Chapter - 5

DISINVESTMENT AND PRIVATISATION
IN
PUBLIC SECTOR ENTERPRISES
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MEANING AND RATIONAL OF PRIVATISATION

Though the PSUs have contributed heavily to develop the industrial base of the country, a number of problems have begun to manifest themselves in many of the public enterprises. Serious problems have been observed in the insufficient growth in productivity, poor project management, over-manning, lack of continuous technological upgradation, inadequate attention to R & D and the human resource development. The low rate of return on capital invested has inhibited the ability of public enterprises to regenerate themselves in terms of new investment as well as in new technology development. This resulted in many of the public enterprises becoming a burden rather than an asset to the government. In the sixties and seventies, the public sector policy has been largely guided by Industrial Policy Resolution of 1956 which gave the public sector a strategic role in the economy. However, the policy resolution of 1991 adopted a new approach.

There has been a marked change in the perception towards the role of public sector in the Indian economy since 1991. Some economists argued that the fiscal crisis of 1991 was a result of the public sector's inability to generate adequate returns on investment. The government’s attitude also changed markedly as is clearly demonstrated in the following statement made in the New Industrial Policy, 1991: "After the initial exuberance of public sector entering new areas of industrial and technical competence, a number of problems have begun to manifest themselves in many of public enterprises. Serious problems are observed in the insufficient growth in productivity, poor project management, over-manning, lack of continuous technological upgradation, and inadequate attention to R & D (Research and Development) and human resource
development. In addition, public sector enterprises have shown a very low rate of return on the capital investment. This has inhibited their ability to re-generate themselves in terms of new investment as well as in technology development. The result is that many of the public enterprises have become a burden rather than being an asset to the Government. 1 Consequently, the New Industrial Policy, 1991, advocated privatisation of public sector enterprises. For purposes of privatisation, the government has adopted the route of disinvestment which involves the sale of public sector equity to the private sector and the public at large. The main approach of the government in this regard is to bring down its equity in all non-strategic public sector undertakings to 26 percent (or lower) and close down those public sector undertakings which can not be revived. The disinvestment programme began in 1991-92 and government stakes in different public sector companies have been sold in varying degrees by 2004-05. Till 1998-99, the government used to sell minority stakes through domestic or international issue of shares in small trances every year. Post 1999-2000, there has been a greater stress on strategic sale --involving an effective transfer of control and management to a private entity, the argument being that the government would get a better price from the private sector it is ceding actual control. The prominent companies that have witnessed strategic sale in the recent past include Modern Foods, BALCO, CMC, VSNL, IRB, ITDC Hotels, IPCL, Maruti Udyog Ltd. and HZL.

The relevance of privatisation of public sector in India is justified on following grounds:

(1) Solution to the problem of low profitability and inefficiency in public sector enterprises.

(2) End of political interference in economic decisions.

(3) Increase in Government reserves through sale of shares of public sector enterprises.

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(4) Freedom from pulls and pressures on the budget due to the losses in public sector enterprises.

(5) Solution to the problem of lack of autonomy, inadequate management incentive, etc.

(6) Convert ‘public sector’ to ‘people sector’ by selling the shares of public sector enterprises to the general public.

(7) Synchronising with economic liberalisation wave in the world.²

Concept of Privatisation

Privatisation is a process by which the government transfers the productive activity from the public sector to the private sector. In a narrow sense, privatisation implies the induction of private ownership in publicly owned enterprises, but in a broader sense, it connotes besides private ownership (or even without change of ownership), the induction of private management and control in the public sector enterprises. Barbara Lee and John Nellis define the concept in this manner: “Privatisation is the general process of involving the private sector in the ownership or operation of a state owned enterprise. Thus, the term refers to private purchase of all or part of a company. It covers ‘contracting out’ and the privatisation of management through management contracts, leases, or franchise arrangements.”³

Stuart M. Butler defines privatisation as “the transfer of government assets or functions to the private sector.”⁴ And, according to D. R. Pendse, “Any process which reduces the involvement of the state or the public sector in the economic activities of the nation, is a privatisation process.”⁵

Butler distinguishes four forms of privatisation. First, the most complete form of privatisation is to sell government-owned assets to private buyers,

² Dr. K. L. Gupta, Public Enterprises in India, 1998, P. 77.
removing government entirely from any involvement in the activity. This form of privatisation claims certain advantages:

(a) Government can obtain a considerable amount of revenue in a very short time;
(b) such sales of government assets are likely to yield a better price than the present value of the government's probable income from the asset. The second form of privatisation called 'deregulation' involves simply transferring to private sector service presently under government monopoly. This form claims some advantages:

(a) more competition and wider choice to the benefit of the consuming public;
(b) reduces the government budget as government ceases to render the service which is privatised.

The third form of privatisation is 'contracting out'. Here, the government continues to fund the service but invites private entrepreneurs (individual or corporate) to bid for the right to provide the service under contract. This form does not reduce the government's commitment to provide the service involved, but the cost of the service is reduced because of competition among the contractors. Another advantage of this form is that the savings from the contracting out are likely to be the largest when the degree of competition within the private sector is more intense.

In the fourth form of privatisation, known as 'vouchers', the government continues to fund the service. But, instead of a government agency giving a contract to private firm to provide a service, the agency gives the users of the service the means - probably a voucher - to purchase the service in the open market. This form is said to be most appropriate in cases where a sound and healthy market for a service exists, but where consuming households have insufficient income to obtain adequate supply. This approach enables the government to keep the cost of the service as low as possible by encouraging voucher holders to seek the most efficient provider of the service.
Methods of Privatisation

Privatisation in broad terms mean disengaging the state from those activities done by private sector. The first major programme of privatisation was adopted in U.K. by the conservative government of Margaret Thatcher during 1980s. In this swift and widespread programme a large number of public sector companies that dominated a wide swathe of industries and service in U.K., including railways, aerospace, oil, telecommunications, mining, and bus services were sold off. This was followed by privatisation in France and many other OECD countries, former communist countries and developing nations. For adopting privatisation wholly and partially the corporation should follow certain legal, accounting financial and socio-economic pre-condition and requirements. These should be properly examined and finalised before implementing privatisation proposals. The methods for divestiture depend on the existing state of the capital market. The profitability of the enterprise, the competitiveness of its products and proportion of the total equity that is divested.

The methods of divestiture would vary from sale by auction in the enterprise as a whole through tenders or by flotation of equity in the stock market partially.

The success of partial or total privatisation could depend on the modalities adopted. The modalities should lead to objective selection of persons or institution who share the ownership, the most equitable compensation for the equity to be disinvested and transparency. The adoption of the modalities should be with a view to get the best price for the government while ensuring that the economy would be managed well in future. The methods of privatisation by these countries were frequently one or a combination of the following methods:

1. **Initial Public Offering (IPO):**

   This is the most important methods for privatisation in UK and OECD countries. Under this method, the shares of public sector undertakings (PSUs) are sold to retail investors and institution. The government may in some cases, sell
shares of a PSU in international market also. Under this transaction, the state sells to the general public all or large block of its stocks in a wholly or partly owned SOE. Technically, this amount to secondary distribution of existing government held shares but it is commonly handled largely as a primary issue. A prospectus for the offering is prepared, and normally the services of an investment bank as advisor are required. The bank or a syndicate may also underwrite the offering. The offering may be on a fixed price or on a tender basis. The shares may be marketed internationally or only domestically. The IPO method is the best method in the case of those countries which have a strong capital market. In fact, OECD countries raised as much as two thirds of all their privatisation proceeds in 1990s through IPOs.

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

However, the main problem in this method is the problem of ‘valuation’ - i.e., what should be the ‘price’ of the share? Since in most countries, shares of public sector undertakings are not traded on the stock exchanges, it is not possible to find out the right price at which the government should sell the shares of a PSU. Moreover, this method can not be adopted in small countries with weak capital markets and institutions.

2. Direct Private Sale (Full or Partial): 

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

The main benefit claimed for this method is that performance and efficiency of the enterprises is expected to improve as the private partner introduces better management practices on the one hand, and the unit is freed from government shackles on the other hand. The government may realize a better price as the strategic partner may be willing to pay more because of the synergy he perceives in combining the PSU business with own existing business. The strategic partner would be willing to inject more capital into the PSU and modernize its business operations as he would be keen in generating profits. Thus, one of the principal advantages of a private sale of shares is that the prospective owner is known in advance and can be evaluated on the basis of his ability to bring in benefits such as management, technology, market access, etc.

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

In India, private placement of equity has been done in case of CONCOR and GAIL. Strategic sale, which has been recommended in most of the cases of disinvestment by the Disinvestment Commission also, falls in the category of private sale. Strategic sales has been effected in 10 enterprises till March 2003. The Disinvestment Commission has recommended trade sale of certain properties of Indian Tourism Development Corporation, Hotel Corporation of India, etc. which is again a form of private sale. Trade sale means sale of a business or a division or an activity. A trade sale is generally regarded as a quicker option to execute and has been used for small enterprises in other countries.
3. New Private Investment in SOE:
A government may wish to add more capital to an SOE and achieve this by opening equity ownership to the private sector. The main characteristic of such privatisation method is that the state does not dispose off any of its existing equity in the SOE. Rather, it increases the equity and causes a dilution of the government’s equity position. The resulting situation will be joint private/government ownership of the enterprise.

4. Management/ Employees buy out:
The term management buy-out (MBO) generally refers to the acquisition of a controlling shareholding in a company by a group of managers. In this route of privatisation, managements and employees themselves buy major stakes in their own firms. This method has been widely used in Croatia, Poland, Romania and Slovenia. The advantage of this method is that it is easy to implement, both politically and technically. It might also be better for corporate governance in that insiders have better access than outsiders to the information needed to monitor managers. This method also offers advantage in terms of managements/employees motivation to find ways to cut costs and improve productivity.

5. Liquidation – Sale of SOE:
In special conditions, the government may prefer to liquidate the SOE and sell its assets instead of selling it as an ongoing operation. It takes place mostly when it is more beneficial for the state to sell individual assets instead of the enterprise. This method has been used as a form of privatisation in Poland particularly with small and medium sized firms.

6. Fragmentation:
Reorganization (or break-up) into component parts. This method involves breaking up or reorganization of an SOE into several separate entities. It also includes having off of some activities. This method permits piece meal privatisation and application of different methods of privatisation to different component parts, thereby maximising the overall process. It is applicable where
SOE incorporates too many activities that, in the aggregate, are not attractive to potential investors. Also, the state may wish to sell only certain components of the SOE while retaining other. Another reason for fragmenting an SOE may be that it is a monopoly and the government may fragment it into separate enterprises to create competition, e.g., electricity generation and distribution.

7. **Equal Access Voucher Programmes**:

This form of privatisation involves distribution of vouchers across the population and attempts to allocate assets approximately evenly among voucher holders. Such programmes excel in speed and fairness. However, they raise no revenue for the government and have unclear implications for corporate governance. Mongolia, Lithuania, the former Czechoslovakia, Albania, Armenia, Kazakhstan, Poland and Romania (in its 1995 programme) followed this method of privatisation. The Czech Republic’s equal access voucher programme has been the most successful to date. Thus, the Czech experience shows how a well-designed voucher programme can overcome many problems, “It can depoliticize restructuring, stimulate development of capital markets, and quickly create new take holders with an interest in reform.”

**Public Auctions**:

Public auctions are predominantly used for small or medium-sized SOEs, which do not require technology transfer or other special inputs. It provides for open competitive bidding, which makes the process transparent. The process is also comparatively fast. In India, the initial nine rounds of disinvestment followed auction method. Auction are relatively less time consuming and has low transaction cost.

**Sale to Foreigners**:

This is a variant of the strategic sales method, where the buyer is not a domestic company, but a foreign company. In small countries, the amount of

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domestic private capital is often limited. Therefore, the government sells its stakes to foreign company. At times, sales to a foreign company are preferred as the expectation is that the foreign company will bring with it world class technology and expertise to run the PSU. In cases where the government has set up a PSU in collaboration with a foreign company, it may simply sell its stake to the latter. This is what the Government of India has done in the case of Maruti Udyog Ltd. where it has sold its stake to the foreign collaborator Suzuki Company of Japan.

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

**Disinvestment of Public Sector Enterprises**

*Concept of Disinvestment*:

The term disinvestment is used to indicate the process of privatisation. In India, the term disinvestment is used rather than privatisation. Privatisation implies a change in ownership resulting in a change of management, while disinvestment may or may not lead to a change of management. The disinvestment of public sector enterprises means the sale of public sector equity leading to a dilution of government's stake. Thus, disinvestment implies sale of shares (ownership) of the PSEs to outsiders conferring to right ownership to these units. This disinvestment may take place in the form of sale of partial shares of the public sector units to the private entrepreneurs or all of their shares to private entrepreneurs. The process of disinvestment was initiated by the government of India during 1991-92 as part of a package of PSEs reform. The disinvestment of government stake from PSEs follows from the Industrial Policy Statement of 1991-992.
Background of the Disinvestment Process

One of the basic objectives of starting disinvestment of the public sector in India was to build infrastructure for economic development and rapid economic growth. However, a number of problems such as low productivity, over-managing and other economic compulsions, viz., deterioration of balance of payments position, and increasing fiscal deficit led to adoption of a new approach towards the public sector in 1991. The New Economic Policy 1991 envisaged that the state should by the large leave industry and commerce to private sector. It was as part of this policy that the government embarked on disinvestment of Central Public Sector Enterprises (PSEs) in 1991.

Low Productivity of Investments:

From 1950-51 to 1980-81, India’s growth rate roughly constant but saving and investment rate (at current prices) more than doubled. In the 1980’s, the growth rate increased significantly without any increase in saving and investment rates. Investment and saving as percentage of GDP in the five decades from 1950-51 is given in the following Table 5.1:

<table>
<thead>
<tr>
<th>Table 5.1 Investment and Saving as Percentages of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Investment</strong> (current prices, % GDP)</td>
</tr>
<tr>
<td>1950-51: 10.2</td>
</tr>
<tr>
<td>1960-61: 15.7</td>
</tr>
<tr>
<td>1970-71: 16.6</td>
</tr>
<tr>
<td>1980-81: 22.7</td>
</tr>
<tr>
<td>1989-90: 24.1</td>
</tr>
<tr>
<td><strong>Investment</strong> (constant 1980-81, prices % of GDP)</td>
</tr>
<tr>
<td>1950-51: 14.7</td>
</tr>
<tr>
<td>1960-61: 18.1</td>
</tr>
<tr>
<td>1970-71: 18.7</td>
</tr>
<tr>
<td>1980-81: 22.7</td>
</tr>
<tr>
<td>1989-90: 21.8</td>
</tr>
<tr>
<td><strong>Domestic savings</strong> (current prices, % GDP)</td>
</tr>
<tr>
<td>1950-51: 10.4</td>
</tr>
<tr>
<td>1960-61: 12.7</td>
</tr>
<tr>
<td>1970-71: 15.7</td>
</tr>
<tr>
<td>1980-81: 21.2</td>
</tr>
<tr>
<td>1989-90: 21.7</td>
</tr>
<tr>
<td><strong>GDP growth</strong> (% p.a. 10 year averages)</td>
</tr>
<tr>
<td>1950-51: -</td>
</tr>
<tr>
<td>1960-61: 3.6</td>
</tr>
<tr>
<td>1970-71: 3.3</td>
</tr>
<tr>
<td>1980-81: 3.7</td>
</tr>
<tr>
<td>1989-90: 5.7</td>
</tr>
</tbody>
</table>

*Source: Joshi and Little (1997)*

The above table suggests that principal explanation for India’s slow growth is low of saving and investment.
Fig. 5.1 Investment and saving as percentages of GDP

Fiscal Situation in the 1980s:

The Table 5.2 shows consolidated finances of Central and State Governments, 1960-61 to 1989-90.

During 1980's the fiscal situation deteriorated rapidly. This was largely due to an escalation of current expenditure of the government. The table which gives consolidated central and state government revenue, expenditure and deficit over the period 1960-61 to 1989-90 divided into five year averages and expressed as percentage of GDP reflects this situation.
<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Revenue of which:</td>
<td>12.7</td>
<td>13.4</td>
<td>14.6</td>
<td>17.8</td>
<td>18.1</td>
<td>20.0</td>
</tr>
<tr>
<td>Direct taxes</td>
<td>2.9</td>
<td>2.5</td>
<td>2.5</td>
<td>2.9</td>
<td>2.4</td>
<td>2.4</td>
</tr>
<tr>
<td>Indirect taxes</td>
<td>6.9</td>
<td>8.1</td>
<td>9.5</td>
<td>11.7</td>
<td>12.7</td>
<td>14.6</td>
</tr>
<tr>
<td>Non-tax revenue</td>
<td>2.9</td>
<td>2.8</td>
<td>2.6</td>
<td>3.2</td>
<td>3.0</td>
<td>3.0</td>
</tr>
<tr>
<td>2. Current expenditure of which:</td>
<td>11.8</td>
<td>12.9</td>
<td>14.2</td>
<td>15.3</td>
<td>18.6</td>
<td>23.0</td>
</tr>
<tr>
<td>Defence</td>
<td>2.6</td>
<td>3.0</td>
<td>3.0</td>
<td>2.9</td>
<td>3.0</td>
<td>3.7</td>
</tr>
<tr>
<td>Explicit subsidies</td>
<td>0.7</td>
<td>0.9</td>
<td>1.1</td>
<td>1.9</td>
<td>2.6</td>
<td>3.6</td>
</tr>
<tr>
<td>Net Interest payment</td>
<td>0.4</td>
<td>0.4</td>
<td>0.5</td>
<td>0.7</td>
<td>1.2</td>
<td>2.5</td>
</tr>
<tr>
<td>3. Current revenue balance</td>
<td>0.9</td>
<td>0.5</td>
<td>0.4</td>
<td>1.5</td>
<td>(-0.5)</td>
<td>(-2.9)</td>
</tr>
<tr>
<td>4. Capital expenditure</td>
<td>6.6</td>
<td>6.0</td>
<td>5.1</td>
<td>6.9</td>
<td>7.5</td>
<td>7.1</td>
</tr>
<tr>
<td>5. Total expenditure</td>
<td>18.4</td>
<td>18.9</td>
<td>19.3</td>
<td>23.2</td>
<td>26.1</td>
<td>30.0</td>
</tr>
<tr>
<td>6. Fiscal deficit (5-1) Met through:</td>
<td>5.7</td>
<td>5.5</td>
<td>4.7</td>
<td>5.4</td>
<td>8.0</td>
<td>10.0</td>
</tr>
<tr>
<td>Domestic borrowing</td>
<td>3.4</td>
<td>3.0</td>
<td>2.7</td>
<td>3.6</td>
<td>5.6</td>
<td>7.3</td>
</tr>
<tr>
<td>External borrowing</td>
<td>1.9</td>
<td>1.8</td>
<td>0.7</td>
<td>0.9</td>
<td>0.7</td>
<td>0.7</td>
</tr>
<tr>
<td>Budgetary deficit</td>
<td>0.4</td>
<td>0.8</td>
<td>1.2</td>
<td>0.9</td>
<td>1.7</td>
<td>2.0</td>
</tr>
<tr>
<td>7. Primary fiscal deficit</td>
<td>5.3</td>
<td>5.2</td>
<td>4.2</td>
<td>4.7</td>
<td>6.8</td>
<td>7.5</td>
</tr>
</tbody>
</table>

Source: Joshi and Little, (1994)
Fiscal Deficit of the Central Government:

To get a clear picture of fiscal situation of the Central Government in 1980’s, the fiscal deficit during this period has been shown in the following Table 5.3:

Table 5.3 Fiscal Deficit of Central Government: 1975-76 to 1990-91

<table>
<thead>
<tr>
<th>Year</th>
<th>Fiscal deficit (2)</th>
<th>Budget deficit (3)</th>
<th>Primary deficit (4)</th>
<th>Revenue deficit (5)</th>
<th>Monetary deficit (6)</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>


The above table shows that the fiscal deficit of the government was around 8 percent of GDP from 1985-86 onwards, as compared with 6 percent at the beginning of the 1980s and 4 percent in the mid-1970s. The steady growth of government expenditure, particularly non-plan expenditure, has been the main reason for the country falling into a fiscal crisis. A significant element of this is the growth in interest payments, which is an efficient system would have been covered by returns on productive capital expenditure and investment financed by the debt.
Fig. 5.2 Fiscal Deficit of Central Government: 1975-76 to 1990-91
The worsening fiscal deficit and Gulf War of 1990 brought the nation to the brink of International default. An increasing erosion of confidence in the government's ability to manage the economy led to a drying up of the market for external commercial loans in 1990-91. Also, the net outflow of Non-Resident Indian (NRI) deposits which began in October 1990 and continued more or less through 1991 was an additional significant contributor to the balance of payment crisis.

Due to deteriorating balance of payment situation, the Reserve Bank of India resorted to sharp contraactionary measures through the use of monetary and credit policy instruments. Notwithstanding these measures and the large drawings from the International Monetary Fund (IMF) amounting to US $ 2.4 billion in July 1990 and January 1991, there was sharp reduction in foreign exchange reserves during 1990-91. In July 1991, the foreign exchange was little over US $1 billion, barely sufficient to finance imports for a fortnight. As inflation accelerated to almost 14 percent and foreign exchange reserves dwindled, international default by India seemed a real possibility in 1991. On 6 July 1991, 47 tons of gold from the vaults of RBI was air lifted to London and deposited in Bank of England. Earlier, the government has leased 20 tons of gold to State Bank of India to be sold in international market. The government also turned to the IMF and the World Bank for assistance. However, the international agencies were particularly critical of the poor returns on SOE investments and budgetary support to them. The then Finance Minister, wrote to the World Bank, promising no new SOE except in core sector, no further nationalisation of sick units, to initiate closure of unviable units, to establish a time-table for eliminating budgetary support and greater autonomy to SOEs to cope with harder budgetary constraints.

It was in this atmosphere of crisis that a newly elected government launched a programme of economic reforms in mid-1991. Policy initiatives of July 1991 amounted to a dual strategy of reform-fiscal stabilisation to bring about
macroeconomic stabilisation and structural reform of the industrial and trade policy.

Need of Disinvestment:

The critics of public sector enterprises have mentioned the following arguments in favour of transferring public enterprises to the private sector:

1. Inefficiency of public sector units:

Many public sector units are characterised by inefficiency in the use of physical and human resources. Therefore, these units have no right to waste the scarce natural resources which if utilised efficiently and effectively can be really helpful and fruitful in the economic development of the country.

2. Sickness in the Public Sector:

Most of the public sector enterprises are incurring losses from year to year like FCI, HMT, etc. As a result, these units have become so sick that they can not be revived. In the interest of the economic development of the country, such units must be eliminated or sold to the private sector.

3. Excess Human Resources:

Several public sector enterprises are troubled by this problem of excess manpower. They are not fruitful and productive resources to these enterprises. This problem of excess manpower can be solved by transferring these units to the private sector.

4. Under Utilisation of Capacity:

Several PSEs are not fully utilising their productive capacity. A large number of these units are not able to ensure more than 50 percent utilisation of plant capacities. It could be avoided if these units are handed over to the private sector.
5. Lack of Autonomy:

There is a lack of proper autonomy or freedom to take policy decisions independently in the matters in case of these units. Many a times a profitable opportunity misses out due to looking to the higher ups for decisions. Therefore, they are not in a position to earn good profits. Private enterprises are totally independent and hence, good profit makers.

6. Lack of Professional Management:

There is lack of professional management in case of PSEs. Several public enterprises are not being managed professionally because the civil servant run them on bureaucratic lines. They do not adopt or follow sound and suitable commercial principles in taking important decisions. Moreover, there is the absence of scientific inventory control and dynamic marketing efforts on the part of public enterprises.

7. Lack of Accountability:

On paper, the management of these enterprises are accountable to the public through the Parliament. But, this public control is not as effective as in case of private sector. In a private enterprise, the management is fully and directly responsible to the owners of the business for results and in case of inefficient and poor performance, the management can be changed.

Objectives of the Disinvestment Programme

The privatisation programme flagged off in October 1991 without clear-cut objectives. The stated objective was to raise resources to finance fiscal deficit. It was proclaimed that the step meant widespread holding which again meant increased efficiency. Moreover, there was no well-defined strategy laid down to achieve these unclear objectives. This was evident by the way the government offloaded, in the very first year, small lots of 2 percent and 3 percent of a company’s equity capital which left major control still in government’s hands. This revealed the unstated object of the government which was to retain control
over the management. In the Disinvestment Policy 2000-01, the government for the first time seemed prepared to reduce its stake in the non-strategic PSUs even below 26 percent if necessary.

Giving the rationale for disinvestment, the Ministry of Disinvestment outlined the following as the primary objectives:

1. Releasing the large amount of public resources locked up in non-strategic PSEs, for redeployment in areas that much higher on social priority, such as basic health, family welfare, primary education and social and economic infrastructure;

2. Stemming further outflow of these scarce public resources for sustaining the unsustainable non-strategic PSEs;

3. Reducing the public debt that is threatening to assume unmanageable proportions;

4. Transferring the commercial risk to the private sector wherever the private sector is willing and able to step in; and

5. Releasing other tangible and intangible resources, such as, large manpower currently locked up in managing PSEs, and their time and energy, for redeployment in high priority social sector that are short of such resources.

Emergence of Disinvestment Policy

The most important form in the process of privatisation of public sector enterprises in India is disinvestment of capital in public sector enterprises. Initially, in 1991-92, the government resorted to bundling options wherein shares were offered only in bundles of “very good”, “good” and the “average” companies. This resulted in disinvestment at very low prices. The government then realised that framing proper strategies for disinvestment was essential. The policy of the government of India on disinvestment has evolved over a period and it can be briefly stated in the form of following policy statements made in chronological order:
1. Industrial Policy Statement of 24th July 1991:

The Industrial Policy Statement of 24th July, 1991 stated that the government would disinvest part of its holding in selected PSEs but did not place any cap on the extent of disinvestments was stated to be to provide further market discipline to the performance of public enterprises. The policy document stated: “In the case of selected capital of these enterprises will be disinvested in order to provide further market discipline to the performance of public enterprises.”

2. Interim Budget, 1991-92 (Chandrashekhar Government):

The Department of Economic Affairs submitted a paper regarding disinvestment in Feb. 1991 to the Cabinet Committee on Political Affairs (CCPA). The CCPA gave general approval to pursue the approach of disinvestment. Thereafter, the first public announcement of the government decision to disinvest upto 20 percent of its equity in selected public sector enterprises was made on March 4, 1991 at the time of presenting the Union Government’s interim budget for 1991-92 by Chandrashekhar Government. The objectives of the policy was stated to be to broad-base equity, improve management, enhance availability of resources for the PSEs and yield resources for the exchequer. The budget document stated, “It has been decided that government would disinvest upto 20 percent of its equity in selected PSEs, in favour of mutual funds and financial or investment institutions in the public sector. The disinvestments, which would broad base the equity, improve management and enhance the availability of resources for these enterprises, is also expected to give Rs. 2500 crore to the exchequer in 1991-92.”


In this pronouncement, the cap of 20 percent for disinvestments was reinstated and eligible investor’s universe was again modified to consist of mutual funds and investment institutions in the public sector and the workers in
these firms. The objectives too were modified, the modified objectives being, “to raise resources, encourage wider public participation and promote greater accountability.” The budget document stated: “In order to raise resources, encourage wider public participation and promote greater accountability, upto 20 percent of government equity in selected undertakings would be offered to mutual funds and investment institutions in the public sector, as also to workers in these firms.”

4. Report of the Committee on the Disinvestment of Shares in PSEs (Rangarajan Committee): April 1993:

The government had constituted a committee in February 1992 under V. Krishnamurthy, the then Member, Planning Commission, to institutionalise the disinvestment process.\(^7\) The term of reference of the committee were to devise criteria for selection of public sector enterprises for disinvestment during 1992-93, and to advise on limits on the percentage of equity to be disinvested in respect of such PSEs. It was also to suggest the target clientele, make suggestions on the modus operandi of disinvestment and lay down the criteria for valuation of equity shares of such PSEs. The government reconstituted the Committee in November 1992 with Dr. C. Rangarajan, the then Member, Planning Commission as Chairman and Dr. Y. Venugopal Reddy as member secretary to suggest the correct method of divestiture. The committee took upon itself to indicate the objectives sought to be achieved through disinvestment in public sector equity. According to it, the objectives were:

(a) To map up resources of non-inflationary character to meet the budgetary needs which include requirements of developmental activities and social obligations.

(b) To subserve, in the medium term, the overall fiscal objective of gradually reducing the fiscal deficit and bringing about a positive

\(^7\) Ministry of Finance, Department of Economic Affairs, Office Memorandum No. 14/1/SE/92 dated 26 Feb., 1992.
overall impact on future liabilities and income flows to Government.

(c) To improve the overall economic efficiency by bringing about a more competitive atmosphere with emphasis on the cost and quality of product and service to the customers of PSE.

(d) To enhance the efficiency of individual enterprises by imparting a new dynamism in the management to these enterprises through diversification of the ownership and control as also larger and freer access to the expanding capital market in India.

(e) To realign the extent of ownership, control and regulation in different activities consistent with the technological needs and developments in industrial policy.

The Committee gave its report on April 20, 1993. The Committee did not suggest any criteria for selection of enterprises for disinvestment on the ground that the financial year 1992-93 was about to end. Regarding level of disinvestment, it recommended that the percentage of equity to be divested could be up to 49 percent for industries explicitly reserved for the public sector. It recommended that in exceptional cases, such as the enterprises, which had a dominant market share or where separate identity had to be maintained for strategic reasons, the target public ownership level could be kept at 26 percent, i.e., disinvestment could take place to an extent of 74 percent. In all other cases, it recommended 100 percent disinvestment of government stake holding. 51 percent or more equity by the government was recommended only for 6 schedule industries, namely coal and lignite, atomic energy, radioactive minerals, mineral oils, arms, ammunition and defence, equipment and railway transport. Another important recommendation of the Committee was that foreign investors might not be allowed to buy more than 24 percent of equity except strategic alliance on terms approved by the government. The Committee suggested a separate apex agency for designing and implementing disinvestment.
5. The Common Minimum programme of the United Front Government 1996:

The highlights of the policy formulated by the United Front Government were as follows:

"The question of withdrawing the public sector from non-core strategic areas will be carefully examined subject, however, to assuring the workers and employees of job security or, in the alternative, opportunities for retraining and redeployment. The United Front Government 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."


Pursuant to the above policy of the United Front Government, a Disinvestment Commission was set-up under the chairmanship of G. V. Ramakrishna. It was set-up for advising the government on disinvestment in general and for drawing up long term disinvestment programme for the PSEs referred to the Commission. The long-term strategy of the Disinvestment Commission had four objectives:

1. To strengthen PSEs, where appropriate, in order to facilitate disinvestment;
2. To protect employee’s interest;
3. To broaden base ownership; and
4. To augment receipts for the government.

The disinvestment commission broadly classified the PSEs into two categories disinvestment - the core group and the non-core group. Those in the core group were defined as having a considerable market presence. In these PSEs, as the private sector is yet to mature fully, the public sector disinvestments with the aim of enhancing the intrinsic value of PSU shares. The Commission recommended that the core and non-core PSUs should be restructured prior to disinvestment. It identified about 100 PSUs and classified them as ‘Navratnas’; and ‘Miniratnas’. Nine well performing PSUs under the core category were identified by the government for granting autonomy, which meant giving them
freedom in incur capital expenditure, raise resources, and enter technology contracts. These PSUs popularly known as ‘Navratnas’, are BHEL, BPCL, HPCL, IPCL, IOC, NTPC, ONGC, SAIL and VSNL.

The Disinvestment Commission advocated ‘Strategic Sale’ of particular PSUs or sale of equity blocks to a single buyer accompanied by transfer of management to the private investor. The government showed its willingness to hand over control through strategic sales to any private party acquiring 25 percent in the company. The Disinvestment Commission has the mandate to offload upto 74 percent government equity in the non-core and non-strategic areas. There is no change in the government’s present shareholding in strategic areas. The government has identified arms, ammunition and the allied items of defence equipment, defence aircraft and warship, atomic energy and railway transport as strategic areas.

The Disinvestment Commission submitted twelve reports recommending disinvestment of 58 PSUs out of the 71 referred to it. These reports contained specific recommendations including disinvestment through strategic sale in 29 PSUs, trade sale in 8 PSUs, offer of share through GDR and domestic route for 5 PSUs, no disinvestment for 1 PSU, disinvestment deferred in 11 PSUs, and closure of 4. The government decided to disinvest in 45 PSUs out of the recommended 58. The tenure of the Disinvestment Commission ended on November 30, 1999.

The Commission also gave its view on important issues like creating of Disinvestment Fund, revamped VRS, Employee Pension-cum-Insurance scheme, counseling service for employees availing of VRS and safeguards to officers and staff for bonafide commercial decisions. The Disinvestment Commission examined each of the PSUs referred to it and advised the government on the extent of disinvestment feasible as well as the mode of disinvestment and the steps to be initiated. Recommendations ranges from offer of sale of shares involving no change in ownership/management to strategic sale involving change in ownership/management. In some cases, closure/sale of assets of PSUs was recommended while in some cases, deferment of disinvestment was
proposed. The following Table 5.4 shows the summary of recommendations of the Disinvestment Commission:

**Table 5.4 Summary of Recommendations of the Disinvestment Commission**

<table>
<thead>
<tr>
<th>Modalities of disinvestment</th>
<th>No.</th>
<th>Name of PSUs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade Sale</td>
<td>8</td>
<td>ITDC, MEIL, HCIL, R-ASHOK, U-ASHOK, PHL, SIIL, MSTC</td>
</tr>
<tr>
<td>Strategic Sale</td>
<td>29</td>
<td>HTL, ITI, BALCO, BRPL, KOCL, MFL, EIL, HPL, IBP, NEPA, HZL, PPCL, NFL, FACT, IPCL, HCL, SCI, HLL, AL, HSCL, STC, MMTC, PPL, MECON, HLL, HOC, RCF/RNL, BHEL</td>
</tr>
<tr>
<td>Offer of Shares</td>
<td>5</td>
<td>GAIL, CONCOR, MTNL, MALCO, NMDC</td>
</tr>
<tr>
<td>No Disinvestment</td>
<td>1</td>
<td>RITES</td>
</tr>
<tr>
<td>Disinvestment Deferred</td>
<td>11</td>
<td>OIL, ONGC, MOIL, NTPC, NHPC, POWER GRID, NLC, SAIL, CEL, PEC, MECL</td>
</tr>
<tr>
<td>Closure/Sale of Assets</td>
<td>4</td>
<td>EPIL, ET&amp;T, HVOC, RICL</td>
</tr>
<tr>
<td>Total</td>
<td>58</td>
<td>58</td>
</tr>
</tbody>
</table>

*Source: Disinvestment Commission Reports (1 to 12)*

**Guidelines on Modalities of Sale**

The Disinvestment Commission recommended the following guidelines on modalities of sale of PSEs:

(i) **Offer of Sale**: This involves a total or partial change of equity ownership through a direct sale of shares at a fixed price or by a back-building process.

(ii) **Strategic Sale**: This involves selling a substantial stake with managed control or a minority stake supplemented by technology transfer arrangement. The joint venture route would be an alternative.
(iii) **Sale of Units after Restructuring:** This is applicable where a multiunit organization could be spun-off into independent companies which could then be disinvested.

(iv) **Leasing and Management Contracts:** Where it may not be feasible to value the underlying assets of a PSU, it may be leased out to the best bidders so that government retains the benefit of ownership, but the operational deficiencies are improved. In case of management contracts alone, it may not be necessary to lease the assets. The Commission also classified the PSUs as Strategic, Core and Non-Core.

(A) In the strategic group, there should be no disinvestment as they are important from national security angle. This includes arms and ammunition and allied items of defence equipment, defence aircrafts, atomic energy and minerals, railway transport.

(B) In the core group, which are capital or technology intensive such as telecom, power generation and transmission or petroleum exploration, the presence of public sector will be necessary as a countervailing force. The Commission recommended for core-group industries that public sector disinvestment be limited to a maximum of 49 percent.

(C) In the non-core industries, where there are large number of players and there is competition, which ensures consumer protection, disinvestment should be up to 74 percent.

7. **Budget Speech 1998-99:**

In its first budgetary pronouncement, the BJP-led Government decided to bring down Government shareholding in the PSUs to 26% 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 holding in PSEs involving strategic considerations and that the interests of the workers would be protected in all cases.
8. Strategic and Non-Strategic Classification:

On 16th March, 1999, the Government classified the Public Sector Enterprises into strategic and non-strategic areas for the purpose of disinvestment. It was decided that the Strategic Public Sector Enterprises would be there in the areas of:

(a) Arms and ammunitions and the allied items of defence equipment, defence air-craft and warship;
(b) Atomic energy (except in the areas related to the generation of nuclear power and applications of radiation and radio-isotopes to agriculture, medicine and non-strategic industries);
(c) Railway transport.

All other Public Sector Enterprises were to be considered non-strategic. For non-strategic Public Sector Enterprises, it was decided that the reduction of Government stake to 26% would not be automatic and the manner and pace of doing so would be worked out on a case-to-case basis. A decision in regard to the percentage of disinvestment, i.e., government stake going down to less than 51% or to 26%, would be taken on the following considerations:

(a) Whether the industrial sector requires the presence of public sector as a countervailing force to prevent concentration of power in private hands; and
(b) Whether the industrial sector requires a proper regulatory mechanism to protect the consumer interest before public sector enterprises are privatised.

9. Budget Speech 2000-2001:

The highlights of the policy for the year 2000-01 were that for the first time the government made the statement that it was prepared to reduce its stake in the non-strategic PSFs even below 26% if necessary, that there would be increasing
emphasis on strategic sales and that the entire proceeds from disinvestment/privatisation would be deployed in social sector, restructuring of PSEs and retirement of public debt.

There are many PSUs, which are sick and not capable of being revived. The only remaining option is to close down these undertakings after providing an acceptable safety net for the employees and workers. Resources under the National Renewal Fund have been sufficient to meet the cost of Voluntary Separation Scheme (VSS) for such PSUs. At the same time, these PSUs have assets, which if unbundled and realised, can be used for funding VSS. Government will put in place mechanisms to raise resources from the market against the security of these assets and use these funds to provide an adequate safety net to workers and employees.

Government established a new department for disinvestment to establish a systematic policy approach to disinvestment and privatisation.

**Decision dated 23.06.2000:**

In order to secure the presence of the public sector, a countervailing force, the government took the decision of not going for disinvestment of GAIL, IOC and ONGC and retaining them as flagship companies.

**10. Second Disinvestment Commission:**

The government reconstituted the Disinvestment Commission in July 2001 for a period of two years with R. H. Patil as Chairman. The Commission has four other part-time members and one member secretary. The task of this Disinvestment Commission was to advise the government on all non-strategic PSEs and their subsidiaries excluding IOC, ONGC and GAIL. It was also stated that the Commission would also prioritise, examine and make recommendations taking into consideration the existing policy as formulated on 16 March, 1999 and

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the budget speeches of the Finance Minister from time to time. It was also decided that for prioritisation, the following criteria will be observed:

(a) Where disinvestment in PSEs would lead to large revenues to the governments;
(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.

Six reports (Reports 13 to 18) have been submitted by the reconstituted commission till March 2003. In these reports, the Commission has made fresh recommendations for 17 PSEs and review recommendations for four PSEs. The Commission recommended strategic sale in case of 8 PSEs and sale of entire government stake or closure in 6 PSEs out of 17 freshly examined PSEs.

The following Table No. 5.5 to 5.7 show the disinvestment in PSEs.

**Table 5.5 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>0.90000</td>
<td>221.65</td>
</tr>
<tr>
<td>GAIL</td>
<td>(i) Divested/sold to institutional investors 3.0610 181.78</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(ii) Cross holding by ONGC 4.0840 245.04</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(iii) Cross holding by IOC 4.0840 245.04</td>
<td></td>
<td></td>
</tr>
<tr>
<td>IOC</td>
<td>Cross holding by ONGC 3.1272 1208.96</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ONGC</td>
<td>(i) Cross holding by IOC 12.5349 2034.96</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(ii) Cross holding by GAIL 2.7719 450.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>VSNL</td>
<td>GDR issue             1.0000 783.68</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>31.5630</td>
<td>5371.11</td>
<td></td>
</tr>
</tbody>
</table>

Note: All these PSEs were partially disinvested earlier also.

Table 5.6 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</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industries Ltd.</td>
<td>Strategic sale of 74% equity</td>
<td>0.0920 (Face value Rs. 1000)</td>
<td>94.51 (After adjustment)</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>15.9398</td>
<td>1573.78</td>
</tr>
</tbody>
</table>

Note: Other than MFIL, all other enterprises partially disinvested earlier also.

Source: Enterprise-wise details obtained by researcher from Ministry of Disinvestment.

Table 5.7 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 percent</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 Refineries</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 enterprises were partially disinvested earlier also.

Source: Ministry of Disinvestment.

11. Budget Speech 2001-02:

The Budget Speech for the year 2001-02 has highlighted that after setting up of the Ministry of Disinvestment, the process of privatisation of PSEs has been streamlined. To maximise returns to Government, the approach has shifted from the disinvestment of small lots of shares to strategic sale of blocks of shares to strategic investors.
It was declared that the proceeds would be used for providing:
(a) Restructuring assistance to PSEs
(b) Safety net to workers.
(c) Reduction of debt burden

The following Table 5.8 shows the position of disinvestment in 2001-02:

<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 percent</td>
<td>152.00</td>
</tr>
<tr>
<td>HTL</td>
<td>Strategic sale of 74 percent</td>
<td>55.00</td>
</tr>
<tr>
<td>IBP</td>
<td>Strategic sale of 33.58 percent</td>
<td>1153.68</td>
</tr>
<tr>
<td>VSNL</td>
<td>Strategic sale of 25 percent</td>
<td>1439.00</td>
</tr>
<tr>
<td>PPL</td>
<td>Strategic sale of 74 percent</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>Total</td>
<td></td>
<td>3130.94</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.

12. Disinvestment Direction 2002-03

The current direction of privatisation policy is summarised in a suo-motu statement laid in both the Houses of Parliament on December 9, 2002, Government has announced its policy that the main objective of disinvestments is to put national resources and assets to optimal use and in particular to unleash the productive potential inherent in our public sector enterprises. The policy of disinvestments specifically aimed at:

(i) Modernisation and upgradation of Public Sector Enterprises
(ii) Creation of new assets

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9 Economic Survey, 2002-03, P. 150.
(iii) Generation of employment
(iv) Retiring of public debt
(v) To ensure that disinvestment does not result in alienation of national assets, through the process of disinvestments, remain where they are. It will also ensure that disinvestment does not result in private monopolies.
(vi) Setting up disinvestment proceeds funds.
(vii) Formulating the guidelines for the disinvestments of natural assets companies.
(viii) Preparing a paper on the feasibility and modalities of setting up Assets Management Company to hold, manage and dispose the residual holding of the Government in the companies in which Government equity has been disinvested to a strategic partner.
(ix) Government is taking the following specific decisions:
(a) To disinvest through sale of shares to the public in Bharat Petroleum Corporation Limited (BPCL);
(b) To disinvest in Hindustan Petroleum Corporation Limited (HPCL) through strategic sale; and
(c) To allot, in both cases of BPCL and HPCL, a specific percentage of shares to employees of the two companies at concessional prices.

13. Budget Speech : 2003-04 :

In 2003-04 budget, target for disinvestment was kept at Rs. 14,500 crores. The government was able to raise Rs. 1300 crores by making public offer in Maruti Udyog Ltd. and Hindustan Zinc Ltd. The government to achieve this target decided to make public offer of shares of six PSUs, CMC (formerly Computer Maintenance Corporation), IPCL (Indian Petrochemical Corporation Ltd.), IBP (earlier Indo-Burma Petroleum), now controlled by Indian Oil Corporation, Dredging Corporation of India, the Oil and Natural Gas Corporation
(ONGC) and GAIL (formerly Gas Authority of India). Since all these PSUs are highly profitable organisations, their shares were over-subscribed and total realisations of disinvestment during 2003-04 were of the order of Rs. 15,547 crores. In other words, target of disinvestment of Rs. 14,500 crores was exceeded.

14. Budget Speech 2004-05:

The disinvestment and privatisation are useful economic tools. Government will selectively employ these tools, consistent with the declared policy. Government will establish a Board for Reconstruction of Public Sector Enterprises (BRPSE). The Board will advise the Government on the measures to be taken to restructure PSEs, including cases where disinvestment revenues or closure or sale is justified. The disinvestment revenues will be part of the Consolidated Fund of India. While presenting the budget for 2005-06, the manner in which the said revenues have been or will be applied for specified social sector schemes will be reported to the House.

Decision dated 27.01.2005

(i) Government decided, in principle, to list large, profitable Public Sector Enterprises (PSEs) on domestic stock exchanges and to selectively sell a minority stake in listed, profitable PSEs while retaining at least 51% of the shares along with full management control so as not to disturb the public sector character of the companies.

(ii) Government has also decided to constitute a “National Investment Fund” into which the realisation from the sale of minority share holding of the Government in profitable PSEs would be channelised. The Fund would be maintained outside the Consolidated Fund of India. The income from the Fund would be used for the following broad investment objectives:

(a) Investment in social sector projects which promote education, health care and employment;

(b) Capital investment in selected profitable and revivable Public Sector
Enterprises that yield adequate returns in order to enlarge their capital base to finance expansion/diversification.

Disinvestment Process

The Government established a new department of disinvestment on 10-12-1999 to establish a systematic policy approach to disinvestment and privatisation and to give a fresh impetus to this programme, which will emphasize increasingly on strategic sale of public enterprises. The Department has been assigned the job of all matters relating to disinvestment of Central Government equity from central public sector undertakings, decisions on the recommendations of Disinvestment Commission, on the modalities of disinvestment and reconstructing, implementation of disinvestment decisions including appointment of advisors, pricing of shares of central public sector undertakings for purpose of disinvestment of government equity and Disinvestment Commission.

The Department of Disinvestment has prepared a lengthy procedure for carrying out disinvestment in public enterprises. The procedure is reviewed from time to time and modified with the intention of accelerating the process further. At present it is as follows:

(1) Proposals for disinvestment in any public sector undertaking (PSU), based on the recommendations of the Disinvestment Commission or in accordance with declared Disinvestment Policy of the Government, are placed for consideration of the Cabinet Committee on Disinvestment (CCD).

(2) After CCD clears the disinvestment proposals, the selection of an advisor is conducted through a competitive bidding process. The Advisor assists the government in preparation and issue of advertisement in leading newspapers inviting Expressions of Interest (EOI) from interested parties.

(3) After receipt of the EOIs, prospective bidders are short-listed based on pre-determined screening criteria.
(4) Then prepare the information memorandum in consultation with the concerned PSU. This is given to the short-listed prospective bidders who have entered into a Confidentiality Agreement.

(5) The draft share purchase agreement and share holders’ agreement are also prepared by the Advisors with the help of a legal advisor.

(6) The prospective bidders undertake due diligence of the PSU and hold discussions with the advisors/the government/ the representatives of the PSU for any clarifications.

(7) Concurrently, the task of valuation of the PSU is undertaken in accordance with the standard national and international practices. Based on the reactions received from the prospective bidders, the share purchase agreement and share-holders’ agreement are finalised.

(8) These are then vetted by Ministry of Law and are approved by the government. Thereafter, these are sent to the prospective bidders for inviting the final binding bids (Technical and Financial).

(9) The bids received, as above, are examined, analysed and evaluated by the Inter-Ministerial Group (IMG), and their (IMG’s) recommendations are placed before the CCD for the final approval of the bids, the strategic partner, share purchase agreement and share holders’ agreement, and other ancillary issues.

In the disinvestment process mentioned above, the Department of Disinvestment is assisted at each stage by an Inter-Ministerial Group (IMG), comprising officers from the Ministry of Finance, Department of Public Enterprises, the Administrative Ministry/Department controlling the PSU, apart from the officers of the Department of Disinvestment and the advisors. After the transaction is completed, all papers and documents relating to it are to be turned over the Controller and Auditor General of India (CAG), to enable the CAG to undertake an evaluation of the disinvestment, for placing it in Parliament or releasing it to the public.
Guidelines for Evaluating PSEs:

The Ministry of Disinvestment has decided certain guidelines for evaluating PSEs. It has suggested four methods to arrive at the reserve price of a PSE. These are:

1. **Discounted Cash Flow Method (DCF):** The discounted cash flow method discounts the expected cash flows of the PSE to arrive at its present value.

2. **Balance Sheet Method:** The balance sheet method values a company on the basis of the value of its underlying assets. This method of evaluation does not project the future cash flow.

3. **Market Multiple Method:** This method uses information on how the market is evaluating comparable firms.

4. **Assets Valuation Method:** This method estimates the cost of replacing the tangible assets of the business and the cost so arrived at as the value of the firm. The asset valuation method overlooks the value of intangibles such as good will, brands, distribution network, and customer relationship which are important to determine the intrinsic value of enterprise. The asset valuation method is more suitable in case of liquidation than in the case of companies sold as running concerns.

The DCF method is superior to the other three as it perfects future cash flows and the earning potential of the firm, takes into account intangibles such as brand equity, marketing and distribution network, the level of competition likely to be faced in the future, risk factors to which the enterprise is exposed as well as the value of its core assets. Sometimes, it is better to use a combination of methods in case of PSUs having sizeable tangible assets such as surplus land, which are unrelated to its core business.

**The PSE Sell-off Methods:**

The following methods have been adopted by the Government to sell-off shares in PSEs:
**Bidding**: This method was adopted in 1991-92. When the government invites bids for a portion of its stakes in a public sector enterprise, it is essentially conducting an auction. The Department of Public Enterprises invites closed bids from government financial institutions and mutual funds. The tendering process is driven by a reserve price based on valuation models such as net asset value, earning potential, and previous realisations if available. These were determined after consultation with merchant bankers such as IDBI and SBI caps. The government sets a price below which it is unwilling to sell its stake. This price is referred to as the reserve price. In 1991-92, the government resorted to bundling option wherein shares were offered only in bundles of 'very good', 'good' and 'average'. The realised amount exceeded the targeted amount in the very first year of disinvestment programme due to acceptance of low bid for share bundles. However, this strategy instead of helping the government to disinvest shares in loss-making enterprises at reasonable prices, resulted in disinvestment at very low prices. The share bundles included certain PSU shares such as MTNL, ITI, VSNL, CMC and Cochin Refineries which would have otherwise commanded a high premium if sold individually. The practice of bundling shares was abandoned thereafter. The government, in subsequent year, sold shares for each company separately.

**Sale of Shares in the Market**: During 1991-99, shares of companies like IOC, BPCL, HPCL, GAIL and VSNL were sold in the market. The shares of these blue chip companies were sold at the price earnings ratio of around 4.5-6.0. The sale of shares through public issue not only brings down the government’s equity holding in the company but there is also the advantage that the money so realised can be used for expansions. However, a public issue does not result in a change in management style and functioning of the companies. The control of the companies continues to be vested with the government.

**Global Depository Receipts (GDR) Route**: The government decided to tap the overseas market for disinvestment due to sluggish capital market conditions. In
March 1997, the VSNL disinvestment took place through the GDR issue which was priced at $13.93 and was over subscribed 10 times. The second GDR issue of VSNL in Feb. 1999 was priced at a lower price of $ 9.25. MTNL and GAIL were the other GDR issues. The government sold 18 percent equity in GAIL in 1999-2000 and raised Rs. 1,095 crore through the disinvestment of 155 million shares represented by 22.5 million GDRs. The disinvestment through off-loading of minority shares through domestic, ADR, or GDR markets was not productive.

**Cross-Holding**: After widely missing the targets on the PSU disinvestment front, the government adopted an innovative route to meet the disinvestment target in 1998-99. Cash-rich oil companies were asked to subscribe to each other’s shares. This swapping of share, within oil sector PSUs took place just before the close of 1998-99. This cross-holding of Indian Oil Corporation (IOC) buying 10 percent government stake in ONGC and 5 percent stake in GAIL, ONGC buying 10 percent in IOC and 5 percent in GAIL, and GAIL buying 2.5 percent stake in ONGC helped the government gather Rs. 4,867 crores at the end of the year.

**Strategic Sale**: In this method, the government sells its shares in the PSE to a strategic partner. For the bulk of the PSEs, however, disinvestment through the strategic sale route and through retail shares holding appear to be easier and safer options. Strategic sales imply selection of partners based on their strengths in technology, markets, finance or management. Strategic sale are bound to be more profitable for the government as the buyers are likely to pay more for participation in management. A strategic sale is indicative of the government’s sincerity about disinvestment. It also enables a higher valuation since it takes into account intrinsic valuation, not just the prevailing market price. Moreover, private investors introduce new technologies, induct fresh investors, introduce new technologies, induct fresh investments, and improve efficiency. Under strategic sale, the government transfer part of its holding to a strategic partner who would control the operation and financial policy of the enterprise. The strategic partner is chosen through an elaborate bidding process. The transfer of ownership is subject
to certain restrictions imposed through covenants. The strategic sale of BALCO, CMC, HTL, MFIL, PPL, JESSOP, IBP, LJMC, VSNL, HZL, Maruti and IPCL was done at a higher price-earnings ratio ranging between 11 to 89. VSNL's price earnings ratio of around 11 was higher by around 6 than in the case of public issue. In strategic sale, the money goes to the government exchequer instead of the company. The recourse to strategic sale has made the process of disinvestment more beneficial from the revenue point of view. One of the advantages of a strategic sale is that the price consideration would be much higher than what would be dictated by stock market conditions, since the prospect of participation in management/management control will be incentive behind the offer.

Proceeds from Disinvestment and Methodologies Adopted:

Generally, the government has adopted two methods of disinvestment: (1) selling of shares in select PSEs and (2) strategic sale of a PSE to a private sector company. The former method was used over the period 1991-92 to 1998-99 and since 1999-2000, the emphasis shifted to the latter method. The proceeds from disinvestment from April 1991 to November 2005 amounted to Rs. 47,671.62 crore. Details of the annual realisation and the methodologies adopted are given in the Table 5.9.

Total Investment in PSUs:

PSUs operate at two levels - Centre Level PSUs and State Level PSUs. Data about Central Government PSUs is compiled annually in Public Enterprises Survey is very authentic. As per information provided, during 14 year (1990 to 2004), investment in Central Government PSUs has risen from Rs. 99,330 crores on 31st March 1990 to Rs. 3,49,209 crores as on March 31, 2004, indicating an annual average growth rate of 9.4%. Total proceeds realised from disinvestments is of the order of Rs. 49,126 crores, i.e., 14.1% to total investment in CPSUs.
<table>
<thead>
<tr>
<th>Year</th>
<th>No. of transaction</th>
<th>Budget receipt (Rs. Crore)</th>
<th>Receipts through sale of residual/minority shares (Rs. Crore)</th>
<th>Receipts through sale of shares to CPSEs (Rs. Crore)</th>
<th>Receipts through strategic sale (Rs. Crore)</th>
<th>Total receipts (Rs. Crore)</th>
<th>Main transaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991-92</td>
<td>47</td>
<td>2500</td>
<td>3037.74</td>
<td>0.00</td>
<td>0.00</td>
<td>3037.74</td>
<td>Minority shares sold in Dec 1991 and February by auction method in bundles of ‘very good’, ‘good’ and ‘average’ companies</td>
</tr>
<tr>
<td>1992-93</td>
<td>29</td>
<td>2500</td>
<td>1912.42</td>
<td>0.00</td>
<td>0.00</td>
<td>1912.42</td>
<td>Shares sold separately for each company by auction method</td>
</tr>
<tr>
<td>1993-94</td>
<td>-</td>
<td>3500</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>Equity of six companies sold by the open auction but proceeds received in 1994-95.</td>
</tr>
<tr>
<td>1994-95</td>
<td>17</td>
<td>4000</td>
<td>4843.10</td>
<td>0.00</td>
<td>0.00</td>
<td>4843.10</td>
<td>Shares sold by auction method</td>
</tr>
<tr>
<td>1995-96</td>
<td>4</td>
<td>7000</td>
<td>168.48</td>
<td>0.00</td>
<td>0.00</td>
<td>168.48</td>
<td>Share sold by auction method</td>
</tr>
<tr>
<td>1996-97</td>
<td>1</td>
<td>5000</td>
<td>377.67</td>
<td>0.00</td>
<td>0.00</td>
<td>379.67</td>
<td>GDR-VSNL in international market</td>
</tr>
<tr>
<td>1997-98</td>
<td>1</td>
<td>4800</td>
<td>910.00</td>
<td>0.00</td>
<td>0.00</td>
<td>910.00</td>
<td>GDR-MTNL in international market</td>
</tr>
<tr>
<td>1998-99</td>
<td>5</td>
<td>5000</td>
<td>5371.11</td>
<td>0.00</td>
<td>0.00</td>
<td>5371.11</td>
<td>GDR-VSNL; Domestic offerings of CONCOR and GAIL; Cross purchase by three oil sector companies, i.e., GAIL, ONGC and IOC.</td>
</tr>
<tr>
<td>1999-2000</td>
<td>5</td>
<td>10000</td>
<td>1479.27</td>
<td>0.00</td>
<td>0.00</td>
<td>1860.14</td>
<td>GDR-GAIL; Domestic offering of VSNL; Capital restructuring of BALCO; Strategic sale of MIFL.</td>
</tr>
<tr>
<td>Year</td>
<td>No. of transaction</td>
<td>Main transaction</td>
<td>Total receipts (Rs. Crore)</td>
<td>Receipts through strategic sale (Rs. Crore)</td>
<td>Receipts through sale of shares to CPSEs (Rs. Crore)</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>2000-01</td>
<td>5</td>
<td>Strategic sale of BALCO and LIMC, Sale of KRL, CPCL and BRPL to CPSEs.</td>
<td>1871.26</td>
<td>5657.44</td>
<td>0.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2001-02</td>
<td>8</td>
<td>Strategic sale of CMC, HTL, VSNL, IBP, PPL, and sale of hotel properties of ITDC and HCL; Special dividend from STC and MMC; Sale of shares to VSNL employees.</td>
<td>5657.44</td>
<td>3347.98</td>
<td>0.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002-03</td>
<td>8</td>
<td>Strategic sale of FZL, IPCL and sale of hotel properties of HCL and ITDC; Control premium from renunciation of rights issue from MUL; Put Option of MFIL; Sale of shares to employees of HZL and CMC.</td>
<td>3347.98</td>
<td>15547.81</td>
<td>0.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003-04</td>
<td>2</td>
<td>Offer for sale of MUL, IBP, IPCL, CMC, DCL, GAIL, and ONGC; Sale of shares to ICL Ltd.</td>
<td>15205.35</td>
<td>342.06</td>
<td>0.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004-05</td>
<td>3</td>
<td>Offer for sale of NTPC, Sale of shares to IPCL employees, etc.</td>
<td>96800</td>
<td>2700.06</td>
<td>0.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

According to Ministry of Disinvestment, estimated total investment in State Level Public Enterprises was of the order of Rs. 1,62,063 crore as on 31st March 2000. Six states, viz., Gujarat, Maharashtra, Karnataka, Uttar Pradesh, West Bengal and Punjab accounting for 63.6% of total investment in all SLPEs.

Disinvestment has also been undertaken in State. As per information compiled by Institute of Public Enterprises, Hyderabad, out of 222 State Level Enterprises (SLPEs) identified for disinvestment/ winding up/ restructuring, the process of disinvestment/ privatisation has been initiated in 124 enterprises, 30 SLPEs have been privatised and 68 SLPEs have been closed down, as per information available at the website of Ministry of Disinvestment up to 25.12.2002. However, the information is highly inadequate, because it does not provide the total amount realised, the extent of privatisation / disinvestment and the share of equity retained by the state government. Though the information is highly unsatisfactory, it does provide us a glimpse of the privatisation undertaken in SLPEs.

Taking the Central Government PSUs and State Level PSUs, total investment in Public Enterprises in India is of the order of about Rs. 5,11,270 crores - a huge figure indeed. Bulk of this investment, nearly three-fourth has been incurred in heavy and basic industries and infrastructure so as to provide an industrial base to the economy as also to build its capacity for growth.

Public Sector Policy in Common Minimum Programme of UPA Government:

The policy of the Government on Disinvestment has evolved over a period of time. The National Common Minimum Programme (NCMP) outline the present policy of the Government with respect to the Public Sector, including disinvestment of Government’s equity in Central Public Sector Enterprises (CPEs). The salient features of the policy is laid down in NCMP are as follows:

1. The Government is committed to a strong and effective public sector whose social objectives are met by its commercial functioning.

2. The Government is pledged to devolve full managerial and
commercial autonomy to successful, profit making companies, operating in a competitive environment.

3. Generally, profit making companies will not be privatised.

4. All privatisations will be considered on a transparent and consultative case-by-case basis.

5. The Government will retain existing ‘Navratna’ companies in the public sector, while these companies raise resources from the capital market.

6. While every effort will be made to modernize and restructure sick public sector companies and revive sick industry, chronically loss-making companies will either be sold-off, or closed, after all workers have got their legitimate dues and compensation.

7. The Government will induct private industry to turn around companies that have potential for revival.

8. The Government believes that privatisation should increase competition, not decrease it. It will not support the emergence of any monopoly that only restricts competition. It also believes that there must be direct link between privatisation and social needs - like, for example, the use of privatisation revenues for designated social schemes. Public sector companies and nationalised banks will be encouraged to enter the capital market to raise resources and offer new investment avenues to retail investors.

The UPA government intended to make an effort to reverse the policy of the NDA government regarding disinvestment of profit-making PSUs and also to remove the shortcomings witnessed in the privatization of PSUs. The policy was, therefore, welcomed.

However, in practice, the UPA government proposed a disinvestment of 10 percent government equity in BHEL. It may be noted that BHEL was designated as Navratna. Similarly, the Finance Ministry proposed a disinvestment of government equity of 20 percent in case of BALCO which earned a profit before
tax of Rs. 1,222 crores in 2003-04. Both these proposals were opposed by the left parties as violations of the policy of disinvestment enunciated in the National Common Minimum Programme. As a consequence of the strong opposition by the left parties, the Finance Minister during the budget of 2005-06 and 2006-07 did not make any provision for disinvestment of PSUs.

The Government has decided to establish a Board for Reconstruction of Public Sector Enterprises (BRPSE) to advise the Government on ways and means for strengthening public sector enterprises (PSEs) in general and to make them more autonomous and professional. The Board would consider reconstructing - financial, organisational and business - of central PSEs and suggests ways and means for funding such schemes. The Board would also advise the Government on disinvestment/ closure/ sale in respect of chronically sick / loss making companies which can not be revived.

The Government has approved the constitution of a National Investment Fund comprising of proceeds from disinvestment of public sector units. The broad objective of the fund will be to make investment in social sector projects and capital investment in selected profitable or revivable PSEs that yield adequate returns, in order to enlarge their capital base to finance expansion/ diversification. The fund will come into effect from April 1, 2005.

The Government has also given ‘in principle’ approval for listing of currently unlisted profitable PSEs each with a net worth in excess of Rs. 200 crore, through an initial public offer (IPO), either in conjunction with a fresh equity issue by the PSE concerned or independently by the Government on a case by case basis, subject to the residual equity of the Government remaining at least 51 percent and the Government retaining management control of the PSE.

A Critical Evaluation of Privatisation and Disinvestment:

The Industrial Policy Statement of July-1991 envisaged the disinvestment of a part of the share holding in selected public sector enterprises to provide financial discipline and improve the performance of public enterprises.
Subsequently, as part of the budget speech for 1991-92, the government also announced the intention of partial disinvestment in selected PSEs in order to raise resources, encourage wider public participation and greater accountability. Disinvestment Commission was also set up on Dec 10, 1999 which was to act as a nodal agency for disinvestment and to have a systematic policy approach towards 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 decision on the recommendation 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).

Undervaluation of Assets:

A study of the foregoing analysis shows that the performance on the disinvestment front over the period 1991-92 to 2004-05 has been dismal. Only in four years - 1991-92, 1994-95, 1998-99 and 2003-04, the targets for disinvestment were exceeded. According to C. P. Chandrashekhar and Jayati Ghosh, the success in 1991-92 was due to decision to accept extremely low bids for share ‘bundles’ which included equity from PSUs which would have otherwise commanded a handsome premium. The average price at which more than 87 crore shares were sold in this year was only Rs. 34.83 as compared with the average price realisation of Rs. 109.61 since then.\(^\text{10}\) In 1994-95, success was due to the off-loading of a significant chunk of shares in very attractive and profitable PSUs like BHEL, Bharat Petroleum, Container Corporation of India, Engineers India, GAIL, MTNL, etc. And in 1998-99, the success was due to the reason that cash-rich PSUs like

\(^{10}\) C. P. Chandrashekhar and Jayati Ghosh, The Market That Failed : A Decade of Neoliberal Economic Reforms in India (New Delhi, 2002), P. 89.
ONGC, GAIL and IOC were forced to buy shares of other PSUs, "This amounted to forcing PSUs, that needed further investment themselves so as to be restructured, to face up to more liberal and competitive environment, to hand over their investible surpluses to finance the fiscal deficit of the government." The success in 2003-04 was primarily due to sale of 142.60 million shares in ONGC which fetched as much as Rs. 10,695 crore.

In all other years, realisations from disinvestment were much less than the targets. The main reason for this poor performance were as follows:

1. The government carried out the whole exercise of disinvestment in a hasty, unplanned and hesitant way. Thus it failed to realise not only the best value but also the other objectives of the disinvestment programme.

2. The government launched the disinvestment programme without creating the required conditions for its take-off. This would be clear from the fact that it did not try to list the shares of the public sector enterprises on the stock exchanges. Thus, adequate efforts were not made to build-up the much needed linkage between the public enterprises on the one hand and the capital market on the other.

3. The government did not adopt suitable methods to oversee the disinvestment of public sector share holding.

4. The Department of Public Enterprise and the Finance Ministry adopted techniques and methods which resulted in far lower realisation than justified.

On account of all these reasons, there was considerable ‘under-pricing’ of public enterprises shares resulting in considerable loss to the government. To illustrate, consider the pricing in the first two rounds. In Report No. 14 of 1993, the Comptroller and Auditor General of India pointed out that in these two rounds, the extent to loss to the government in percentage terms varied from 127

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11 Ibid, P. 90, Also P. 92.
percent in the case of HPCL (its share having been sold for Rs. 243 against the market price of Rs. 550) to as high as 616 percent in the case of NIC (its share having been sold for Rs. 11 against the market price of Rs. 82). The average loss consequent upon the underpricing comes to about 256 percent. If we apply its percentage to the divestiture proceeds for 1991-92 and 1992-93, we find that the potential proceeds would have been Rs. 12,554 crore as against the actual realisation of only Rs. 4,951 crore.\textsuperscript{12} The same problem of under pricing continued in later rounds also.

Undervaluation of assets implies substantial losses for the government and therefore for the tax-paying citizens of the country. There is a basic problem with all privatisation of public assets, which means that they tend to be associated ultimately with losses to the State exchequer rather than gains. If the government sells the asset that provides income or profit equal to more than the prevailing interest on government securities, then the government would lose future income by selling it. On the other hand, from the private sector's point of view, it makes no sense to purchase an asset unless it provides at least a rate of return equal to the rate of interest on government securities, because that is where the private investor could otherwise put the money. "This means that for such sales to occur, either (a) the private investor must believe that it is capable of generating more profits than the public sector - but that is essentially a management issue and there is no logical reason why the public sector can not also employ managers to achieve this; or (b) the asset must be undervalued so that the actual rate of return for the private buyer turns out to be higher, which really means that the state exchequer has lost the money."\textsuperscript{13}

\textbf{Utilisation of Money from Disinvestment}

As shown above, the public sector equity has been sold for a fraction of what it could actually fetch. However, this is only one part of the story. The entire

\textsuperscript{12} Sunil Mani, "Economic Liberalisation and the Industrial Sector", Economic and Political Weekly, May 27, 1995, P.M.45, Table 7 on P.M. 41 and Table 8 on P.M.42.

\textsuperscript{13} C. P. Chandrashekhar and Jayati Ghosh, op. cit., PP. 90-91.
manner in which the proceeds from disinvestment have been used is objectionable. When the programme of disinvestment was initiated in 1991-92, the Finance Minister had stated that a part of the proceeds would be used for providing resources in the NRF (National Renewal Fund) which can be used for various schemes of assistance to workers to the unorganised sector. Moreover, these “non-inflationary resources would also be used to fund.... special employment creating schemes in backward areas.” In 1997, the first report of the Disinvestment Commission headed by G. V. Ramkrishna stated that the proceeds of disinvestment should not be used to bridge the budget deficit, but instead should be placed in a separate fund to be used for four purposes: (i) retiring public debt; (ii) restructuring PSUs; (iii) developing the social infrastructure; and (iv) voluntary retirement schemes. Similar sentiments were expressed in various budget speeches of the Finance Ministers in various years. For the year 2001-02, the Finance Minister had set the target for disinvestment at Rs. 12,000 crore of which Rs. 7000 crore was to be used to provide “restructuring assistance to PSUs, a safety net to workers and reduction of (the public) debt burden” while the remaining Rs. 5000 crore was to be used to provide “additional budgetary support to the plan primarily in the social and infrastructure sectors.”

The list of objectives of disinvestment given earlier also expressed such lofty ideals. However, the actual experience with the utilisation of disinvestment proceeds during the last decades belies all these declarations. The government has used the entire proceeds from disinvestment to offset the shortfalls in revenue receipts and thus reduce the fiscal deficit which it was required to do as part of the IMF stabilisation programme. In this context, the following comments of C. P. Chandrashekhar and Jayati Ghosh are pertinent: “The experience suggests that the fiscal convenience was the prime mover of such disinvestment. Having internalized the IMF prescription that reducing or doing away with fiscal deficits is the prime indicator of good macroeconomic management, the government found privatisation proceeds of PSUs to be a useful source of revenue to window-
dress budgets." Thus the resources generated from the disinvestment of PSUs have been used to meet current consumption needs. This amount to frittering away valuable public assets. It is like selling family silver to support a profligate lifestyle. Moreover, once a PSU is privatised, the government is deprived of the future yields from this enterprise. This could be a large long-term loss in the case of profit generating PSUs. This points to the shortsightedness of the government's disinvestment programme.

Private phase of disinvestment policy has been facing severe opposition from the employees, trade unions, selected political parties and even from the administrative ministries. At the present time, there appears to be lack of political consensus among the coalition partners in the Central Government on economic reforms, including privatisation of public sector enterprises. It appears that socialistic attitudes are hard to overcome. Moreover, the prospect of loss of territory together with the perks that go with it appears to have inspired interested sections to raise the hurdles in the path of privatisation. These underlying reservations have been camouflaged by raising the bogey of massive unemployment, sell-out to foreigners and prospect of economic slavery. "The opposition could be couched as driven by public interest and might even be so. But equally undeniably the control of a public enterprise confers on the minister concerned, considerable discretion in the choice of strategic options to be adopted by the unit besides influencing any number of routine operational discussions."15

At times, sale of a PSU to a private company can only result in the substitution of a public monopoly by a private monopoly. In such cases, inefficiencies of monopoly power will merely be transferred to the public sector, with the costs being borne by the consumers, or, "monopolistic exploitation by efficient private owners replaces the inefficiencies of public ownership."16 The danger is particularly present in the case of public utilities. For example, in

Cochabamba, Bolivia's third largest city, water supply was privatised and sold to a foreign Consortium Auuas del Tunari in 1999. The consortium resorted to huge increases in tariffs and at the same time, put restrictions on the use of water. This caused widespread resentment provoking riots. As a result, the government had no option but to put an end to the contract.

Undervaluation of PSEs points to the prevalence of widespread corruption on the one hand, and complicity between sections of the government and particular business groups on the other hand (in the case of strategic sales). In this context, the comments of Joseph Stiglitz are pertinent, "Perhaps the most serious concern with privatisation, as it has so often been practiced, is corruption. The rhetoric of market fundamentalism asserts that privatisation will reduce what economists call the "rent-seeking" activity of government officials who either skim off the profits of government enterprises or award contracts and jobs to their friends. But in contrast to what it was supposed to do, privatisation has made matter so much worse that in many countries today, privatisation is jokingly referred to as "briberisation". If a government is corrupt, there is little evidence that privatisation will solve the problem. After all, the same corrupt government that mismanaged the firm will also handle the privatisation."[17]

In India, neither the calendar of disinvestment is drawn up nor very seriously adhered to. Timeframe for disinvestment is uncertain. In other countries, disinvestment programme of PSEs has taken the form of physical, organisational, financial and manpower restructuring. India has missed the comprehensive understanding of the approach resorting to mostly financial restructuring which could not produce the desired results. India has fallen prey to the short-term objective of raising revenues, leading to partial realisation of benefits. Therefore, our disinvestment programme should be exercised to achieve the long-term objective of enhancing competition, promoting optimum allocation of resources, etc. Thus, the government carried out the whole exercise of

disinvestment in a hasty, unplanned and hesitant way. Thus, it failed to realise not only the best value but also the other objectives of the disinvestment programme.

The government launched the disinvestment programme without creating the required conditions for its take-off. This would be clear from the fact that it did not try to list the shares of the public sector enterprises on the stock exchanges. Thus, adequate efforts were not made to build-up the much needed linkage between the public enterprises on the one hand and the capital market on the other.

One of the genuine fears of labour is that privatisation is bound to result in unemployment. Most of the privatisation experiments around the globe are testimony to the fact that this indeed does happen. The Government of India has been repeatedly harping on the tune that a result of privatisation there has only been a ‘marginal’ retrenchment of labour.\(^\text{18}\) However, the fact of the matter is that there is a strong pressure from the corporate sector to ‘reform’ labour laws to enable it to hire and fire workers as it wishes and indications are that the government is falling in line. This means that the future employment scenario for labour is a cause of worry. The fear of retrenchment and consequent unemployment is all the more as there is no safety net scheme for labour worth the name. How many workers will be able to get VRS (Voluntary Retirement Scheme) and on what conditions is only a matter of speculation. In any case, VRS is no solution of unemployment.

The government did not adopt suitable methods to oversee the disinvestment of public sector shareholding. The Department adopted techniques and methods which resulted in far lower realisation than justified.

Improvement in efficiency should be the primary objective of privatisation. This objective can be achieved when inefficient public sector units are privatised. Instead, in the last decade, some of the best performing units have been sold off.

\(^\text{18}\) Govt. of India, Economic Survey, 2002-03 (Delhi 2003), P. 150.
Most of the blue chip companies were sold at very low prices. The distress sale was a result of an inappropriate pricing strategy and delays in pricing. The delay in pricing the VSNL issue resulted in a massive loss to the nation. The same mistake was committed when the shares of GAIL were sold at half the proposed price. To make disinvestment a success, the government should come to terms with the fact that it is the market that determines the price of a PSU stock.

In the case of strategic sale of a unit, the government did not put in substantial efforts to restructure or market the PSUs. Hence, most of the time, it ended up selling a company cheap. For instance, the restructuring of Paradeep Phosphates was incomplete and it was sold off at a low price to Zuari Macro Phosphate. The restructuring of a unit should be of both financial and operational nature.

An important argument in favour of privatisation of PSEs is the belief that this would help in improving their performance. But some critics have pointed out that there is no positive relationship between ownership and performance. Thus, according to them, the belief that privatisation, by itself, leads to better performance is questionable. Pranab Bardhan and John E. Roemer have stated: “Our claim is that competitive market are necessary to achieve an efficient and vigorous economy; but that full scale private ownership is not necessary for the successful operation of competition and market.”19 Their claim is substantiated by the experience of China. The experience of China reveals that to improve and strengthen the efficiency of inefficient units, it is necessary to create competitive market structure. It is a competitive environment, rather than ownership, that promotes allocative efficiency.

To sum-up, the main factors responsible for poor outcome of disinvestment in India include the lack of an overall strategy for disinvestment; the absence of systematic efforts to re structure and prepare enterprises for disinvestment; the arbitrary selection of enterprises for disinvestment without any consultation with them; a high degree of secrecy: the lack of objectivity in the share valuation

methods; and a lack of incentives for enterprises to participate enthusiastically in
the programme (for example, there was no provision for enterprises to retain a
percentage of the disinvestment proceeds); opposition from the relevant
administrative ministry, employees, trade unions and interest group; lack of
domestic capital and lukewarm response of foreign capital and above all lack of
political consensus on disinvestment.

**Conclusion:**

The opposition to privatisation policy can be moderated by evolving a
political consensus in the Parliament as well as with state governments;
restructuring public enterprises with a view to privatisation; sharing the benefits
of privatisation with employees as well as general public. The benefits of
privatisation by learning from the U.K. experience can be shared with employees
by giving them a limited number of shares free of cost by selling shares to
workers at a discounted price and introducing a concept of bonus share to the
employees. The general public can reap the benefits of disinvestment through two
routes. First, by getting a wider share ownership through the policy of preferring
small applicants while disinvesting. Secondly, by making efficiency improvement
as one of the major goals of disinvestment and evolving a mechanism to pass on
the benefits of efficiency improvement to the general public.

One can not but fully agree with the present Prime Minister of India
Dr. Manmohan Singh, the architect of India’s economic reforms, when he said,
"Privatisation should no longer be seen as an instrument of reducing the budget
deficit. It must have a wider purpose. The proceeds of privatisation or
disinvestment must be used for three purposes. First, to strengthen the better off
PSEs and make them even more competitive. Secondly, some of the funds must be
used to finance specific social programmes such as public education and health.
This is what Mexico did, and this is vital to gain political acceptability for
privatisation. Finally, some of the proceeds must be used as a seed capital to
strengthen infrastructure."

Privatisation/Disinvestment will succeed only if it is conceived as a part of
overall liberalisation process, involving removal of protection of inefficient
industries in the public sector, amendments to laws which hinder competition, reforms aimed at opening up of hitherto closed sectors of the Indian economy and rapid reform of the financial sector. These measures would help considerably in increasing investment for creation of world class infrastructure and for creation of better living standards of the people.

Lastly, it can be concluded that liberalisation and the privatisation/disinvestment to the extent necessary for a sound economy, needs to be expedited. The opportunities and challenges of the change must be accepted. Only then, policy can reach its logical conclusion of ushering in a new economic order in which the government instead of frittering away its resources on industry, trade and business is able to develop the social sectors like education, health, rural development programmes with higher budgetary support.