible. The government and industry liaison should
improve to face international competition. Anti-dumping machinery in the government should be much more alert and agile to protect the country's interest.

The real long-term solution for meeting the challenge of globalisation lies in making industry competitive. Better use of resources and sizing up and seizing of the opportunity needs much greater alertness and swift-footedness. Managerial expertise in all areas of operations has to increase substantially. Indian firms, by and large, continue to put inadequate emphasis on the 'soft area' of human resource. Much greater attention is needed to involve and integrate employees at various levels in the production process and decision making. We have also to carefully choose areas of special advantage to us, e.g., items which involve labour-intensive operations.