CHAPTER - 7

ISSUES & CONTROVERSIES OF DISINVESTMENT IN INDIA
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ANALYSIS
The debate, controversies and compromises on disinvestment are currently making headlines. The anti-disinvestment faction particularly within the ruling coalition has become vocal and aggressive. Of late, it was the disinvestment euphoria that has improved the overall market sentiment, resulting in the total PSU market capitalization moving up significantly. The Bombay Stock Exchange Public Sector Unit (PSU) index which is the benchmark for PSU performance on the stock market has moved up substantially during the last year.

The BSE PSU Index which tracks the performance of some of the listed PSU stocks on the Bombay Stock Exchange including banking stocks has exhibited an upward trend as evident from 52 Week High and Low of BSE PSU Index and the index as on December 13, 2002 vis-a-vis 52-Week High and Low. More than 60% of the BSE PSU market capitalization is accounted for by companies under the broad industry group of oil and gas followed by the banking industry with an exposure of around 18%. The euphoria was more pronounced in prices of oil stocks such as IBP, HPCL, BPCL and other stocks such as NALCO, Engineers India, Shipping Corporation of India etc. The banking stocks too
participated in the rally, despite the government to move aggressively in this sector except permitting 49% FDI in private banks. The trigger to banking stocks was provided by softening of interest/ rates, promulgation of the securities ordinance facilitating banks to recover delinquent assets and the expected consolidation in the industry. The imbroglio over the disinvestment of HPCL and BPCL move resulted in PSU stock prices crashing in particular and overall market in general. The postponement of disinvestment decision had also resulted in downgrading of Indian paper by S & P. Let us now turn to the issues raised against disinvestment.

The issues raised against disinvestment as already pointed out are mode of investment i.e., strategic vis-a-vis public offer, profit making, creation of private, monopolies and strategic importance of the PSU under disinvestment. One of the yardsticks for measuring the huge productive potential of the public sector enterprises is the disinvestments receipt from such enterprises, relative to the losses they presently incur, or the net present value of the low profits. It is evident that the government has approximately received Rs. 11,315 cr. The opportunity cost at 10% works out to around Rs. 1,140 cr. However, PPL and JESSOP led to an average annual outgo of Rs. 126 cr.

Thus on an aggregate basis, the government lost Rs. 73.59 cr. Strategic sale of part of the equity has resulted in benefit to the tune of Rs. 1140 cr + 74 cr = 1213 cr. It is stated by the disinvestment ministry that there can be no justification for maintaining public sector character in these industries/ companies, if the taxpayer has to lose more than Rs. 1,213 cr every year by non-privatization. As per the traditional parameter i.e., price/earnings ratios for valuation of security too would give a level of comfort for sale of equity through strategic route. The rough estimate is that the government is going to fetch substantially higher amount by sale
of oil PSUs through strategic sale route as compared to public offer mode. The strategic route for divestment followed in recent years has yielded good dividends. This has resulted in market capitalization of PSUs going up clearly demonstrating the confidence shown by the investing community in this mode of divestment. The disinvestment through the public offer mode, is justified on the grounds of sharing the wealth with people. It is to be appreciated that wealth of PSUs belong to the entire population of the country not to chosen few who participate in the stock markets.

The implicit assumption is that public will buy shares at the prevailing market price. But the moment it is known that the government will not relinquish control, the price will crash. Therefore, the proceeds from whatever limited sale takes place will be meager. But quite apart from unlocking their productive potentials, disinvestments do also galvanize these enterprises to promote high quality employment as well as competition in the marketplace. In the Indian context, we have to examine whether the government would really let go off control after a public offer and appetite for stocks of government companies.

There is also the question of whether our markets have the depth to absorb the offerings of such companies. Going by the current trends, there should be appetite for stocks such as BPCL and HPCL but the government may have to price them attractively in relation to the market price. This would mean that its realizations would suffer but then, the positive offshoot could be that such an offer will lend much needed vibrancy to the domestic markets. The government would have to take a call on how much it can sacrifice to keep the privatization program going. The book-building route, which offers the twin advantage of transparency and efficiency in pricing, can be adopted. Now it has been decided that
there will be an open offer for Bharat Petroleum Corporation, and a strategic sale of Hindustan Petroleum Corporation. Besides, in cases of both BPCL and HPCL, a specific percentage of shares to the employees of the two companies at one-third of the market price will be allotted. The Finance Ministry has also been asked to prepare a paper on the feasibility of setting up an asset management company to monitor and manage the residual holdings of the government in disinvested PSUs. However, there is not much of a disagreement on the usage of the money for social purposes and building infrastructure, which would benefit majority of the population.

**TABLE 1. Disinvestment –Target, Receipt and Mode**

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of cos. in which equity sold</th>
<th>Target Receipt for the year</th>
<th>Actual Receipts</th>
<th>Methodology</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991-92</td>
<td>47</td>
<td>2500</td>
<td>3038</td>
<td>Minority shares by auction method in bundles of 'very good', 'good', and 'average' companies.</td>
</tr>
<tr>
<td>1992-93</td>
<td>35</td>
<td>2500</td>
<td>1913</td>
<td>Bundling of shares abandoned. Shares sold separately for proceeds received in 1994-95.</td>
</tr>
<tr>
<td>1993-94</td>
<td></td>
<td>3500</td>
<td>Nil</td>
<td>Equity of seven companies sold by open auction but proceeds received to 1994-95</td>
</tr>
<tr>
<td>1994-95</td>
<td>13</td>
<td>4000</td>
<td>4843</td>
<td>Sale through auction method, in which NRIs and other persons legally permitted to buy, hold or sell equity, allowed to participate.</td>
</tr>
<tr>
<td>1995-96</td>
<td>5</td>
<td>7000</td>
<td>362</td>
<td>Equities of four companies auctioned and government piggy backed in the IDBI fixed price offering for the fifth company</td>
</tr>
<tr>
<td>1996-97</td>
<td>1</td>
<td>5000</td>
<td>380</td>
<td>GDR (VSNL) in international market.</td>
</tr>
<tr>
<td>Year</td>
<td>No.</td>
<td>Amount</td>
<td>Dividend</td>
<td>Remarks</td>
</tr>
<tr>
<td>----------</td>
<td>-----</td>
<td>--------</td>
<td>----------</td>
<td>-------------------------------------------------------------------------</td>
</tr>
<tr>
<td>1997-98</td>
<td>1</td>
<td>4800</td>
<td>909</td>
<td>GDR (MTNL) in international market.</td>
</tr>
<tr>
<td>1998-99</td>
<td>5</td>
<td>5000</td>
<td>5371</td>
<td>GDR(MTNL) / Domestic offerings with the participation of FIIs (CONCOR, GAIL). Cross purchase by the oil sector companies i.e., GAIL, ONGC and Indian Oil Corporation.</td>
</tr>
<tr>
<td>1999-00</td>
<td>2</td>
<td>10000</td>
<td>1829</td>
<td>GDR-GAIL VSNL- domestic issue, BALCO restructuring, MfL’s strategic sale and others.</td>
</tr>
<tr>
<td>2000-01</td>
<td>4</td>
<td>10000</td>
<td>1870</td>
<td>Strategic sale of BALCO, LIMC; KRL (CRL), CPCL (MRL).</td>
</tr>
<tr>
<td>2001-02</td>
<td>10</td>
<td>12,000</td>
<td>5632</td>
<td>Strategic sale of CMC-51%, HTL – 74%, VSNL – 25% IBP – 33.58%, PPL – 74%, and other modes: ITDC, HCI, STC, MMTC</td>
</tr>
<tr>
<td>2002-03</td>
<td>6</td>
<td>12,000</td>
<td>4748</td>
<td>Strategic sale of JESSOP – 74%, HZL – 26%, MFIL – 26%, IPCL – 25% and other modes: HCI, ITDC and Maruti</td>
</tr>
<tr>
<td>Total</td>
<td>48</td>
<td>78300</td>
<td>30888</td>
<td></td>
</tr>
</tbody>
</table>

There is often an argument that the Government should not sell profit-making companies. BALCO was a profit-making company, which earned the government an average dividend (over eight years) of Rs. 5.69 cr every year on the equity sold. As against this the government would now get Rs. 82.65 cr every year. CMC was a very well managed and profitable company, yet the average dividend was only Rs. 0, 80 cr. The government’s benefit now is Rs. 15.2 cr annually. Similarly, Maruti Udyog Limited gave average returns to the tune of Rs. 13 cr annually to the government and IPCL gave Rs. 16.24 cr on equity sold against Rs. 242 cr and Rs. 149 cr. respectively. The similar arguments hold true for other companies disinvested. In the liberalized environment it is but natural for even the profitable companies to lose market share and the margin. It has already been proved in the case of Maruti and now VSNL controlled by Tatas. In
the Oil sector, for example, private competition is already free to enter the high margin retail business. Reliance’s network may sooner or later eat into the market share and margin of both HPCL and BPCL. It is good to exit when the industry prospects are bright. In the emerging highly competitive environment, when the prospects of generating good returns diminish, they may not even look at PSUs or they may be valued at ridiculously low levels. Again, this is to be viewed in the context of time value of money. Now that our import restrictions and tariffs have come down considerably, monopoly power in the domestic market is difficult to sustain.

**TABLE 2**

<table>
<thead>
<tr>
<th>Base public sector Undertaking (PSU) Index</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Base Date:</strong> February 1, 1999</td>
</tr>
<tr>
<td><strong>Base Value:</strong> 1000</td>
</tr>
<tr>
<td><strong>December 13, 2002:</strong> 1571.92</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>All Time High</th>
<th>All Time Low</th>
<th>52-Week High</th>
<th>52-week Low</th>
</tr>
</thead>
<tbody>
<tr>
<td>1700.95</td>
<td>717.69</td>
<td>1704.79</td>
<td>872.03</td>
</tr>
<tr>
<td><strong>April 2, 2002</strong></td>
<td><strong>October 24, 2000</strong></td>
<td><strong>June 17, 2002</strong></td>
<td><strong>December 28, 2001</strong></td>
</tr>
</tbody>
</table>

Source: Bombay Stock Exchange, Mumbai.

Regarding the issue of strategic importance of the PSUs, it would be desirable to build certain preconditions in the agreements itself as to the expected behavior of the new management in times of war etc., rather than stalling the divestment program. In sectors that are deemed to be strategic, there would be a case for retaining one player in the public sector. But other than that, private sector firms and market forces must be allowed to compete on a level playing field. There are more market-
savvy ways of ensuring that the strategic partner acts in the best interests of the divested company.

For instance, the government has succeeded in the case of Maruti Udyog Limited. The Suzuki company, the acquirer of Maruti, paid Rs. 1,000 cr to GOI for controlling interest. It further committed itself to underwrite two IPOs in future, through which the GOI would disinvest its shares. Translated to either BPCL or HPCL, it could be that GOI now offloads a part of its stake to a strategic partner who also underwrites a future IPO of the remaining or part thereof. Once, the base underwriting price gets fixed in advance as in the case of Maruti, it is in the best interests of the strategic partner to ensure that the company is run efficiently and effectively. Any asset stripping would certainly impact on the public offer and may endanger devolvement. On the other hand, if the markets improve, say after two years, the GOI could get a handsome premium on the IPO, which would be priced as per the then prevailing market price or the base price already fixed, whichever is higher. This would satisfy the opponents of the disinvestments through strategic sale route, which have been hankering for sale through IPOs.

**Time to fine-tune**

The government has sold Modern Foods to Hindustan Lever Limited, BALCO and Hindustan Zinc to Sterlite Group, CMC and VSNL to Tata Group and IPCL to Reliance Group. Disinvestment issues, which have created controversies, now however need a mention at this juncture. This includes the resale of the Centaur Hotel by its new owner and Batra Hospitality Services, to the Sahara Group. The successful bidder in this case could reap a windfall of around Rs. 32 cr (bought the property at Rs. 83 cr and sold for Rs. 115 cr), in less than four months. Logically
speaking, a major part of such gain ought to have accrued to exchequer, if the bidding process had been more effective. The disinvestment minister maintained that there was nothing in the shareholders agreement, which is an essential covenant that could have stopped the transaction. The government ought to clarify as to whether the

TABLE - 3

<table>
<thead>
<tr>
<th>Company</th>
<th>Industry</th>
<th>Mkt Cap as at December 13, 2002</th>
<th>% to Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rashtriya Chemicals</td>
<td>Agriculture</td>
<td>1004.07</td>
<td>0.66</td>
</tr>
<tr>
<td>BHEL</td>
<td>Capital Goods</td>
<td>4091.16</td>
<td>0.00</td>
</tr>
<tr>
<td>Bharat Electronics</td>
<td>Capital Goods</td>
<td>1418.80</td>
<td>0.00</td>
</tr>
<tr>
<td>BEML</td>
<td>Capital Goods</td>
<td>286.94</td>
<td>0.00</td>
</tr>
<tr>
<td>Dredging Corporation</td>
<td>Capital Goods</td>
<td>714.00</td>
<td>6510.90</td>
</tr>
<tr>
<td>HOCL</td>
<td>Chemical</td>
<td>123.95</td>
<td>123.95</td>
</tr>
<tr>
<td>HMT</td>
<td>Diversified</td>
<td>983.16</td>
<td>983.16</td>
</tr>
<tr>
<td>State Bank of India</td>
<td>Finance</td>
<td>14554.8</td>
<td>0.00</td>
</tr>
<tr>
<td>Corporation Bank</td>
<td>Finance</td>
<td>1772.92</td>
<td>0.00</td>
</tr>
<tr>
<td>Bank of Baroda</td>
<td>Finance</td>
<td>20.46.84</td>
<td>0.00</td>
</tr>
<tr>
<td>Bank of India</td>
<td>Finance</td>
<td>1834.62</td>
<td>0.00</td>
</tr>
<tr>
<td>Punjab National Bank</td>
<td>Finance</td>
<td>1655.49</td>
<td>0.00</td>
</tr>
<tr>
<td>IDBI</td>
<td>Finance</td>
<td>1263.23</td>
<td>0.00</td>
</tr>
<tr>
<td>Oriental Banks</td>
<td>Finance</td>
<td>947.30</td>
<td>0.00</td>
</tr>
<tr>
<td>Union Bank</td>
<td>Finance</td>
<td>842.02</td>
<td>0.00</td>
</tr>
<tr>
<td>Andhra Banks</td>
<td>Finance</td>
<td>810.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Indian Overseas Bank</td>
<td>Finance</td>
<td>642.74</td>
<td>0.0</td>
</tr>
<tr>
<td>Dena Bank</td>
<td>Metal and Mining</td>
<td>261.63</td>
<td>26631.59</td>
</tr>
<tr>
<td>Steel Authority</td>
<td>Metal and Mining</td>
<td>3696.71</td>
<td>0.00</td>
</tr>
<tr>
<td>Company</td>
<td>Sector</td>
<td>Cost 1</td>
<td>Cost 2</td>
</tr>
<tr>
<td>--------------------------------</td>
<td>-------------------------</td>
<td>---------</td>
<td>---------</td>
</tr>
<tr>
<td>National Aluminum</td>
<td>Metal and Mining</td>
<td>6124.16</td>
<td></td>
</tr>
<tr>
<td>Nayvelli Lignite</td>
<td>Miscellaneous</td>
<td>4222.44</td>
<td>14043.31</td>
</tr>
<tr>
<td>Engineers India</td>
<td>Oil and Gas</td>
<td>1669.64</td>
<td>1669.64</td>
</tr>
<tr>
<td>ONGC</td>
<td>Oil and Gas</td>
<td>51084.09</td>
<td></td>
</tr>
<tr>
<td>ICO</td>
<td>Oil and Gas</td>
<td>17724.38</td>
<td></td>
</tr>
<tr>
<td>HPCL</td>
<td>Oil and Gas</td>
<td>9334.97</td>
<td></td>
</tr>
<tr>
<td>BPCL</td>
<td>Oil and Gas</td>
<td>6578.47</td>
<td></td>
</tr>
<tr>
<td>Gas Authority (GAIL)</td>
<td>Oil and Gas</td>
<td>5864.59</td>
<td></td>
</tr>
<tr>
<td>Kochi Refineries</td>
<td>Oil and Gas</td>
<td>623.16</td>
<td></td>
</tr>
<tr>
<td>IBP Limited</td>
<td>Oil and Gas</td>
<td>535.96</td>
<td></td>
</tr>
<tr>
<td>Chennai Petroleum</td>
<td>Telecom</td>
<td>409.67</td>
<td>92155.29</td>
</tr>
<tr>
<td>Mahanagar Telecom (MTNL)</td>
<td>Telecom</td>
<td>6533.10</td>
<td></td>
</tr>
<tr>
<td>ITI Limited</td>
<td>Transport</td>
<td>200.20</td>
<td>6733.3</td>
</tr>
<tr>
<td>Container Corporation</td>
<td></td>
<td>1769.72</td>
<td>1769.72</td>
</tr>
<tr>
<td></td>
<td></td>
<td>151624.93</td>
<td>151624.93</td>
</tr>
</tbody>
</table>

Sahara Group was trying to sidestep any covenants that the disinvestment policy might have prescribed. Another controversy which needs a mention, of course, is the privatized VSNL's decision to invest substantial sums in a Tata group company though is abating now, but was an issue recently. The Reliance's takeover of IPCL ought to have spurred the introduction of competition law. The above issues only expose the lacuna in the policy, but can be corrected proactively as the process moves on. There is nothing wrong in fine-tuning and effecting a mid-course correction.
<table>
<thead>
<tr>
<th>Sr.</th>
<th>Name Sold</th>
<th>GOI Equity</th>
<th>Realization</th>
<th>Govt. borrows @ 10 % Interest on</th>
<th>Dividend recd. By govt. on equity sold</th>
<th>Average of last eight years up to 2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Mordern Foods</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>I Phase</td>
<td>9.63</td>
<td>105</td>
<td>10.50</td>
<td>0.48</td>
<td></td>
</tr>
<tr>
<td></td>
<td>II Phase</td>
<td>112.52</td>
<td>44</td>
<td>4.40</td>
<td>0.17</td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>BALCO</td>
<td>112.52</td>
<td>826.50</td>
<td>82.65</td>
<td>5.69</td>
<td></td>
</tr>
<tr>
<td>3.</td>
<td>CMC</td>
<td>7.73</td>
<td>152</td>
<td>15.20</td>
<td>0.80</td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>HTL</td>
<td>11.10</td>
<td>55</td>
<td>5.50</td>
<td>0.29</td>
<td></td>
</tr>
<tr>
<td>5.</td>
<td>IBP</td>
<td>7.44</td>
<td>1153.68</td>
<td>115.36</td>
<td>1.84</td>
<td></td>
</tr>
<tr>
<td>6.</td>
<td>VSNL</td>
<td>71.25</td>
<td>3689^</td>
<td>368.90</td>
<td>10.40</td>
<td></td>
</tr>
<tr>
<td>7.</td>
<td>Hindustan Zinc Ltd.</td>
<td>109.85</td>
<td>445</td>
<td>44.50</td>
<td>3.50</td>
<td></td>
</tr>
<tr>
<td>8.</td>
<td>Maruti Udyog</td>
<td>66.00</td>
<td>2424 ^^ **</td>
<td>242.40</td>
<td>13.00</td>
<td></td>
</tr>
<tr>
<td>9.</td>
<td>IPCL</td>
<td>64.50</td>
<td>1490.84</td>
<td>149.00</td>
<td>16.24</td>
<td></td>
</tr>
<tr>
<td>10.</td>
<td>Others (ITDC Hotels, PPL, JESSOP etc.)</td>
<td>427.63</td>
<td>929.81</td>
<td>101.46</td>
<td>(126)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Grand Total</td>
<td>891.03</td>
<td>11314.83</td>
<td>1139.87</td>
<td>73.59</td>
<td></td>
</tr>
</tbody>
</table>

^ Including Dividend and Dividend tax.
** Expected

^ ^ Minimum amount to be received over three tranches; could go up to Rs. 3158 cr.

It is seen over a period of time that the divestment of government stakes in PSUs continues to be plagued with missed opportunities. In the case of CMC, for instance, at the end of the long process, there was finally one bidder for acquiring the...
government stake. Had the CMC been sold a couple of years ago, when the information technology sector was at its peak, the price realized would have been much more. The story is similar as regards to the proposed sale of government stake in Maruti Udyog Limited. The price that has been realized from the sale was much less compared to the price that Suzuki would have paid on the earlier occasion. In the case of VSNL too, the government sold its stake at less than half the price it would have got several years ago.

WHY NO TO DISINVESTMENT

The case against disinvestment of profit-making public sector enterprises like HPCL and BPCL has been made often enough. These enterprises are capable of earning returns that are well above the rate of interest on government bonds. In fact it is because they are capable of earning such returns that private agents see them as attractive purchases.

For these private sector players, public sector bonds are a risk-free source of return, making the yields on such bonds the floor to the expected rate of return on investment. Unless purchases of public sector equity are expected to more than cover this floor as well as provide for an additional margin to cover the risk associated with investment in such equity, disinvestment offers are unlikely to find any takers. In the circumstances, it is unclear why the government itself should not retain this return and cover the costs of whatever expenditure is going to be met with disinvestment proceeds by issuing debt at an interest rate that is more than covered by the yield on equity. Further, the fact that the yield on equity needs to be higher than the interest rate on government bonds makes nonsense of the argument that disinvestment proceeds should be used to retire public debt and reduce the interest outgo on the government’s budget.

Despite this very obvious and direct reason why disinvestment of profitable public sector units should not occur, the government has been desperate to go in for partial privatisation through the strategic sale route. The facts that this
route involves only partial sale of say 26 per cent of equity to a single buyer, and that such sale is strategic or is accompanied by the handover of managerial control to the buyer are both indicative of the massive concessions that the government has to provide to make disinvestment a successful initiative. Clearly, private buyers are not willing to risk too much of their own capital in a single enterprise making it difficult for the government to find buyers for outright purchase of its equity stake in full. In addition, private players are obviously not keen to hold a minority stake in the equity of a unit that the government manages.

Faced with these two behavioural responses of the private sector to its privatisation effort, the government in a desperate bid to make its disinvestment programme a success, has had to offer the private sector substantial control over profitable productive assets with a relatively small investment. Since past experience with government investment and lending to the private sector through the financial institutions suggests that the government would in all probability play the role of a silent and non-interfering partner, the economic advantages and power that accrue to the private player as a result of strategic acquisition are substantial. Such advantages would be all the greater if acquisition of control through the strategic sale route provides the buyer with a monopolistic position as has happened in the case of the Reliance acquisition of IPCL. And the manner in which such power can be misused has come in early, as evidenced by the effort of the Tata group to use the cash surpluses of VSNL to finance their own private expansion plans.

ALTERNATIVES

The point is that despite providing these huge concessions, the evidence from instances varying from Modern Foods to Balco and more recently the ITDC properties suggests that disinvestments occurs at prices that are extremely low, given the worth of or the income earning capacity of the assets that are being sold. Rather than bend so far as to give the private sector a cheap route to profit and lose resources of its own in the process, the government could have adopted other alternatives to find funds for crucial investments. It could, for
example, be argued that if the government wanted to release resources for investment in the infrastructural sector it could have focused attention on two areas: First, it could have sold the stake which the financial institutions hold in a number of private companies in which they have little or no role in actual management. Rather than have those resources tied up in units which have now been supported with State funds for long, it makes sense to divest those shares either to the private promoters or to the market and use the proceeds for other expenditures. Second, the government can intensify the now virtually non-existent effort to recover the large volume of resources, estimated at more than Rs.65000 crore, locked up as non-performing bank assets primarily in large and medium private sector units. Unfortunately the disinvestments controversy does not draw attention to these important questions, but seeks to stall the process with talk of the need for mid-course review and correction. This makes the dissenters susceptible to the charge that they are playing into the hands of particular interests, who want to guard against the acquisition of these assets by their current or potential competitors. This also lends credence to those who argue that the “progressive” policy of disinvestment and reform is being sought to be derailed by those who have nothing to argue against the policy, but would like to maintain the status quo in support of traditional vested interests. Those who have led the campaign against mindless privatisation must expose the controversy within the NDA on this issue as a charade that diverts attention from and tends to discredit the real battle against a fraudulent set of policies aimed at enriching a segment of the private sector at the expense of the State exchequer.

The role of the State vs. Market has been one of the major issues in development economics and policy. In a mixed economy such as 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 liberalization, privatization and globalization de-emphasized the role of the public sector in the nations economy. The faculty at IIT-Bombay has been studying various aspects of the New Economic Policy such as financial sector reforms, fiscal implications of reforms, and of globalization.
To date several arguments have been proffered by the apologists of market-oriented economic structures:

- the government must not enter into those areas where the private sector can perform better
- market-driven economies are more efficient than the state-planned economies
- the role of the state should be as a regulator and not as the producer
- Government resources locked in commercial activities should be released for their deployment in social activities.

It is also contended that the functioning of many public sector units (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 PSUs was about 3.4% as against the average cost of borrowing, which was 8.66%. Disinvestment (or divestment) of the PSUs has therefore been offered as one of the solutions in this context. Disinvestment involves the sale of equity and bond capital invested by the government in PSUs. It also implies the sale of government’s loan capital in PSUs through securitization. However, it is the government and not the PSUs who receive money from disinvestment.

The fixation of share/bond price is an important aspect of disinvestment. Now, the Disinvestment Commission determines the share/bond price. Disinvested shares are listed, quoted and traded on the stock market. Indian and foreign financial institutions, banks, mutual funds, companies as well as individuals can buy disinvested shares / bonds. Disinvestment is generally expected to achieve a greater inflow of private capital and the use of private management practices in PSUs, as well as enable
more effective monitoring of management discipline by the private shareholders. Such changes would lead to an increase in the operational efficiency and the market value of the PSUs. This in turn would enable The much needed revenue generation by the government and help reduce deficit financing. However, to date the market experience has been otherwise. The large national budgetary deficit on revenue account has been increasing. The government has not used the disinvestment proceeds to finance expenditure on capital account; i.e. the disinvestment policy has resulted in capital consumption rather than generation. Administrative costs of the disinvestment process have also been unduly high. The actual receipts through disinvestment have often fallen far short of their target (see figure). During the period 1991-92 to 2002-2003, the government had targeted the mobilization of about Rs. 78,300 crores through disinvestment, but it could actually mobilize only Rs. 30,917 crores.

Problems associated with Disinvestment

A number of problems and issues have bedeviled the disinvestment process. The number of bidders for equity has been small not only in the case of
financially weak PSUs, but also in that of better-performing PSUs. Besides, the government has often compelled financial institutions, UTI and other mutual funds to purchase the equity which was being unloaded through disinvestment. These organizations have not been very enthusiastic in listing and trading of shares purchased by them as it would reduce their control over PSUs. Instances of insider trading of shares by them have also come to light. All this has led to low valuation or under pricing of equity. Further, in many cases, disinvestment has not really changed the ownership of PSUs, as the government has retained a majority stake in them. There has been some apprehension that disinvestment of PSUs might result in the crowding out of private corporate (through lowered subscription to their shares) from the primary capital market.

An important fact that needs to be remembered in the context of divestment is that the equity in PSUs essentially belongs to the people. Thus, several independent commentators have maintained that in the absence of wider national consensus, a mere government decision to disinvest is not enough to carry out the sale of peoples assets. Inadequate information about PSUs has impeded free, competitive and efficient bidding of shares, and a free trading of those shares. Also, since the PSUs do not benefit monetarily from disinvestment, they have been reluctant to prepare and distribute prospectuses. This has in turn prevented the disinvestment process from being completely open and transparent. It is not clear if the rationale for divestment process is well-founded. The assumption of higher efficiency, better / ethical management practices and better monitoring by the private shareholders in the case of the private sector ☟ all of which supposedly underlie the disinvestment rationale ☟ is not always borne out by business trends and facts.

Total disinvestment of PSUs would naturally concentrate economic and political power in the hands of the private corporate sector. The US economist Kenneth Galbraith had visualized a role of ☟countervailing power ☟ for the PSUs. While the creation of PSUs originally had economic, social welfare and political objectives, their current restructuring through disinvestment is being
undertaken primarily out of need of government finances and economic efficiency.

Lastly, to the extent that the sale of government equity in PSUs is to the Indian private sector, there is no decline in national wealth. But the sale of such equity to foreign companies has far more serious implications relating to national wealth, control and power, particularly if the equity is sold below the correct price! If the disinvestment policy is to be in wider public interests, it is necessary to examine systematically, issues such as - the correct valuation of shares, the crowding out possibility, the appropriate use of disinvestment proceeds and the institutional and other prerequisites.

Valuation of Public Sector Units for the purpose of Disinvestment

The process of disinvestment in India began in 1992, under the aegis of new economic liberalization policy put forward by then Finance Minister, Dr. Manmohan Singh. Disinvestment was supposed to be the tool in the hands of government to improve the functioning and profitability of public sector enterprises and also raise funds to mitigate its fiscal deficits. However, over the past decade, this exercise has been plagued by criticisms and controversies and has not achieved desired results for the government because of political bickering.

The enunciated Government of India’s policy on disinvestment as per Economic Survey 2001 was:

Bring down Government equity in all non-strategic PSUs to 26% or lower, if necessary; Restructure and revive potentially viable PSUs; Close down PSUs which cannot be revived, and Fully protect interests of workers. There have been several criticisms of the disinvestment process. One is that valuations processes were unsound and that the government gave away its stakes too cheaply; two, disinvestment has been merely a revenue-raising affair for the government, with little thought being given to the requirements of the firms concerned; thirdly, it is contended that the government’s reluctance to
disinvest more than 51% and relinquish control over PSUs has meant that the
government has been unable to attract suitably priced bids, as bidders do not
believe the firms’ performance would improve significantly with small
government stakes being offloaded.

An important and perhaps most critical issue in the process of
disinvestments or privatization of PSUs is valuation. Be it disinvestments
of 1991-92 or that of BALCO in 2001, valuation has always been at the
core of controversy. This is so because there are several methods of
valuation and different methods yield widely varying results. The criticality
of the issue of valuation in disinvestment or privatization can be easily
gauged from the fact that the value of BALCO as put by different people
differed as widely as from Rs.1100 crore to Rs.5000 crore.

History of Disinvestment

Prior to disinvestment of Modern Foods Industries (India) Ltd., only minority
stakes in PSEs were sold. Sale of minority stakes led to lower realizations and
gave the impression that government’s sole objective is to reduce fiscal deficit
and not to improve performance or governance. The bundling and bidding
method were adopted as first method of disinvestment, subsequently followed
by the tendering and the issuance of global depository receipts (GDR). The
auction and public float methods were never used for effecting disinvestments.
The government had narrowly focused only on disinvestment of shareholdings
without considering other issues such as initial price offers (IPOs), involvement
of strategic partners, offloading shares in the capital market, setting up an SPV,
employees stock ownership and participation and management buyouts. At
present the preferred policy is to privatize PSUs through the strategic sale
route. The other route to privatization is to dilute government holding through
public offering. Therefore, the current strategy of the government is to transfer
the ownership of PSUs as going concern, rather than to liquidate enterprises
and sell their assets after stripping the same to realize its investment.
Challenges in valuation of Indian PSUs

- Companies listed on stock exchange can be assessed fairly on the basis of market price of shares. However, most of the PSUs are either not listed on stock exchange or command extremely limited trade float.

- Valuation of PSU is different from establishing the price for which it can be sold. Government can only realize what the buyer is willing to pay for the PSU.

- Valuation is a subjective figure arrived at by the bidder by leveraging his strengths with the potential of the company.

- The profitability of the PSUs as reflected through the profit and loss account does not adequately reflect the earning potential of PSUs because the PSUs have generally been run in unprofessional manner.

- Public Sector undertakings own not only huge business assets but also highly valuable non-business assets like real estate, residential complex and utilities like power plant etc.

- Valuing companies in India becomes even more difficult, as there is no databank of transactions carried out in the past. In the US, the valuation report of any acquisition has to be filed with Securities and Exchange Commission (SEC).

Valuation Techniques

The guidelines on valuation in the PSUs, are prescribed in Chapter 18 of the manual titled "DISINVESTMENT: POLICY & PROCEDURES", published by the Ministry of Disinvestment in 2001. The disinvestment Commission has prescribed four approaches to valuation of PSUs. These are:
• The Discounted Cash Flow method

• The Balance Sheet method

• Transaction Multiple method

• The Net Asset Value method
  While the first three are business valuation methodologies generally used for valuation of a going concern, the last methodology would be relevant only for valuation of assets in case of liquidation of a company. Let us discuss about each one of them:

The Discounted Cash Flow method

The Discounted Cash Flow (DCF) methodology expresses the present value of a business as a function of its future cash earnings capacity. This methodology works on the premise that the value of a business is measured in terms of future cash flow streams, discounted to the present time at an appropriate discount rate.

The Balance Sheet method

The Balance sheet or the Net assets on the basis of the value of its underlying assets. This is relevant where the value of the business is fairly represented by its underlying assets. The NAV method is normally used to determine the minimum price a seller would be willing to accept and, thus serves to establish the floor for the value of the business.

Transaction Multiple method

This method takes into account the value paid for similar transactions in the industry and benchmarks it against certain parameters, like earnings or sales. Two such parameters are: Earnings Before Interest, Taxes, Depreciation & Amortisations (EBITDA), & Sales. Although the Transaction Multiples method captures most value elements of a business, it does not properly reflect the cash flows generated by a business, or take into account the time value of money. However, it is considered as a useful rule of thumb, in valuing
businesses by various valuation experts. Accordingly, one may have to review a series of comparable transactions to determine a range of appropriate capitalisation factors to value a company as per this methodology.

**The Net Asset Value method**

The asset valuation methodology essentially estimates the cost of replicating the tangible assets of the business. The replacement cost takes into account the market value of various assets or the expenditure required to create the infrastructure exactly similar to that of a company being valued. Since the replacement methodology assumes the value of business as if we were setting a new business, this methodology may not be relevant in a going concern. Instead it will be more realistic if asset valuation is done on the basis of the new book value of the assets. The asset valuation is a good indicator of the entry barrier that exists in a business. Alternatively, this methodology can also assume the amount which can be realized by liquidating the business by selling off all the tangible assets of a company and paying off the liabilities.

**The Right Valuation Approach**

All of the above methods have their own merits and demerits. No method will suffice in any particular case. The valuation methods are benchmark figures and in no way can predict the exact price at which an entity can be sold. The buyer will be willing to pay the price depending on the synergy value that will result from improvements made when the companies are combined. This value will accrue to the acquirer's shareholders rather than to the target's shareholders. The more the synergy value a particular acquisition can generate, the higher the maximum price an acquirer will be interested in paying. Price a buyer would be willing to pay could be a function of Synergies expected from proposed integration of Target Company.

In case of Modern Foods depending on the valuation method, the company's value oscillated between Rs 28 crore and Rs 78 crore. Hindustan Lever, however, offered Rs 125.45 crore. HLL quoted the price depending on the
value they thought they would derive from the company. Asset Value (NAV) methodology values a busin

The value is a function of the individual's perception of the risk, the nature of financial resources available to the purchaser, opportunity, and other similar factors. Therefore, the government in order to realize better proceeds from disinvestment should consider following issues in future: It is important to understand that price is not value; in fact, the difference between price and value is the raison d'être of investment valuation, independent of market pricing. The final value to be paid by acquirer will depend on the controlling premium he is willing to pay. Most foreign companies are not comfortable with less than 51 percent holding. But the government isn't offering 51 percent in most strategic sales. The government should have clear future policy when going in for big ticket disinvestments like Air India. For instance, main assets of Air India are the bilateral rights. Will these bilateral rights vest with Air India – if yes, Air India's valuation will be higher. However, no country in the world has committed all its bilaterals to one airline.

These uncertainties with regard to future of the sector will prevent bidders to quote higher prices for Air India. There is no reason why the government should continue to hold a part of the equity in PSEs that are operating in non-core sectors. This strategy leads to sub-optimal realization of revenue and significant loss to the government. In the cases of disinvestment involving transfer of control of management affairs to the private investor, higher weightage has to be given to the value of assets both tangible and intangible and relatively lower value can be assigned to fair market price. While disinvesting minority shares, more weightage will have to be given to market price. In such case asset valuation approach needs to be given lesser weightage. Nonetheless, what is important is that, not merely should the value derived be unquestionable on the basis of well-established equity valuation principles, but also the processes and methodologies (and the underlying
assumptions) adopted for deriving such value be reasonable. Transparency in valuations is a must so as to avoid controversies.

Disinvestment and the Destruction of the Indian Economy

India was declared an independent country in August 1947 and in 2003, after more than half a century, no government, either in the centre or in the states has felt the responsibility of providing safe drinking water to the citizens of the country. Rather it allowed corporates both Indian and foreign to sell water and earn fabulous profits. Nobody was accountable, they were allowed to sell water full of dangerous chemicals like pesticides causing immense damage to public health. This is the latest version of the ‘privatisation and ‘corporatisation’ of modern India! In a country of one billion people, electricity is required in every house, whether it is the Rashtrapati Bhavan (presidential residence) in Delhi, a five star hotel or only a six by four feet jhuggi (shanty) in an unauthorised colony. (The majority of Delhi people are forced to live in these jhuggis unlike the learned judges occupying spacious government bungalows in the heart of the metropolis and who are paid by these hapless jhuggiwalas through indirect taxes.

These learned judges want that there should not be any jhuggi in Delhi on government land and that there should not be any provision of subsidised land for the settlement of these millions of citizens of the country. Electricity is one of the most highly profitable businesses in the world and demand for it will only increase. The government says that in future the electricity business will be only in the hands of private companies and not with the public sector, on the ground of efficiency and better service. The government handed over Delhi electricity to two private companies as the public sector was in a mess and the power situation was extremely chaotic. Two private companies with distinct market orientation were entrusted with the job of power distribution and each has monopoly right over its own area of operation. So where is the free
competition in a so-called market economy? Ask any one in Delhi, during the last one year private power suppliers refused to listen to consumers' complaints, the power situation is worse than what it was there during the chaotic regime of public sector. The regulatory commission on electricity in Delhi is a paper tiger; no one knows what it is doing. At least it is not accountable to the hapless unorganised household consumers of electricity in Delhi. One of these two companies which has now been taken over by Reliance created total chaos in power distribution in Orissa. So 'privatisation' or 'corporatisation' as mandated by the international organisations like the World Bank (WB), International Monetary Fund (IMF) and World Trade Organisation (WTO) is being implemented not to meet any specific requirements of our country and its billion people. It is implemented to destroy completely the hold of the community that it had on those services. In a unipolar world commanded by the USA, capitalism of the worst form is experienced by the poor people in the developing countries with around or less than one US dollar per day per capita income.

**Destruction of the third world economies**

The representatives of the transnational corporations in US, Japan and elsewhere are in a hurry to fulfill their narrow selfish ever-expanding greed for wealth and power and they have absolutely no regard for the people in the rest of the world. This exposes the hollowness of the market economy and globalization, or in other words it is a blueprint to globalize robbery and internationalize poverty. It may not be out of place to mention here that though the US demands that its exports should reach all coasts without any hindrance, but as a matter of policy it puts the maximum obstructions on imports to the US.

This is the tragedy of the US brand of globalization! It is of great concern to the think tank of the G-7 countries that more and more economies in Latin America are showing tiredness with the textbook capitalism followed by the G-7 countries during the last 2 decades. The economic balloon of artificial prosperity was blasted first in Argentina during the last 3 years. The rich and affluent people there came out into the streets with their eating utensils
demanding a refund of their dollars kept as deposits in the banks. The IMF policies were declared bankrupt to solve the policies of pauperisation of the vibrant economy of Argentina where the Argentine currency was linked to the US dollar. Next came the left electoral victory in neighbouring Brazil and it showed that US policies of exploitation and extortions are being challenged in its very courtyard. Now, it is the turn of Venezuela, the second richest oil reserve after Iraq with more than 60 percent of the population in abject poverty and almost all the public sector units have already been privatised under the order of the WB and IMF. People are crushed by poverty and unemployment. The oil companies and other MNCs paralysed the economy and are trying their level best to throw out the duly elected popular government of Chavez. The situation in Bolivia, Ecuador and in many other Latin American counties are beyond description and these are the places where the WB, IMF and WTO were ruling for decades with their anti-people policies. Here in the name of globalization, destruction is more or less complete. In August 2002, 400 representatives of labour and civil society organizations from throughout Latin America met in the Ecuador capital and established a tribunal against privatization, which was charged with having led to the ‘globalization of poverty.’ We know from the history of Nigeria how the oil companies virtually destroyed the natural resources of that country and how no one listened to their problems. Now a new issue is being taken up by the MNCs and that is the ‘privatization of water resources’ which were exclusively under community ownership and management. In 2001, 50 percent of World Bank loans required countries to privatise services and more than 80 percent of the loans required cost recovery requirements. In Ghana, for example, in May, 2001, after the insistence of the WB and IMF water fees from community water areas were increased and three buckets of water cost a family almost 20 percent of the daily minimum wage! So capitalism not only failed miserably in the G-7 countries, it is creating mass destitution in the developing world.
India is forced to bankruptcy and destruction

Both in the human development index and in terms of the governance of the country India is still a really very backward country in the world. Per capita income of the vast majority is less than one dollar a day. We are not taking into consideration the recent report of the United Nations System wide evaluation of global water resources, which ranked India a poor 120th out of 122 countries in water quality. (Business Standard dated 6.3.03). On the other extreme till today people are killed by the elected government on the basis of religious faith, both the Human Rights Commission and the 'independent' judiciary never thought it necessary to punish the killers, though the evidence is there in great abundance. In the so called progressive state of India in terms of literacy, infant mortality etc. etc. children are denied their fundamental right to study in a school on the plea that either they are having HIV positive or their parents are leprosy patients. During the last 12 years of so-called reform, unemployment instead of declining has increased.

Though we are a leading exporter of Information Technology (IT), we avoid publishing exact employment and unemployment data and sector-wise fearing public criticisms. When the leader of the opposition on the floor of the house challenged the Prime Minister of his promise to create jobs for a million persons each year, instead of answering with facts and figures the entire issue was made a big laughing matter. Employment in the unorganised sector is the largest basket with innumerable holes kept for exploiting as slave labour, but no parliamentary party wants to touch it.

According to a rough estimate the organised sector provides jobs to around only 8 to 9 percent of our workers. In the organised sector since 1997 there is continuous decline in jobs. In 1997 the total employment in the organised sector was 28.25 million – the public sector provided 19.56 million and the private sector 8.69 million. By 2001 total employment declined to 27.79 million – the public sector – 19.14 million and the private sector 8.65 million. Thus jobs
are vanishing at a fast speed with every new injection of capital-intensive technology imported from the west. Data from the Annual Survey of Industries (ASI) shows that the factory sector shed 7 lakh jobs between 1998 and 2000. Even then the World Bank demands that Indian labour laws should be thoroughly changed so that the ‘hire and fire’ policy of the 18th century can be brought back to India in 21st Century. So to oblige them the government is going to amend the entire labour law of the country.

The Voluntary Retirement Scheme is now an economic policy to retrench people without providing any social insurance benefit. The central public sector enterprises have cut employee strength from 2.179 million in 1991 to 1.994 million in 2001-02. After privatization of these public sector units these employees are simply thrown out without any compensation. It is disastrous for this poor country.

After 1991 the Congress government in the centre started implementing the economic reform programme of the WB and IMF and today after 12 years of its implementation, the country is the net loser; while the politicians and the bureaucracy personally got their due commission as agents of these MNCs. For the first 30 years after independence the rate of economic growth with nominal additions for new jobs was around 3 to 3.5 percent per annum, in the next two decades the new Hindu rate of growth is stabilised around 5 to 5.5 percent per annum with no additional job creation, rather employed people were thrown in the unemployment and poverty dustbin. In the US this peculiar ‘thin’ labour force working after massive retrenchment is exploited fully and they claim increase in labour productivity.

The World Bank wants that all the public sector units should be privatised and our government is complying with that directive more than faithfully. The World Bank and IMF know that Britain ‘privatized’ its railway system but was compelled to bring it back to the public sector due to continuous public pressure. In the same manner South Korea renationalized its’ electricity business as people were suffering in the hands of the private operators. France has not privatized many of her business units including that of Air Bus. We are
asked to privatize because our public sector units are loss making and the management is very inefficient. But then why privatize the profit making units? It is a fact that our management is totally anti people but that is not only in the public sector units alone as it is the broad policy of the government. In text books, the citizens are the real masters and the consumers are the real kings, but in practice we have yet to get our simple ‘legal right to information’ of what is happening in the country.

Till to day we don’t know who is paying how much tax. It is alleged that payment of tax is avoided; bribes keep both taxpayers and the bureaucracy happy. A rough estimate of the quantum of black money in the economy is around 40 percent of the GDP. The number of public sector units (PSU) in the country is about 240 and their total equity investment is around Rs 78484 crores. The fiscal deficit last year was around 5.9 percent of GDP and for the current year it is projected around 5.6 percent of GDP or around Rs 153000 crores. The government wants to collect Rs 13200 crores by the sale of PSUs next year against Rs 3360 crores collected last year against a target of Rs 12000 crores. In the current year the net increase in tax due to additional imposition or withdrawal of taxes is virtually nil because the WTO wants reduced indirect taxes and custom and excise duties. The state level elections at the end of this year and central elections next year have compelled the government to be friendly to the rich taxpayers. That is why all the recommendations of Dr. Kelkar Committee were thrown into the dustbin as demanded by the BJP. Not only that, as on March 2002 the total outstanding tax arrears of the centre was around Rs 86400 crores which must have increased during the current year.

Thus the government is willingly punishing salary earners by deducting tax at source and allowing the big tax payers either to evade tax and accumulate black money and/or to throw the tax issue to the spider net of never ending legal procedures. Even today we have a system of tax called Minimum Alternate Tax (MAT) where some small amount is collected on voluntary basis based on the book profit. So both the government and business are in league
not to collect even the legal dues from industry and commerce and all of which are in the private sector. By continuing with exemption of Capital Gain Tax for fake Mauritius-based companies gave incentives to avoid paying taxes. However, the public sector units are never allowed to manipulate their accounts and evade taxes. The profit earning PSUs paid every year huge amounts to the public exchequer by way of various taxes, interests and dividends. During 1998-99, 1999-2000 and 2001-2002, the government was given dividends by the PSUs of Rs 4894, Rs 5437 and Rs 8260 crores respectively. During 2000-2001 PSUs paid the government around Rs 164068 crores (more than the fiscal deficit figure of 2003-04) in the form of dividends, interest and taxes.

The oil PSUs are the most profit generating units in the country. The private sector finds it cheaper to bribe politicians and avoid paying taxes. They don’t pay back to the banks and financial institutions their outstanding loan and interest. This has reached an astronomical figure of around one lakh crores of Rupees and though now there is a law to realise the dues no one is coming forward to obey that law. The Reserve Bank of India has asked the Banks to mutually settle the issue. This is the anti-national role of the banking regulator of the country! Every day one or more cooperative banks are closing their shops and the defaulters are never penalised by the RBI.

Those who advocate privatisation and corporatisation should tell us what happened last year to so many transnationals in the US where laws are supposed to be strictly enforced. As soon as Enron collapsed, it was amazing how one after another a host of so many big houses queued up before the bankruptcy courts telling the world how they indulged in window dressing their accounts and committed the worst fraud of the century. In this connection it was not at all surprising when Mr. Bush and his Vice-President were found committing the worst form of fraud in share dealing based on inside information of the companies (Halliburton) in which both of them were in the management. When the fifth largest auditing firm, Anderson of the US, was caught red-handed in manipulating accounts and destroying their records, the world auditing business knew that they actually practiced under the protection of law.
Anderson was sent immediately to bankruptcy but our own auditing firms are still surviving. Every one knows that they are directly involved in so many scams being systematically investigated by Joint Parliamentary Committee of the Parliament. Nothing happens to the big sharks, some small fishes are caught and punished here and there. The Unit Trust of India financial scandal is the biggest scam in the public sector, but no minister was sent to jail for defrauding the millions of small investors.

In the same manner organized loot is going on the name of disinvestment. You take any company in the public sector which is disinvested ‘strategically’. The ITDC hotels were sold for a price and then they were resold by their purchasers to a third party at fabulously higher prices, pocketing huge profits without paying a single penny from their pockets. Modern Food, VSNL and Balco were sold, but no one bothered to charge the value of land and underground minerals which these companies were given. Balco did not pay for the thermal plant that they took over. In the same manner handing over IPCL to Reliance is pure and simple fraud on the country as it has already been given enough monopoly power to hold the country to ransom. In the name of the market economy the BJP is only helping growth of monopolies in the country.

Now they want to disinvest two giant oil companies – HPCL and BPCL to the private sector. As the US is interested to grab international oil resources, the fascist RSS in India also wants that the agents of the international oil cartels should come back and take over our oil industry once again. It took tremendous guts for Sri K.D. Malaviya to nationalise the all powerful oil industry and ask the multinationals to get out of India. The Oil and Natural Gas Commission was never given the required cooperation in subsequent years to explore off shore and river basin oil fields, but even then whatever we have to-day is a great asset and it is in the interest of the country that we should allow ONGC to grow and try to make India at least one of the big producers of oil in the world.

The anti-India oil lobby wants us to ignore what is happening in Venezuela, Middle East and in Africa and why their democratic governments are fighting relentlessly against these oil cartels of the world. The people of these countries
are brutally exploited by the oil giants. The war on Afghanistan was launched just to have access to the oil resources of erstwhile Soviet states, which the US took out from Soviet Russia. If the RSS refuses to see beyond their nose and act only for some selfish personal profit, the future generation will not excuse the organisation and its leadership. Sri Atal Behari Vajpayee and his BJP party have exposed thoroughly their anti-national activities and people of this country can’t forgive them.

Privatization and corporatisation is a broad policy to capture the market of developing countries by the sick G-7 countries. The absolute number of poor people in the world is increasing. The experience in Latin America and Africa should teach us what will happen to our so-called rich people after privatization of the Argentine or Brazilian pattern is introduced in India. It was the Bombay Club of the pre-independence days of the then business community who forced the government to introduce planned development and growth of the nationalized sector investment in industry and commerce.

The Indian family-owned private sector developed their empire under well-planned camouflage and support of the licence-permit raj. So this system was advocated and introduced by the government to safeguard Indian business interests and without it the present day Indian business community could not have come to the existing state of affluence. They were never interested in competition and till to day they want protection from the state either in the form of subsidy or tax concession. They take loans from the banks and never want to repay; they evade taxes and if caught red handed take the legal route to avoid payment of taxes. To safeguard their narrow individual interests various chambers dictate the government’s taxation and import and export policies. They survive only when there is oligopoly or monopoly in market structure.

The Indian public sector was developed with public money but it never served the interest of the ordinary Indian citizen, rather it was used as a milch cow for the nourishment and growth of the Indian private sector. But when the MNCs were brought to India and they are going for widespread acquisition, amalgamations and mergers with their tons of financial resources, the Indian
private sector wants to run away from the scene at the first opportune moment. Chauhans of Thums Up was the classical example. Now they are caught selling adulterated drinking water. In such an hour of crisis, to safeguard the interests of millions of unprotected wage earners, small and marginal cultivators who account for more than three-fourths of the population, it is the duty of the Indian state to protect the existing public sector units and formulate the necessary laws so that Indians are not made beggars in their own country. These foreigners could not achieve their dangerous design in the mid-sixties, discouraging us to invest in agriculture (this policy is still valid when they want to send us genetically modified crops). They tried to feed us with third rate wheat meant for fodder in their own country under the Public Law 420. Rather our cultivators accepted the challenge and made the country self-sufficient in food and milk and now they are feeding the rest of the world. In the same manner we are producing oil which is about 30 percent of our requirements and our own refining capacity is self-sufficient. Our steel production is sufficient and we export even some quantity to China. The people and the political parties who are trying to sell the profit earning viable strategic PSUs and trying to destroy our economy, are already marked out. Public hatred and anger against such anti-national policies is very difficult to contain. From the 2003-04 Budget presentation it is clear that the BJP will play its ‘privatization programme’ in slow motion till next year’s Lok Sabha election, but people may not excuse such an anti-people and anti-national party so easily.

The disinvestment debate

AFTER a great deal of initial excitement and reservations, disinvestment of public sector enterprises has become an ongoing process in the country. But the debate continues, with some enthusiastically endorsing it and others expressing apprehensions and opposition. By and large, this debate has been at the ideological level. Ideology cannot be kept out of the debate, but disinvestment has other dimensions too. The modalities of disinvestment are important. So are its consequences. It is on these aspects that Sudhir Naib’s work on disinvestment assumes significance. It is one of the few
comprehensive treatments of disinvestment in India. After dealing with the evolution and rationale of the public sector in India (which may be familiar material) and a discussion of the influence of ownership on efficiency, the author moves on to an evaluation of privatization and disinvestment in other parts of the world; in the United Kingdom in the 1980s during the prime ministership of Margaret Thatcher; in the Eastern European countries and the former Soviet Union after the collapse of communist regimes; in the East Asian countries and China; in Latin America; in West Asia and North America.

The critical assessment of disinvestment in other parts of the world forms the background to Naib's detailed empirical account of disinvestments in India. (The material covered in this section of the book is not easily available to readers in India.) Public sector enterprises (PSEs), which were given a special role in India's planned economy, grew both in terms of numbers and investment for over four decades from the early 1950s. At the commencement of the First Five Year Plan there were five PSEs with a total investment of Rs.29 crores. At the end of the Seventh Plan in 1990, there were 244 PSEs and the investment in them had gone up to Rs.99,329 crores. Although disinvestments had started from the early 1990s, at the end of the Eighth Plan in 1997, investment had soared to Rs.213,610 crores. At the end of the fiscal year 2000-01, PSEs had a total investment of Rs.274,114 crores.

The PSEs made a significant contribution to industrial production, 100 per cent in lignite, over 80 per cent in coal, crude oil and zinc, almost 50 per cent in aluminium and over 30 per cent in finished steel. In terms of profitability, the PSEs showed diverse patterns. In 2000-01, 122 enterprises made a profit with the top 10 among them - giants such as the Oil and Natural Gas Corporation (ONGC), the National Thermal Power Corporation (NTPC), the Indian Oil Corporation (IOC) and the Videsh Sanchar Nigam Limited (VSNL) - accounting for close to 70 per cent of the total net profit of Rs.19,604 crores. Sector-wise, petroleum, power and communications contributed to 60 per cent of the profits. During that year, there were 111 loss-making enterprises with a total loss of Rs.12,839 crores. The major contributors to the losses were Hindustan
Fertilizer, the Fertilizer Corporation of India (FCI), Bharat Coking Coal, and some other enterprises dealing with coal. The return on investment of all PSEs taken together remained low - post-tax profitability being only about 5 per cent on capital employed. The author says: "The public sector in India, which was perceived to be the vehicle of speedy economic development, has run into rough waters. It not only failed to produce surpluses which it was expected to generate for future growth, but the return on investment remained poor." The question that is examined is whether disinvestment and privatisation can lead to better results.

According to the author, at the theoretical level the poor performance of PSEs can be attributed to three factors: they are not governed by profit maximising considerations; there is no direct equivalent of bankruptcy constraint; and since shares are not traded in the market, the discipline that the market imposes is absent. The general presumption is that these three factors adversely affect the enterprises. However, this is not a matter that can be or should be settled on a priori theoretical arguments. Since the disinvestment of PSEs has been taking place over a fairly long period, it is now possible to submit it to empirical scrutiny.

The strength of Naib's work is that he reviews the empirical evidence from different parts of the world and has conducted empirical studies of his own in India. Before moving to these decisive empirical aspects, there is another important matter to be considered: how exactly is the disinvestment of PSEs to be achieved? One possibility is strategic sale with complete transfer of management to an enterprise in the private sector. Modern Food Industries, Bharat Aluminium Company Limited (BALCO), VSNL, Centaur Hotel Airport Mumbai and a few others were sold off in this manner. A second procedure adopted was partial disinvestment whereby the government still retained effective control by holding 51 per cent or more of equity. This has been the procedure adopted in the majority of cases. This is not a simple procedure, though. A decision has to be made as to who would be eligible to acquire the shares - other enterprises, employees or the public at large - and the manner in
which the shares are to be off-loaded. A critical account of the policy decision favouring disinvestment fairly soon after the economic reforms were launched, the setting up of the Disinvestment Commission, its recommendations and the modalities adopted for disinvestment year after year, right from the beginning up to 2002-03. The chapter also touches on the difficulties in the valuation of PSEs to arrive at appropriate reserve price before placing the shares on the market. Turning now to the performance of the enterprises after disinvestment, the treatment is in two parts. First, in Chapter 2 there is a survey of the literature dealing with this aspect at the theoretical and empirical levels. Naib points out that at the theoretical level the presumption is that public enterprises would perform less efficiently and profitably than private enterprises and that, therefore, the expectation would be that disinvestment would lead to better performance of the enterprises concerned. But the empirical studies lead to a more qualified conclusion. "First, when market power is significant... there is no systematic difference between public and private firms. Second, in competitive markets where other allocative inefficiencies associated with market failure are not substantial, often, private firms are more efficient than public ones. Third, the key factor driving performance is competition. When public enterprises operate in markets where they have market power, they do just as well (or poorly) as private firms operating under similar markets under regulation."

The second part of the empirical appraisal relates specifically to the Indian situation on the basis of secondary data as well as the author’s own inquiries of the performance of selected PSEs after disinvestments. Apart from the fact that in the short period of a decade or less there was not enough time for the divested enterprises to make necessary adjustments, these empirical studies faced two limitations. The first was that in many instances the disinvestments were partial, with the government retaining management and control.

Secondly, for reasons not related to disinvestments as such, there was an industrial recession in the second half of the 1990s and the early part of the present century, which adversely affected many enterprises making it difficult to trace the impact of disinvestment. Out of 38 disinvested enterprises examined,
six recorded losses; they include Hindustan Photofilms, Hindustan Machine Tools (HMT), ITI and the Steel Authority of India Limited (SAIL). On the other hand, ONGC, IOC, the Gas Authority of India Limited (GAIL), VSNL, Neyveli Lignite, Bharat Heavy Electricals Limited (BHEL) and several others increased their profitability. The explanation that the author offers is that the fall in profitability was in the case of enterprises operating in a competitive environment while improvement in profitability was in the case of enterprises operating in a monopoly environment. Employment levels dropped following disinvestment, but because voluntary retirement schemes were in operation, it is difficult to attribute the fall to disinvestment as such.

The author has tried, and in large measure succeeded, in examining disinvestment of PSEs taking place currently almost throughout the world without taking an ideological position for or against the phenomenon. His survey of the theoretical literature and his concentration on empirical evidence make the book a very valuable contribution to a highly contested theme. However, at the deeper level the work reflects some conceptual confusion. The first is the assertion in the introductory chapter that "disinvestment which is a form of ownership transfer comes under the umbrella of privatization". It can be readily granted that during the past two decades or so the term 'disinvestment' has been used to refer to the transfer of ownership of public sector enterprises and hence has been associated with privatization. But surely, transfer of ownership and disinvestments are standard and routine practices within the private sector. In fact, transfer of ownership is one of the basic premises of the corporate form of organization and that is what is taking place everyday in the stock market. It is also common practice for private enterprises to hive off part of their activities to other enterprises. The practice of buying and selling entire enterprises is also quite common. If so, it is not correct to bring disinvestments under the umbrella of privatization.

At the same time, it is equally important not to treat the investment and disinvestment decisions and actions of the state on a par with similar activities of other (private) enterprises in the economy. This is not because the activities
themselves are different, but because the role of the state in the economy is not the same as that of other units. The role of the state in the economy as a whole in relation to other units is somewhat similar to that of the central bank in relation to commercial banks. Just as the performance of the central bank cannot be evaluated in terms of the criteria used to judge the performance of commercial banks, the function of the state, including its investments and disinvestments, calls for different procedures of evaluation.

This is because the "bottom line" of enterprises in the private sector, the profitability factor, is easy to locate, but in the case of the state (as that of the central bank) the bottom line is not so specific. It may be standard practice to use the criteria of private sector enterprises (essentially some profit ratios) to judge the disinvestments of state-owned enterprises, but that is a limited, and often less than proper procedure. However, that is what the author has relied upon in the book. The Department of Disinvestment will have a new role to play: facilitating overseas investment in domestic projects. On September 19, Investment Commission identified six projects (see chart) which could be used by the DoD as "the starting point for facilitation of overseas investments". Also, the DoD’s assistance could be extended to foreign direct investment and domestic investment, it said. Earlier last month, Finance Minister P Chidambaram directed DoD to take on mega projects that were being pursued by the Commission since the department had no work on its hand after the government put on hold all disinvestment proposals.

The minister directed that since DoD was already providing secretariat services to the Commission, it should lend a helping hand in the progress of investments that were $500 million-plus or "strategic and prestigious". He asked DoD to coordinate with Commission head Ratan Tata, the chairman of Tata Group, in identifying the projects and the activities where the DoD could help. The Investment Commission was formed in December 2004 to engage potential investors on behalf of the government, identify their problems and advise the government on the measures needed to spur flow of investment into the
economy. Its aim was to attract investments worth $150 billion in the 10 years. Sources said the DoD was being given the mandate as the Foreign Investment Implementation Authority, formed in February 2005, had failed to provide "pro-active one-stop aftercare service to foreign investment". The seven-member FIIA, headed by Secretary (Department of Industrial Policy & Promotion), was to provide necessary approvals and solve operational problems in association with the concerned states.

Disinvestment In Core Sector PSUs Imperative

A diligent study of the power sector reveals that the disinvestment programme, if achieved in the power sector alone has the potential of doubling the aggregate disinvestment target set by the government for the entire PSUs[Public Sector Undertakings] in India. The government sector enterprises like NTPC, NHPC, and PGCIL hold the promise of generating these funds through a judicious mix of 26% private placements and 25% fresh placements. The process of disinvestment combining the sale of equity with dilution of government stake would definitely ensure better valuation for these PSUs. The disinvestment planned figure for the last fiscal year was Rs. 10,000 crores and the government of India could not achieve a fourth of that figure. Similar projections in this year's budget has been made which makes it amply clear that despite its failure in the earlier fiscal year, the government of India is serious to go ahead with the disinvestment agenda. But the real dampening elements are the challenges posed by coalition politics where different ministries are under the aegis of members of different sections of the ruling alliance and there is a lack of consensus. The disinvestment of oil sector PSUs is one such glaring instance. There is much ado about some of the Public Sector Undertakings. The importance of these undertakings have been extolled to an extent that they have been treated as holy cows. Post liberalisation, there has been a marked understanding in industrial sectors and also in the parleys of the governments that this need not be the case.
The rationale of operative economics and the rate of return to the scales is of paramount importance for any operation, leave aside a public sector entity. Often, it has been witnessed that the rate of return of a majority of the public sector enterprise have not been in common measure to the rate of investment. Understanding precisely this contention, the government of India, belatedly though has embarked upon a selective disinvestment process.

To this effect, the disinvestment commission constituted ad hoc, has also allayed earlier perceptions that the petroleum sector does not carry about itself; such strategic concerns that disinvestment in this sector could result in destabilisation or make a negative impact on state control. The ministry for disinvestment has also suggested that it is open to the idea of paring its shareholding in the public sector oil and gas companies below 50%. Almost as though to sound apologetic, the government has veered clear of making much of a strait jacket in the approach to disinvestment and seeks to follow a custom built and non-pedantic approach for each unit’s disinvestment. The fears that has been reinforced over the years is that some of the oil multinationals had given a lot of bellyache to the government of India during the contingencies of wars and the oil crunch in the 70s.

Those who had anything to do with the so called strategic sectors especially power, oil & gas, telecom, etc. have been preying on this phobia and reinforcing the misplaced belief alienation of control in this sector goes against national interest. Involvement of private parties augments a positive structural readjustment in the management. Much of the PSU woes arise from the lackadaisical bureaucratised set up that yields much more clout than it actually deserves. Instead of an efficient and professional handling of an enterprise, much energy is spent in sustaining the status quo. Palliating the interest of much flab that does precious little is also something where the PSUs cannot think or act independently. The labour unrest that many of the PSUs are encountering notably the UPSEB and the ongoing Telecom strike is a case in point. The government while disinvesting has to take into account how well it can accommodate the labour interest together with that of the PSU.
For example, the government of India continues to say that the prices of LPG should be somewhere in the region of Rs. 300+ per each bottle. But if we look at the issue with a different perspective, the government has also factored in the overall inefficiencies in operation and the prices jack up due to these inefficiencies which is as much as 25%. Private entrepreneurs are allowed to import LPG and set up their own handling and marketing facilities. This introduces the element of market administered prices (MAP) and the PSUs would have to face the competition of efficient managements and operators who would be vending their wares with positive consumer responses backing them. The disinvestment process will bring in contemporary management expertise that would enable to meet the stiff market competition of the emerging market scenario.

The Hazira Project is a case in point where the ONGC commissioned an international agency Chapman Petroleum Engineering to study the feasibility report for the Hazira Gas Project. There were rosy projections of 16.8 billion SCM (standard cubic metre) of resources. The report was taken at its face value and a subsequent study by the Institute of Reservoir Studies in association with the ONGC reveals that the reserves where a mere 20% of the projection of Chapman Petroleum Engineering's studies.

If ONGC were a divested company, much of this muddle would not have happened because the matter would have been approached professionally and the earlier report not taken on its face value and multiple studies would have been instituted. Then there would always have been provisions to nail the agency if there projections were proved wrong. In fact, the financial contingency of the government of India is such that it needs to think about divesting more than 49%. It should not bind itself to the fix of keeping a sustained share base. Rather, the government has not gone ahead with its initial proposal of retaining a Golden Share in the PSUs and involve Indian partners of sufficient financial muscle to act as a countervailing influence on any foreign partners who buy the equity that the government chooses to off-load. This will ensure that the government still retains statutory powers in these strategic sectors and
whenever a contingency arises, can invoke them to guard national challenge. These practises are quite common in more advanced nations, notably the UK and USA where the governments are encouraged to keep off from enterprise and concentrate on the social development issues. The existential realities for the government of India are its increasing debt burdens. The immediate avenue at hand for revenue generation is disinvestment of PSUs. This will bring in foreign direct investment and better technologies. On the other hand, the government of India would not have to pump in the independent outlays it has to set apart for these PSUs. On the contrary, there will be financial liquidity to retire debts in which it is steeped into.

ANALYSIS

Though the imbroglio over the strategic sale of BPCL/HPCL is far from over, the mandarins within the government have come up with yet another proposal to meet the year’s disinvestment targets. A booming stock market has inspired the bureaucrats in Delhi to suggest the sale of equity cross-holdings the three top notch energy companies, IOC, GAIL&ONGC, hold in each other via the book building route. The three energy majors, following a government diktat, had collectively spent Rs.4,643 crores in January 1999, buying shares in each other. The move, widely criticized then, had helped shore up takings for a government facing revenue shortfall. Speculation was also rife that the government was in the process of a creating an integrated Indian Energy behemoth to take on the global energy giants, post deregulation. While the governments intent, if it has any, regarding the structure of the energy industry is still hot air the current sell-off is bound to generate another windfall for the government.

For starters, IOC currently holds a 9.6 per cent stake in ONGC and another 4.8 per cent in GAIL; ONGC holds another 9.1 per cent in IOC and 4.8 per cent in GAIL while GAIL has a 2.4 per cent stake in ONGC. Given the current Bull Run on the stocks the sale of these crossholdings is expected to fetch around
Rs.174.5 billion from the market netting IOC nearly Rs.75 billion, ONGC Rs.34.4 billion and GAIL Rs.17.6 billion with the government pocketing nearly Rs.13 billion by way of capital gains. Deny, as some may, the unexpected windfall is bound to reflect on the government’s balance sheet, this time facing a mounting deficit. Per say, the divestiture of cross holdings makes perfect sense.

The three energy giants have carved out aggressive growth strategies and are in the need for funds. Given the market run, their stocks touching an all time high and the original purpose of cross-holdings achieved; bailed out a government then facing revenue shortfall; it would be in the scheme of things to sell off these stakes to pursue greener pastures. What, however, is worrisome is the system and institution to decide the feasibility of exercising what is essentially a business option and the intent of such moves in a sector so crucial to the overall health of the economy. Given the current state of the economy with forex reserves touching a high of $100 billion the proposed sale has not generated much heat. However, the concern this time round is the effect the proposed mop up operations will have on the liquidity in the market just at a time when domestic retail investor sentiments are picking up and the effect it will have on the markets appetite for other government offloading in companies like CMC and VSNL. More importantly, will the offloading provide the government the opportunity to privatize BPCL/HPCL through this back door option? Again, what happens to the proceeds from disinvestment, the windfall must be seen as one, which just shouldn’t end up being the feed tiding over current government expenditure?

The ministry may well deny any direct linkage between the markets for the cross holdings and these other scraps but it brings us back to the basic question. When and how, if at all, does the government purpose to free the oil firms from the clutches of state control? The need for an integrated Petroleum Sector Regulator has been touched upon by the author in an earlier analysis (The Quandary of Oil Sector Reforms, ORF Strategic Trends, Issue 3, and
October 10, 2003) and the present context only reinforces it. Now, even the power ministry has gone on record asking for a Petroleum sector regulator. At the very least, a downstream regulator on the lines of the DGH (Directorate General of Hydrocarbons) is a pressing requirement if these blue chip public sector energy companies are to hold out in a deregulated environment.