The congress government led by Mr. Narsinmharao announced the new Industrial policy on 24th July 1991. The government has initiated a series of radical changes in its policies relating to industry, trade, finance, foreign investments and fiscal aspects. The various changes, also called structural adjustments, when put together constitute an economic policy.

The New Industrial Policy (1991)

The new economic policy was necessitated by the worst economic crisis, which was never witnessed by the country after independence. The most visible aspects of economic crisis are:

- Extremely low foreign exchange reserves of the country (Rs.2400 crores) in early 1991
- International agencies lowered the countries credit rating.
- Rapidly increasing burden of national debt. (60% of GNP in 1991)
- Increase in the fiscal deficit of the previous five years forced the government to borrow increasingly to meet shortfall in the revenue account.
• Fiscal implications were mounting as borrowing added to the already prevailing debt burden.

• High price level, during 1985-90 the GDP grew at an average rate of 57 percent by money supply increased 15.7 percent per annum. This excess liquidity led to high price level.

• Economic reform process that started in the 1980s in both the developed and developing countries. It is related to changing role of government in the economic development process.

• Need for deregulation, privatization in pursuance to the WTO agreement and the structural adjustments in the economy.

• Public Enterprises have shown a very low rate of return on capital invested. This needed the adoption of the new approach to public enterprises

• Public enterprises which were at the commanding heights of the economy now many of these have become a burden on the government rather than being an asset to the government.

**The main aim of the new industrial policy was**

a. To unshackle the Indian industrial economy from the unnecessary bureaucratic control.

b. To introduce liberalization with a view to integrate the Indian economy with the world economy.

c. To remove restrictions on direct foreign investment as also to free the domestic entrepreneur from the restrictions of MRTP Act, and,

d. The policy to shed the load of the public enterprises, which were incurring losses over the years.
All these reforms of the industrial policy led the government to take initiatives in respect of policies in the following areas:

a. Industrial licensing  
b. Foreign investment  
c. Foreign technology policy  
d. Public sector policy  
e. MRTP Act

The new economic policy has four components, which are

a. Liberalization  
b. Privatization  
c. Globalization and  
d. Stabilization

The structural adjustment programme has been forced on the economy because of the several reasons. They are:

1. Excess of consumption over the revenue resulting in heavy government borrowing;
2. Growing inefficiency in the use of resources;
3. Over protection;
4. Mismanagement of the firms
5. Imprudent borrowing from abroad and mishandling and mismanagement of foreign exchange reserves.
Industrial Licensing Policy

The role of the government was to be changed from that of only excersing control to one of providing help and guidance by making essential procedure fully transparent and by eliminating delays. Industrial licensing to be abolished for all projects except for a short list of industries related to security and strategic concerns social reasons hazardous chemicals and over riding environmental reasons and items of elitists consumption industries reserved for small-scale sector will continue to be so reserved.

Foreign Investment

In order to invite foreign investment in high priority industries, requiring large investment and advance technology. It was decided to provide approval for direct foreign investment up to 51 percent foreign equity in such industries.

For the promotion of exports of Indian products in the world markets, the government would encourage foreign trading companies to assist Indian exporters in export activities.

Foreign Technology

With the view of technological dynamism in Indian industries the government would provide automatic approval for the technological agreements related to high priority industries within specified parameters. No permission will be necessary for hiring of foreign technicians foreign testing of indigenously developed technologies.


**Public Sector Policy**

The 1991 Industrial policy has adopted a new approach to public enterprises. The priority areas for growth of public enterprises in the future would be the following:

a. Essential infrastructure goods and services
b. Exploration and exploitation of oil and mineral resources
c. Technology development and building of manufacturing capabilities in areas which are crucial in the long term development of the economy and where private sector investment is inadequate.
d. Manufacture of products where strategic considerations predominate such as defense equipment.

At the same time public sector will not be barred from entering areas not specifically reserved for it.

In view of these considerations government will review the existing portfolio of public investments with greater realism. This review will be in respect of industries based on low technology, small scale and non-strategic areas, inefficient and unproductive areas, with low or nil social considerations or public purpose, and area where private sector has developed sufficient expertise and resources.

The government will strengthen those public enterprises which fall in the reserved areas of operation and are in high priority areas of are generating good or reasonable profits such enterprises will be provided a greater degree of management autonomy through the system of memoranda of under standing competition will also be induced in these areas by inviting private sector participation. In the case of selected enterprises part of government holdings in the equity share capital of
these enterprises will be disinvested in order to provide further market discipline to the performance of public enterprises.

**Monopolies and Restrictive Trade Practices Act (MRTP Act)**

With the growing complexity of industrial structure and need for achieving economies of scale for ensuring higher productivity and competitive advantage in the international market, the interference of the government through the MRTP Act has to be restricted.

The pre-entry scrutiny of the investment decisions by so-called MRTP companies will no longer be required. Instead, emphasis will be on controlling and regulating monopolistic, restrictive and unfair trade practices rather than making it necessary for the monopoly houses to obtain prior approval of central government for expansion, establishment of new undertakings, merger, amalgamation, and take over and appointment of certain directors.

The trust of policy would be more on controlling unfair or restrictive business practices.

**Further Liberalization by Dereservation**

The government decided in April 1993 to remove three more items from the list of 18th industries reserved for compulsory licensing. These three items were: Motorcars white goods (which includes refrigerators, washing machines, air conditioners, etc) and raw hides and skins and patent leather. The basic purpose of dereservation of these items was to increase the flow of investment in these industries.

In persuasion of liberalization policy towards foreign investment, the government decided in Dec. 1996 to include 16 categories of
industries in respect of which automatic approval would be accorded to foreign equity participation up to 51 percent. This list of industries covers a wide range of industrial activities in the capital goods and metallurgical industries, entertainment electronics, food processing industries, mining (upto 50 percent) and those having significant export potential.

The government also added another list of nine industries for which atomic approval up to 74% would be allowed.

The basic thrust of these changes is that there will be no case-by-case approval for various proposals lying before the government. The main aim of the major policy initiative is to facilitate foreign direct investment in infrastructure sector, core and priority sectors, export-oriented industries, and linkage with agro and farm sectors.

**Limitations of 1991 Policy**

- Virtual scraping of licensing means absence of a mechanism to determine priorities and to develop backward areas.
- Policy is silent about tackling the growing industrial sickness. The government has not announced a clear exit policy for sick units. This shows that government was pressurized by the trade union lobby.
- Of-loading of 20 percent equity in profit making public sector units to mutual funds is a revenue raising exercise than genuine attempt at privatization.
- Even with the scraping of all the regulations, the expected foreign investment may not come through Infrastructure deficiencies will deter foreign investment.
• The policy is drafted at the behest of IMF, which means virtual surrender of economic sovereignty of the country to a foreign agency.

As a consequence of India agreeing to the conditionality of IMF / World Bank which are used by USA as its mouth-piece. India had no option to but accept the ‘Blue-Print’ of this trinity; this model has succeeded in a few economic chaos in several other countries. There are more than 65 policy changes effected after the adoption of NEP in India. Broadly, these changes fall in time with: 4.1

1. Stabilization programme, which is instead to balance disequilibria at the macro level between the aggregate demand and supply, between saving and investments and between import and exports.
2. Liberation programme intended to facilitate opening up of Indian economy to the word at large, removing hurdles of licence-raj allowing the market forces to decide prices, reducing government’s role on the public sectors, allowing foreign investors to do business; and
3. Globalization programme to orient Indian economy to the world economic grid, which is popularization as globalization.

To effectualise these objectives, several experts were identified and appointed as chairman of various comities to programme the task of suggesting reforms in the insurance sector, drug policy, reforms housing policy reforms, Agricultural Policy reforms, etc. These policy changes cover almost the entire gamut of socio-economics fields.

**The Intent of the New Economic Policy**

1. Sustained economic growth
2. Self-reliance
3. Modernization
4. Equity and raising of the living standards of the poor
5. Increased export and earning of foreign exchange
6. Creation of more employment opportunities
7. Control of fiscal deficits and inflation
8. Achieving of better growth rate.


The 1991 policy statement is truly historic, whether it is a result of IMF pressure or our own realization that the time has come to open up the economy.
Merits of 1991 Policy

- Policy took the bold step to end up the license permit raj and to enable the MRTP companies to establish new under takings and effect plans of expansion, merger, amalgamations and take over without prior government approval.
- The liberalization of the rules relating to direct foreign investment, permitting 51 percent equity in a wide range of industries. The earlier facilitation of foreign technology agreements and other related measures go a long way in attracting foreign investment and technology.
- Reforms relating to the public sector like privatization and transferring sick units BIFR will help improve the performance of the government undertakings.
- Finally the new policy statement is a most welcome package. There is a greater reliance on the market a bold attempt at deregulation, a desire to integrate with the world economy and to modernize.

Privatization Strategy

Prerequisites of Reform

Before SOE reform option is chosen, the decision-makers have to see that the country meets certain conditions that are necessary for success of various reform options. The first question to be addressed is whether the country is ready for such reforms. For this, three conditions will have to be met.
(a) **Political desirability** Reforms must be politically desirable. They become desirable when the political benefits outweigh the political costs. Political costs are in the form of antagonizing labour unions, managers, suppliers, and other beneficiaries of the State ownership. Some political benefits are proceeds to treasury, better quality or greater supply to consumers, lower burden on taxpayers, better return to investors, etc. Reform will be more attractive politically if the political benefits can be advanced and the political costs postponed. The more uncertain the benefits of reform, the less politically attractive it will be. One could thus speak of the expected net present *political* value of a reform, much like the traditional net present (economic) value of an investment. Attractiveness of SOE reform also depends on the political leaders' attitude to risk. Leaders with higher discount rates may find SOE reform less attractive than those with lower discount rates.

(b) **Political feasibility** Reform is politically feasible when leadership can secure the approval and support of other parts of government entities whose cooperation is critical to success. The leadership must also be able to withstand opposition to reform from potential losers; these may be SOE employees, especially when such groups are organized and can resort to strike. The likelihood of opposition is greater if there is surplus manpower.

(c) **Government credibility**: Credible governments have reputation for keeping promises. Investors must believe that the government will not renationalize privatized firms; SOE employees and others who fear that they may lose out in reform must believe that the government will deliver on any promises of future compensation.
Further, credible governments have significant domestic restraints on policy reversal. They also submit to international restraints such as trade treaties, which make it costly to reverse reforms.

Although this framework of political desirability, feasibility and credibility has some explanatory and predictive value, yet it is a static model. Reforms are a dynamic process and evolve over a period of time. The political desirability and feasibility are not independent conditions, because they jointly determine the net political benefit of reform. Desirability depends partly on how feasible a reform is, and on the political cost that leaders must incur to make a reform feasible. Similarly, government credibility is not always a given thing but can be created.
Privatization Methods:

The success or failure of a privatization method would depend on a number of factors such as the state of the stock market, the degree of competition, the liberalization and economic policies (including the extent of foreign ownership), and the level of entrepreneurship available in the country.

There are several methods of privatization, which may be divided into non-divestiture, and divestiture methods:

**Non-divestiture methods:**
1. Restructuring
2. Lease and Management contract
3. Contracting out
4. Joint ventures

**Divestiture Methods:**
1. Public offerings of shares (full or partial)
2. Direct private sale (full or partial)
3. New private investment in SOE.
4. Management/Employees buy-out
5. Liquidation-sale of SOE asset
6. Fragmentation-Reorganization (or break-up) into component parts.
7. Public auction
8. Mass or voucher privatization

Privatization in broad terms mean process of disengaging the state from those activities which are best done by private sector. It may involve divestiture or non-divestiture option. Whereas divestiture option involve transfer of ownership rights from public to private sector, non-divestiture option involve management transfer and mercerization.
Divestiture option may be preceded by non-divestiture techniques, which are usually aimed at improving the financial and/or operations of the SOE, thus increasing the potential sale value.

**Non-Divestiture Options**

The main types of non-divestiture options are restructuring, privatization of management (management contract, lease or concession), contracting out, and joint venture.

(a) *Restructuring* SOEs can reform through restructuring—organizational, financial and operational. The organizational restructuring may involve splitting of the SOE into smaller units, and labour rationalization. The financial restructuring includes writing off excessive debts, and operational restructuring means infusion of new investment or technology into the SOE.

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

(i) The private operator leases assets or a facility owned by SOE and uses them to conduct business on his own. The lease sets both the terms and conditions under which the lessee may operate these assets and facilities, and the compensation to be paid to state on this count. Lessees assume the full commercial risk for operating the assets. Under a lease, the lessee hires its personnel. However, under management contract the contractor may have wide powers
over existing personnel but they remain employees of the enterprise and are often subject to government pay scales and conditions,

(ii) A lessee pays the state for the use of assets or facilities, whereas a management contractor is paid by the state for its management or skills. The contractor has no financial exposure and receives his fees regardless of the profitability of the enterprise.

The choice between lease and management contract depends on the government’s objectives and the state of enterprises in question. If the enterprise is unlikely to respond to external management expertise, it may choose to lease certain assets or facilities to generate revenue. If on the other hand, the enterprise is merely in need of a short-term injection of management skills to become profitable, a management contract may be appropriate. Under both leases and management contract, debt liability of the SOE with respect to the underlying assets will continue to be borne by the state.

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

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

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

### Divestiture Options

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

(a) **Public offering of shares (full or partial):** Under this transaction, the state sells to the general public all or large block of its stocks, in a wholly or partly owned SOE. Technically, this amounts to secondary distribution of existing government-held shares but it is commonly handled largely as a primary issue. A prospectus for the offering is prepared, and normally the services of an investment bank as adviser are required. The bank or a syndicate may also underwrite the offering. The offering may be on a fixed price or on a tender basis. The shares may be marketed internationally or only domestically.

This method is usually used for profitable, large-scale SOEs. If the SOE is not a strong performing firm, a public offering is possible only after it's restructuring and turn-around. Alternatively, a government may
wish to privatize an SOE in two steps. First, sell a minority but controlling interest to an investor or core group of investors through a direct private sale who would bring in the leverage necessary to turn the company around. Once the company had become profitable, the remainder of the government held shares is offered to the general public. In several privatization through public offering in France, a block of shares was first sold to a preselected core group of shareholders.

The advantages of public offering are that they permit widespread shareholding, normally characterized by openness and transparency. For these reasons it is politically more palatable. However, without strong equity markets, public offering will not generate much response. Another issue, which needs consideration, is crowding out effect of large public offerings which may prevent available resources and savings from being invested in the creation or expansion of other productive enterprises.

In offer for sale to public at fixed price, the price is generally at a discount to market to ensure success and immediate capital appreciation for investors. In Indian disinvestment programme this method was used when offer of 10 lakh shares of VSNL at a fixed price of Rs. 750 per share were offered. However, this method is dependent on capital market conditions. The transaction cost is high, in the range of 4 to 5 per cent depending on issue size.

Offer for sale to public can be through book building process also. In this, price is discovered through a bidding process. Transaction cost is high in this case—5 to 6 per cent depending on the issue size. In public sector Maruti in June 2003 and in private sector, Bharati Enterprises in Jan/Feb 2002 made use of this method.

In international offering, an offer to international investors is made through issue of depository receipts, which represent underlying shares (ADRs in the USA market and GDRs in other markets). Valuation
of price is done by international qualified institutional buyers through book building and is related to domestic market price. Price discovery is done through bidding and allocations made at cut-off price (Dutch auction) or at bid price (French auction). The issue is fully underwritten. The regulation requirement in this case is tougher as disclosure requirements of Securities Exchange Commission (SEC) and accounting in accordance with Generally Accepted Accounting Practices (GAAP) are to be met for ADRs, and listing requirements at NASDAQ/New York Stock Exchange/London Stock Exchange. It is a time consuming process and transaction cost is high (4 to 5 per cent). Precedent cases in public sector has been VSNL, MTNL and GAIL.

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

Direct sale through competitive bidding is preferable as it allows comparison of offers by competing bidders and selects the buyer based not only on highest purchase price but also the greatest compliance with various government requirements and privatization objectives. It also has high degree of transparency when compared to sales to selected buyers. In direct private sale, the purchaser is either engaged in the same line of business or has some special interest in the SOE. Direct sales may involve the participation of foreign investors either as competitive bidders or as selected buyers who may have been chosen because they possess the necessary capital, technology and know-how.
One of the principal advantages of a private sale of shares is that the prospective owner is known in advance and can be evaluated on the basis of his ability to bring in benefits such as management, technology, market access, etc. In many instances, the future success of the operation may be as important to governments as the proceeds from the sale. In some cases, a partial private sale may be a necessary first step to full privatization, as it brings in a leveraged party who is able to turn the SOE around so that it becomes attractive to investors. Besides, the private sale permits all the required flexibility to conclude special arrangements with a suitable purchaser. It is important to ensure that the buyer is not acquiring SOE with a view to dismantle it, and sell the assets (unless the vendor regards it as acceptable).

The private sale is much simpler in terms of disclosure than a public offering. However, to ensure that public interest is served, procedures must be introduced to govern valuation, purchaser selection process (pre-qualification, bidding process), etc. A number of countries, viz., France, Philippines, Argentina, Brazil, Togo have introduced mandatory procedure or guidelines for private sales that cover such matters (Vuylsteke 1988). Private placement with a strategic investor is an appropriate method of divestiture when enterprises are not large enough to warrant a public share offering, and the SOEs weak performance can be turned around by means of its transfer to a financially strong and experienced private investor.

Mechanism for handling employment issues needs to be sorted out. There usually is a need for government 'distancing' in cases of partial privatization to allay investor fears of continued interference.

In India, private placement of equity has been done in case of CONCUR and GAIL. Strategic sale, which has been recommended in most of the cases of disinvestment by the Disinvestment Commission also, falls in the category of private sale. Strategic sale has been effected in 10 enterprises
till March 2003. The Disinvestment Commission has recommended trade sale of certain properties of Indian Tourism Development Corporation, Hotel Corporation of India, etc., which is again a form of private sale. Trade sale means sale of a business or a division or an activity. A trade sale is generally regarded as a quicker option to execute and has been used for small enterprises in other countries.

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

(d) Management/Employees buy-out The term management buy-out (MBO) generally refers to the acquisition of a controlling shareholding in a company by a group of managers. This may involve leveraged management buy-outs (LMBO), wherein purchase is debt-financed and assets are used as security for it. However, where a large amount of debt is used, the enterprises are left very exposed to unfavourable changes in the macroeconomic environment. Therefore the experience, quality and motivation of the management and workforce are critical to the success of management/employee buy-outs. This method offers advantage in terms of management/employees' motivation to find ways to cut costs and improve productivity. National Freight Corporation of UK is a classic case of 100 per cent employee buy-out.
(e) **Liquidation-sale of SOE assets**: In certain circumstances, the government may prefer to liquidate the SOE and sell its assets instead of selling it as an ongoing operation. It occurs mostly when it is more advantageous for the state to sell individual assets instead of the entire enterprise. Liquidation has been used as a form of privatization in Poland particularly with small and medium-sized firms.

(f) **Fragmentation – Reorganization (or break-up) into component parts**: This method involves breaking up or reorganization of an SOE into several separate entities. It also includes hiving off of some activities. This method permits piecemeal privatization and application of different methods of privatization to different component parts, thereby maximizing the overall process. It is applicable where SOE incorporates too many activities that, in the aggregate, are not attractive to potential investors. Also, the state may wish to sell only certain components of the SOE while retaining others. Another reason for fragmenting an SOE may be that it is a monopoly and the government may fragment it into separate enterprises to create competition, e.g., electricity generation and distribution. Once an SOE has been broken up into component parts, further privatization method can be applied, viz., private sale, sale of assets, MBO, etc.

(g) **Public auctions** Public auctions are predominantly used for small or medium-sized SOEs, which do not require technology transfers or other special inputs. It provides for open competitive bidding, which makes the process transparent. The process is also comparatively fast. One drawback of this technique is the inability to impose conditions of sale. This method has been used in numerous Central and Eastern Europe countries for 'small privatizations' involving business such as hotels, restaurants, shops, and repair services. In India, the initial nine rounds of
disinvestment followed auction method. Auctions are relatively less time consuming and has low transaction cost.

(h) Mass privatization Mass privatization (also called voucher or coupon privatization) has been widely used in the countries in transition of Central and Eastern Europe. Mass privatization is based on the population-wide distribution of vouchers or certificates free of charge or for a nominal fee. Usually, these vouchers are distributed to all adult citizens. The rationale behind this privatization method is the fact that, in these countries, ownership of the assets of the means of production was considered to belong to the people as a whole, represented by the State. Moreover, since in these countries almost the entire economy was in the hands of the State, making rapid ownership transformation would be virtually impossible through more standard forms of privatization.

The main advantage of mass privatization is the rapid transfer of ownership from the State to individual shareholders. Consequently, it encourages popular support for the privatization process and contributes to the building of the necessary broad-based consensus for privatization. On the other hand, the principal argument against mass privatization is that it does not, in itself, result in improved economic efficiency. This is due to several reasons. First, widely dispersed ownership may result in ineffective control of the privatized enterprises, especially when the key actors lack the necessary experience and skills for enterprise management in a commercial market context. Furthermore, it does not address the real problems facing PSEs such as undercapitalization, huge indebtedness, outdated equipment and technology, insufficient competition and poor management. Another problem is that the transfer of ownership without any provisions for fostering competition or without adequate regulation merely transforms State-run monopolies into private companies.
Many countries have tried these options with various degrees of success. For instance, mass or voucher privatization was the main method of sale in East European countries, as was strategic sale in Sri Lanka, Brazil, Chile, Jamaica and a host of African states. Some countries have opted for more than one form of privatization. For instance, in the UK, there have been private placements and employee buy-outs in addition to public flotation.

Liquidation has been resorted to as for privatization in Poland, particularly with small and medium-size firms. After studying their experiences, it cannot be categorically said that one method of privatization is better than the other.

Ultimately, the success or failure of a privatization method would depend on a number of factors such as the state of the stock market, the degree of competition, the liberalization and economic policies (including the extent of foreign ownership) of the country, and the level of entrepreneurship available in the country.

In India, the first attempts at disinvestment were through selling small percentages of shares of both good and not-so-good companies by bundling and offering them to financial institutions. This method of disinvestment, practiced from 1991-92 to 1998-99, was criticized by the then Comptroller and Auditor General (CAG).

Following these comments, the policy of disinvestment was changed in 2000.
**Strategic Sale Method:**

The then government opted for strategic sale as the method of disinvestment as per the recommendations of the Disinvestment Commission, which had suggested the strategic sale methodology for maximizing returns to the government and providing the public enterprise with the right kind of expertise it needed to compete successfully in the market.

Strategic sale implies selling of a substantial block of government holdings to a single party, which would not only acquire substantial equity holdings of up to 51 per cent but also bring in the necessary technology for making the public sector enterprise viable and competitive in the global market.

The selection of the strategic partner had, therefore, to be done keeping in view the deficiencies of the enterprise and the strengths of the strategic partner. Valuation of the enterprise would depend on the extent of disinvestment, the nature of the competition that the public enterprise was facing and the pricing and regulatory machinery in existence. In strategic sale, where the management would be controlled by the strategic partner, the valuation of land and other physical assets need also to be computed at current market values to fix the reserve price.

To get the best value through strategic sale, it would be necessary to have a transparent and competitive procedure and to encourage enough competition among viable parties.

There is no doubt that the strategic sale method followed by the National Democratic Alliance (NDA) regime was successful. Of the total Rs. 45,066 crore C-so far realized from disinvestment through
various methods, strategic sale alone accounted for Rs 25,462.12 crore from 2000 onwards.

This methodology also benefited all those who invested in public sector units (PSU) stocks, including retail investors and financial institutions and also provided strength to the market. The small investor who had stake in the privatized enterprises has gained tremendously due to the open offer after the strategic sale in CMC, VSNL, IBP and IPCL. The Government's residual shareholding in partly disinvested PSUs has also jumped substantially.

In three years (1999-2002), disinvestment proceeds (inclusive of dividend and dividend tax) provided more than Rs 11,300 crore to the exchequer.

By selling loss-making companies and those that had been referred to the Bureau of Industrial and Financial Reconstruction (BIFR), the government saved the amount it would have had to pay in rehabilitation packages, which will now be provided by strategic investor.

However, complaints of under valuation and other wrong doings have dogged these strategic sales. The CAG's comments have pointed attention at under valuation, sale of enterprises to single bids, and so on. These comments must necessarily be probed by agencies, the CVC or the CBI, so that the wrongdoers are exposed. This will also lead to better appreciation of factors that go into successful sale of public enterprises. This does not imply that privatization through the strategic sale method is prima facie wrong; right procedures must be put in place so that such complaints do not occur.

The recommendations of some newspaper editorials that, only public offers should be undertaken for sale of equity of public sector enterprises suffer from the classic knee-jerk reaction to recent events.
While it is true that the public flotation method would widen the base of ownership and provide profit opportunities for retail investors, a number of safeguards would have to be taken for the objectives to be achieved.

A leaf can be taken from the UK example of privatization. There before chunks of equity were floated on the stock exchange for retail investors, a highly professional management team was in place in the companies concerned and it was given sufficient time of, say, two-three years, to prepare the company for privatization.

During this period, the management was given the free hand to downsize the strength of employees and implement measures to make it lean and keen for competition. Second, the necessary regulatory machinery was installed before these companies were privatized and the government practiced what is known as 'arms length' regulation over the company and the regulatory machinery. Should India want to undertake privatization through the public flotation route, similar steps would be necessary.

If the government does not want to relinquish ownership and wishes to retain 51 per cent or more of the equity in any PSD, there is the danger of status quo in the working culture of the enterprise. For instance, working efficiency in the nationalized banks has not improved substantially due to disinvestment of shares to the public.

If the government remains the single largest shareholder in a company, with the rest dispersed among retail investors, there is the danger of the government indulging in back-seat driving. That would amount to power without responsibility.
It is, therefore, better for the government to disinvest 100 per cent of equity through the public flotation route, in case the stock market is deep enough, after placing a highly professional management team in the company and creating appropriate regulation.\footnote{G. Ganesh, The right route to privatization, Internet}
Conclusion

The well-designed privatization strategy can help to give credibility and guidance to the process. The strategy involves identifying government objectives, defining guidelines for selecting SOEs, and choosing appropriate techniques for privatization.

The commonly pursued objectives are budgetary and financial improvement, development of the economy and efficiency of the enterprise. Regarding choice of enterprises for privatization, an enterprise whose presence in the public sector has no economic justification, should be selected automatically for divestiture. It is tempting to divest the best-run enterprises first, as it is easier to find buyers for them. However, potential economic gains come from divesting the worst run enterprises, but here the problem is to find a right buyer. Price is of secondary importance in such cases. In case foreign buyers are involved, care should be taken to structure the deal in such a way that there are no undue gains to foreigners at the cost of domestic participants, as this can lead to political and social tensions.

Privatization may involve non-divestiture or divestiture option. The non-divestiture options include restructuring, lease and management contract, contracting out, and joint venture. Divestiture option involve transfer of ownership rights from the public to the private and the principal methods for this are public offering of share, direct private sale, new private investment, management/employee buy-out, liquidation, fragmentation, public auctions and mass privatization.

A policy issue while devising divestiture strategy is whether to go in for partial or full privatization. Partial privatization is politically more acceptable and is helpful in determining the fair price of shares initially. Another issue is, should the privatization be gradual or swift.
Gradualism spreads out the political costs of privatization and allows for learning between rounds of reform. However, gradualism carries the risk of degenerating into inaction. Concerns of employees and concerns of consumers also needs to be looked into while formulating privatization strategy.

In conclusion, divestiture strategies need to be pragmatic and tailored to the specific circumstances and characteristics of the country concerned. The political, economic, social and institutional settings and the risks associated with the interaction of all these must be carefully analyzed.