Chapter - 1

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In this chapter an attempt has been made to provide detailed background related to the genesis of Public Sector Undertakings in India, right from the evolution till the need for reaching a stage where the government of India felt the need to disinvest its holdings from some public sectors. The rationale, historical background, contribution of public sectors and genesis of disinvestment has been outlined here.

1.1 Evolution of Public Sector in India

Prior to 1947 i.e. the independence of our country, there were almost no "Public Sectors" in our economy. The only instances which one can find some mention were the Indian Railways, The Post & Telegraph, The Port Trust, The Ordnance and the Aircraft Factories and a few more Government controlled undertakings. After independence, India adopted the road of planned economic development through Five year plans. In this India opted for dominance of the Public Sector firmly believing that political independence without economic self-reliance would not enable the Government to fulfill the aspirations of the countrymen. The passage of Industrial Policy Resolution of 1956 and adoption of socialist pattern of society as the national economic goal of the country built the foundation of the dominant public sector as we see it today. It was believed that a dominant public sector would reduce the inequality in the distribution of income and wealth and advance the general prosperity of the nation.

The second Five Year Plan document clearly stated that "all industries of basic and strategic importance, or in the nature 'of public utility services should be in the public sector. Other industries, which are essential and require investment on a large scale, which only the State, in, the present circumstances, could provide have also to be in the public sector". It is further emphasized that, "the public sector has to expand rapidly. It has not only to initiate development which the private sector is either unwilling or unable to undertake, it has to play the dominant role in shaping the entire pattern of investment in the economy". The investment in public sector enterprises has grown from Rs. 29 Crore in 5

PSU on 01.04.1951 to Rs.2,52,554 Crores in 240 P5U on 31.03.2000 and to the tune of Rs. 5,55,740 crores in 2009.

1.2 Economic Contribution of PSUs from 1990 to 1998

If on e examines the achievements of the PSUs by the yardstick of objectives they were expected to achieve, one would observe that many of these objectives have, at best, met with limited success. The infrastructure for economic development is still inadequate. The return on investments in PSUs, at least for the last two decades, has been quite low and the PSUs have not been able to generate resources for development. The PSU survey shows that between 1986-87 and 1997-98, the Central Government owned PSUs, as a whole, never earned post-tax profits that exceeded 5 per cent of total sales or 6 per cent of capital employed. Thus, the return earned by the public sector was significantly lower than the rate of return for a time deposit of one year in commercial banks. Also, the PSUs' highest return on capital employed (6 per cent in 1995-96 and 1997-98) is at least 3 per cent points below the interest paid by the Government on its borrowings. Thus, adjusted for the effective interest rate, they have actually been giving negative return on capital. If the profits of the PSUs working in the monopoly environment are excluded, the picture becomes even worse.

For the period 1988-89 to 1997-98 the unit gross profits and post-tax profits of PSUs in the manufacturing sector were significantly lower than the private sector companies, when measured as a proportion of sales revenue net of indirect taxes but excluding the profits of PSUs in the monopoly areas (petroleum, power, coal and lignite), the post-tax profits turn to losses for the manufacturing PSUs for 9 out of the 10 years. Table 1.1 demonstrates the above points.

A close look of the table 1.1 proves that PSUs have always performed very poorly in terms of profit. One may argue that this was not the purpose for which these were set up but erosion of capital cannot be justified at any cost. Money comes from tax payers and how can it be allowed to be wasted.

Table 1.1

PSUs Profitability compared to the Private Sector as on 31st March

[Profit after tax (PAT)/net sales percent)]

As on 31 March	92-93	94-95	95-96	97-98	99-00	02-04	04-06	07-08
All Non-service PSUs	2.40	2.00	2.20	3.00	4.40	4.90	4.40	5.28
PSUs	-0.80	0.10	-0.10	-1.20	1.60	3.40	2.70	3.08
Pure manufacturing PSUs	-4.50	-5.30	-5.40	-6.90	-2.30	-2.40	-4.30	-3.90
Manufacturing Private Sector	5.70	4.90	4.90	6.60	9.10	9.00	7.00	6.20

Source: NCAER Study Report

Table 1.2 shows a comparison between the PSUs and the private sector companies from the point view of the cost structure. Here also, PSUs have performed quite poorly as compared to priva sector with regard to various cost parameters.

Table 1.2

Comparison of Cost Structure *(As Percentage of Sales)*

Parameters / As on 31 March	**92-93**	**94-95**	**95-96**	**97-98**	**99-00**	**02-04**	**04-06**	**07-08**
Raw materials / Net sales								
PSEs.	39.5	39.6	39.8	36.3	35.0	35.9	35.9	40.6
Private sector mfg.	44.4	44.1	41.4	42.5	42.9	42.3	42.3	40.4
Power and fuel / Net sales								
PSEs	10.3	10.9	12.7	13.5	12.9	13.3	14.9	19.5
Private Sector mfg	6.8	7.0	6.9	6.6	6.2	6.5	6.6	5.0
Wages/Net sales								
PSEs	18.6	17.3	18.1	17.7	17.6	19.2	19.1	23.3
Private Sector mfg	8.9	8.8	8.6	8.1	7.9	7.9	7.9	6.5
Interest / Net sales								
PSUs	8.8	9.9	11.3	11.5	9.0	9.1	9.8	11.7
Private Sector mfg	6.0	6.7	6.0	5.2	5.2	5.8	5.9	4.7
A. Raw Material differential	-4.9	-4.5	-1.6	-6.2	-8.7	-7.9	-6.4	0.2
B. Wages + Interest + Power differential	16.0	15.6	20.6	22.8	20.2	21.4	23.1	38.5
C. Total differential (A+B)	11.1	11.1	19.0	16.6	11.5	13.5	16.7	38.7

Source: NCAER Study Report.

The above Table shows that despite huge investment in the public sector the Government was required to provide more funds every year. The public sector equity base of about Rs. 40,000 crores (up to March 1990) yielded Rs. 17,938 crores for the Government as dividend in nine years. However. the Government had to invest a further sum of Rs. 61.21 l crore during this period in the form of equity (Rs. 24,829 crore), plan loans (Rs. 26,185 crore) and non-plan loans (Rs. 10,197 crores), besides providing for the Voluntary Retirement Scheme. The average rate of return on the Government investment for these years works out between 1 per cent and 6.5 per cent.

Public Sector Undertakings (PSUs), 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 PSUs with a total investment of Rs. 29 crores. At the end of the Seventh Plan in1990; there were 244 PSUs 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, PSUs had a total investment of Rs.274,114 crores. The PSUs made a significant contribution to industrial production, 100 percent in lignite, over 80 per cent in coal, crude oil and zinc, almost 50 percent in aluminum and over 30 per cent in finished steel.

In terms of profitability, the PSUs 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 Cooking Coal, and some other enterprises dealing with coal. The return on investment of all PSUs taken together remained low - post-tax profitability being only about 5 per cent on capital employed. According to reports "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.

At the theoretical level the poor performance of PSUs 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 theoretical arguments.

1.3 Brief History of Public Ownership

It would be worthwhile to shed some light on the history of ownership of PSUs. Main reasons for the State ownership of industries could be stated as under:

A) The development of public enterprises was seen as an appropriate policy response to bring about improvements in the economy, both in the developed as well as the developing countries. There appeared to be an economic consensus around the world accepting public enterprises as an inevitable part of the economy, specially to manage natural monopolies and also the core industry. While the public sector contributed significantly to the development efforts, the low rates of return on such investments and the inability of governments to finance the growing demands of such industries; changed the consensus in favor of economic liberalisation and privatization from the 1970's, in almost all countries.

B) Such industries could not have been developed by private sectors during 1940's or 1950's as there was not enough money in the money market and entrepreneurship was limited. So Government used high rates of taxation and deficit inflationary financing to develop public industries. Rescue Missions / Nationalisation - Some times Government had to step in to rescue certain enterprises, whose closure could result in significant loss of jobs and also because of several other economic and social reasons.

C) Another rationale for State ownership was the belief that State investment in and the control of the strategic sectors of the economy was necessary for the economic development of those sectors and the security of the country.

D) A few Public Sector Enterprises were established to balance or replace weak private sectors, to develop the industrially backward areas, to generate employment and to make goods available at lower cost.

We all know that the public enterprises have served as the backbone of the Indian economy in providing infrastructure facilities, supporting the cause of constitution and trying for a meaningful solution to balance economic and regional growth. Hence, any attempt to structurally adjust them must be the product of substantial thought followed up by a strong action plan. These were set up both to realize the economic and ideological necessity. To some extent they helped in realizing the planned economic growth that had to be undertaken at independence and thereafter. Overburdened with social obligations, PSEs crumbled financially in many areas of its activities.

The government had to give a second thought to the relevance of the PSEs in view of the gigantic investment in them. Here it may be noted that Mrs. Thatcher, the ex-Prime Minister of the U.K., with an ideological zeal in her party's election manifesto first brought the wave of privatization in 1979. The term privatization has not been well defined as yet. Mukhopadhaya (1988) observed that since the privatization has been recently coined there is not single definition as yet universally accepted by one and all. Interpreted in a narrow sense, the term privatization mainly means broadly a change of ownership from state to the private sector.

In such 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.

Looking at the assessment, out of 38 disinvested enterprises, six recorded losses; they include Hindustan Photofilms, Hindustan Machine Tools (HMT), Indian Telephone Industries (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 could be offered was 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 was difficult to attribute the fall to disinvestment as such.

The Government sold minority shareholdings in Central Government PSUs (CPUS) in earlier years of disinvestment. It generated an income of Rs.18000 crores till the year 1999. It completed strategic sales in four central PSUs in 2000-2001 and attempted to sell Shares of PSUs in open market which had not been successful due to lack of depth of Indian share market. Even when PSE shares were sold in Indian market most of it had to be bought by Indian Financial Institutions. This merely transferred public sector risk from one hand to another. UTI bought about Rs.6400 crores worth of PSE shares, which resulted in a' net loss of about Rs.5050 crores to the UTI. As recent as in 2009, the government of India (TOI, 9th Nov) once again reiterated to offload 10% stake from all public sector undertakings to which there have been positive reactions (TOI 11th Nov 2009)

1.4 Disinvestment Procedures

From 1991-92, when it started and till 1996-97, disinvestment was handled by the Department of Public Enterprises (Ministry of Heavy Industries) and subsequently, from 1st April, 1997 till 9th December, 1999, by the Department of Economic Affairs (Ministry of Finance). The Department of Disinvestment (DoD) was set up as a separate department on 10th December, 1999 and was subsequently renamed as Ministry of Disinvestment (MODI) w.e.f. from 6th September, 2001. From 27th May, 2004, the Department of Disinvestment is one of the Departments under the Ministry of Finance.

The procedures followed for disinvestment have evolved over a period of time. These were based on decision- making through inter- ministerial consultations and involvement of professionals and experts, in view of the technical and complex nature of transactions and the need for transparency and fair play. The decision making process, the bidding procedure and the methods used for valuation of equity of CPSE sold are described below for the different modes of sales.

Decision making process:

The decision making process consisted of the following steps:

a) Identification of the CPSE whose shares were to be sold, the percentage of shares to be sold and the mode of sale.
b) Appointment of various advisers who would assist in the process of sale.
c) Selection of the bidders.
d) Determination of the reserve price; and
e) Approval of the price and other terms at which the shares were to be sold.

The details have been provided as under.

Generally, though not universally, the starting point till May, 2004 was study of the target CPSE by the Disinvestment Commission. In June, 1997, the Government decided that the recommendations of the Disinvestment Commission would be processed by the Department of Economic Affairs (Ministry of Finance) through a Core Group of Secretaries on Disinvestment (CGD), chaired by the Cabinet Secretary, for obtaining the decision of the Cabinet thereon. At that time, it was also decided that for disinvestment transactions exceeding Rs.500 crore, CGD would directly supervise the implementation of the Cabinet decision through an inter- ministerial operational group. This group consisted of Joint Secretaries from Ministry of Finance, Department of Public Enterprises, the administrative ministry concerned and the CMD of the CPSE concerned. In all the cases, where CGD was to directly supervise the disinvestment, CGD would recommend the timing,' pricing and extent of disinvestment etc., based upon the advice of the inter-ministerial operational group, to the Finance Minister, Industry Minister and the Minister of the administrative ministry for approval. For disinvestment transactions below Rs.500 crore, the administrative ministry concerned would be responsible for implementing Cabinet decisions, though they were to be monitored by CGD. The administrative ministries concerned would be provided appropriate technical assistance by the Department of Public Enterprises and Ministry of Finance.

This system was further modified in 1999 when the Department of Disinvestment (converted into Ministry of Disinvestment on 6th September, 2001) was established and issues, such as, which company was to be sold, the percentage of shares and the mode of sale were decided, on a case-by-case basis, by the Cabinet or one of its committees duly authorized in this regard. Generally, DOD/MODI would initiate a proposal for consideration of CGD which would further recommend the case to the Cabinet Committee on Disinvestment. Thus, there was a three-tier structure for decision- making and implementation of decisions:

- Cabinet Committee on Disinvestment (CCD) at the apex level;

- Core Group of Secretaries on Disinvestment (CGD) as a recommendatory body; and

- Inter- Ministerial Group (IMG) as a consultative group.

CCD was chaired by the Prime Minister. The functions of CCD, constituted in January, 2000 were as follows:

a) To consider the advice of the Core Group of Secretaries regarding policy issues relating to the disinvestment programme;

b) To decide the price band for the sale of Government's shares through international/domestic capital market route prior to the book building exercise. and to decide the final price of sale in all cases;

c) To decide the final pricing of the transaction and the strategic partner in case of strategic sales;

d) To decide on cases where there is disagreement between the recommendations of the Disinvestment Commission and the views of DOD/MODI; and

e) To approve the three-year rolling plan and the annual programme of disinvestment every year.

CGD was headed by the Cabinet Secretary. It functioned as the Empowered Group for vetting the recommendations of the Disinvestment -Commission, monitored the progress of implementation of CCD decisions, in disinvestment transactions exceeding Rs.500 crore directly supervised the process of disinvestment and made recommendations to CCD on disinvestment policy matters.

A separate IMG was formed for each case of disinvestment. Generally, it was chaired by Secretary, DOD / MODI and comprised the *officers* of Ministry of Finance, Department of Public Enterprises, Department of Legal Affairs, Department of Company Affairs, the Administrative Ministry, the CMD and the Director (Finance) of the CPSE concerned. IMG was the forum where inter- ministerial consultation took place at the primary level. Recommendations of the IMG were considered by the CGD.

1.5 Summary

In this chapter, background in which public sectors were created was provided and the role these sectors have so far played in the economy of our country was discussed. What went wrong and why did the government and policy makers realise that the investment from these sectors need to be withdrawn gradually and part of control be given in the hands of private sector is a serious matter. Efforts have been made in the subsequent chapter to focus on these issues.