In the budget of 1999-2000, the policy regarding disinvestment was to privatize non-strategic PSEs through gradual disinvestment or strategic sale. For the first time the word “Privatization” was used instead of disinvestment. Whereas earlier only partial disinvestment was being undertaken by the government.

Till March 2003 ten PSEs have been privatized resulting in transfer of management control to strategic partner.

It is desirable to take up those PSUs for study, in which more than 50% disinvestment has taken place. Such of the few selected PSUs are:

- Bharat Aluminium Company Ltd. (BALCO)
- Modern Food Industries (India) Ltd. (MFIL)
- Maruti Udyog Ltd. (MUL)
- Hindustan Petroleum Company Ltd. (HPCL)
- Bharat Petroleum Company Ltd. (BPCL)

The case study of these privatized enterprises is covered in this chapter.

Since the beginning of disinvestment process as from end 1991 to Dec. 1999, about Rs. 18,290 crore (182.9 bn) was raised by selling small portion of government equity in 39 enterprises. This only resulted in government raising revenue without bringing any change in management. During its second stint (1999 to 2004) the BJP led NDA government gave a big
momentum to the disinvestment process. Finance minister Yashwant Sinha stated the decision of reducing government stake in non-strategic PSEs to 26%. He also doubled the budgeted targets of disinvestments. The department undertook the first strategic sale of the government owned bakery (Modern Food Industries Ltd.) with a transfer of management control to an Indian multinational- Hindustan Lever Ltd. (HLL). This was really the first –ever total privatization of a central PSE. 14 more PSEs were disinvested through the strategic sale route in the following three years from 2000-2001 to 2002-2003. The strategic sale route hit road block in 2003-2004 when the Minister for Petroleum objected to strategic sale of a couple of oil PSEs, HPCL and BPCL, proposed by the Ministry of Disinvestment. After a prolonged battle within the NDA, a compromise was struck by agreeing to the modality of Initial Public Offer (IPO) of equity in the case of six PSEs. This yielded Rs.141 billion on compared to the budgeted figure of Rs.132 billions.

BALCO’s disinvestment case is another case selected for study because BALCO’s case is a landmark decision that has laid to rest many issues regarding disinvestment, as the case was challenged in the Supreme Court by the employees union of the company. The issues before the court were:

1. Whether the decision of disinvestment is amenable to judicial review by the High Court/Supreme Court?
2. Whether the employees have a locus standi in such matters?
3. Whether it is fit case for Public Interest Litigation (PIL)?
BALCO is a non-core group industry of which 51% equity sold to the strategic partner, Sterlite Industries Ltd. in March 2001.

In other cases of disinvestment, the strategic partner did not have any control before acquiring government equity but in the case of Maruti Udyog Ltd. (MUL), even before disinvestment the share of government was 49.74% and that of Suzuki 50%. MUL was already a privatized company in which disinvestment took place through rights issue in favour of Suzuki Motor Company (SMC). This was due to Suzuki was the technology suppliers. Therefore at the time of disinvestment the government had a minority holding in relation to Suzuki.

MUL is the first enterprise where government has decided to quit completely by March 2004.
Case I: Bharat Aluminium Company Ltd. (BALCO)

BALCO is a fully integrated aluminium producing company, having its own captive mines, an alumina refinery, an aluminium smelter, a captive power plant, and down-stream fabrication facilities. It was set up in 1965 and its main plant and facilities are situated in Korba (Chhattisgarh). It also has a fabrication unit in Bidhanbagh (West Bengal). The refining capacity of BALCO is 2 lakh tonnes per year and its smelting capacity is 1 lakh tonnes per year. BALCO had 6,436 employees at the time of privatisation.

BALCO has certain constraints, e.g., it has a small sized smelter and has high power costs due to old technology resulting in high employee cost and lower operating margins. Its production cost and employee cost to sales ratio is higher than both NALCO and HINDALCO.

The government had 100 per cent stake in BALCO prior to disinvestment. In 1997, the Disinvestment Commission classified BALCO as non-core for the purpose of disinvestment and recommended immediate divestment of 40 per cent of the government stake to a strategic partner, and further reduction to 26 per cent within two years of the strategic sale, through a domestic public offering. It further recommended divestment of the entire remaining stake at an appropriate time thereafter. The Cabinet accepted the recommendation of the Disinvestment Commission for divestment of 40 per cent stake through a strategic sale and further divestment through the capital market. Later, in 1998, the Disinvestment...
Commission revised its recommendation and advised the government to consider 51 per cent divestment in favour of a strategic buyer along with transfer of management which was accepted by the Cabinet. The government thereupon appointed M/s Jardine Fleming as advisor to assist in the sale of its 51 per cent stake in BALCO to a strategic buyer.

As BALCO had a bloated equity of Rs 489 crore (4.89 billion) and large unutilized free reserves of Rs. 424 crore (4.24 billion), it was suggested by the Ministry of Mines that BALCO's equity be reduced by 50 per cent prior to disinvestment, using its substantial cash surplus. This proposal was accepted. As a result, the government received Rs 244 crore (2.44 billion) from the capital restructuring of BALCO, and another Rs 31 crore (310 million) as tax on this amount, in March 2000 prior to disinvestment.

**Pre-Disinvestment Scenario**

Financial results of BALCO from 1997-98 to 1999-2000 prior to disinvestment are given in Table 7.1

The strategic sale process for BALCO started in late 1997, and finally came to an end in March 2001. The 51 per cent stake was sold to Sterlite Industries, the highest bidder, and fetched the government Rs 551.50 crore (5.51 billion). The price received was higher than the values indicated by the various methods of valuation used.
Table 7.1

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>848.51</td>
<td>870.90</td>
<td>896.64</td>
</tr>
<tr>
<td>Other income</td>
<td>48.10</td>
<td>68.84</td>
<td>70.08</td>
</tr>
<tr>
<td>Total income (1 + 2)</td>
<td>896.61</td>
<td>939.80</td>
<td>966.72</td>
</tr>
<tr>
<td>Total expenditure</td>
<td>714.08</td>
<td>758.24</td>
<td>806.28</td>
</tr>
<tr>
<td>Profit before depreciation, interest and taxes (PBDIT)</td>
<td>182.53</td>
<td>181.56</td>
<td>160.44</td>
</tr>
<tr>
<td>Profit before interest and taxes (PBIT)</td>
<td>141.53</td>
<td>140.64</td>
<td>122.01</td>
</tr>
<tr>
<td>Profit before tax (PBT)</td>
<td>134.87</td>
<td>134.34</td>
<td>116.19</td>
</tr>
<tr>
<td>Profit after tax (PAT)</td>
<td>79.84</td>
<td>76.32</td>
<td>55.89</td>
</tr>
<tr>
<td>Dividend</td>
<td>20.00</td>
<td>23.00</td>
<td>18.00</td>
</tr>
</tbody>
</table>


Source: Sudhir Naib, *Disinvestment In India Policies, Policies, Procedures, Practices*, Sage Publications, Pg. 392
The valuation of the company for 100 per cent equity done by various methods is given in Table 7.2

**Table 7.2**

**BALCO: Valuation under Different Methods**

<table>
<thead>
<tr>
<th>Valuation Method</th>
<th>Value (in Rs crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discounted cash flow (DCF) (computes likely earnings in coming years)</td>
<td>651.2 to 994.7</td>
</tr>
<tr>
<td>Comparables (looks at peer group companies)</td>
<td>587.0 to 909.0</td>
</tr>
<tr>
<td>Balance sheet method (looks at net worth from balance sheet)</td>
<td>597.2 to 681.9</td>
</tr>
<tr>
<td>Asset valuation (replacement cost/sale value of assets)</td>
<td>1054.9 to 1072.2</td>
</tr>
</tbody>
</table>

_Source: Ministry of Disinvestment, Government of India._

The sale price of Rs 5 51.50 crore (5.51 billion) for 51 per cent share of BALCO’s equity corresponds to Rs 1081.40 crore (10.81 billion) for 100 per cent equity. In all, the government recovered Rs 826.50 crores (551.5+244+31) from this transaction.

_Source: Sudhir Naib, Disinvestment In India Policies, Policies, Procedures, Practices, Sage Publications, Pg. 390_
Post-Disinvestment Scenario

Although the shareholders agreement with the strategic buyer provided for adequate protection to all levels of employees with regard to their job safety and severance packages, yet employees went on strike from 3 March 2001. This was the first case where a profitable PSE with large work force was being privatized. Writ petitions were filed in Delhi and Chhattisgarh High Courts. The state government also challenged the BALCO sale. These petitions were transferred to Supreme Court. However, after 67 days, the workers resumed work from 9 May 2001.

The strike was resorted to partly out of fear that the management will retrench work force to reduce the employee cost-to-turnover ratio, which is higher than HINDALCO and NALCO. Following the strike, BALCO’s production halved and it had to spend an extra Rs 180 crore (1.8 billion) over the next six months to return to 95 per cent production.

Wages in BALCO had not increased after April 1999, even though a revision was due. In spite of loss due to the strike, an ex. gratia payment of Rs. 5,000 was paid to all employees and a long term wage agreement for a period of five years has been entered into by the management with the employees in October 2001, which workers say is the best till date. This agreement guarantees benefit of 20 per cent of basic pay to each employee.

In December 2001, the Supreme Court upheld the disinvestment of 51 per cent equity of BALCO in favour of Sterlite Industries for Rs 551.50 crore (5.51 billion), stating that the correctness of the government’s disinvestment policy could not be gone into by the court. The court observed that it is neither within the domain of courts nor the scope of the judicial review to embark upon an enquiry as to whether a particular public policy is wise or whether better public policy can be evolved. The
court ruled that wisdom and advisability of economic policies are ordinarily not amenable to judicial review unless it can be demonstrated that the policy is contrary to any statutory provision or the constitution. Further, the court held that the allegations of lack of transparency or that the decision was taken in a hurry or there had been an arbitrary exercise of power were without any basis. The court emphasized that valuation is a question of fact and it will not interfere in this matter unless the methodology adopted is arbitrary. The Supreme Court criticized the Chhattisgarh government for making baseless allegations against the Union government in the case.

There is a change in the attitude of workers now. Employees are currently working 365 days a year without overtime to achieve 100 per cent output. The general secretary of the BALCO Mazdoor Union, who led the strike, has stated that the strike was a terrible mistake as ever, idle employees are being paid and the company pay package is best in the last three decades. (Outlook, 25 March 2002). However, whereas the management has focused on improving its relationship with workers at plant level, at the same time it has not refrained from en mass transfer of employees (other than plant workers) from metros (The Times of India, 3 April 2002). This will hit this category of employees who so far had a good time in serving at metro cities.

As the management has already appeased the workers at plant, the employees positioned in metros have little choice. This is one fall out of disinvestment that employees who had comfortable place of posting other than the plant, can be forced to move out on transfer. It is not that the company did not have the power to transfer employees earlier but in a public ownership pressures could have been brought to stall such transfers.
The new management is planning a major modernization to increase output to 4 lakh tonnes from the current 1,30 lakh tonnes per year. Thus, the investment constraint has been removed as new owners are putting in money for modernization. Efforts to increase sale both in domestic as well as foreign markets are also being made.

To cut costs, the head office was shifted from Delhi to the plant site at Korba, which resulted in redundancies. The loss-making unit in Bidhanbag (West Bengal) has been closed. Contract labour is also only one half of the level earlier. At the time of privatization, BALCO had 6,436 employees. The present strength is 5011. Thus there has been a net reduction of 1,425 in its work force.
Case II:

Modern Food Industries (India) Ltd. (MFIL)

In February 2000, as part of its disinvestment programme, the Government of India (GOI) sold Modern Food Industries (India) Limited (MFIL) to Hindustan Lever Limited (HLL) for Rs.1.05 bn. This was hailed as a major step in the GOI's disinvestment plan. However, some analysts questioned the GOI’s decision to sell MFIL a company with 14 production units spread across the country and almost 0.5 million square meters of land - for just Rs.1.05 bn.

In 2000-01, employees at MFIL accused HLL of trying to shut down some manufacturing units by retrenching more than half of the 2,000 workforces a relying on third parties to meet production needs. By December 2000, 10 month after HLL took over MFIL, its accumulated losses went up to Rs.470.40 mn as again; its networth of Rs.330.1 bn. Subsequently, under the Sick Industries Act (SICA), MFIL was referred to the Board of Industrial and Financial Reconstruction (BIFR)

In 2001, HLL announced that MFIL would be able to make a cash profit in two years. It announced a turnaround strategy, which involved improving the quality of the product and the raw materials (refined flour), improving the manufacturing process controls, and modernizing the plant and machinery. Existing distributors would be trained and new ones identified. HLL was also looking for new outlets that could sell bread. To implement this strategy, HLL invested Rs.80-90 mn in MFIL.
Background Note

Modern Bakeries (India) Limited, incorporated in October 1965, was renamed Modern Food Industries (India) Limited (MFIL) on 11th November 1982. The company had 14 bakery units located in 13 cities and six other units at other places. Its products were bread, oil, flour, fruit pulp, fruit juice drinks, beverage concentrates and energy food. In the early 1990s, the bakery units accounted for 8 percent of the turnover of MFIL.

In the early 1990s, due to labour trouble, decline in market demand and the closure of a plant, capacity utilization remained low, between 19 percent and 30 percent at the Ranchi unit, between 31 percent and 53 percent in the Kolkata unit, and below 50 percent in the Jaipur, Kanpur and Delhi-11 units. Consequently, many bakery units were running at a loss.

MFIL fixed a norm of 0.50 percent of total production as defective production. In addition, a norm of 0.50 percent for bread returned from the market was also allowed. However, the percentage of defective production and return of unsold, damaged and defective bread exceeded the norms.

Up to 1993-94, the cumulative losses of MFIL's Roller Flour Mill, Fruit Juice Bottling I Plant, Fruit Pulp Processing Plant and Oil Plant were Rs.11.85 mn, Rs.64.4 mn, Rs.32.40 mn and Rs.81,94 mn respectively. In 1997, MFIL was referred to the Disinvestment Commission. In February 1997, the Commission recommended 100% sale of the company. While making this recommendation, the
Disinvestment Commission identified some of MFIL's weaknesses: under-utilization of the production facilities, large workforce, low productivity and limited flexibility in decision-making. In September 1997, the government approved 50 percent disinvestment to a strategic partner through competitive global bidding. In October 1998, ANZ Investment Bank was appointed as the Global Adviser for assisting in the disinvestment. In January 1999, the GOI decided to divest up to 74 percent of its stake in MFIL. An advertisement inviting Expression of Interest from the prospective Strategic Partners was issued in April 1999.

Ten parties responded to the advertisement. Of these, only four conducted a due diligence of the company, which included visits to the Data Room, interaction with the management of MFIL, and site visits. After conducting a due diligence, only two parties remained in the field, and on the last day (October 15, 1999) only HLL submitted a bid.

In January 2000, the cabinet committee on disinvestment approved HLL's bid for buying out a 74 percent government stake in MFIL for Rs. 0.05 bn. As per the agreement signed with the government, HLL would have five Directors on the Board of MFIL, while the government would nominate two people to the Board, including the chairmen. The agreement restricted the retrenchment of employees within a year of the buyout. HLL was, however, free to implement a VRS after that period. The government also had the option to sell its remaining holdings to HLL after the completion the first year and up to the end of the third year of the shareholders' agreement.
The acquisition of Modern Foods provided HLL controls over 14 bread-manufacturing units and a distribution network with 22 franchise units. HLL officials said that the vast distribution network of MFIL would help the company growth in the high-end of the foods business. HLL, which sold branded wheat, fell that it could generate synergies in procurement. This would be critical to success in a low margin, high volume business.

Analysts felt that private-sector interest in MFIL disinvestment could herald a radical change in the Indian market for breads. In the early 1990s, Indian companies were not interested in major investments in the bakery segment, especially breads because of the relatively low margins. MFIL used its status as a government company to procure wheat at subsidized rates. As a result, it could produce and distribute at prices which competitors would not be able to match. The quasi monopoly status bestowed by this cost advantage would vanish after privatization, making investments in the sector more attractive for others.
Pre-Disinvestment Scenario

Results of MFIL from 1995-96 to 1999-2000 in respect of sales and profitability are tabulated in Table 7.3

<table>
<thead>
<tr>
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<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Sales — Bread</td>
<td>95.0</td>
<td>104.0</td>
<td>103.5</td>
<td>89.0</td>
<td>78.0</td>
</tr>
<tr>
<td>Energy food/Non-Bakery operations</td>
<td>45.2</td>
<td>62.8</td>
<td>78.0</td>
<td>71.0</td>
<td>71.0</td>
</tr>
<tr>
<td>Total</td>
<td>140.2</td>
<td>166.8</td>
<td>181.5</td>
<td>160.0</td>
<td>149.0</td>
</tr>
<tr>
<td>Net Profit/Loss</td>
<td>+11.52</td>
<td>+16.45</td>
<td>+7.65</td>
<td>-7.00</td>
<td>-48.00</td>
</tr>
</tbody>
</table>

Source: Ministry of Disinvestment, Government of India.

MFIL recorded profits from 1995-96 to 1997-98, but the same were due to allotment of wheat at subsidised rate. Once allocation of subsidised wheat was withdrawn, the performance of MFIL started declining as higher input prices could not be fully passed on to consumers. Further, there was high overheads costs, viz. Rs 1.90 per loaf vis-a-vis industry norm of Re 0.90 per loaf, and mounting arrears from state governments. As such, the performance of the company during this period of subsidised wheat allocation' reflects a growth in sales and profitability, that was essentially artificial.
Post-Sale Drama

Analysts felt that the sale of MFIL was well-timed since the company was sold, a going concern, not as a BIFR case. However, some analysts were of the opinion that the sale was undervalued. Apart from machinery at its 14 bakeries, MFIL had 19 franchises and six ancillary units scattered across the country. Some analysts felt that the real estate alone —16 acres in Delhi, 4 acres in Kanpur and 18 acres in Mumbai — would be worth over Rs.5 bn. They felt that HLL had paid for the brand and got the fixed assets for free.

The Comptroller and Auditor General of India (CAG) also criticized the government for not valuing MPIL correctly. The CAG said that the value of the plant and the machinery should have been considered, and not just dismissed as scrap. The CAG also criticized the valuer of MFTL (ANZ Grindlays Bank) for not taking into account the value of surplus land in Delhi Business Unit-I as well as the leased land of the Silchar Unit in Assam. The CAG report stated that the "government seemed to have fortuitously received a bid for a far higher amount from the single bidder compared to the value arrived at by the Global Adviser." ANZ Grindlays Bank valued a 74 percent stake in MFIL at Rs.463 mn, while HLL actually paid Rs.1.05 bn for it.

The GOI said that its decision to sell off 74 percent of its stake in MFIL to HLL ensured a cash flow higher than ANZ Grindlays Bank's valuation and prevented the company from being declared sick. ANZ Grindlays Bank had valued the entire company at Rs.785 mn only, while HLL had valued MFIL at Rs.1.65 bn. FILL made an upfront payment of Rs.1.05 bn for the 74 percent government equity in MFIL, besides agreeing to infuse Rs.200 mn for technology up gradation and
modernization. The GOI also claimed that HLL was the only bidder, which submitted a formal proposal and offered a higher sum than ANZ Grindlays Bank's valuation. Thus, the best option before the GOI was to sell majority equity to HLL and save the company from being caught in the BIFR's net.

The GOI also said that the finances of MFIL had come under serious strain: MFIL's net worth had recorded an erosion of 20 percent in 1998-99, and efforts to turn it around would have required fresh capital infusion to the tune of Rs.800 mn. In addition, when MFIL was sold to HLL, its capacity utilization was a dismal 15 percent. Capacity utilization was expected to substantially improve in the near future, with HLL planning a major brand building initiative for MFIL. Officials of the Department of Food Processing said that with a 75 percent enhancement in capacity utilization, a total of about 5,000 employees would be required as against the current strength of just 2,000. According to a senior official, "The employees have gained as they are no longer employees of a potential BIFR company, but are employees of a highly profitable group with no threat to their jobs."

In mid-2000, the officers of MFIL protested against the sale of 74 percent of MFIL's equity by the GOI. One official said, "The sale of the 74 percent equity of Modern Foods this January to HLL without our consent amounts to violation of our fundamental rights." Union sources said that as per the terms and condition of service in PSUs, it was their fundamental right to determine the rightful ownership of the company. The Union complained that HLL had already started pruning existing manpower. They were also apprehensive about the fate of the employee! Belonging to the backward classes as most of them were taken purely on the basis of their "reserved" status.
Post-Disinvestment Scenario

The decline in sales of Modern Bread, which continued till the beginning of 2000, has been arrested. The results for 2000-2001 are given in Table 7.4

<table>
<thead>
<tr>
<th>Details</th>
<th>Pre-Disinvestment</th>
<th>Post-Disinvestment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales — Bread</td>
<td>89.0</td>
<td>78.0</td>
</tr>
<tr>
<td>Energy food</td>
<td>71.0</td>
<td>71.0</td>
</tr>
<tr>
<td>Total</td>
<td>160.0</td>
<td>149.0</td>
</tr>
<tr>
<td>Net Profit/Loss</td>
<td>-7.00</td>
<td>-48.00</td>
</tr>
</tbody>
</table>

Note: Includes Rs 1 crore towards increase in wages for settlement and Rs 9 crore towards repairs and maintenance of plant and equipment, safety/hygiene and market development.

Source: Ministry of Disinvestment, Government of India.
Turning Around MFIL

After HLL acquired MFIL, the latter’s losses went up. By December 2000, MFIL’s accumulated losses increased to Rs.470 mn (in 1998-99, MFIL made losses of around Rs.69 mn) as against its networth of Rs.330 mn. In early 2001, MFIL was referred to the Board of Industrial and Financial Reconstruction as more than 50 percent of its networth had been eroded by its losses. Officials of MFIL alleged that HLL wanted MFIL to be referred to BIFR so as to get some relief from banks and financial institutions. They further contended that if HLL had used the Rs.200 mn it infused into MFIL as preference share capital instead of loans, MFIL would not have become sick. However, HLL officials said that they had little choice but to go to the BIFR because MFIL’s accumulated losses had exceeded 50 percent of its peak net worth over a four-year period. According to Section 23 of the Sick Industries Act (SICA) if a company’s accumulated losses over four years exceed 50 percent of networth then it has to be declared sick and referred to BIFR.

However, analysts felt that HLL could have prevented MFIL from entering the BFIR's ambit. According to one analyst, "If the amount that HLL brought in brought in was equity or preference capital before December 31, 2000, Modern Food could have escaped the clutches of the BFIR." MFIL officials alleged that referring MFIL to the BIFR was a strategy for retrenching employees and closing unviable units. However, Gunender Kapur, Executive Director (Foods), HLL was of the opinion that taking MFIL to the BIFR was just a 'technicality'; he was confident that in two years MFIL would be able to post a cash profit as a result of the turnaround strategy initiated by HLL. The HLL officials also claimed that between February and December 2000, MFIL's sales had doubled.
In 2001, HLL set a two-year timeframe to turn around MFIL. The turnaround included providing financial assistance to distribution channels and introducing better-quality bread ingredients to improve quality. HLL had already pumped in around Rs.200 mn in MFIL by way of secured loans and corporate guarantees. HLL officials claimed that MFIL's sales had more than doubled since it was acquired. Said Kapur, "While we have already achieved a turnaround in sales, a turnaround in financial terms (profitability) will happen in the next two years." The increase in sales (actual figures not revealed) was mainly due to an increase in the number of outlets that sold MFIL bread. In Mumbai, the number of outlets increased to about 250 from 100, and crossed the 400-mark in New Delhi.

Ever since HLL took over the company, it seemed to have focused on improving the quality of the product and its distribution. It also helped MFIL leverage on HLL's strengths in areas such as wheat procurement, communication, treasury, and training. According to Kapur, "Post-acquisition, the task before Levers was not only to increase distribution and sales, but also to ensure that Modern Bread’s daily delivery system was well established and further strengthened to ensure the delivery of fresh stock of bread twice a day." He further added, "Improvement in quality is an ongoing process which will continue in the year 2001."
In mid-2001, HLL introduced a voluntary retirement scheme for employees of four units of MFIL that were closed and for its surplus employees at other locations. Work was suspended between 1991-99 at four of MFIL's 19 factories-Kirti Nagar (closed since June 1999), Ujjain (closed since March 1994), Bhagalpur (closed since October 1998) and Silchar (abandoned at the project stage itself in October 1991). Workers in these units were drawing wages. Moreover, many units at different locations had surplus manpower.

HLL officials said MFIL's losses would reduce to Rs.200 mn in 2000-01 from Rs.480 mn in 1999-00. In 2000-01, the first year under HLL's management, bread sales of MFIL increased to Rs.1.02 bn from Rs.780 mn in 1999-2000. Growth in bread sales in the first four months of 2001 was 80 percent over the corresponding period of 2000.

However, MFIL employees were not ready to accept that the performance of the company would improve in the future. Said an employee, "How can HLL revive the company when it is going about shutting down plants." They pointed out that the units at Bhalgalpur in Bihar and Kirti Nagar in Delhi had been closed and just about half of the Lawrence Road factory in Delhi was operational. The employees were not confident that capacity utilization would go up to 75 percent as claimed by HLL from the dismal 15 percent at the time of takeover. Since November 2000, MFIL's franchisees had been turned into ancillaries and as a result, the sales figures of these franchisees had been added to the sales figures of MFIL. The employees therefore argued that there had been no real increase in sales. The employees also felt HLL's turnaround strategy for MFIL would involve shutting down of units, laying off workers and relying on third-party production (outsourcing).
However, HLL officials said that its outsourcing plan was based on the presence or absence of an MFIL unit in a given region. For instance, in Mumbai, MFIL had its own plant, so HLL did not outsource bread there. On the other hand, in Pune it did not have its own plant and so it relied on an ancillary (refer Table I for both sides of the story). Kapur said that HLL had no plans for using MFIL's vast stretches on land for its expansion. He said, "We will use Modern's land for Modern' expansions, and nothing else."

In August 2001, Peter Selvarajan, Managing Director of MFIL, said that MFIL would break-even in another two to three years. When the three-year lock-in period would come to an end in 2003, HLL would be able to call for the balance 26 percent stake of GOI in MFIL, at a price that would not be less than the first acquisition. This price would be determined by an independent accounting agency. Meanwhile MFIL's management was planning to initiate talks with the employee federations to put in place a streamlined and productivity-linked incentive scheme for its workforce. Selvarajan said that MFIL management would initiate the second round of talks with the two employee federations, Hind Mazdoor Sabha (HMS) and Indian National Trade Union Congress (INTUC), to chalk-out a streamlined productivity linked package of a permanent nature. Industrial relations had assumed great significance at MFIL after the disinvestment process was initiated, as a result of apprehensions regarding closure of units and subsequent lay-offs, he said.
MFIL’s management had initially worked out a one-year agenda with employee federations in September 2000. MFIL had a workforce of about 2000 of which 490 had applied for the VRS scheme introduced by the company in June 2001. Of the 520 applications for VRS, about 490 were cleared at a cost of an estimated Rs.150 mn to the company.

Table 7.5
The Two Sides of the Story

<table>
<thead>
<tr>
<th>MRL Viewpoint</th>
<th>HLL Viewpoint</th>
</tr>
</thead>
<tbody>
<tr>
<td>HLL made MFIL sick.</td>
<td>MFIL was potentially sick.</td>
</tr>
<tr>
<td>HLL is outsourcing, not making bread.</td>
<td>HLL is outsourcing where it doesn't have plants.</td>
</tr>
<tr>
<td>HLL is shutting down MFIL's plants.</td>
<td>These plants were set to up to handle MFIL's diversification.</td>
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<tr>
<td>HLL will exploit MFIL's real estate. Workers feel insecure.</td>
<td>HLL will do so only for MFIL's own expansion. Staff reacting well towards HLL efforts.</td>
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Source: Sunjeeb Dutta, PSU Disinvestment, ICFAI University Pg. 101
In late 2001, MFIL was also looking for ways to spread its manufacturing base and was aggressively setting up ancillaries through arrangements with existing bakeries. The company was exploring the possibility of expanding in big towns, where MFIL did not have a presence, besides spreading to other smaller towns. The next few years would tell whether MFIL could be transformed from an ailing PSU into a breadwinner by HLL.
In May 2002, a two-stage sell off began in Maruti Udyog Ltd. (MUL) with a Rs. 400 crore (4 billion) rights issue at a price of Rs 3,280 per share of Rs. 100 each (12,19,512 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 is 54.20 per cent and 45.54 per cent respectively. In the second stage, the government will off load it's holding in two tranches. In the first tranche, government will sell 36 lakh shares out of its existing 65.80 lakh shares by March 2003. Suzuki has agreed to underwrite this first public offer of 36 lakh shares at Rs 2,300 per share. After the first public offer, the government share in MUL will come down to 25 per cent. Thereafter in the second tranche, the government will sell off its balance equity by public offer and quit from MUL. For the second tranche, the government has a 'put' option1 at a discount of 15 per cent and/or 10 per cent of average market price. The 'put' option is up to 30 April 2004. The government is thus assured of a total consideration of Rs 2,424 crore (24.2 billion), if it exits from Maruti by April 2004 (Rs 1000 crore control premium, proceeds of 36 lakh shares at the rate of Rs 2300 per share in the first tranche, and proceeds of 29.8 lakh shares at the rate of Rs 2000 per share in the second tranche).

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1. Put option refers to the right, but not the obligation, to sell an asset below a specified price within a given time period. In the context of the Maruti Udyog Ltd. (MUL) case, the government has a 'put' option that allows it to sell its shares at a discount of 15% or 10% of the average market price up to 30 April 2004.
In other cases of disinvestments, the strategic partner did not have any control before acquiring government equity. But in the case of MUL, even before disinvestment, the share of government was 49.74 per cent and that of Suzuki 50 per cent. This was due to Suzuki being the technology suppliers. Therefore, at the time of disinvestment, the government had a minority holding vis-a-vis Suzuki. Further, the earlier existing agreement stipulated that Suzuki's consent is required by government to transfer its shares to third party. Thus, the disinvestment in Maruti started with certain constraints.

In the earlier transactions with Suzuki in 1982 and 1992, when Suzuki's shareholding was allowed to be increased vis-a-vis government, first from 26 per cent to 40 per cent and then from 40 per cent to 50 per cent, no control premium was paid by Suzuki, though control passed to them. In fact, the government did not receive any payment as shareholding was allowed to be increased by issuance of new shares. Because of these constraints, Suzuki's initial offer was only Rs. 170 crore (1.7 billion) as control premium, which was subsequently increased to Rs. 286 crore (2.86 billion). The agreement about the present control premium of Rs. 1000 crore (10 billion) was reached after hard negotiations for over a month. Therefore, this deal preempts any controversy over the control premium. Similarly, initially Suzuki was not willing to incorporate any underwriting of the public issue by government of its shares. With lot of negotiations, Suzuki agreed for the same. The case thus brings out the value of hard negotiations, despite constraints, undertaken by negotiating team.
Since Maruti Udyog Ltd. was not a listed company, the government and Suzuki agreed to determine the fair value of MUL shares through valuation by three independent valuers and then take the average. KPMG, Ernst & Young, and S.B. Billimoria were appointed as valuers. The fair value per share recommended by the three valuers was Rs. 3,200 by KPMG, Rs. 3,142.18 by Ernst & Young, and Rs. 3,500 by S.B. Billimoria. Thus the average value came to Rs. 3,280. Based on this, the fair value of the government's existing 65.80 lakh shares works out to about Rs. 2,158 crore (21.58 billion). What government is receiving from Suzuki now is Rs. 1,000 crore (10 billion) as control premium and considering the undertaking of the two tranches, it would be an additional Rs. 1,424 crore (14.24 billion) for the existing shares. If the existing shares could be sold at more than the present book value, the government's receipt would further go up. Thus, the government will at a minimum get Rs. 2,424 crore (24.24 billion) against the fair value of Rs. 2,158 crore (21.58 billion), that is, Rs. 266 crore (2.66 billion) more. As such, the valuation is not likely to generate any controversy unlike some previous disinvestments.

Another significant aspect of the Maruti divestiture plan is the *prima facie* decision of the government to exit from Maruti completely by March 2004. Other than hotel properties, Maruti is going to be the first enterprise where government is planning to exit completely.
In February 2002, the government decided in principle to disinvest BPCL and HPCL. It is interesting to note that both the companies were not referred to the Disinvestment Commission for its views. On 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. Five 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 per cent is likely to be offered in domestic market and 25.20 per cent in ADR. Five per cent of equity will be offered to employees.

Center for Public Interest Litigation challenged in the Supreme Court, the government’s executive decision to privatize HPCL and BPCL without Parliament's approval. It argued that unless the laws which nationalized the two oil companies in the 1970s were repealed or amended, the government should stop disinvestment. The preamble of the nationalization law said that oil distribution would be state-owned. A
two-judge bench of the Supreme Court in its order given on 16 September 2003 asked the government to seek Parliament's approval before proceeding with privatization. It is important to note that the Court did not question or challenge the disinvestment process. The principle on which it has disallowed sale of the two oil PSUs is a purely legal and technical one, that is, since the oil companies in question were created through an Act of Parliament, they cannot be privatized without prior legislative approval.

The ruling has far-reaching implications. There are a number of PSUs, both at the Central and State levels that have been created by legislative act. If prior approval of the legislature is to be taken in all such cases, progress is bound to be slow. It is feared that Maruti privatization will be challenged using this order as precedent. Further, future privatization of nationalized banks and coal PSUs— as and when they are taken up— might also need legislative approval. In short, the Court order severely restricts executive discretion while enlarging Parliamentary authority over sell-offs.

The government's preference for the executive rather than parliamentary route on this issue is largely a reflection of lack of consensus on disinvestment, even after a decade of economic liberalization. The deep political divisions are not confined to the opposition parties but also within the ruling coalition. This was evident from the two extreme responses that the Supreme Court verdict evoked. While Disinvestment Minister Shourie described it as a 'major setback', Petroleum Minister Naik hailed it as a 'historic judgment'. This will be seen as an indication of the lack of unanimity among the political class on the issue of privatization.
**Conclusion**

Although the post divestiture performance results are available for a short period, yet one can conclude that post-privatization scenario in MFIL, LJMC and BALCO suggest that ownership matters in improving performance.

BALCO was a test case of privatization of enterprise, which had a large work force. The supreme court ruling that correctness of the government’s disinvestment policy can not be gone in to the court and general improvement in service conditions of the employees has sent an encouraging signal to other enterprises put on disinvestment list. As such there has been no labour opposition in subsequent strategic sales as seen in case of CMC, HTL, IBP, VSNL, Paradeep Phosphates, Hindustan Zinc, Maruti and IPCL. But these enterprises had moderate manpower.

Strategic sales with transfer of management control to strategic partner have resulted in buoyancy in capital market as there is a general filling among investors that financial returns now will be higher. With privatization, employees will now be more accountable and this is likely to improve productivity and profitability.