CHAPTER VI

Implementation of Disinvestment Policy, General Progress

Evolution of Disinvestment in India

The government of India started disinvestment way back in 1991-92, under the new policy of liberalization. Public sector units shares were initially issued to local financial institutions and banks, a major chunk of it being placed with unit trust of India. The actual realization from disinvestment from 1991-92 to around RS. 30,888 crores. The bundling and bidding were adopted as the first method of disinvestment. This subsequently followed by the tendering and issuance of the global depository receipts. The Department of Public Enterprises (DPE) was the nodal agency to steer the disinvestment process. The DPE was empowered to prepare the bundles, advertise the bids, select the bidders, and finalize the price and effect disinvestment.

Initially government focused only on disinvestment of shareholding without taking into consideration other important issues such as the initial public offer, involvement of strategic partners, off loading shares in the capital market, book-building process, etc.

It also did not touch upon issue such as transfers mergers acquisitions and issues relating to restructuring of PSUs. However, during the recent past the GOI has successfully brought in the strategic investors and privatized PSUs such as modern foods, CMC, BALCO, VSNL, Hindustan Zinc, IPCL, Maruti Udyog, etc. IOC has taken over IBP at a hefty valuation beating all other bidders at a wider margin, resulting in one PSU acquired by another PSU. For Instance, IOC has taken 33.58% in
IBP at a price of RS. 1,551 per share and paid Rs.4483.68 crores to government at a price earnings ratio as high as 63. Though IOC has justified the valuation, it surprised the majority of the players in the stock market.

The moment GOI started moving on faster pace for disinvestment of oil PSUs in general and HPCL and BPCL in particular, a stiff opposition stalled the entire process of disinvestment. Objection were raised on the pace and procedures of disinvestment. The opponents of the disinvestment were against the strategic sales as the preferred mode of diluting government’s stake. Under strategic sale government transferred part of its holding to a strategic partner who will control the operating and financial policy of the enterprise. The strategic partner is identified through an elaborate bidding process. The transfer of ownership is subject to certain restrictions through covenant. The other reasons advocated against privatization of PSUs include, strategic importance of the PSUs under disinvestment, profit making and creation of private monopolies. It is also expressed by the minister that Bharat Sanchar Nigam Limited and Mahanagar Telephone Nigam Limited would not be privatized in the near future. The staling of the disinvestment process also has led to the reopening of the previously settled privatization of a few companies. The opponents sought a review of the disinvestment program. The compromise formula of disinvesting one oil PSU (HPCL) through a strategic sale and other (BPCL) through Initial public offering has found favor with the opponents.

Table 6.1 shows the details of disinvestment since 1991 to 2002-2003 i.e. No. of companies in which equity sold, target receipt for the year, actual receipts and methodology of sale.
### Table 6.1

**Implementation**

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>1992-93</td>
<td>35 (18)</td>
<td>2500</td>
<td>1913</td>
<td>Bundling of shares abundant. Shares sold separately for each company by auction method.</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 in 1994-95</td>
</tr>
<tr>
<td>1994 – 95</td>
<td>13 (23)</td>
<td>4000</td>
<td>4843</td>
<td>Sale through auction, in which NRIs and other persons legally permitted to buy, hold of sale equity, allowed to participate.</td>
</tr>
<tr>
<td>1995-96</td>
<td>5 (4)</td>
<td>7000</td>
<td>362</td>
<td>Equities of four companies auctioned 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>1997-98</td>
<td>1</td>
<td>4800</td>
<td>902</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 (VSNL)/domestic offering with the participation of FLLs (CONCOR, GAIL). Cross purchase by three oil sector companies for i.e., GAIL, ONGC and Indian Oil Corporation</td>
</tr>
<tr>
<td>1999-2000</td>
<td>2 (6)</td>
<td>10000</td>
<td>1829</td>
<td>GDR — GAIL VSNL —domestic issue, BALCO restructuring, M.FIL’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, LJMC; KRL (CRL), CPCL (MRL).</td>
</tr>
<tr>
<td>2001-02</td>
<td>10</td>
<td>12000</td>
<td>5632* (3130.94)</td>
<td>Strategic sale of CMC - 51%, HTL - 74%, VSNL - 25%, IBP - 33.58%, PPL - 74% and other modes: ITDC, HCI, MMTC</td>
</tr>
<tr>
<td>2002-03</td>
<td>6</td>
<td>12000</td>
<td>4748* (3265.14)</td>
<td>Strategic sale of JESSOP - 72% 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* (2664.29)</td>
<td>Total no. of companies in which disinvestment has taken place so far</td>
</tr>
</tbody>
</table>

Total no. of companies in which disinvestment has taken place so far

# Figures (Inclusive of amount expected to be realized, control premium, dividend/dividend tax and transfer of surplus cash reserve prior to disinvestment etc.)

6.1 Chartered Financial Analyst Feb-2003, Pg. 88
6.2 Sudhir Naib, Disinvestment in India, Sage Publication, Pg. 245 Note: Figures in bracket are from Source 2
Table 6.2
A Short History of PSU Disinvestment

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>July, 1991</strong>:</td>
<td><strong>February, 1992</strong>:</td>
<td><strong>October, 1992</strong>:</td>
<td><strong>August, 1996- March, 1998</strong>:</td>
<td><strong>Disinvestment commission Set up. Submits 7 reports covering 41 PSUs</strong></td>
</tr>
<tr>
<td>The GOI decides to Disinvest its holding in the public sector to raise resources and widen the ownership of PSUs.</td>
<td>Rs. 1611 crore raised from Second phase of disinvestment in 31 PSUs. Pricing is based on average of Net Asset Value and value based on profit-earning capacity.</td>
<td>Rs. 68195 crore raised by selling 12.87 crore shares in 8 PSUs through the tender route.</td>
<td>Disinvest in 31 PSUs. Bidding is opened to the public and the financial institutions.</td>
<td></td>
</tr>
<tr>
<td><strong>December 1991:</strong></td>
<td><strong>December, 1992:</strong></td>
<td><strong>November, 1992:</strong></td>
<td><strong>1994-95</strong>: Rs.2,292 crore raised in first phase of disinvestment in 7 PSU; Rs.3315 crore raised in second phase, covering 21 PSUs.</td>
<td>Poor investor response to disinvestment in MTNL, Oil India, &amp; Container Corporation Ltd. amount raised to Rs.1397 crore against a target of Rs. 7,000 crore</td>
</tr>
<tr>
<td>Rs.1427 crore raised from first phase of disinvestment in 31 PSUs.</td>
<td>Rs. 1,183.83 crore raised by selling shares in 12 PSUs. Bidding is opened to the public and the financial institutions.</td>
<td>C. Rangarajan Committee set up. Recommends that the GOI should disinvest 49 percent in PSUs operating in sectors reserved for them, and 74 percent in other PSUs.</td>
<td><strong>1995-96</strong>: <strong>Disinvestment commission</strong> Set up. Submits 7 reports covering 41 PSUs</td>
<td></td>
</tr>
</tbody>
</table>

Source: ICFAI Reader, April (1999, PSU Disinvestment Page 72)
**Chronology of Reform And Disinvestment In The 1990s**

Reform of India’s SOEs has been among the ‘matters arising’ on the national agenda of economy since the mid-1980s. Because of the profound political obstacles, which surrounded the issue; action on it was constantly deferred. At least three senior committees were formed in the past 15 years to advice government on what should be done with the SOEs: those headed by L.K. Jha, Arjun Sengupta and V. Krishnamurthy.

The economic crisis of 1991 appeared to make reform of the SOEs an issue, which could no longer be deferred. The government’s Industrial policy statement, issued in July, 1991, soon after the Rao government had come to office, foreshadowed disinvestment of some government-held shares in selected SOEs; this announcement was confirmed in the Budget Speech which announced that up to 20 per cent of government’s equity would be sold to mutual fund and institutional investors. By December a list of 31 companies has been selected. This was a mixed portfolio of companies; 8 were categorized as ‘Very good’ firms, 12 were as ‘good’ and 11 were ‘not so good’ (that is, firms with a sound track record but whose net asset value per share was less than Rs.20)

This ranking of firms arose from another measure designed to increase both the efficiency of the SOEs and the return to the exchequer. SOEs were required to sign Memoranda of Understanding (MoU) with the government. Originally recommended by the Arjun Sengupta Committee in 1985, MOUs were introduced in 1989-90. Amongst the other things SOE is must indicate in its MOU what its target and performance criteria are. Annual performance evaluation are made on the basis of which SOEs are placed in categories.
Phase 1:
First Round: 1991-92

The shares, which were to be divested in 1992, were offered as ‘lucky dip’ packages of assorted shares. Because there was no existing market value of the shares and hence a concern that shares might be offered well below market price (or conversely might be significantly over-priced), and because it had been decided to offer mixed packages of shares, the package were sold to institutional investors. The share sales were largely completed by February 1992. The full 20 per cent of shares were sold in firms such as Hindustan Petroleum Corporation Limited and Bongaigon Refineries & Petrochemical Ltd. At the other extreme, only 0.27 per cent of shares in Indian Railway Construction Company Limited were sold. The final sales constituted a disinvestment of 8 per cent of government holding in the 31 companies; the government received Rs.30,380 million from the sale.

Second Round: 1992-94:

A second round of disinvestment was undertaken at the end of 1992. This round involved some new firms, including the giant Steel Authority of India Limited (SAIL), as well as others involved in the first round. This was followed by the disinvestment of third tranche in March 1993 and a fourth a year later.
1994-95:

In this round, approved foreign institutional investors were also permitted to bid. A total of Rs.42,034 mn was raised from these sales.

1995-96:

This round of equity sales was a failure; only Rs. 3,570 mn were raised as against a target of Rs. 70,000 mn.

“The sales attracted considerable criticism. The government was accused of disposing of people’s assets at throwaway prices. An editorial in the Indian Express Several years later referred to the share sales as ‘no more than an any-which-way sale of odd PSU shares for a cash-strapped government’".6.3

An editorial in the Hindu Business Line commented that the 1995 round of assets sales had been “a total failure” which represented a clear adverse judgment by investors “about the prospect for earnings growth in these companies”6.4.

6.3, 6.4: Economic Liberalization and institutional reforms in South Asia, Dilip Dutta, Pg.323
A report by the Comptroller and auditor General of India (CAG) condemned the early rounds of disinvestment, stating that there had been inadequate preparation and few serious efforts had been made to sell stocks to institutional investors. The CAG also condemned the procedure of clubbing good stocks with bad ones saying that it reduced the value received by the government.

In a more sweeping criticism of the post-1991 reforms generally, Balraj Mehta accused Finance Minister Manmohan Singh of having ‘picked up the blueprints prepared by the IMF- world bank combination’:

“The fact is that structural adjustment as conceived and proposed to be implemented, would unleash the forces of primitive accumulation of capital of capitalism by unbridled exploitation of labour and natural resources by foreign capital and Indian comprador business interests working as junior partners in this process”⁶.⁵.

With the wisdom of hindsight, some of these criticism seem misplaced, at least as far as the charge of selling off shares cheaply is concerned. By 1996 a number of SOE shares had fallen considerably in value and as a consequence the market valuation of the corporation was dramatically lower than when the shares were floated. SAIL, for example, which was valued in March 1994 at Rs.19929 crore was worth just over half that much (Rs.10961) two years later. On the other hand, exposure to market evaluation seem to have increased the efficiency of a number of

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⁶.⁵: Economic Liberalization and institutional reforms in South Asia, by Dilip Dutta, Pg.323
SOEs. A survey of data on SOEs for 1994-95 concludes that about 50 per cent of the (top 100) enterprises (in terms of net sales) had higher year-on-year gross profits to total capital employed ratios in 1994-95 (than the previous year).

As for the charge that India was forced to dance to the IMF’s tune, It was told by an informant close to the decision that the IMF standby agreement was seen as a politically convenient means to implement reforms which the Narasimha Rao government desired in any event. According to this source, serious consideration was given to accepting a second IMF loan, which was not needed for currency stabilization, on the grounds that it would justify further economic reforms. Another participant was emphatic that “there was no question of IMF pressure”

**The Role And Position of SCOPE**

One of the most unexpected aspects of the saga of Indian disinvestment has been the leading role played by the Standing Conference of Public Enterprises (SCOPE). SCOPE is the peak body representing India’s SOEs. What is interesting and unexpected is the consistency with which in recent years it has pressed for structural reform and a greater role for market-forces in the running of SOEs. In its public rhetoric SCOPE has welcomed economic liberalization and sought reforms, which would allow the public sector to compete on terms of equity in the market. SCOPE’s secretary-General M.A. Hakeem expressed some of these ideas in a commentary published in the Financial Express in 1995.

“PSEs welcome the liberalization measures and are prepared to compete with the private sector in India and abroad….It is no longer necessary and valid to enter a debate on public sector Versus private
sector. Ownership is not going to be so relevant as Professional and independent management and independent of the business...

Unfortunately, the interface between the PSEs and the government has undergone hardly any change. The boards of PSEs, in many cases are incomplete.... instead of being provided with experts who could contribute to the business decision [boards] are loaded with people who are not relevant to the business. Even though some stray loosening of restrictions as taken place, still formal and informal controls from the respective ministries do not allow the enterprises to act freely. One of the serious problems, which many of the enterprises face today, is the flight of the technically competent manpower. This is largely due to inadequate compensation provided by PSEs as they are not free to decide compensation in accordance with the market demand. (Hakeem, 1995).  

6.6: Peter Mayer, “We Are The Slowest Reformers”: Disinvestment of India’s State owned Enterprises, Editor Deelip Dutta, Pg. 326,327
This Excerpt Summarizes Many of SCOPE’s Concerns

The continued subordination of SOEs to ministries, requirements to the model employers, obligation to locate plans in economically backward areas, the political nature of appointments to boards, and, in an era of rapidly rising salaries in the private sectors, these stagnation of executive compensation. SCOPE appears lukewarm on disinvestment, preferring reforms, which rise efficiency and global competitiveness.

Having considered the anomaly of an SOE interest group actively to promote public sector reforms let me turn to another unlikely player.

Phase 2:
1996-97:

The Disinvestment Commission

The United Front (UF) government, which took power after the 1996 election adopted a Common Minimum Program (CMP) as the agenda of the unlikely coalition. Section 13 of the CMP dealt with the ‘Public Sector’

Section 13

Public sector enterprises, which are essentially commercial enterprises, should conduct their business on commercial lines. They can not be allowed to be dissolve; they should show a healthy return on the capital employed. It is widely acknowledged that the public sector requires to be reformed and restructured. The United Front Government will identify public sector companies that have comparative advantages and will support them in their drive to become global giants. Other profit
making and efficient public sector companies will be strengthened and their management professionalized, and participation of workers in the management of these companies will be encouraged. Sick or potentially sick public sector companies will be rehabilitated through a menu of option that may include handing over the management to professional groups or workers’ cooperative.

The question of withdrawing the public sector from non-core and non-strategic areas will be carefully examined subject, however, to assure the workers and employees of job security or, in the alternative, opportunities for retraining and redevelopment. The United Front will establish a Disinvestment Commission to advise the government on these steps. Any decision to disinvest will be taken and implemented in a transparent manner. Revenues generated from such disinvestment will be utilized in two vital areas, health and education, particularly in the poorer and backward districts of the country. A part of such revenues will be earmarked to create an investment fund, which will be used to strengthen other public sector enterprises (United Front Government 1996).

On August 7, 1996 it was announced that the Disinvestment Commission (DC) would be created and that it would be headed by G.V. Ramakrishna, former secretary for petroleum, former member planning commission and former Chairman of the Securities Exchange Board of India (SEBI). The mandate of the commission was to ‘off load’ up to three-quarters of the government’s holding in ‘non-core’ and ‘non-strategic’ industries. Although the DC was charged with working out both the strategy and tactics for the disinvestment of government holding in SOE’s, the suite of firms whose shares would be sold was to be selected by Core Group of Secretaries to government. Setting up the new Commission and initiating its activities took time. In late September, Ramakrishnan complained publicly that the Core Group had still not referred any cases
Implementation of Disinvestment Policy, General Progress

to the commission. And member of his staff were still not on the payroll. By mid-October a list of 40 SOEs had been approved by the Core Group, which included Air India, the Gas Authority of India Limited (GAIL), Steel Authority of India Limited (SAIL), the Oil and Natural Gas Commission (ONCG) and Indian Telephones.

Trade Union concern was intensified by this development. Their anxieties had repercussions, via the communist party Marxist, which was a constituent of the United Front government. Ramakrishnan emphasized that no disinvestment would take place until all stakeholders, including the unions, had been consulted. He also expressed a wish to undertake a processes of ‘book building’ to increase the eventual value of enterprises when disinvestment took place.

Till 15th August 1997 DC could show little progress. In part this reflected political dissension within the UF government and in part of the process of consultation with stakeholders and the examination of the balance sheets of individual firms. Although there were some criticisms in the financial process, the Finance Minister P. Chidambaram professed to be unworried that the budget target of Rs.50,000 mn. from disinvestment could not possibly be achieved. Barely a fortnight later, however DC Chairman Ramakrishna announced that the first recommendations on disinvestment would appear before the end of the month. These duly appeared, recommending disinvestment of holdings in three SOEs. In April, a second report was issued listing six more SOEs in which up to three-quarters of government holding could be sold. By the end of June recommendations had been made for the disinvestment of up to forty-nine per cent of public holding in nine enterprises.

In early July Cabinet took its first action on the recommendations and approved disinvestment by early 1998 of four enterprises: Gas Authority of India Limited (GAIL), Mahanagar Telecom Nigam Limited
(MTNL), Container Corporation of India Limited (CONCOR) and Indian Oil Corporation (IOC). In mid August, shortly after the first birthday of the DC, the government had approved two consortia each composed of three international investor bankers to co-ordinate international offering of GAIL and MTNL.

In late July Industry Minister Murasoli Maram announced that the nine designated firms would be made substantially independent of government in their accountability and in their day-to-day operations, though their performance would be monitored by the Department of Public Enterprises. The nine designed firms would have the power to hire and fire, to close down unprofitable units and to enter into joint ventures.

**The Disinvestment Commission’s Report, Submitted In February 1997 Underlined The Long-Term Strategy on Disinvestment**

- Strengthen PSUs where appropriate in order to facilitate disinvestment.
- Strengthen profitable PSUs to promote greater competitiveness to enable payment of higher dividends to the government and to enhance share values strengthen other marginally profitable PSUs and reduce their future dependence on the budget.
- Financially restructure and revive loss-making PSUs to invite private capital for long-term turnaround.
- Protect employee interests
- Sustaining long-term employment by financial turnaround of loss-making PSUs
• Providing adequate and fair compensation though VRS to surplus workforce
• Provide scope for employee participation in management
• Boradbase ownership
• Enhance retail reach of PSU shares to small investor and offer at suitable price discount as compared to the institutional investor.
• Augment receipts for government
• Enhance government receipts by disinvestment in profitable PSUs.

On 16th March 1999, the government classified the industries into strategic, core and non-core for the purpose of disinvestment:

1. Strategic group – This includes only four industries viz.,
   • Arms and ammunitions and defense equipment
   • Atomic energy
   • Minerals specified in the schedule to Atomic Energy Order 1953
   • Railway transport

2. Core group – In sectors, which are capital or technology intensive, the most prevalent market structure, is an oligopoly. With the entry of private sector in these areas, there may be a tendency towards oligopolistic market structures. Examples are telecom, power generations and transmission or petroleum exploration. The commission felt that the presence of public sector would be necessary for sometime as a countervailing force and prevents concentration of private economic power. At the same time a proper regulatory mechanism should be in place in order to regulate industries particularly in non-competitive market for protecting interests of customers. According to the committee, it may be desirable to continue public sector presence in these basic industries till such time, as the market becomes fully competitive.
Thus in these core industries disinvestment is limited to a maximum of 49 percent.

3. Non-core group – Over the past four decades, private sector investments have grown considerably in these industries. The presence of a large number of players including mature industries have made these markets fully contestable. These would ensure that the customer's interests are well protected. It can therefore be concluded that the initial objectives of the public sector in such industries have been met. Further investment in such industries would be driven more by demand-supply imbalances and public investment shall no longer be necessary. Such industries can be categorized as non-core and can be disinvested up to 74 percent in such cases.

Table 6.3 shows the grouping of PSU’s in ‘core’ and ‘non-core’ group:

**Table 6.3**

**Grouping of PSUs**

<table>
<thead>
<tr>
<th>Group</th>
<th>Name of the PSUs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Core</td>
<td>ONGC, OIL, BRPL, SAIL, MTNL, GAIL, AI, CONOR, PH; NLC, NCL, SECFL, WCFL, BALCO, NALCO, IBP, NTPC, PGCIL, NHPC, KIOCL</td>
</tr>
<tr>
<td>Non-core</td>
<td>SCI, ITDC, IPCL, FACT, NFL, MFL, HCIL, HTL, ITI, MFIL, HLL, BEML, HCL, HZL, MOIL</td>
</tr>
</tbody>
</table>

*Source: PSU Disinvestment, ICFAI University, Pg.XVIII*
Out of the 35 companies recommended by the commission, only MTNL, GAIL, CONCOR, BALCO, HCIL, ONGC and few others have been disinvested partially. More so, most of the divestment has been through an equity swap between each of these firms.

**Disinvestment In 1996-97**

In the budget speech for 1996-97, a target of Rs 5000 crore (50 billion) was fixed for mobilization of resources through disinvestment of PSE shares. In the process of identifying the enterprises to be taken up for disinvestment during 1996-97, the government considered names of enterprises from the petroleum and communication sector. However, the government finally decided to take up two PSEs (IOC and VSNL) initially for the first two tranches. While Indian Oil Corporation (IOC) and Videsh Sanchar Nigam Ltd. (VSNL) were earmarked, and preparatory work had also been initiated for the GDR issue, only VSNL could be taken up for disinvestment (in GDR) during the said period and IOC GDR could not be launched due to unfavourable market conditions. In the GDR, 39 lakh shares of VSNL could be disinvested resulting in realization of Rs 380 crore (3.8 billion).

**Disinvestment In 1997-98**

The Budget for 1997-98 had taken a credit for an amount of Rs 4800 crore (48 billion) to be realised from disinvestment of government held equity in public sector companies. This was proposed to be achieved by disinvestment in MTNL, GAIL, CONCOR and IOC. A GDR issue of 40 million shares (4 crore) held by the government in MTNL was offered in the
international market in the month of November, 1997. The issue was a success and an amount of Rs 902 crore (9.02 billion) was realised. However, due to extremely unfavourable conditions in the international market, it was decided to defer the issues of GAIL, CONCOR and IOC.

**Phase 3**

**1998-99 onwards:**

This phase marked a paradigm shift in the disinvestment process. First, in the 1998-99 budget, the BJP government decided to bring down government shareholding in the PSEs to 26 per cent in the generality of cases, (thus facilitating ownership changes, as was recommended by the Disinvestment Commission). It however, stated that the government would retain majority holdings in PSEs involving strategic considerations and that the interests of the workers would be protected in all cases.

In 1999-2000, the government stated that its' policy would be to strengthen strategic PSEs, privatise non-strategic PSEs through gradual disinvestment or strategic sale and devise viable rehabilitation strategies for weak units. For the first time, the expression 'privatization' was used instead of disinvestment.

The government formed the Department of Disinvestment on 10 December 1999, which was to act as a nodal agency for, disinvestment and to have a systematic policy approach towards disinvestment.
In a significant decision, the government announced in the budget of 2000-2001 that it was prepared to reduce its stake in the non-strategic PSEs to even below 26 per cent if necessary. It further stated closure of those PSEs, which cannot be revived. The emphasis remained on strategic sales. The budget statement for the year stated that entire proceeds from disinvestment/privatization would be deployed in social sector, restructuring of PSEs and retirement of public debt.

The government reconstituted the Disinvestment Commission in July 2001 for a period of two years under the chairmanship of Dr R.H. Patil. The commission has four other part-time members and one member secretary. The government decided to refer all 'non-strategic' PSEs including subsidiaries (excluding IOC, ONGC, and GAIL) to the Disinvestment Commission for it to prioritise, examine and make recommendations taking into consideration the existing policy as articulated on 16 March 1999 and the budget speeches of the Finance Minister from time to time. It was also decided that for prioritization, the following criteria will be observed:

(a) Where disinvestments in PSEs would lead to large revenues to the government;
(b) Where disinvestment can be implemented with minimum impediments and in relatively shorter time span; and
(c) Where continued bleeding of government resources can be stopped earlier.
The reconstituted commission has submitted six reports (Reports XIII to XVIII) till March 2003. In these reports, fresh recommendations have been made for 17 PSEs and review recommendations for four PSEs. The commission recommended strategic sale in case of eight PSEs and sale of entire government stake or closure in six PSEs out of the 17 freshly examined PSEs.

**Disinvestment in 1998-99**

The budget for 1998-99 had taken a credit for an amount of Rs 5,000 crore (50 billion) to be realized from disinvestment of government held equity in public sector enterprises. This was proposed to be achieved by disinvestment through offer of shares in GAIL, VSNL, CONCOR, IOC and ONGC.

The government disinvested 0.90 crore shares (9 million) of its equity in CONCOR in the domestic market in November 1998 and realized Rs 221.65 crore (2.21 billion). VSNL GDR cum domestic offering of 1 crore (10 million) share was completed in February 1999, and an amount of Rs 783.68 crore (7.83 billion) was realized. Government also offloaded 30 million of GAIL in the domestic market in February 1999, and realized Rs 181.78 crore (1.81 billion). These disinvestments amounted to Rs 1187.11 crore (11.87 billion). In addition, a unique modality of disinvestment was also adopted, viz., cross holding amongst the oil enterprises under which government disinvested/part of its equity holding amongst the enterprises inter-se, namely ONGC, IOC and GAIL. In these transactions, the government realized Rs 4184 crore (41.8 billion). Strictly speaking, this swap of cross holding of equity by PSEs cannot be considered disinvestment. The
details of these transactions are given in Table 6.4 below. Thus, in all, an amount of Rs 5371.11 crore (1187.11 plus 4184) was realized during 1998-99.

Table 6.4
PSEs Disinvested in 1998-99

<table>
<thead>
<tr>
<th>Name of the Enterprise</th>
<th>Mode of Disinvestment</th>
<th>No. of Shares Sold (in crore)</th>
<th>Receipts (in Rs crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>CONCOR</td>
<td>Domestic issue</td>
<td>0.9000</td>
<td>221.65</td>
</tr>
<tr>
<td>GAIL</td>
<td>(i) Divested/sold to institutional investors</td>
<td>3.0610</td>
<td>181.78</td>
</tr>
<tr>
<td></td>
<td>(ii) Cross holding by ONGC</td>
<td>4.0840</td>
<td>245.04</td>
</tr>
<tr>
<td></td>
<td>(iii) Cross holding by IOC</td>
<td>4.0840</td>
<td>245.04</td>
</tr>
<tr>
<td>IOC</td>
<td>Cross holding by ONGC</td>
<td>3.1272</td>
<td>1208.96</td>
</tr>
<tr>
<td>ONGC</td>
<td>(i) Cross holding by IOC</td>
<td>12.5349</td>
<td>2034.96</td>
</tr>
<tr>
<td></td>
<td>(ii) Cross holding by GAIL</td>
<td>2.7719</td>
<td>450.00</td>
</tr>
<tr>
<td>VSNL</td>
<td>GDR issue</td>
<td>1.0000</td>
<td>783.68</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>31.5630</td>
<td>5371.11</td>
</tr>
</tbody>
</table>

Note: All these PSEs were partially disinvested earlier also. Source: Public Enterprises Survey, 1998-99, Vol. I gives total amount realised as Rs 5,371 crore (53.7 billion). Enterprise-wise details obtained by author from Ministry of Disinvestment.

Source: Sudhir Naib, Disinvestment in India, Sage Publication, Pg. 236
Disinvestment in 1999-2000

The budget for 1999-2000 had taken a credit of Rs 10,000 crore (100 billion) from disinvestment. In January 2000, strategic sale of Modern Foods India Ltd (MFIL) to the extent of 74 per cent of its equity was done in favour of Hindustan Lever Ltd (HLL) to realize Rs 105.45 crore (1.05 billion). As per the agreement with HLL, the government provided for post closing adjustments for the pre closing period (1 April 1999 to 31 January 2000). Under this clause, Rs 10.94 crore (109.4 million) was returned to HLL. Thus net realization was Rs 94.51 crore (945.1 million) for 74 per cent equity in MFIL. This was for the first time that more than 50 per cent shares of a PSE were sold to a strategic partner and the management of the company transferred to the private sector. Further, government disinvested 13.50 crore (135 million) of shares of GAIL by GDR issue to realize Rs 945 crore (9.4 billion). Also, Rs 75 crore (750 million) was realized by disinvesting 0.10 crore shares of VSNL in domestic market. Government also realized Rs 459.27 crore (4.59 billion) through cross holding amongst IOC, ONGC and GAIL. In addition, Rs 244.42 crores (2.44 billion) was realized by financial restructuring of BALCO. This was done by reducing BALCO’s equity by 50 per cent by using its substantial cash surplus. The government is considering withdrawal of reserves from PSEs before disinvestment as disinvestment proceeds, but such an amount is strictly speaking not disinvestment proceeds per se. In all, Rs 1818.20 crore (18.18 billion), (i.e., Rs 1573.78 crore (15.73 billion) by disinvestment/ cross holding in five PSEs plus Rs 244.42 crore (2.44 billion) by capital restructuring of BALCO) was realized during 1999-2000. The details of PSEs disinvested are given in Table 6.5.
Table 6.5
PSEs Disinvested in 1999-2000

<table>
<thead>
<tr>
<th>Name of the Enterprise</th>
<th>Mode of Disinvestment</th>
<th>No. of Shares Sold (in crore)</th>
<th>Receipts (in Rs crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GAIL</td>
<td>GDR issue</td>
<td>13.5000</td>
<td>945.00</td>
</tr>
<tr>
<td>IOC</td>
<td>Cross holding by ONGC</td>
<td>0.4212</td>
<td>162.79</td>
</tr>
<tr>
<td>ONGC</td>
<td>(i) Cross holding by IOC</td>
<td>1.1718</td>
<td>190.19</td>
</tr>
<tr>
<td></td>
<td>(ii) Cross holding by GAIL</td>
<td>0.6548</td>
<td>106.29</td>
</tr>
<tr>
<td>VSNL</td>
<td>Domestic Market</td>
<td>0.1000</td>
<td>75.00</td>
</tr>
<tr>
<td>Modern Food Industries Ltd.</td>
<td>Strategic sale of 74 per cent equity (face value Rs 1000)</td>
<td>0.0920</td>
<td>94.51 (After adjustment)</td>
</tr>
</tbody>
</table>

**Total** 15.9398 1573.78

*Note: Other than MFIL, all other enterprises were partially disinvested earlier also. Source: Enterprise-wise details obtained by author from Ministry of Disinvestment.*

*Source: Sudhir Naib, Disinvestment in India, Policies, Procedures and Practices, Sage Publication, Pg. 238*
Disinvestment in 2000-2001

Against a target of Rs 10,000 crore (100 billion), the government could realize Rs 1868.73 crore (18.68 billion) during the year. Rupees 55.50 crore (555 million) was realized by strategic sale of 51 per cent of BALCO equity to Sterlite Industries. The balance of Rs 13 17. 23 crore (13. 17 billion) was obtained through taking over of BRPL and Chennai Refineries by IOC (Rs 658.13 crore) and Kochi Refinery by BPCL (Rs 659.10 crore). Again, bulk of proceeds came by expanding the domain of public sector where they have acquired other PSE units. The details are given in Table 6.6.

Table 6.6
Disinvestment in 2000-2001

<table>
<thead>
<tr>
<th>Name of the Enterprise</th>
<th>Mode of Disinvestment</th>
<th>Receipts (in Rs crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>BALCO</td>
<td>Strategic sale of 51 per cent</td>
<td>551.50</td>
</tr>
<tr>
<td>BRPL and Chennai Refineries</td>
<td>Taken over by IOC</td>
<td>658.13</td>
</tr>
<tr>
<td>Kochi Refinery</td>
<td>Taken over by BPCL</td>
<td>659.10</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>1868.73</td>
</tr>
</tbody>
</table>

Note: Other than BALCO, all other PSEs were partially disinvested earlier also.

Source: Ministry of Disinvestment.

Source: Sudhir Naib, Disinvestment in India, Policies, Procedures and Practices, Sage Publication, Pg. 238
Disinvestment in 2001-2002

Against a target of Rs 12000 crore (120 billion), the government realized Rs 3130.94 crore (31.3 billion) during the year. The highlight of these disinvestments was that strategic sales were effected in CMC, HTL, IBP, VSNL and PPL. In CMC Ltd 51 per cent of equity was sold to Tata Sons Ltd for Rs 152 crore (1.52 billion), 74 per cent of equity of HTL was sold to Himachal Futuristic Communications Ltd (HFCL) for Rs 55 crore (550 million). In IBP 33.58 percent out of government holding of 59.58 per cent was sold to IOC for Rs 1153.68 crore (11,53 billion). In VSNL 25 per cent equity out of government holding of 52.97 per cent was sold to Panatone, a Tata group company for Rs 1439 crore (14.39 billion). Further, 1.97 per cent of VSNL equity has been given to employees at a concessional rate. Besides the bid price of Rs 1439 crore in VSNL, the government had received Rs 1,887 crore (18.87 billion) as dividend and Rs 363 crore (3.63 billion) as dividend tax from the company. Thus there was a realization of Rs 3689 crore (36.89 billion) from VSNL. In Paradeep Phosphates Ltd (PPL) 74 per cent equity was sold to Zuari Maroc Phosphates Private Ltd for Rs 151.70 crore (1.51 billion) in February 2002. Also in February 2002, the government decided to sell 72 per cent equity of Jessop and Co. Ltd, (a sick company) to Ruia Cotex Ltd for Rs 18.18 crore (181.8 million). Since Jessop & Co. is under the purview of BIFR, it is being approached for approval to the proposal of induction of strategic partner. In March 2002, the Cabinet Committee on Disinvestment (CCD) approved 26 per cent of equity sale out of its holding of 76 per cent in Hindustan Zinc Ltd to Sterlite Industries for Rs 445 crore (4.45 billion). With this sale, the management control will also pass on to Sterlite Industries. However, the proceeds of this sale will materialize in fiscal 2002-2003. With these disinvestments, the government holding in HTL,
IBP, VSNL, and PPL will be 26 per cent. A number of ITDC hotels have been sold, viz., at Agra, Gaya, Hassan, Mamallapuram, Madurai, Udaipur, Qutab and Lodhi Hotel in Delhi. The ITDC hotel at Bangalore has been given on long-term lease. In addition, three hotels of Hotel Corporation of India Ltd – Hotel Airport Mumbai, Hotel Juhu Mumbai, and Hotel Raigir were sold for Rs 242.51 crore (2.42 billion). However as HCIL is a subsidiary of Air India, the disinvestment proceeds went to Air India. As disinvestment process is being initiated in MMTC and STC, reserves were withdrawn from them to the extent of Rs 100 crore (1 billion) (MMTC - Rs 60 crore, STC - Rs 40 crore). The details of these transactions are given in Table 6.7.
Table 6.7

Disinvestment in 2001-2002

<table>
<thead>
<tr>
<th>Name of the Enterprise</th>
<th>Mode of Disinvestment</th>
<th>Receipts (in Rs crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>CMC</td>
<td>Strategic sale of 51 per cent</td>
<td>152.00</td>
</tr>
<tr>
<td>HTL</td>
<td>Strategic sale of 74 per cent</td>
<td>55.00</td>
</tr>
<tr>
<td>IBP</td>
<td>Strategic sale of 33.58 per cent</td>
<td>1153.68</td>
</tr>
<tr>
<td>VSNL</td>
<td>Strategic sale of 25 per cent</td>
<td>1439.00</td>
</tr>
<tr>
<td>PPL</td>
<td>Strategic sale of 74 per cent</td>
<td>151.70</td>
</tr>
<tr>
<td>ITDC</td>
<td>Sale of eight hotels and long term lease of one hotel</td>
<td>179.56</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>3130.94</strong></td>
</tr>
</tbody>
</table>

Note: Out of these six PSEs, three – CMC, VSNL and ITDC – were partially disinvested earlier also.

Source: Ministry of Disinvestment website.

Disinvestment in 2002-2003

The target for disinvestment proceeds for 2002-2003 has been kept as Rs 12,000 crore (120 billion). In March 2002, the government had approved disinvestment of 26 per cent equity in Hindustan Zinc Ltd (HZL) in favour of Sterlite Opportunities and Ventures Ltd, a Special Purpose Vehicle promoted by Sterlite Industries (India) Ltd and Sterlite Optical Technologies Ltd. The proceeds of this transaction amounting to Rs 445 crore (4.45 billion) (translating to about Rs 40.50 per share) was realized in April 2002. In addition, disinvestment of 1.46 per cent of equity in favour of employees yielded Rs 6.18 crore (61.8 million).
In May 2002, a two-stage sell off began in Maruti Udyog Ltd (MUL) with a Rs 400 crore (4 billion) right issue at a price of Rs 3280 per share of Rs 100 each (1,219,512 shares) in which the government renounced whole of its rights share (6,06,585 shares) to Suzuki, for a control premium of Rs 1000 crore (10 billion). Relative shareholding of Suzuki and government after completion of the rights issue was 54.20 per cent and 45.54 per cent respectively. In the second stage, the government is to offload its holding in two tranches. In the first tranche, the government sold 27.5 per cent of its equity through Initial Public Offer (IPO) in June 2003. The cut-off price was declared by the government at Rs 125 per share of Rs 5 face value. This was nine times more than the price at which the government had sold a part of its share in Maruti to the Japanese joint venture partner Suzuki Motor Corporation, in 1992. This IPO yielded Rs 993 crore (9.93 billion). In order to reward retail investors, 60 per cent of the total issue was allotted to them and remaining 40 per cent to institutional investors. The issue was over-subscribed by over 10 times. The success of Maruti IPO brought out that when there is already a strong strategic partner in place like Suzuki, the market will respond positively. The enthusiastic response to the issue also brought out the depth of the domestic capital market. Keeping in view, the overwhelming response in Maruti case, the government has decided to sell its remaining shares to the public in the five privatised companies—Tata controlled VSNL, and CMC, Reliance managed IPCL, Sterlite controlled BALCO, and Indian Oil managed IBP through IPO route.
It is felt that there is a need for generating more awareness regarding the methodology of book building process as used in Maruti IPO. Public is generally familiar with the methodology of applying in fixed price issues and is not very conversant with book building process as used in Maruti.

Strategic sale of IPCL was also finalized in May 2002. Although the decision to disinvest IPCL was taken in December 1998, it took three-and-a-half years to finalize the deal. Earlier, the government was exploring the possibility of Vadodara Complex of IPCL being transferred to IOC in view of their synergy of operations and then disinvest 25 per cent equity in rest of IPCL. Finally, Reliance Petroinvestments Ltd (Reliance Group) was inducted as strategic partner in IPCL through sale of 26 per cent equity shares at a consideration of Rs 1491 crore (14.91 billion) which (translated to about Rs 231 per share. The Reliance bid far exceeded the next highest bid of IOC (Rs 826 crore, translating to about Rs 128 per share). The reserve price for 26 per cent equity based on discounted cash flow method had worked out to Rs 845 crore (8.45 billion). High premium was paid by Reliance because of its synergy with IPCL business and to get a strong hold over the domestic petrochemical market in which it is already a big player. With this acquisition, Reliance average market share in all products will be about 67 per cent, and for some products like paraxylene and mono-ethylene glycol it will have 98 to 94 per cent of the local market.67

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6.7: The Economic Times, 22 May 2002.
The relevant question is, will this dominance of local markets lead to monopolistic excesses? A good indicator will be price behaviour of these products in future. The government contemplated to legislate a competition bill about two years back, but it has not seen the light of the day. There is a need of such legislation to counter threats of monopoly abuse.

In June 2002, four ITDC properties, viz., Kovalam Ashok Beach Resort (Rs 40.39 crore), Hotel Airport Ashok Kolkata (Rs 19.39 crore), Hotel Aurangabad Ashok (Rs 16.50 crore) and Hotel Manali Ashok (Rs 3.65 crore) were sold yielding a total of Rs 79.93 crore. Another five ITDC hotels were sold in July 2002 for Rs 163.60 crore. The details of these sales are: Hotel Kanishka (Rs 92.37 crore), Hotel Indraprastha (Rs 43.39 crore), ITDC’s incomplete project in Chandigarh (Rs 17.27 crore), Hotel Varanasi Ashok (Rs 8.38 crore), and Hotel Khajuraho Ashok (Rs 2.19 crore). Hotel Ranjit was sold in October 2002 for Rs 29.28 crore.

In June 2002, 6.06 per cent of government equity in CMC Ltd was disinvested in favour of employees for Rs 6.07 crore. While in January 2000, strategic sale of Modern Foods India Ltd (MFIL) to the extent of 74 per cent of its equity was done in favour of Hindustan Lever Ltd the residual 26 per cent equity was also sold to Hindustan Lever Ltd for Rs 44.07 crore (440.7 million) in November 2002.

The details of disinvestment during 2002-2003 are given in Table 6.8.
### Table 6.8
Disinvestment in 2002-2003

<table>
<thead>
<tr>
<th>Name of the Enterprise</th>
<th>Mode of Disinvestment</th>
<th>Receipts (in Rs crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>HZL</td>
<td>(a) Strategic sale of 26 per cent</td>
<td>(a) 445.00</td>
</tr>
<tr>
<td></td>
<td>(b) 1.46 per cent equity disinvested in favour of employees</td>
<td>(b) 6.18</td>
</tr>
<tr>
<td>Maruti Udyog Ltd.</td>
<td>Control premium for sell off to Suzuki</td>
<td>1000.00</td>
</tr>
<tr>
<td>IPCL</td>
<td>Strategic sale of 26 per cent</td>
<td>1491.00</td>
</tr>
<tr>
<td>ITDC</td>
<td>Sale of 10 properties</td>
<td>272.81</td>
</tr>
<tr>
<td>MFIL</td>
<td>Residual sale of 26 per cent equity</td>
<td>44.08</td>
</tr>
<tr>
<td>CMC</td>
<td>6.06 per cent equity disinvested in favour of employees</td>
<td>6.07</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>3265.17</strong></td>
</tr>
</tbody>
</table>

**Note:** Other than Maruti Udyog Ltd, other PSEs were partially disinvested earlier.

**Source:** Ministry of Disinvestment reply to Lok Sabha. Unstarred Question No. 1351 answered on 26 Feb. 2003.

**Source:** Sudhir Naib, Disinvestment in India, Policies, Procedures, Practices, Sage Publications, Pg.243
In future, petroleum sector is likely to come up for disinvestment. In June 2000, the government decided that ONGC, IOC and GAIL be treated as flagship companies in the oil sector where government holding would not be reduced below 51 per cent. In February 2002, the government decided in principal to disinvest BPCL and HPCL. On 26 January 2003, the Cabinet Committee on Disinvestment took a decision that out of government holding of 51.01 per cent equity in HPCL, it will offer 34.01 per cent equity with management control to a strategic investor and 5 per cent equity will be offered to employees. Post disinvestment, the government share in HPCL will come down to 12 per cent. Further, a decision was taken that out of 66.2 per cent equity holding of government in BPCL, it will divest 35.20 per cent in domestic and international market. Of this, 10 cent is likely to be offered in domestic market and 25.20 per cent in ADR and 5 per cent of equity will be offered to employees.

The government decision to disinvest in HPCL and BPCL without parliamentary approval was challenged in Supreme Court. The Court in its order on 16 Sep 2003 asked the government to seek Parliament’s approval before proceeding with disinvestment since the two oil companies were created through an Act of Parliament. This ruling has far reaching implications.
PSU Sale Off Models: Shourie’s Strategic Sale

The disinvestment minister Arun Shourie has speed up the disinvestment process by disinvesting fourteen PSUs in a period of 24 months. The speed of disinvestment has become critical and the every single valuation and sale exercise undertaken by government has been criticized for the valuation and methodology adopted by the government. Examining closely the process of disinvestment it can be said that Shourie and his team have actually managed to evolve a consistent and fairly sophisticated approach to this PSU selling spree. The government does not talk about its methods. While the GOI has not made its methodologies public, the underlying principle seems to be maximization of returns through innovative sale of techniques.

Business world analyzed the 14 strategic sales (refer table 6.9) undertaken by the Disinvestment Minister Mr. Shourie. It is discovered that three basic sale of models emerged showing the approach, method and philosophy of the GOI. Most sale-offs fit into one of these three models. There were a few exceptions like the recent sale of IPCL and Maruti Udyog. But these exceptions only proved the rule and also indicated that disinvestment ministry was willing to ‘tweak’ these models if the need arose.

The first model applies to cash-rich companies, where cash reserves and other assets are delinked from the entities that are sold. Past examples: BALCO and Videsh Sanchar Nigam (VSNL). Future assets to go on sale; State Trading Corporation (STC), Minerals and Metals Trading Corporation (MMTC), Bharat Petroleum Corporation (BPCL), and Hindustan Petroleum Corporation (HPCL). The tweak: if the specific PSU requires the move immediately for expansion or new ventures, its cash reserves will remain untouched as was done with Maruti. Here, its
foreign partner, Suzuki Motor Corporation, managed to convince that the company required the money.

**Chart 6.1**

The PSU Sale Off Models

- **The Three Models**
  The disinvestment ministry has evolved three models to sell off the various PSUs

- **The Cash Model**
  The GOI takes out cash and real estate from the company and then sells the remaining entity
  Past examples: BALCO and VSNL
  In the pipeline: MMTC and STC

- **The Demerger Model**
  The GOI spins off the various assets and/or properties as separate entities and then sells them individually
  Past examples: ITDC and HCI

- **The Restructuring Model**
  Loss-making PSUs are restructured both financially and operationally to make them more attractive for the buyers
  Past examples: Paradeep Phosphates
  In the pipeline: SAIL and EPIL

- **The Variants**
  Since the disinvestment ministry is on a learning curve, it fine-tunes the various models in specific cases

  **The Maruti Case**
  The foreign partner, Suzuki, ensured that it didn't have to buy the entire stake held by the GOI.

  **The SCI Case**
  It was decided that although individual assets may fetch higher prices, it was easier to sell the company in one go.

  **The IPCL Case**
  The GOI sold one of its units prior to the sale to prevent the creation of a monopoly in the petrochemical sector.

*Source: Alam Shrinivas, PSU Valuation, PSU Disinvestment, ICFAI, Pg.61*
The second model relates to PSUs where the sale of individual assets may fetch a higher price compared to the one where it is sold as an ongoing concern in such cases, properties are demerged and sold separately. That was, what was done with hotels owned by India Tourism Development Corporation (ITDC). Recently, it was debated whether it would be more profitable to sell the individual vessels of the Shipping Corporation of India (SCI) rather than selling the company as a whole. The disinvestment ministry decided to pursue the latter path.

The third model adopted by the ministry is in the cases like the ailing Paradeep Phosphates, where, prior to the sales, a financial restructuring exercise was undertaken to make it more attractive to prospective buyers. It is now being done with loss-making companies like Steel Authority of India (SAIL) and Engineering Projects India (EPIL), where loans are being written off or converted into equity and non-core units hawked off.

Since the GOI is trying to fit future divestments into one of these three models, it is obviously confident that these models can help it get better prices. Therefore, it's time to analyze the efficacy of the models themselves.

Table 6.9 shows PSU Disinvestment during Mr. Arun Shourie’s regime.
Table 6.9
PSU Disinvestment during Shourie’s Regime

<table>
<thead>
<tr>
<th>Company</th>
<th>Stake Sold (%)</th>
<th>Total Price (Rs.cr)*</th>
<th>The Methodology</th>
</tr>
</thead>
<tbody>
<tr>
<td>Modern Foods</td>
<td>100</td>
<td>149.00</td>
<td>Complete sale to Hindustan Leve in two phases after minor restructuring</td>
</tr>
<tr>
<td>Balco Industries</td>
<td>51</td>
<td>826.50</td>
<td>Simple sale to Sterlite after taking out cash reserves</td>
</tr>
<tr>
<td>CMC</td>
<td>51</td>
<td>152.00</td>
<td>The Tatas purchased the stake after only they were left in the fray</td>
</tr>
<tr>
<td>HTL</td>
<td>74</td>
<td>55.00</td>
<td>Simple sale of a company that wasn’t doing too well</td>
</tr>
<tr>
<td>Lagan Jute</td>
<td>74</td>
<td>2.53</td>
<td>The loss-making entity was an ongoing concern</td>
</tr>
<tr>
<td>ITDC</td>
<td>100</td>
<td>179.55</td>
<td>Nine of its properties were demerged and sold as separate entities</td>
</tr>
<tr>
<td>Hotel</td>
<td>100</td>
<td>242.51</td>
<td>Three of its properties were demerged and sold as separate entities</td>
</tr>
<tr>
<td>IBP</td>
<td>33.58</td>
<td>1,153.68</td>
<td>The stake was purchased by IOC at a fairly high premium</td>
</tr>
<tr>
<td>VSNL</td>
<td>25</td>
<td>3,689.00</td>
<td>Simple sale to the Tatas after taking out cash and delinking its real estate</td>
</tr>
<tr>
<td>Paradeep Phosphates</td>
<td>74</td>
<td>151.70</td>
<td>An incomplete financial restructuring was undertaken before selling it</td>
</tr>
<tr>
<td>Jessop &amp; Co,</td>
<td>72 18.18</td>
<td></td>
<td>Post-restructuring, the loss-making entity was sold as an ongoing concern</td>
</tr>
<tr>
<td>Hindustan Zinca</td>
<td>26</td>
<td>445.00</td>
<td>Sterlite Industries took it over in a simple sale transaction</td>
</tr>
<tr>
<td>IPCL</td>
<td>26</td>
<td>1,491.00</td>
<td>To stop creation of a monopoly, one of its units was sold off beforehand</td>
</tr>
<tr>
<td>Maruti Udyog</td>
<td>50</td>
<td>2,424.00**</td>
<td>For the first time, a part of the money will flow back into the company</td>
</tr>
</tbody>
</table>
* Includes cash taken out of the company prior to disinvestment in the form of dividends and dividend tax

**Minimum expected realization to the government in a 3-phase disinvestment.

*Source: PSU Disinvestment Concept and Cases, ICFAI University, Pg.66*
Some Important Issues in PSU Sale-Off And Valuation

Asset Stripping:

"Wherever we feel that the PSU doesn’t need their cash reserves immediately for pursuing expansion or new projects, we will take the money out," says a categorical Baijal. STC and MMTC, which will be disinvested in the near future, were forced to pay dividends of Rs.40 crore and Rs.60 crore, respectively. For MMTC, the figure was six times the average annual dividends it has paid in the last three years and, for STC, it was nearly seven times the amount. It seems that both HPCL and BPCL will pay massive dividends this year from their free reserves of Rs.6,147 crore and Rs.3,779 crore, respectively.

The logic for dipping into reserves of cash-rich PSUs is fairly simple. The money belongs to the government, the majority shareholder. The PSUs don't need it. And no buyer will normally pay a premium for the cash reserves. "When you are valuing a company on the basis of future earnings, neither the cash available with it, nor its debt burden play any role," explains Kaushik Dutta, partner, PricewaterhouseCoopers.

The buyer can also bring his own cash or raise fresh capital once he has purchased the company. That's quite true for the Tata group, which paid Rs.1,439 crore for a 26% stake in VSNL. So, it would have been unwilling to pay a premium for VSNL's cash reserves. At best, it would have merely hiked its bid price by an amount equivalent to the reserves. And that's the same as the GOI taking the money out prior to the sale by paying itself a dividend of Rs.1,887 crore. Nothing wrong with that. The problem arises when the management of the PSU feels that it requires the money, as was the case.

6.8: Alam Shrinivas, PSU Valuation, PSU Disinvestment: Concept & Cases, ICFAI, Pg.62
with VSNL. After all, VSNL is in the midst of readying itself to provide domestic long-distance services for which the outlay is expected to be a staggering Rs.2,000 crore. Its management did tell Baijal that the cash reserves should remain intact or the proposed entry could get derailed. And that would allow competition to get a head-start over VSNL in the near future.

**MUL and IPCL: Two Models that Differed**

The sale of Indian Petrochemicals Corporation (IPCL) and Maruti Udyog denote firsts in India's disinvestment history. In the case of Maruti, a small portion of the proceeds will flow into that company - and not entirely into the government's coffers - for the first time. And, in IPCL's cases, the disinvestment ministry tried to stop the possible formation of a monopoly in the petrochemicals sector. Both these sell-offs were, thus, unique and didn't fit the three sale models (See Chart 6.1, 'Shourie's PSU Sell-off Models') that have emerged in the 24 months. There were many reasons for the disinvestment ministry to stray off the course in both these cases.

Consider what will happen to Maruti, where the government had decided to sell its 50% holding in three phases. The first phase entails a Rs.400-crore rights' issue, in which the GOI will renounce its entitlement in favor of its equal foreign partner, Suzuki, for a consideration of Rs. 1,000 crore. Suzuki, whose stake will go up to 54.40% after the issue, will then control the company. And the Rs.400 crore will flow into the company's coffers.
In the second phase, the GOI will sell 36 lakh shares in an IPO and earn a minimum of Rs.828 crore. That's because Suzuki has underwritten these shares at a price of Rs.2,300 per share (face value: Rs.100). The government's remaining stake will be sold in the last phase.

The complicated deal was worked out because Suzuki was unwilling to fork out a huge sum to completely buy-out the GOI's stake. All that the foreign partner wanted was to become a majority owner and get the government out of the company. Under the current arrangement Suzuki is only picking up a 4.5% additional stake during the rights' issue. It will be forced to buy the partner's remaining stake only if the GOI is unable to get a pre-determined minimum price for its share in the two subsequent public issues.

What raised the alarm when IPCL was put on the block was that Reliance Industries - which now owns IPCL - could become a near-monopoly if it emerged as the highest bidder. To prevent such a situation, one of three complexes owned by IPCL was given away to IOC (Obviously, there were no perceived problems if a PSU, 10C, managed to buy out another one, IPCL). No one realized that the sale of the unit prior to disinvestment actually made IPCL more attractive for the prospective buyers. The reason: the oldest and the least profitable Baroda unit was transferred to IOC and what remained behind in IPCL were two modern facilities.

But, in VSNL's case, the disinvestment ministry seems to have played the right cards. Talking to BusinessWorld, the Tata's senior managers categorically stated that all ongoing projects are onstream and the new owner is willing to invest whatever it takes, to ensure that VSNL remains the telecom leader. They also said that an
investment blueprint has been drawn up and group companies would pump in the money required by VSNL in the near future.

But what was done in the case of VSNL is unlikely to work uniformly for all the other cash-rich, profitable PSUs. In some cases, the model may need to be constantly changed keeping in mind the peculiar characteristics of each PSU. An example of this is Kudremukh Iron Ore Company (KIOCL). Its disinvestment is on the cards and its management is opposed to the GOI's decision to pay itself huge dividends from the company's existing liquid cash base of Rs.120 crore.

Here too, the GOI's initial logic was that the company didn't require the money as it had no long-term projects. But the management pleaded that it had promoted a joint venture, Kudremukh Iron and Steel Co. (KISCO), in which it needed to make additional investments, apart from the Rs.275 crore already sunk into it. Baijal and his team weren't convinced. The new thinking was: sell the parent's stake in KISCO as well as its holdings in the parent separately, even while emptying out the latter's reserves.

But KIOCL resisted the new proposal as well. It advised the GOI that selling the joint venture (whose pig iron unit is not doing well) at this stage may not be a good idea. It said the sale may not fetch a price of more than Rs.150 crore, or merely 55% of the money that has been invested in the company. So, the GOI then came up with a third proposal to merge KISCO with the parent after getting a green signal from other shareholders that included former KIOCL employees and other PSUs. And sell the merged entity without touching the cash reserves.

This move was also opposed by KIOCL since it felt the merger would pull down the valuation of the combined entity. After all, the combined profit and loss account would hit the fortunes of the
profitable parent (net profit in 2000-01: Rs.58.50 crore) due to the KISCO's problems. While the debate on the KIOCL sell-off continues, last year, it declared a dividend of a mere 3.5%.

Clearly, the GOI needs to consistently evolve its model of emptying out the reserves of cash-rich PSUs prior to disinvestment. The same can be said about the disinvestment ministry's decision to delink real estate from PSUs, as was the case with VSNL. Baijal feels that VSNL was a test case where it was decided to take out 800 acres (worth Rs.778 crore) of land from the entity sold to the Tatas. The delinking process is still incomplete, but Baijal says: "We have decided to sell this real estate separately in open auctions at a later date."

Obviously, the logic is that the land, when sold to real estate developers at a time when prices improve, could fetch a huge premium and maximize the seller's profits. In addition, most experts feel that a buyer who is biting into a business may not necessarily pay a premium for real estate. The change in telecom technology has ensured that companies like VSNL don't need additional land for expansion as was the case earlier. So, says Dutta, the Tata's would have been unwilling to pay a premium for the land.

Roddy Sale, an expert in disinvestment who just quit his job with J P Morgan, agrees: "There was no strategic value attached to the land owned by VSNL." But in cases where the land has strategic importance or is critical for expansion or hard to replace, buyers should be forced to pay a premium. To understand that, consider Rashtriya Ispat Nigam Ltd., (RINL) which, too, is to be sold off.
RINL is sitting on 21,000 acres in Visakhapatnam, of which, it currently utilizes a small portion for its 2.5-million tpa steel unit. Us management states that the company actually plans to expand the capacity to 10-12 million tpa soon. RINL is best placed for doing that since it has several advantages including proximity to the port and easy access to the growing East Asian markets. So, its additional land should help the GOI get a premium over the price arrived at through normal valuation methodologies. That is, if the GOI plays its cards well instead of merely delinking the excess land as it had done in VSNL.

**Demerging Properties and De-enhancing Value**

The demerger route does yield benefits initially. Therefore, what the GOI did with ITDC's nine hotel properties and Hotel Corporation of India's (HCL) three - spinning them off as separate entities with separate balance sheets and dividing the overall equity bases of the individual companies - did seem successful. The success is visible from the sale price of some of the prime properties like Qutab Hotel (Rs.35.67 crore), Lodhi Hotel (Rs.76.22 crore) and Centaur, Juhu (Rs.153 crore).

For these three properties, the buyers paid a hefty premium of between 17-times and 73-times the face value of the shares (after the entities had been demerged and spun off into separate entities). For instance, in the case of Lodhi Hotel, the GOI got a value of Rs.7,300 per share (face value: Rs.100) and the figure was Rs.3,900 per share in the case of Qutab Hotel. The GOI's realization should also be seen in the perspective that these hotels were loss-making.
ITDC's Lodhi Hotel was the worst case with net losses in the past three years. In 2000-01, it posted a loss of Rs.2 crore on sales of Rs.5.6 crore, which had come down from a peak of Rs.8.4 crore in 1996-97. HCI's Centaur, Juhu, posted a net loss of Rs.2.30 crore in 2000-01 (sales: Rs.30.90 crore). This was shocking as it had shown profits in the previous five years with the highest profit of Rs.19.13 crore in 1996-97 (sales: Rs.41.84 crore).

Essentially, the buyers were paying for the prime land and the location, and not necessarily for the business. This sounds plausible because most of the new owners are planning to revamp the rooms as well as the look of their properties. And that would be like building a new property. From a seller's perspective, it would seem that the GOI did not have to spend huge sums on these properties to revamp them and also managed to get high premia for its shares.

That's only half the story though. In smaller cities like Agra, Madurai, and Rajgir, the properties attracted much lower valuation multiples. Especially, if one considers the fact that buyers were basically paying for the real estate. ITDC's property in Agra was sold for Rs.3.93 crore, or just over twice the face value, and HCI's Rajgir property was sold for Rs.6.51 crore, or less than four times the face value. Even Sushil Gupta, one of the promoters of the Delhi-based Hyatt who paid Rs.35.67 crore or 39-times the face value of the shares for Qutab Hotel, may have got the property cheap.

That's because, apart from the 65 rooms, Qutab owns 30 apartments that have been leased out to various tenants. Now, if the new owner decides to get rid of these apartments through long leases, he could recover over 80% of the money he paid for the entire property on very conservative pricing of Rs. 1 crore per apartment.
Obviously, it may seem that the GOI did not take this into account while doing its calculations.

That explains why there's a feeling that the GOI could have delinked the apartments from Qutab Hotel and sold them separately. The same logic can be applied to the number of dwelling units owned by PSUs in the townships situated next to their plants. Many of them can be separated from the manufacturing entity and sold off prior to the disinvestment. For example, Mecon has 2,000 houses in its township in Ranchi, while SAIL owns or has leased out 1.40 lakh such units at its various plant locations in cities like Bokaro and Bhilai.

If one wants an estimate of what the GOI could earn from such a strategy, here's an insight. SAIL has decided to dispose of 25% (or 35,000 units) of its dwelling stock over the next three years. By 2005, the company hopes to raise Rs.300-400 crore by giving out these houses to both existing and former employees on a long-term lease basis. Yet another example: MMTC has 500 dwelling units in south Delhi and each of them can be sold for a minimum of Rs.40 lakh. That would imply a realization of Rs.200 crore.

In comparison, at this point of time, no one expects MMTC to fetch a price higher than Rs.200 crore for a strategic stake of 26%. While the valuation figure for SAIL is difficult to estimate due to its huge losses and the fluctuating outlook of the industry, it's fair to say that selling its houses separately may help increase the GOI's realizations as and when the company is sold off. But to do that, the GOI needs to get its act together and constantly improvise its existing selling models.
Problems also arise when you try to sell off corporate entities that are in a financial mess. These would inevitably include perpetually loss-making entities (Paradeep Phosphates and Jessop & Co.) or those that have gone into the red recently (SAIL). In such cases, the GOI has decided to restructure the finances and their operations a bit to make them more attractive for the buyers.

Probably the most drastic recast was done in the case of Paradeep Phosphates, which underwent three such exercises in the last eight years. In 1994, it got a relief of Rs.354 crore through conversion of loans into equity (Rs.90 crore) and preference shares (Rs.117.65 crore) and write-offs (Rs.146.39 crore). Also, penal interest on outstanding were waived. In 1999-2000, Rs.129.72 crore of loans were written off; in the next year, Rs.85 crore was converted into equity.

Did that help Paradeep? Only to an extent, since the restructuring, although inevitable, was half-backed and not carried to its logical conclusion. Post-restructuring, Paradeep’s debt remained high at Rs.200 crore and accumulated losses ballooned to Rs.431.50 crore. Then, the company had outstanding dues to MMTC and a few foreign suppliers that totaled a whopping Rs.856 34 crore. Obviously, it was too much to expect a great price despite the financial rejigging and finally, it was sold to Zuari Maroc Phosphates for Rs.151.70 crore.

To achieve a better price in case of ailing companies, the GOI should undertake both financial and operational restructures - write off loans and penal interest for a certain period and fix specific and achievable operational milestones for each stage. Most consults like PricewaterhouseCoopers’ Dutta agree with this logic. Take the case of SAIL, where the restructuring is expected to be completed by 20Cb and
includes operational and financial parameters. The company expects to exit, most of the non-core areas including power (a few units have been sold to joint ventures with NTPC and DVB), fertilizer and alloy steel. Apart from that, the GOI has already approved a financial restructuring package.

But, in such cases, the disinvestment ministry has to get help not only from the administrative ministries, but also from the states where the units are located. In some cases, the diplomatic corps need to be activated as well. Take SAIL’s restructuring, which is getting stuck at various levels. The sale of the Salem steel unit has been opposed by the State government and its legislature has passed a resolution against a possible sale. Similarly, the ailing IISCO, a 100% subsidiary, cannot be sold until key issues are sorted out with the Russian government.

It implies that when SAIL is put one block in 2004-05, it may not have been restructured adequately to fetch a good price. Once again, the Go. may end up selling a company cheap. In fact, this will always be the case if the restructuring exercise is, half-backed or is incomplete in its implementation. Also, each loss-making PSU may need a different treatment to make it an attractive buy. The one or two or three sizes that fit all, PSUs will yield lower prices, forcing the government to sell its diamonds for the price of glass.
Disinvestment in India began in 1991-92 and the first Disinvestment Commission functioned from August 1996 to November 1999. However, till 1999 no written procedure for disinvestment was available. In December 1999, the government established the Department of Disinvestment. With the constitution of the department, the veil over the disinvestment process started lifting. The Department of Disinvestment is responsible for all matters relating to disinvestment of Central government equity from Central PSUs, taking decisions on the recommendations of the Disinvestment Commission and implementation of disinvestment decisions, including appointment of advisors, pricing of shares, etc. For decision-making and implementation of disinvestment, there is a three-tier mechanism in the government, viz., Cabinet Committee on Disinvestment (CCD), Core Group of Secretaries on Disinvestment (CGD), and Inter-Ministerial Group (IMG).

The CCD is chaired by the Prime Minister and comprises several ministers. The CCD considers the advice of the Core Group of Secretaries on Disinvestment regarding policy issues relating to the disinvestment programme and decides the final pricing of the transaction and the strategic partner in case of strategic sales.

The Core Group of Secretaries is headed by the Cabinet Secretary and comprises several Secretaries. The Core Group makes recommendations to the CCD on disinvestment policy matters and directly supervises the implementation of the decisions of all strategic sales. Further, it monitors the progress of implementation of the Cabinet decisions.
The Inter-Ministerial Group is chaired by Secretary, Department of Disinvestment and comprises officers of Ministry of Finance, Department of Public Enterprises, Administrative Ministry and the CMD of the PSE concerned. It is responsible for day-to-day implementation of the disinvestment decision.

Advisor’s play a crucial role in the disinvestment process. Advisory services are provided by merchant bankers, but in addition the legal advisors, chartered accountants and asset valuers are also required for specific services. Environmental auditors and public relations firms have also been appointed for some disinvesting PSEs. Advisors advise governments on all aspects of privatization transactions. In addition to implementing the basic steps mentioned above, advisors also counsel government on the strategic options open to it for privatization. The responsibilities of the advisor inter alia include suggesting measures to enhance sale value, preparing a detailed information memorandum, marketing of the offer, inviting and evaluating the bids, assisting during negotiations with prospective buyers, drawing up the sale and other agreements and advising on post-sale matters.

Advisors are appointed by a competitive bidding procedure. The fees payable to the advisors generally consist of two components. The first component is called 'success fee', which is a fixed percentage of the gross proceeds to be received by the government from the disinvestment. Since it is directly linked with the amount of money realizable from disinvestment, it serves as an incentive to the advisor to get the best price from disinvestments. The other component of the fee is called 'drop dead fee' which is a lump sum amount payable to the advisor only in the event of transaction being called off by the government. However, fees vary from transaction to transaction.
A lot of transparency has been built in the process of disinvestment, through the efforts of Ministry of Disinvestment. In this, the website of the ministry is playing a key role. The ministry has also initiated number of measures to educate parliamentarians and the public about the way they are proceeding in disinvestment. It has been stated that after a strategic sale is conducted, all the relevant papers concerning the transaction are sent to Comptroller and Auditor General of India for examination. However, the cost incurred in sale of an enterprise is not made public. It has been informally ascertained that costs incurred on advisor's fee and other expenses on disinvesting an enterprise comes to about 2 to 3 per cent of sale value. It is suggested that details of this expenditure should also be made public for evaluation of the disinvestment process.

**Achievement of the Objectives of Disinvestment**

Success or otherwise of disinvestment process has to be reviewed from the point of view of achievement of objectives. Although the government did not come out with a precise statement about the objectives of disinvestment programme, yet one can infer from the Industrial Policy Statement 1991, and budget statements that the broad objectives sought to be achieved were fiscal, distributional and efficiency.

There can be significant conflicts between these objectives and hence the resolution of these conflicts or trade-offs can be an important determinant of the shape of individual divestment programmes. Consider, for example, the sale of a monopoly, Promotion of efficiency may require introduction of competition and/or regulatory measures to contain the firm's monopoly power. But the revenues from asset sales are likely to be higher if such steps are not taken. The search for maximum revenue may
also come into conflict with distributional goal that might be served by selling the equity at a low price.

To examine the fiscal objective of raising non-inflationary resources and reducing fiscal deficit, we look at disinvestment proceeds to see as to how far it has reduced the fiscal deficit, and internal debt. Table 6.12 reflects this.

Table 6.12 shows, the total disinvestment proceeds from 1991-92 to 2001-2002 is Rs 23,382 crore (233.82 billion), while the total fiscal deficit is about Rs 878,973 crore (8789.73 billion) in the corresponding period. This means that on an average 2.66 per cent of the fiscal deficit has been financed through divestiture. Contribution of disinvestment proceeds is almost negligible in retiring internal debt on account of market borrowings.

The distributional objective which was sought to be achieved by encouraging wider public participation has been totally ignored in the whole disinvestment process. Now, with increasing emphasis on strategic sales where a majority stake is sold to a single party, the objective of public participation is not being pursued. However, wider public participation has been followed successfully in UK, France, Japan and many other countries. Probably, it has not been done assuming that the Indian capital market is not yet vibrant to absorb big-ticket disinvestments. Also, another consideration might have been that thinly spread equity will not bring performance improvement.

To examine the efficiency objective, we examine as to how far the selection of enterprises has been made to achieve the objective of moving away from low technology, non-strategic, and inefficient areas. For this the PSEs referred to the Disinvestment Commission can be analyzed.
The Public Enterprises Survey classifies all Central PSEs in 21 industry segments. The enterprises referred to the Disinvestment Commissions belonged to 17 segments, 10 segments in manufacturing (in all 39 enterprises) and seven segments in services (in all 36 enterprises).

In individual industry segments only fertilizer, and minerals and metals enterprises were predominantly referred. There were several other enterprises, which were inefficient, loss making and had low social consideration but were not referred to the commission. The industry segments, which were not included for disinvestment, were from textiles, and financial services. Textile segment has 14 enterprises, which include 10 National Textile Corporation undertakings, and all of them are loss making. Also, amongst the referred industry segments, there are several cases where total number of enterprises is large but only a miniscule number was referred to the commission. For example in engineering segment there are 38 enterprises but only five were referred. Similarly in chemicals and pharmaceuticals there are 21 enterprises but only six were referred, consumer goods has 18 enterprises but only five were referred, and in trading and marketing services there are 18 enterprises but only seven were referred. Therefore, the objective of moving away from non-strategic area was not reflected fully in referring enterprises to the commission.

Thus, whereas fiscal objective has been met to a limited extent, the distributional objective is not at all being pursued. Regarding efficiency objective, it was found that the objective of moving away from low technology, non-strategic, and inefficient areas was not fully reflected in the enterprises being referred for disinvestment.
Table 6.11 shows a clear picture of the fiscal situation for the central government in 1980s. As it can be seen from the table 6.10, the fiscal deficit of the government which was around 8% of GDP from 1985 to 1986 onwards as compared with 6% at the beginning of 1980s and 4% in the mid 1970s. The steady growth of government’s non-panned expenditure has been the main reason for the fiscal crises. The disinvestment proceeds as shown in table 6.11 help the government to contribute to the exchequer and to reduce the fiscal deficit but to a limited extent.
Table 6.10

Fiscal Deficit of Central Government

1975-76 to 1990-91

(Percent of GDP)

<table>
<thead>
<tr>
<th>Year</th>
<th>Fiscal Deficit</th>
<th>Budget Deficit</th>
<th>Primary Deficit</th>
<th>Revenue Deficit</th>
<th>Monetised Deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975-76</td>
<td>4.1</td>
<td>0.5</td>
<td>2.5</td>
<td>1.1</td>
<td>0.0</td>
</tr>
<tr>
<td>1980-81</td>
<td>6.2</td>
<td>1.8</td>
<td>4.3</td>
<td>1.5</td>
<td>2.6</td>
</tr>
<tr>
<td>1981-82</td>
<td>5.4</td>
<td>0.9</td>
<td>3.4</td>
<td>0.2</td>
<td>2.0</td>
</tr>
<tr>
<td>1982-83</td>
<td>6.0</td>
<td>0.9</td>
<td>3.8</td>
<td>0.7</td>
<td>1.9</td>
</tr>
<tr>
<td>1983-84</td>
<td>6.3</td>
<td>0.7</td>
<td>4.0</td>
<td>1.2</td>
<td>1.9</td>
</tr>
<tr>
<td>1984-85</td>
<td>7.5</td>
<td>1.6</td>
<td>5.0</td>
<td>1.8</td>
<td>2.6</td>
</tr>
<tr>
<td>1985-86</td>
<td>8.3</td>
<td>2.0</td>
<td>5.5</td>
<td>2.2</td>
<td>2.4</td>
</tr>
<tr>
<td>1986-87</td>
<td>9.0</td>
<td>2.8</td>
<td>5.8</td>
<td>2.7</td>
<td>2.4</td>
</tr>
<tr>
<td>1987-88</td>
<td>8.1</td>
<td>1.7</td>
<td>4.7</td>
<td>2.7</td>
<td>2.0</td>
</tr>
<tr>
<td>1988-89</td>
<td>7.8</td>
<td>1.4</td>
<td>4.2</td>
<td>2.7</td>
<td>1.6</td>
</tr>
<tr>
<td>1989-90</td>
<td>7.8</td>
<td>2.3</td>
<td>3.9</td>
<td>2.6</td>
<td>3.1</td>
</tr>
<tr>
<td>1990-91</td>
<td>8.4</td>
<td>2.1</td>
<td>4.4</td>
<td>3.5</td>
<td>2.8</td>
</tr>
</tbody>
</table>


Source: Sudhir Naib, Disinvestment in India Policies, Procedures, Practices – Sage Publications, Pg. 212
Table 6.11

Financing the Fiscal Deficit through Disinvestment

<table>
<thead>
<tr>
<th>The Modalities</th>
<th>Proceeds (Rs. Cr.)</th>
<th>Implications</th>
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</thead>
<tbody>
<tr>
<td>IOC buys GOI's 10% stake in ONGC</td>
<td>2,600</td>
<td>Will affect refinery modernization</td>
</tr>
<tr>
<td>GOI sells 5% stake in IOC</td>
<td>800</td>
<td>Money will not come to IOC</td>
</tr>
<tr>
<td>ONGC buys GOI's 10% stake in IOC</td>
<td>1,600</td>
<td>Will affect its E&amp;P activity</td>
</tr>
<tr>
<td>MTNL buys back 3-4% equity</td>
<td>500</td>
<td>Erode its global image</td>
</tr>
<tr>
<td>VSNL's GDR issue to disinvest 10%</td>
<td>1,050</td>
<td>Will help finance future buy-back</td>
</tr>
<tr>
<td>GOI sells 10% stake in GAIL</td>
<td>700</td>
<td>Won't help GAIL's investment plans</td>
</tr>
<tr>
<td>ONGC buys GOI's 5% stake in GAIL</td>
<td>350</td>
<td>Will not gain from cross holding</td>
</tr>
<tr>
<td>IOC buys GOI's 5% stake in GAIL</td>
<td>350</td>
<td>Will not gain from cross holding</td>
</tr>
<tr>
<td>NALCO converts 50% of its equity into debt</td>
<td>561</td>
<td>Will reduce its bloated equity</td>
</tr>
</tbody>
</table>

BT estimates of proposals likely to materialize by March 31, 1999
### Table 6.12
The Budget and Disinvestment Proceeds

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Disinvestment target</td>
<td>2,500</td>
<td>4,000</td>
<td>3,500</td>
<td>7,000</td>
<td>5,000</td>
<td>4,800</td>
<td>5,000</td>
<td>10,000</td>
<td>12,000</td>
<td>12,000</td>
<td></td>
</tr>
<tr>
<td>Amount realized</td>
<td>3,038</td>
<td>1913</td>
<td>4843</td>
<td>362</td>
<td>902</td>
<td>5371</td>
<td>1573</td>
<td>1869</td>
<td>3131</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Percentage of Amount realized</td>
<td>121.52</td>
<td>54.66</td>
<td>0</td>
<td>121.07</td>
<td>5.17</td>
<td>18.79</td>
<td>107.42</td>
<td>15.73</td>
<td>15.73</td>
<td>26.09</td>
<td></td>
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<tr>
<td>fiscal deficit</td>
<td>36,323</td>
<td>40,173</td>
<td>60,257</td>
<td>57,704</td>
<td>60,243</td>
<td>88,937</td>
<td>1,13,349</td>
<td>104,717*</td>
<td>118,816</td>
<td>131,721</td>
<td></td>
</tr>
<tr>
<td>Disinvestment amount as</td>
<td>8.36</td>
<td>0.06</td>
<td>8.39</td>
<td>0.06</td>
<td>0.57</td>
<td>1.01</td>
<td>4.74</td>
<td>1.50</td>
<td>1.57</td>
<td>2.38</td>
<td></td>
</tr>
<tr>
<td>percentage of fiscal deficit</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internal debt</td>
<td>172,750</td>
<td>199,100</td>
<td>245,712</td>
<td>266,467</td>
<td>307,869</td>
<td>384,476</td>
<td>459,696</td>
<td>714,254</td>
<td>803,698</td>
<td>909,252</td>
<td></td>
</tr>
<tr>
<td>Disinvestment amount as</td>
<td>1.76</td>
<td>0.96</td>
<td>0</td>
<td>1.82</td>
<td>0.11</td>
<td>0.11</td>
<td>0.23</td>
<td>0.22</td>
<td>0.23</td>
<td>0.34</td>
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<td>percentage of internal debt</td>
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**Note:** *Fiscal deficit from 1999-2000 onwards is based on changed system of accounting made in the budget for 1999-2000. According to this, loans to states against state’s share in the small savings collections are to be made from the especially created ‘National Small Savings Fund’ under the Public Account

**Source:** Economic Survey—Various issues
Fiscal Impact of Disinvestment

If we assume that a public enterprise is sold to a private buyer at a fair market price, then such a price will be equal to the present value of the discounted stream of after-tax net earnings of the enterprise. Assuming that this stream is positive in all future years, all other things being equal, this will amount to smaller overall fiscal deficit at the time of the sale. But the counterpart to this initially smaller deficit will be larger deficits in all-future years, reflecting the loss of revenue in the form of remitted profit. However, if the discount rate embodied in the sale price correctly reflects financial opportunity costs, these larger future deficits would be exactly offset if the government used the sale proceeds to purchase other financial assets or to retire an equivalent amount of outstanding debt. In such circumstances, the government and the private sector are simply exchanging financial assets and liabilities, and this should not affect the demand for real resources at the time of sale, or in the future. Fiscal stance is therefore permanently unaffected by the asset sale.

However, if the government uses the sale proceeds to finance a temporary increase in current expenditure or a temporary reduction in taxation (or both), the deficit in the year of the sale would be unaffected while future deficits will be larger. Therefore, it is important to know how the proceeds of disinvestment are used, i.e., whether they are used to retire debt or to increase current expenditure.

It has been argued in favour of privatisation that if the realization from strategic sales is put in bank at 10 per cent interest, the government would earn much more than the dividend it is getting now. Further as the average cost of borrowing of the government is more than 10 per cent, the benefit of privatization is real. However, the validity of these arguments lies in investing the proceeds in an activity, which either yields higher returns than the present dividends
or retires the outstanding debts. If the proceeds are used for wasteful expenditure, then this argument is not valid. Further one has to see the purpose for which the borrowed funds are used. If the borrowings are resorted for current consumption expenditure then such borrowings are undesirable.

One of the major recommendations of the Disinvestment Commission was to establish a separate Disinvestment Fund in which all proceeds of disinvestment would be placed. The government has argued that all monies in the budget are fungible and it matters little whether the proceeds are merged with capital receipts and used to reduce fiscal deficit or to retire debt or reduce borrowing. However, there is merit in the case for a separate Disinvestment Fund.

The classification of deficits into various kinds is useful for bringing out both the fungibility of resources and for identifying areas of weaknesses in the budget. The budgetary deficit indicates the excess of total expenditure over total receipts. The revenue deficit, which indicates the excess of revenue expenditure over revenue receipts, highlights the need to bring down expenditure and broaden the tax net to augment revenue income. The fiscal deficit broadly indicates the extent of government borrowings from all sources necessary to balance budget and encompasses the revenue deficit. The primary deficit is fiscal deficit less interest payments. Thus, the various kinds of deficits indicate different aspects of budgetary imbalance. Therefore, undifferentiated use of disinvestment proceeds to reduce the fiscal deficit will only obfuscate the need to focus attention on balancing the revenue budget. As disinvestment proceeds arise from a one-time sale of government shares in PSEs, while the revenue deficits and fiscal deficits can be recurring and even increasing on a long-term basis, it is important to ensure that these proceeds are not used for current consumption
expenditure. Therefore, the proceeds of disinvestment should be placed separately and not be fungible with other government receipts. Arun Shourie in a suo moto statement made in both houses of Parliament on 9 December 2002, announced that the government would set up a Disinvestment Proceeds Fund to provide visibility to the utilisation of disinvestment proceeds for social and infrastructure sectors. This fund will be used for financing fresh employment opportunities, investments and for retirement of public debt.
Valuation of Shares

The initial disinvestment in 1991-92 came in for heavy criticism for under pricing of shares. The Comptroller and Auditor General of India in its report (No. 14 of 1993) relating to 'Disinvestment of Government Shareholding in selected Public Sector Enterprises during 1991-92' brought out the shortcomings in the process of disinvestment in 1991-92. Briefly the shortcomings were in formulating guidelines for valuation of shares, incorrect method of 'bundling', haste in accepting uncompetitive bids, re-fixation of reserve prices to accommodate those bids, and failure to incorporate 'claw-back' provision. For examining the extent of under-pricing of PSE shares in India, it would be useful to look into the experience of UK in this respect. UK is being taken as a reference point because it is a pioneer in disinvestment. Two methods were used to sell PSE shares. First, 'offer for sale' involved inviting applications from the general public for shares at a set price. The second method was to sell shares by a tender offer by inviting bids above a given minimum tender price. If the offer was over-subscribed, then the shares were sold to the highest bidder. The excess demand was thus rationed by a price mechanism. If a tender offer was under-subscribed the bidder's demands were satisfied at the minimum tender price and the underwriters were made to take up the remaining shares at the minimum tender price.

In India, a variant of tender offer method was used in initial years of disinvestment. In 1991-92, shares were sold in bundles, which buyers could un-bundle after about three to six months. In subsequent years individual PSE shares were auctioned by tender process. However, no underwriters were appointed and as such there was no method of getting the targeted revenue in the event of under-subscription. Moreover, bids were initially restricted to a few buyers and only later this was relaxed.
However, the current prices quotations of these PSEs are not strictly comparable with the average prices at which their shares were divested as equities of BPCL, HPCL and some other PSEs were diluted since the divestment process first started. Also, NALCO had capital restructuring during 1998-99 when its capital was reduced by 50 per cent.

It is to be noted that the price at which share can be sold is determined more by investor perception then any mechanical measure of intrinsic worth. Another important point that needs to be noted is that whenever there is a large scale sale of shares, the prices realized will be lower as large investors like UTI have to keep large sums locked up for a prolonged period, before offloading the same in the capital market.

From 1999-2000, strategic sales are being undertaken. This raises the issue of valuation of enterprises.

**Valuation of Enterprises**

Common sense says that in any sale process, the sale will materialize only when the seller is satisfied that the price given by the buyer is not less than the value of the object being sold. Therefore, determination of that threshold amount, which the seller considers adequate is the first pre-requisite for conducting any sale. This threshold amount is called 'reserve price'. Reserve, price in case of sale of a firm is determined by carrying out valuation of the firm. In firms, which are listed on the stock exchanges, market price of the shares is a good indicator of the value of the firm. However, most of the PSEs are either not listed on the stock exchanges or their shares are highly undervalued. Therefore, deciding the worth of a PSE is indeed a challenging task.
Generally four methodologies are used for valuation of firms: Discounted Cash Flow, Balance Sheet Method, Transaction Multiple Method, and Asset Valuation Method. While the first three are business valuation methodologies generally used for valuation of a going concern, the last methodology would be relevant for valuation of assets in case of liquidation of a firm. However, it may be mentioned that these methods aim to provide an approximate objective measure of what is essentially a subjective exercise. Each method relies heavily upon accounting data and may therefore be influenced by the techniques used in preparing accounts. Valuation of assets such as land and buildings poses particular difficulties.

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 DCF methodology is the most appropriate methodology when the business is being transferred/acquired on a going concern basis.

In DCF method, while computing the cash flows, cash out flows for renovation and modernization of plant and machinery need to be discounted for arriving at realistic figures. Since non-core assets are not reflected in the cash flows, the non-core assets need to be separately valued by the asset valuation method and added to the valuation figure arrived at by the DCF method. In a strategic sale the bidders take into account not only DCF valuation, but also a premium for management control. These premiums would be a subjective item for each bidder and will be reflected in the competitive bids. In this case, value is the synergistic benefits a strategic buyer perceives.
**Employees' Issues in Disinvestment**

Kaur (2002) analyzed the rate of growth of employment in public sector and private sector in the post-reform period. It was found that the rate of growth of employment in public sector has been lower than that for the private sector in the post reform period, viz., 1991-2000. An analysis of level of employment in PSEs reveals that there has been a uniform decline in growth rate of employment among all PSEs during the post reform period. As a result, the share of employment in disinvested PSEs and non-disinvested PSEs to total PSEs has remained more or less constant. Thus, even though the absolute number of people employed in disinvested PSEs was declining, it may have been due to the overall reforms process rather than due to disinvestment. Decline in absolute employment during this period was more a result of changes in macro policy regime than of disinvestment per se.

As far as workers are concerned, initial apprehensions regarding employment after disinvestment are justified. A general fear among the employees at the time of disinvestment is that they may be retrenched or their pay scales and service conditions may be adversely affected. Global experience shows that if the privatized companies grow rapidly, labour re-structuring may not be required. A number of protections are available to the employees under various labour laws. These labour laws are applicable to the company irrespective of whether it is in the public sector or in the private sector. Besides this, employee protection can be ensured by incorporating suitable clauses in the shareholders' agreement.
Review of The Implementation of Disinvestment Policy

Since disinvestment of equity in Central PSEs was started from 1991-92 onwards, the government till 31 March 2003 realized about Rs 26,640 crore (266.4 billion) from divestiture in 45 enterprises. The overall pattern of disinvestment suggests that divestiture was marginal to begin with. Out of the 45 enterprises, seven have been divested below 2 per cent. It is of interest to note that out of these 45 enterprises, 16 enterprises were not referred to the Disinvestment Commission.

Strategic sale with transfer of management has been effected in ten enterprises till March 2003, viz., Modern Food Industries Ltd (MFIL), BALCO, CMC, HTL, IBP, VSNL, Paradeep Phosphates Ltd, HZL, IPCL and Maruti Udyog Ltd. In addition, 18 properties of ITDC have been sold and one given on long-term lease cum management contract. Other than this, Lagan Jute Machinery Company Ltd (LJMC), and Jessop & Co. Ltd, both subsidiaries of Bharat Bhari Udyog Nigam Ltd and three properties of Hotel Corporation of India (Hotel Airport Mumbai, Hotel Juhu Mumbai and Hotel Rajgir) have also been privatized.

The government used various modalities of disinvestment ranging from bundling and bidding followed by tendering and global depository receipts for disinvestment. Modality adopted in disinvestment of Maruti Udyog Ltd. to Suzuki, was unique. The government obtained hefty control premium from Suzuki and agreement to underwrite the subsequent two public offerings of its share of equity before complete exit from Maruti by 30 April 2004. Over a period of time, bidders have also been enlarged. Initially only insurance companies, mutual funds and banks were allowed. Later private parties and foreign institutional investors were allowed from March/April 1994. Nonresident Indians and overseas corporate bodies were also permitted from October 1994 round.
Later foreign markets were tapped through GDR route. Now Indian firms are increasingly being inducted as strategic partners with management control.

Certain modalities followed to get disinvestment proceeds are questionable. For example the modalities of cross holding amongst the oil enterprises inter se adopted in 1998-99 and 1999-2000 is not an actual disinvestment methodology. This in fact has locked up the funds of enterprises involved in cross holding. Further, expanding the domain of big public sector enterprises (IOC and BPCL) by their taking over smaller oil PSEs is again not actual disinvestment. Withdrawal of reserves from PSEs before disinvestment and reflecting it as disinvestment proceeds is also open to discussion.

The public sector employment has come down during the post-reform period due to economic pressures. There has been a uniform decline in growth rate of employment among all SOEs during this period. Therefore, the fear that disinvestment would severely undermine employment is largely exaggerated.

The objectives of disinvestment have not been precisely stated. However, based on budget statement and industrial policy statement, it can be inferred that broadly the objectives sought to be achieved are fiscal discipline and improvement in efficiency. Although, encouraging wider public participation in the disinvestment programme was initially an objective, it was dropped later and the strategic sale route was followed.
The disinvestment process has undergone a major shift in policy since it began in 1991-92. The government has gradually moved from partial divestiture to privatization. This gradual approach prepared political parties and public for accepting major divestiture later. It was probably a right move as in presence of contending political forces, the alternative to the compromise of partial divestiture could have been no divestiture. The current declared policy is that the government is prepared to reduce its stake in the non-strategic PSEs to even below 26 per cent if necessary. However, rationale of retaining minor share holding in a non-strategic PSE is debatable, as it does not serve much purpose.

By following the strategic sale route higher realization has been achieved, but the public has been excluded from the process. Whether this yield of higher return in the short run will benefit the public in the long run is debatable. It is being suggested that in the profitable enterprises equity should be offered to the public and also the employees. This will give the disinvestment process better acceptability and provide opportunity to people in sharing wealth. For this, the controlling majority share should be given to a core investor and the remaining equity should be offered to the public and the employees of the enterprise. This increases the chances of turning over the firm to a good owner and of enhancing shareholders' wealth. However, adequate institutional framework which inter alia includes rules to protect minority shareholding should be put in place.
The rationale of retaining minority stake in non-strategic enterprises is also debatable. The government can realize better price while undertaking 100 per cent sale and no useful purpose is served by retaining a minority holding in a non-strategic sector. The interest of workers can be safeguarded through shareholder agreement even in a 100 per cent sale.

Although there is a three-tier mechanism for decision-making and implementation of disinvestment, viz., Cabinet Committee on Disinvestment, Core Group of Secretaries on Disinvestment and Inter-Ministerial Group, yet the basis of selection of an enterprise for disinvestment is still not clear. There is a need to institutionalize a system to recommend list of enterprises to be disinvested. It is tempting to sell the best-run enterprises first, because they are seen to be the easiest to find buyers for. Economically, however, these enterprises are a lower priority because the potential gains are smaller where the enterprises are already relatively well managed. Conversely, the greatest potential economic gains come from divesting the worst run enterprises. Here the problem is to find a buyer, and price is of secondary importance. The opportunity cost of not selling is high, because the potential gains from changes in performance are substantial. Particular large gains are also possible in industries where public autonomy constraints are especially damaging. Accordingly, enterprises in fast-changing environment and requiring heavy marketing efforts are likely to benefit highly from divestiture. The sale of VSNL and some ITDC hotels is a step in this direction. The other potential candidates in this category can be MTNL, Central Cottage Industries, Handicrafts & Handlooms Exports Corporation, Spices Trading Corporation, MMTC, STC, Tea Trading Corporation, etc.
In almost all-strategic sales, the government has obtained higher value than the 'reserve price', and even thereafter the price of PSE shares have gone up considerably in capital market. This calls for some mechanism in the Ministry to independently evaluate the valuations made by the advisors. For this, a core technical cell managed by professionals should be constituted in the Ministry of Disinvestment. Further, the possibility of reinvesting funds of the privatized PSE should be factored in the reserve price, if this is already not being done. Another issue, which merits consideration, is whether the new owner should be bound to continue in the same business. If this restriction goes, the government can get better realization particularly of hotel properties.

The government has argued that if the divestiture realization is put in a bank at 10 per cent interest, the government would earn much more than the dividend it is getting now. This argument is valid if the government uses the sale proceeds to either purchase other financial assets or retire an equivalent amount of outstanding debt. However, if the government uses the sale proceeds to finance either current expenditure or reduction in taxation (or both), the future deficits will be larger. It is therefore important how the proceeds of disinvestment are used. There is a case for a separate Disinvestment Fund as proposed by the first Disinvestment Commission, in which all the proceeds of divestiture can be placed. This will avoid undifferentiated use of disinvestment proceeds, and take care of the criticism that the proceeds are simply providing government with more funds to meet the fiscal deficit and internal debt requirement rather than generating income.