CHAPTER 4

INDUSTRIAL SECTOR REFORMS

4.1 Introduction

India in 1947 has a sizeable corporate sector accounting for at least 10% of GDP; it had well functioning stock markets and a developed banking system; it had a substantial body of laws relating to the conduct of companies, banks, stock markets, trusts and securities; and it had an equity culture among a section of the urban populace. It was probably the de-colonised country that was best equipped to practice good corporate governance, maximise long term corporate and protect stakeholder rights.

The first barrier to investments came with the Industries (Development and Regulation) Act, 1951 (IDRA), which required all existing and proposed industrial units to obtain licences from the central government. The IDRA continued for four decades before being dismantled in June 1991. The pervasive licensing regime under IDRA fostered entry barriers through pre-emption of industrial licences which, in turn, facilitated widespread rent seeking. Entrepreneurial families and business houses that had built their fortune in textile, coal, iron and steel and jute now used licences to secure monopolistic and oligopolistic privileges in new industries such as aluminium, paper, cement and engineering. Over the years, licensing became increasingly stringent and was accompanied by multiple procedures that required clearances from a large number of uncoordinated ministries. For instance, a typical private sector manufacturing company needed government permission to establish a new plant, manufacture a new article,
expand capacity, change location, import capital goods and do many other things that feel under the rubric of normal corporate activity.

A more serious barrier to entry occurred in 1956, when the Industrial Policy Resolution (IPR) adopted the maxim of ‘a socialist pattern of society’ and prescribed that the public sector would occupy the commanding heights’ of the economy. Schedule A of the IPR listed 17 industries whose future development would be “the exclusive responsibility of the State”, and 12 Schedule B industries where “the State will increasingly establish new undertakings”. By a single stroke, India succeeded in creating yet another barrier to private investment. With it, the government also created a massive state-owned industrial and services sector which brought its specific dysfunctionalities, inefficiencies, cost disadvantages and corporate governance problems.

The late 1960s and early 1970s witnessed a more intensified trend to limit private investment and foster inefficient manufacturing scales. The Monopolies and Restrictive Trade Practices Act, 1969 (MRTP) linked industrial licensing with an asset based classification of monopoly. With the passing of MRTP, private sector businesses whose assets exceeded a paltry amount varying from Rs. 10 million to Rs. 1 billion had to apply for additional licences to increase capacities. More often than not, such applications were rejected. MRTP was followed by widespread nationalisation, which began in 1969 with the insurance companies and banks and, in 1970 encompassed petroleum companies and collieries. Among other things, nationalisation made employment preservation a political objective. The 1970s and early 1980s saw successive governments taking over financially distressed private sector textile mills and engineering companies – thus converting private bankruptcy to high cost public debt.

In addition, the government made a fetish out of ‘small is beautiful’. This occurred in two ways. First, successive governments sponsored the setting up of
mini-plants, and the 1980s saw a mushrooming of technologically non-viable mini-steel, mini-cement and mini-paper units whose profitability hinged upon heavy tax concessions, high initial levering, subsidised long term finance, high tariffs and import quotas and the munificence of government orders. Second, governments actively encouraged small-scale industries. While this is not necessarily a bad thing – small and medium enterprises are often more efficient and flexible compared to larger firms – the small-scale sector was fostered through a plethora of artificial means, such as tax concessions and product reservations. Even today, there are over 800 product lines reserved for the small scale sector, of which more than 600 are not even manufactured in India!

Naturally, these distortions could not have existed in an outward oriented, open economy. They were eventually supported by a regime of high tariffs and import quotas. Despite preferential tariffs for Britain and the Empire countries, there were no major barriers to trade during the colonial era. Consequently, the major industries that existed prior to independence – cotton textiles and yarn, jute, tea and coal – were internationally competitive, and two of them (jute and tea) were driven by exports. Things began to change from the mid-1960s, intensifying with the import substituting regime of the 1970s and early 1980s. Import substitution made it incumbent upon a company to demonstrate to bureaucrats the ‘essentiality’ of any import, and the doctrine of ‘indigenous availability’ ensured the purchase of Indian inputs even at higher price-lower quality configurations.

Import substitution was sustained by quantitative restrictions and high tariffs. Quotas came in the form of various types of import licences. Among them were Actual Users (Industrial) Licenses, Actual Users (Non-industrial) Licenses, Capital Goods Licenses, Customs Clearance Permits, Supplementary Licenses, Import Replenishment Licenses, Special Import Licenses, Additional Licenses, canalisation of imports and Open General Licenses. Over the year industrial tariffs
continued to be raised until the peak rate exceeded 300%. By 1985, the mean tariff rate for intermediate goods was 146% (standard deviation 56%); and for capital goods it was 107% (standard deviation 48%).

To be sure, some of the policies helped setting up industrial capacities, especially in engineering, drugs and pharmaceuticals, chemicals, fertiliser and petrochemicals. But these also created highly protected markets, fostered uncompetitiveness and promoted large scale rent-seeking through a nexus between companies and bureaucrats and politicians – a fertile ground for sowing the seeds of corporate misgovernance.

The strategy of Indian industrialization did not change from Independence to 1990. It emphasized heavy industry public ownership and import substitution. This went along with contempt for price mechanism and a belief that competition was harmful. A licence was needed to start or expand or expand substantially any industrial activity giving employment to more than fifty workers. Big private business, both domestic and foreign, was feared and distrusted. Special obstacles were put in the way of expansion by dominant companies and those with significant foreign ownership. Yet at the same time the political support of private industry was needed. Thus businessmen were protected in many ways from both foreign and domestic competition. Their incumbent workers like those in the public sector were doubly protected as it was made illegal to sack anyone without permission or even to vary the kind of work.

As far as industrial policy went, Indian socialism became both bourgeois and exclusive. Those who promoted these protective policies ignored the fact that they benefited only the relatively well off and excluded large numbers of much poorer people with no jobs in medium – or large scale factories. The ‘permit raj’. as the regime came to be called, created a high cost inflexible capital intensive industry with predominance of very large factories in the public sector. In the
private sector small enterprises were encouraged by various concessions that were both capital intensive and far too small to realize possible economies of scale. It was only in the late 1980s that the prejudices and beliefs which has led to unsuitable industrial development came to be widely questioned.

4.2 New Industrial Policy

In line with the liberalisation measures announced during the 1980s the government announced a New Industrial Policy on July 24, 1991 to de-regulate the industrial economy in a substantial manner. The major objectives of the new policy are “to build on the gains already made, correct the distortions or weaknesses that might have crept in, maintain a sustained growth in productivity and gainful employment, and attain international competitiveness”. In pursuit of these objectives, the government announced a series of initiatives in respect of the policies relating to the following areas:

A. Industrial Licensing
B. Foreign Investment
C. Foreign Technology Agreements
D. Public Sector Policy
E. MRTP Act.

A package for the small and tiny sectors of industry was announced separately in August 1991.

In order to liberalize the economy and to enable the entrepreneurs to make investment decisions on the basis of their own commercial judgement, the 1991 industrial policy abolished industrial licensing for all but 18 industries. With the passage of time, most of these industries have also been delicensed. As of now, licensing is compulsory for only 6 industries.
In respect of delicensed industry, no approval is required from the government. However, entrepreneurs are required to submit an Industrial Entrepreneur memorandum (IEM) to the Secretariat for Industrial Approvals (SIA) which acknowledges receipt.

The 1956 Resolution had reserved 17 industries for the public sector. The 1991 industrial policy reduced this number to 8: (1) arms and ammunition, (2) atomic energy, (3) coal and lignite, (4) mineral oils, (5) mining of iron ore, manganese ore, chrome ore, gypsum, sulphur, gold and diamond, (6) mining of copper, lead, zinc, tin, molybdenum and wolfram, (7) minerals specified in the schedule to the atomic energy (control of production and use order), 1953, and (8) rail transport. In 1993, items 5 and 6 were deleted from the reserved list. In 1998-99, items 3 and 4 were also taken out from the reserved list. On May 9, 2001, the government opened up arms and ammunition sector also to the private sector. This now leaves only 3 industries reserved exclusively for the public sector.

The new industrial policy scrapped the threshold limit of assets in respect of MRTP and dominant undertakings.

The New industrial policy prepared a specified list of high technology and high-investment priority industries wherein automatic permission was to be made available for direct foreign investment up to 51 percent foreign equity. The industries in which automatic approval was granted included a wide range of industrial activities in the capital goods and metallurgical industries, entertainment electronics, food processing, and the services sectors having significant export potential. Besides, these included a number of others industries which are important for the rapid growth of the economy.
4.3 Policy Reforms and Performance

Industrial production in 1991-92 was almost stagnant. Manufacturing sector industries, the major segment of the industrial sector, suffered a decline in production of 1.6% for the first time in the past decade. The severe import compression, which resulted in a decline of nearly 20% in value of imports in dollar terms, combined with a tightening of credit availability was one of the principal supply side factors responsible for the decline in the manufacturing output during this period. Widespread social disturbances and economic uncertainties which prevailed during the year contributed to this decline and to a weakening of investment demand as investment intentions suffered from uncertain conditions which prevailed. On the demand side, the slowing down of overall rate of growth and a decline in agricultural output, especially food-grain output acted as a dampener on manufacturing growth. The year also saw the collapse of exports to markets in erstwhile Soviet Union.

The adverse supply side factors contributing to the contraction of industrial output during 1991-92 were largely removed by the end of the year. Credit controls on imports were relaxed, access to imports was substantially improved with the abolition of import licensing for most items and import duties on raw materials, intermediates and capital goods were brought down substantially. These measures while reinforcing seasonal improvement in the industrial performance enabled the manufacturing sector to show a small positive growth.

With the announcement of the New Industrial Policy in July 1991, a large number of Government induced entry restrictions licensing requirements and controls on corporate behaviour were eliminated. The thrust of the policy measures undertaken in 1992-93 has been to deepen these reforms and extend them to other sectors of industry. Further the industrial and trade policy changes
introduced made imported inputs cheaper and more accessible for industry and at the same time, exposed a larger segment of the Indian industry to international competition. Fiscal policy initiatives sought to improve the incentive for investment in the industrial sector and encouraged a shift towards exports and away from domestic markets.

A number of fiscal and monetary policy measures were initiated to revive the industrial growth. Beside this the capital market was freed from Government control and the office of the Controller of Capital Issues was abolished. Foreign Exchange Regulation Act was amended and investment restrictions on FERA Companies were substantially removed. Foreign investment was further liberalised by removing the conditionality of dividend balancing for the non-consumer goods. Private investment in exploration and refining was allowed in the hydrocarbon sector. The Textile Control Order was repealed. Investment activity picked up as evidenced by the substantial increase from both domestic and foreign investors. There was a quantum jump in new capital issues after the decontrol of the capital market. The National Renewal Fund (NRF) was operationalised to provide assistance to firms to cover the costs of retraining and redeployment of employees arising as a result of modernization and technological upgradation of existing capacities and from industrial restructuring and to provide funds for compensation to employees affected by restructuring or closure of industrial units and also to provide funds for employment generation schemes in the organized and unorganized sectors in order to provide a social safety net for labour.

Industrial production during 1992-93 showed continued improvement compared with 1991-92. Industrial output increased by 3.8 percent over 1991-92 and the manufacturing sector recorded a growth of 3.7 percent. An analysis of the production data in respect of 172 selected industries accounting for a weight of 88.1 percent in the Index of Industrial Production (IIP) showed that 86 industries
with a combined weight of 54.7 percent recorded positive rates of growth and 47 of them with a weight of 13.7 percent showed a rise of over 10 percent. Some of the important industries which recorded a growth of over 10 percent include cement, machinery, wrist watches, I.D. polyethylene, shipbuilding and repairs, sugar, cloth (decentralized sector) polyester fibre and railway wagons. The only industry segment to record a negative growth rate was consumer non-durables, fertilizers and mining quarrying sector. The year 1992-93 recorded a 4 percent rate of growth in the manufacturing sector and a similar growth for the industry as a whole. Basic goods, intermediate goods and consumer goods segment of manufacturing industries with a total weight of 60.7% in the IIP registered a growth of more than 4.5% in 1993-94. Transport Equipment, Chemical Products and Cotton Textile recorded a substantial growth. Consumer durables and intermediate goods performed well. The capital goods industry had a poor performance. The 13 minerals hitherto reserved for the public sector were opened for a private sector participation thus reducing the areas reserved exclusively for public sector. The conditions of entry for large scale units in export-oriented sectors such as garments were relaxed. The limit for consortium lending was raised from Rs. 5 crore to Rs. 50 crore. The minimum lending rate for the highest slab was lowered to 15 percent. The availability of bank credit for commercial sector was increased by lowering the statutory liquidity rate (SLR) and cash reserve ratio. The state governments also took significant initiatives in reforms. Various structural reforms had a positive impact on the investment climate in the country during this period. They evoked a strong positive response from foreign investors and portfolio managers. The foreign direct investment had a spurt in the post liberalisation period. During the period from August 1991 to November 1993 the government approved 3467 foreign collaboration proposals including 1565 proposals of foreign equity of Rs. 122.9 billion. There had also been encouraging
trend in domestic investment due to developments in the capital market and financial assistance, sanctioned by All India Financial Assistance. Sanctions by all financial institutions during 1992-93 increased by 37 percent from 1991-92. Disbursement by all financial institutions in 1992-93 showed an increase of 40% over the year 1991-92. The growth in the sanctions clearly indicated a strong investment climate. The lower growth in disbursement in relation to sanctions was partly a result of companies substituting institutional loans with direct funds raised from the capital market. Companies approached the international financial markets to raise funds through Euro issues of convertible debentures. The reforms programme strengthened the investment sentiment in international market about prospects of Indian economy.

The industrial growth rate was below expectation. It had yet to respond with full vigour to liberalisation measures to remove the bottlenecks in 1993-94 industrial production. Major policy initiatives taken during 1994-95 included delicensing of almost all bulk drugs and allowing automatic approval of foreign equity up to 51 percent in most drugs and formulations. Basic telecommunication services hitherto reserved for the public sector were opened for private sector participation. Many states took procedural and policy reforms to effect liberalisation at the grass root level. During 1994-95 the policy changes included the extension of MODVAT to more sectors, a thorough overhaul of the excise tax structure, further rationalisation and reduction of custom duties, deregulation of bank lending rates.

Economic reforms had a positive impact on the investment climate in the country. They had also evoked a strong positive response from foreign investment and portfolio managers. Domestic investment had encouraged from the sanctions and disbursement of terms loans by All India Financial Institutions and capital market operations. Due to all these factors there had been distinct improvement in
the industrial sector during 1994-95 with significant improvement by capital goods and consumer durables. Major supply bottleneck were removed. The demand also picked up in a significant way. The year ended up with the impressive growth rate of 8.6 percent. The industrial and other economic reforms pursued since the middle 1991 had brought to fore the competitive strength and resilience of the industrial sector. After a brief spell of restructuring and consequent lower growth rates the industrial sector grew at very impressive rates. The high industrial growth rate was well spread out; and manufacturing sector like food products, metal products, transport equipment, non electrical machinery significantly aided the growth in the industrial sector. The capital goods sector emerged as an important contributor to the industry recovery.

The industrial policy reforms initiated in the industrial sector since 1991 included removal of entry barrier, reduction of areas reserved exclusively for public sector, rationalisation of approach towards monopolistic and restrictive practices, liberalisation of investment policy, and far reaching liberalisation of import policy with respect to intermediate and capital goods. Various measures were taken to bring about the regional balance especially the development of backward areas and encouraging the growth of employment intensive small and tiny sector. The investment scenario became buoyant and upward moving since the initiation of economic reforms. After responding to economic reforms with vigour and registering a growth rate of 11.7 percent in 1995-96 our industry passed through a critical phase of transition and restructuring.

The slowdown of industrial growth during 1996-97 was due to a number of factors including constraints in the infrastructure sector, terms of credit availability, lower demand from export and other segments. Crude oil production and hydel power generation declined in first half of 1996 which contributed to slow down in industrial growth. This negative growth coupled with deceleration in
thermal and nuclear power and coal production too contributed to the dampening of industrial growth. Demand factor was also responsible for this slowdown. It slowed down due to delayed budget presentation and high interest rates along with slowdown in investment, exports and private and public consumption expenditure. At the micro level a slowdown was evident in automobiles, steel and fertilizer production. However the manufacturing sector, which contributed the three fourths of industrial production, performed very well.

The slowdown was confined to basic goods sector which was primarily due to infrastructural constraints in energy and mining while all other sub-sectors viz. capital goods, intermediate goods and consumer goods performed very well. Indian industry underwent a sea change in terms of basic parameters governing its structure and functioning.

In spite of the major reforms undertaken since July 1991 some specific separate policy measures were also taken in the form of specific packages aimed at upliftment of tiny, small scale and cottage industries as well as 100 percent EOU’s and units located in the EPZs and Technology Parks. Corrective actions were initiated in the capital and money markets to induce industrial growth. A number of policy measures were announced by the Reserve Bank of India to ensure that genuine production activities get adequate credit. These included substantial scaling down of cash reserve ratio, raising of export credit, permitting commercial banks to provide foreign currency denominated loans and reduction in Prime Lending Rates (PLR) for all advances and announced the maximum spread over PLR by banks. Government liberalised further the policies for foreign direct investment (FDI). Until December 1996 only 35 industries as mentioned in Annexure III of the New Industrial Policy Statement of July 1991 were eligible for automatic approval of FDI up to 51 percent of total equity. In December 1996 Government allowed automatic approval of FDI up to 74% by the RBI in nine
categories of Industries including electricity generation and distribution, construction and maintenance of roads, bridges, ports, harbours, runways, waterways, industries and power plants, water transport, mining services and many more. The list of items for automatic approvals for foreign equity by the RBI was expanded. The Government also announced in January 1997 the first ever guidance for foreign direct investment (FDI) for expeditious approval of foreign investment in areas not covered under automatic approval.

Industrial reforms have been to a large extent aided and supported by the liberal investment policies undertaken by the state Governments. Asian Development Bank extended a loan assistance of US$ 250 million for the Gujrat Public Sector Resource Management Programme to support the on-going reforms at the State-level.

The industrial sector registered a modest growth rate of 7.7 percent during 1996-97. The trend of deceleration continued in 1997-98 as well. Notable factors for this were the subdued condition in the primary and capital markets, slow export growth, excess capacity build up in some sectors in earlier years and a somewhat uncertain economic environment. In course of the year several policy measures were announced for reviving industrial investment. The Union Budget for 1997-98 cut personal and corporate income tax rates across the board. Excise and custom tax rates were modified for many commodities to promote manufacturing sector revival. The credit policy measures announced in 1997-98 covered reduction in the bank rate, further deregulation of interest rate, reduction of CRR and giving freedom to banks in assessing credit requirements for borrowers by withdrawing instructions on maximum permissible bank finance. These measures were taken to facilitate the flow of credit to the industrial sector at cheaper rates.
Various policy reform measures were taken i.e. the number of industries subject to compulsory industrial licensing was reduced from 14 to 9. The investment ceiling on plant and machinery for small scale industrial undertakings/ancillary industrial undertaking was enhanced from Rs. 60 lakhs/Rs. 75 lakhs to Rs. 3 crore and tiny units to Rs. 25 lakh from Rs. 5 lakh. 15 items hitherto reserved exclusively for manufacturing in the small scale sector were dereserved. The list of industries eligible for foreign direct equity investment under the automatic approval route by RBI was expanded. Equity investment upto 100 percent by NRIs/OCBs was permitted in high priority industries. These investments through the automatic approval route of RBI had full benefits of capital repatriation. The ceiling limit of 24 percent for aggregate portfolio investment limit for NRIs/OCBs/FIIs raised to 30 percent of the issued and paid up capital of the company. Export promotion Board was set up for improving export performance. Enhanced autonomy was granted to nine selected PSEs referred to as “Navaratnas”. GAIL and MTNL were also given the same status. Greater functional and operational autonomy was granted to 97 other profit-making PSUs referred to as “Mini-ratnas” for making them more efficient and competitive. Coal lignite, petroleum (other than crude) and its distillation products, bulk drugs and sugar were delicensed in 1998-99. Only five items, of health, strategic and security considerations remained under the perview of industrial licensing. To provide a strong stimulus to the infrastructure sector to accurate over all economic activity the Union Budget substantially increased allocations for energy, transport and communications. The disinvestment of specific portions of equity from selected PSEs like IOC, GAIL CONCOR and VSNL was announced. A separate package of measures was announced for SSI. There was modification in custom tariff structure. Measures like buy-back of shares were initiated to provide a fillip to capital market. The scope for foreign
direct equity investment under the automatic approval route of RBI was enhanced. Indian companies were permitted to accept investment under automatic approval route without obtaining prior permission from RBI.

Industrial production registered a meager growth rate of 4.1 percent during 1998-99. The slowdown in industrial growth was primarily due to slackening in aggregate slump in world trade compounded by an erosion in competitive advantage of Indian Exports on account of steep depreciation in East Asian Currencies, decline in rural demand owing to low agricultural output in 1997-98, and price competition from imports in certain key industries. Industrial policy reforms were pushed further in the Union Budget (1999-2000) after the relatively modest performance in 1998-99. The major policy initiatives announced in the Budget included: (i) far-reaching rationalisation of the excise duty structure by reducing the existing eleven rates to only three; (ii) restoration of 100 percent MODVAT credit; (iii) extension of Technology Upgradation Fund (TUF) scheme for textile industry to spinning industry; (iv) support to domestic industry by imposing minimum 5 percent custom duty on the majority of previously Zero-duty imports and extending countervailing duty to capital project sectors; and (v) giving a strong thrust to road construction by imposing surcharge on diesel. A set of measures for the small scale sector including enhancement of eligibility limit for excise exemption, a new credit insurance scheme, etc. were declared. Several measures were taken for facilitating the inflow of foreign investment in the economy. The scope of the automatic approval scheme of the RBI was significantly expanded. Fiscal incentives and other measures for strengthening the capital markets and banking system were announced. Reforms intending to restructure the public sector were also carried forward by declaring the intention of the Government to encourage raising of market loans for VRS programmes. All these reforms led to strong industrial recovery.

The factors responsible for the slow down of industrial growth during the 2000-2001 included lack of domestic demand for intermediate goods, low inventory demand for capital goods, high oil price, existence of excess capacity in some sectors, business cycle, inherent adjustment legs in industrial restructuring, and infrastructure constraints particularly power, roads and transport and a high interest rate environment due to continued high fiscal deficit. According to use based classification, the growth rates of consumer goods (both durables and non-durables) accelerated during 2000-2001. There was deceleration in the growth rates of basic capital and intermediate goods. The downward trend in the growth rates of capital goods and intermediate goods indicated that investment decisions were not getting firmed up.

In order to consolidate the recovery in industrial growth during 1999-2000 and to push further the industrial policy reform, major policy initiatives announced in the Budget 2000-01 were:

(i) Rationalisation of excise duty, introduction of central value added Tax (CENVAT), and reducing the number of rates of excise duty.

(ii) Extension of Maximum Retail price (MRP) based excise duty to an increasing number of items, which will lead to simplification of the excise procedure.

(iii) The Security and Exchange Board of India (SEBI) was made the single regulator for Venture Capital Fund (VCF).

(iv) Permission to raise FII equity limit to 40 percent through a special resolution by shareholders.
(v) Limit for providing collateral to obtain finance raised from Rs. 1 lakh to Rs. 5 lakh for SSI units in the tiny sector.

(vi) Reduction of import duty on cinematic camera and other related equipments for use in the entertainment industry and 100 percent exemption on export profits extended to non-corporate assesses.

(vii) Reduction in custom duty on several items of the IT and Telecommunication sector.

(viii) Enhancing the corpus of Rural Infrastructure Development Fund ( RIDF) VI and reducing the interest charged on this by half a percent.

(ix) MODVAT credit of CVD paid on project imports allowed upto 100 percent.

A number of fiscal incentives and other measures for strengthening the capital market and banking system were also announced. In pursuance of Government’s commitment to facilitate industrial growth through foreign participation, Foreign Direct Investment (FDI) was permitted through the automatic route for all industries except a small negative list. Many more decision were taken to liberalise the FDI policy. In the process of review of laws, regulations and simplification of procedures an Expert Group was constituted. The group proposed the enactment of new industry Act which would focus on promotion and development of industry instead of regulation.

4.4 Public Sector Enterprises Policy

Public sector enterprises (PSEs) constitute a major national capability in terms of their scale of operations, coverage of the national economy, technological capabilities and stock of human capital. There are over a thousand of public enterprises, about 100 of which are owned by the states. The rest are in the central
Table 4.1: Profitability of Central Public Sector Undertakings

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<td>Number of units</td>
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<td>Paid-up capital</td>
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<td>69,800</td>
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<td>Net Worth</td>
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<td>79,500</td>
<td>90,000</td>
<td>99,200</td>
<td>1,13,900</td>
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<td>Capital employed</td>
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<td>Gross profits</td>
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<td>16,000</td>
<td>18,600</td>
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<td>30,900</td>
<td>37,200</td>
<td>39,700</td>
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<td>Profit before tax</td>
<td>4,000</td>
<td>5,100</td>
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<td>9,800</td>
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<td>15,400</td>
<td>19,200</td>
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<td>Profit after tax (PAT)</td>
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<td>3,300</td>
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<td>Gross profit to Capital employed (percent)</td>
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<td>Pre-tax profit to Capital employed (percent)</td>
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<td>PAT (Net profit) to Net Worth (percent)</td>
<td>4</td>
<td>5</td>
<td>6</td>
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sector. These include departmental undertakings (e.g. railways, post and telecommunications), Financial Institutions (e.g. the State Bank of India, The Industrial Finance Corporation of India, The Unit Trust of India and the Industrial Development Bank of India), and non-departmental enterprises or Government companies or corporations which are either incorporated under the Company Law (e.g. the Steel Authority of India and the Indian Petrochemical Corporation Ltd.) or statutorily created by Acts of Parliament (e.g. Coal India, Air India, Indian Airlines and the National Thermal Power Corporation). Non-departmental enterprises account for 75 percent of value addition, more than 50 percent of gross investment and about a third of the total employment in PSEs. Non-departmental PSEs have thus been an important sector of our economy and have dominated infrastructure and basic industries.

The statement of Industrial Policy of 24 July, 1991, recognised the many problems of public enterprises and sought to rectify them. It noted that many PSEs had become a burden rather than an asset to the Government. The statement proposed that “it is time therefore that the Government adopt a new approach to public enterprises”. Government then started reviewing the existing portfolio of public investment with greater realism, focusing on industries based on low technology, small scale and non-strategy activities, inefficient and unproductive operations, enterprises with low or nil social value or public purpose and branches where the private sector has developed sufficient expertise and resources. The proposals also stressed a greater commitment to support public enterprises essential for the industrial economy to make them more growth oriented and technologically dynamic. Units faltering but potentially viable needed restructuring and a new lease of life. The area reserved for the public sector reduced from 17 to 8 and then to 6 industries viz., defence production, atomic energy, coal and lignite, mineral oil, railway transport and minerals. By the end of
1994 in manufacturing the only area which continued to be so reserved for the public sector related to defence, strategic concerns and petroleum and even here the Government intended to invite the private sector to participate in the case of power generation, in the exploration drilling, refining of oil and in utilisation of natural gas. These were also to be facilitated by the comprehensive amendments in the Foreign Exchange Regulation Act (FERA) and the signing by the Government of the Multilateral Guarantee Agency (MIGA) convention.

The statement gave specific attention to the issue of industrial sickness in public sector and made a commitment to refer all sick PSIs to The Board of Industrial and Finance Reconstruction (BIFR) or a similar body for examination on a case by case basis and appropriate decision on rehabilitation. It also proposed a social security mechanism to protect the interest of workers likely to be affected by such rehabilitation packages. It committed to provide greater autonomy to remaining public enterprises by strengthening the MOU (Memorandum of Understanding) system and providing greater professional expertise on the Board of these enterprises. Transparent MOUs with PSEs were to establish clear performance targets by mutual agreement. Finally the statement announced a decision to disinvest equity in the public sector enterprises.

The announcement made in the Statement on Industrial Policy amounted to a wide ranging public sector reform, with the objective to induce greater efficiency, productivity and competitiveness in the public sector. Enterprises currently in the public sector were to be strengthened so that they could participate profitably in the new competitive environment in both the domestic and international economy.

Among the various policies enunciated for restructuring of the PSUs a major step involved the disinvestment of a part of Government equities in selected public sector undertakings for improving their performance as well as to increase
their public accountability by broad basing their management and ownership. In the process of disinvestment a major step taken by the Government was to set up the Disinvestment Commission. The Government has restructured the equity of 40 major PSUs including, blue-chip companies like ONGC, GAIL, SAIL, MTNL, IPCL, NTPC, BEML Power Grid, NHPC, IOC, IBP and Bongaigaon Refineries.

The Government has granted enhanced autonomy to nine selected PSEs referred to as ‘Navarantnas’. These are IOC, IPCL, ONGC, BPCL, HPCL, NTPC, VSNL, SAIL & BHEL. Two more enterprises GAIL & MTNL have also been given the same status. These PSEs, subject to certain guidelines, now have freedom to incur capital expenditure, decide upon joint ventures, set up subsidiaries/offices abroad, enter into technological and strategic alliances, raise funds from capital markets and enjoy substantial operational and managerial autonomy. All the measures have been taken with the objective of making the PSEs competitive. In the union budget of 1998-99 disinvestment of specified portions of equity from select PSEs like IOC, GAIL, CONCOR & VSNL was announced. Government holding in Indian Airlines was brought down to 49%.

It was also indicated that in the majority of cases Government shareholding in Public Sector Enterprises will be brought down to 26 percent. Government will retain majority holding in PSEs involving strategic consideration. The government strategy towards the public sector continued to encompass a judicious mix of strengthening strategic units, privatising non-strategic ones through gradual disinvestment or strategic sale and devising viable rehabilitation strategies for weak units. The Government intended to encourage marginally profit making PSEs to promote VRS (Voluntary Retirement Scheme) by raising money from banks against Government guarantees and interest subsidy.
It was also proposed to bring down government equity in all non-strategic PSUs to 26 percent or lower and close down PSUs which can not be revived and fully protect the interest of workers.

The Public sector has always absorbed a lot of investment and given little back. A large number of public sector enterprises make losses. Out of 240 operating PSUs as many as 120 were profitable during 1993-94 as compared to 131 during 1992-93. Profits of these profit-making enterprises went up from 7384 crore in 1992-93 to Rs. 9722 crore in 1993-94 i.e. an increase of 31.7%. But the losses of the remaining loss making companies increased from Rs. 4113 crore to Rs. 5287 crore i.e. an increase of over 28.5% during the same period. The overall rate of return over capital employed in the PSUs increased from 2.33 percent during 1992-93 to 2.78 percent during 1993-94. But the gross margin (i.e. before depreciation, interest and taxes) of PSUs as percent of capital employed declined from 18.1 in 1992-93 to 17.33 in 1993-94. At 2-digit level of classification of industry in 2000-01 (April-December) two groups out of 17 recorded a decline. Five industry groups registered positive growth but less than 5%. Seven industry groups registered growth of more than 5%. The heavy capital investment in the past combined with a massive interest burden reduced the gross margins of PSUs. The profitability of PSUs in term of ratios of gross margins and gross profits to capital employed have not improved over the last ten year.

There is consensus that the government should not be operating commercial enterprises. The reasons for this include scarcity of public resources, inefficient and loss making operations of existing public sector enterprises. Accordingly, as part of the liberalisation process, government started reforms in public sector enterprises. The main elements of Government policy towards Public Sector Undertakings (PSUs) are:
• Bring down Government equity in all non-strategic PSUs to 26 percent or lower, if necessary;
• Restructure and revive potentially viable PSUs;
• Close down PSUs which cannot be revived; and
• Fully protect the interest of workers.

Table 4.2: Disinvestment in Public Sector Undertakings

<table>
<thead>
<tr>
<th>Year</th>
<th>Target (Rs. crore)</th>
<th>Achievement (Rs. crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991-92</td>
<td>2,500</td>
<td>3,038</td>
</tr>
<tr>
<td>1992-93</td>
<td>2,500</td>
<td>1,913</td>
</tr>
<tr>
<td>1993-94</td>
<td>3,500</td>
<td>Nil</td>
</tr>
<tr>
<td>1994-95</td>
<td>4,000</td>
<td>4,843</td>
</tr>
<tr>
<td>1995-96</td>
<td>7,000</td>
<td>168</td>
</tr>
<tr>
<td>1996-97</td>
<td>5,000</td>
<td>380</td>
</tr>
<tr>
<td>1997-98</td>
<td>4,800</td>
<td>910</td>
</tr>
<tr>
<td>1998-99</td>
<td>5,000</td>
<td>5,371</td>
</tr>
<tr>
<td>1999-2000</td>
<td>10,000</td>
<td>1,829</td>
</tr>
<tr>
<td>2000-01</td>
<td>10,000</td>
<td>1,869</td>
</tr>
<tr>
<td>2001-02</td>
<td>12,000</td>
<td>5,573</td>
</tr>
</tbody>
</table>


In 2000-2001, 107 PSUs signed Memoranda of Understandings (MOUs). On the basis of provisional data, provided by the Department of Public Enterprises, out of 107 PSUs, 49 PSUs were rated excellent, 26 very good, 12 good, 12 fair, and 7 poor. BALCO has been excluded from evaluation as it ceased to be a PSU during the year. In 2000-01, the aggregated gross margin (provisional)
of MOU signing PSUs was 15.5 percent higher than that of 1999-2000 and 12.8 percent higher than the target set for them.

4.5 Legislative Measures

The shift from an economy laden with controls to one based on the principles of a free market necessitates safeguarding interests of consumers. It also needs to provide for companies to wind up inefficient operations. Important developments to address these and related issues introduced are detailed below:

1. **Introduction of Competition Law Bill**

   The Competition Bill, 2001 to amend the MRTP Act, 1969 and to propose a modern Competition Law has been introduced in the Lok Sabha on August 6, 2001. The Bill is largely based on the recommendations of a High Level Committee.

2. **Amendment in Companies Act, 1956 for incorporating new provision in corporate sickness and insolvency.**

   In order to solve the problems experienced and to reduce the time taken in the winding up/liquidation of companies under the Companies Act 1956, based on the recommendations of a High Level Committee, a Bill namely the Companies (Amendment) Bill, 2001 has been introduced in the Lok Sabha on August 30, 2001.

3. **The Abolition of Sick Industrial Companies Act (SICA) Bill was introduced in the Lok Sabha on August 30, 2001.**

4. **Amendment in Companies Act, 1956 for incorporating new provisions for formation and conversion of co-operatives into companies.**

   Recognising the role performed by co-operatives and to enable formation of co-operatives business as companies and to convert existing co-operative business
into companies under a regulatory framework similar to that for private limited companies, the Companies (Second Amendment) Bill, 2001 has been introduced in the Lok Sabha on August 31, 2001.

5. *The Companies (Amendment) Ordinance, 2001 (Ordinance 7 of 2001)*

Considering the market sentiments and recent developments in the United States of America and other places it was decided to liberalise certain provisions of the Companies Act, 1956 relating to buy back of shares. Accordingly, the Companies (Amendment) Ordinance, 2001 (Ordinance 7 of 2001) was promulgated on October 23, 2001. This ordinance has been replaced with Companies (Amendment) Act, [no. 57 of 2001] by Notification dated December 24, 2001.

The Bill to establish National Company Law Tribunals to address issues of sickness and bankruptcy has been introduced in Parliament, along with that for the abolition of the Sick Industrial Companies Act (SICA) and the dissolution of the Board for Industrial and Financial Restructuring (BIFR). As these Bills get enacted the process of industrial restructuring should become easier and faster. Similarly, Government has initiated the process for amending labour laws to provide for greater flexibility in employing labour, and for outsourcing of services so that labour use becomes more flexible and efficient. Progress in the implementation of these initiatives is essential to enable Indian industry to restructure itself to cope with the more competitive domestic and international environment, and to induce employment-generating industrialisation.

The government’s approach to industrial sector development and growth has been ‘that the Indian industry must be an efficient and competitive one able to stand on its own in the face of foreign competition.’ The test of an efficient industry lies in its capability to provide goods and services of high quality and low
cost. On its part the government committed itself to ‘removal of infrastructural constraints in the power, transport and telecommunications sectors’.

The growth rate of industrial production was 0.6% in 1991-92 and it reached to a peak of 13% in 1995-96. Thereafter a slowdown started and the growth rate came down to 4.1% in 1998-99 and 5.0% in 2000-2001.

Industrial slowdown is widespread covering all broad sectors such as manufacturing, electricity and mining and all end use based groups such as capital goods, intermediate goods, consumer goods both durables and non-durables. The slowdown in domestic and global demand appear to be the major factors constraining industrial growth. This is reflected by low level of prices for manufactured goods in 2001-02. However, given the relatively low level of external sector for the Indian economy, domestic demand and supply side factors have played the key roles for industrial slowdown.

The slowdown in Industrial growth has been due to a number of the following Structural and Cyclical factors:

**Structural factors**

- The adjustment process of industry in response to increased competition in the form of Mergers and Acquisitions is taking longer time than expected.
- Infrastructural bottlenecks and high costs and inadequate and unreliable supply of services in transport, communications and the power sector.
- Low levels of productivity in the industry because of low volumes and inability to reap economies of scale, outdated technology and restricted labour laws.
- Lower speculative demand for sectors like automobiles and real estate due to expectation of lower prices and reduction of taxes and duties in the short and medium term.
Cyclical factors

- Periodic investment cycles, reinforced by government’s decision to reduce customs duties to levels in East Asian countries by 2004, which might have deferred investment decisions.
- Business cycles affecting demand of some cyclical industries like cement, automobiles and steel.
- There is no pent up demand for consumer durables. The above cycles have been reinforced by reduction in inventory levels resulting from the introduction of e-business and e-commerce and better management of supply and demand by industry to cut costs.

Remedial Measures taken in this regard are the following:

- 100 percent FDI has been permitted in many of the sectors.
- Defence industry sector has been opened up for private sector participation with FDI permitted upto 26 percent.
- Excise duty rationalised to a single rate of 16 percent CENVAT.
- Central Excise Rules, 1944 are simplified and a drastic reduction of rules made.
- Peak duty of customs reduced from 38.5 percent to 35 percent with the abolition of 10 percent surcharge.
- Interest rates have been reduced.

Progress has also been achieved in removing some infrastructure bottlenecks: implementation of the National Highways Development Project, implementation of the National Telecommunication Policy, 1999 through the opening up of Domestic Long Distance (DLD) telephony and the introduction of the Convergence Commission of India Bill, 2001 in Parliament. Improvements in the telecommunications sector are visible, with sharp reductions in tariffs for
Domestic Long Distance (DLD) and mobile telephony. Similar reductions in rentals and call charges for fixed lines and International Long Distance (ILD) tariffs and other services could come about through increased competition. They would help reduce input costs for industry.

4.6 Conclusion

The announcement made in the Statement on Industrial Policy amounted to a wide ranging public sector reform, with the objective to induce greater efficiency, productivity and competitiveness in the public sector. Enterprises currently in the public sector were to be strengthened so that they could participate profitably in the new competitive environment in both the domestic and international economy.

The Industrial policy reforms initiated in the industrial sector since 1991 included removal of entry barrier, reduction of areas reserved exclusively for public sector, rationalisation of approach towards monopolistic and restrictive practices, liberalisation of investment policy, and far reaching liberalisation of import policy with respect to intermediate and capital goods. Various measures were taken to bring about the regional balance especially the development of backward areas and encouraging the growth of employment intensive small and tiny sector. The investment scenario had been buoyant and upward moving since the initiation of economic reforms.

The strategy of Indian industrialization did not change from Independence to 1990. It emphasized heavy industry public ownership and import substitution. This went along with contempt for price mechanism and a belief that competition was harmful. A licence was needed to start or expand or expand substantially any industrial activity giving employment to more than fifty workers. Big private
business, both domestic and foreign, was feared and distrusted. Special obstacles were put in the way of expansion by dominant companies and those with significant foreign ownership. Yet at the same time the political support of private industry was needed. Thus businessmen were protected in many ways from both foreign and domestic competition. Their incumbent workers like those in the public sector were doubly protected as it was made illegal to sack anyone without permission or even to vary the kind of work.

As far as industrial policy went, Indian socialism became both bourgeois and exclusive. Those who promoted these protective policies ignored the fact that they benefited only the relatively well off and excluded large numbers of much poorer people with no jobs in medium – or large scale factories. The ‘permit raj’, as the regime came to be called, created a high cost inflexible capital intensive industry with predominance of very large factories in the public sector. In the private sector small enterprises were encouraged by various concessions that were both capital intensive and far too small to realize possible economies of scale. It was only in the late 1980s that the prejudices and beliefs which has led to unsuitable industrial development came to be widely questioned.

A number of fiscal and monetary policy measures were initiated to revive the industrial growth. Beside this the capital market was freed from Government control and the office of the Controller of Capital Issues was abolished. Foreign Exchange Regulation Act was amended and investment restrictions on FERA Companies were substantially removed. Foreign investment was further liberalised by removing the conditionality of dividend balancing for the non-consumer goods. Private investment in exploration and refining was allowed in the hydrocarbon sector. The Textile Control Order was repealed. Investment activity picked up as evidenced by the substantial increase from both domestic and foreign investors. There was a quantum jump in new capital issues after the decontrol of the capital
market. The National Renewal Fund (NRF) was operationalised to provide assistance to firms to cover the costs of retraining and redeployment of employees arising as a result of modernization and technological upgradation of existing capacities and from industrial restructuring and to provide funds for compensation to employees affected by restructuring or closure of industrial units and also to provide funds for employment generation schemes in the organized and unorganized sectors in order to provide a social safety net for labour.

The statement of Industrial Policy of 24 July, 1991, recognised the many problems of public enterprises and sought to rectify them. It noted that many PSFs had become a burden rather than an asset to the Government. The statement proposed that “it is time therefore that the Government adopt a new approach to public enterprises”. Government then started reviewing the existing portfolio of public investment with greater realism, focusing on industries based on low technology, small scale and non-strategy activities, inefficient and unproductive operations, enterprises with low or nil social value or public purpose and branches where the private sector has developed sufficient expertise and resources. The proposals also stressed a greater commitment to support public enterprises essential for the industrial economy to make them more growth oriented and technologically dynamic. Units faltering but potentially viable needed restructuring and a new lease of life. The area reserved for the public sector reduced from 17 to 8 and then to 6 industries viz., defence production, atomic energy, coal and lignite, mineral oil, railway transport and minerals. By the end of 1994 in manufacturing the only area which continued to be so reserved for the public sector related to defence, strategic concerns and petroleum and even here the Government intended to invite the private sector to participate in the case of power generation, in the exploration drilling, refining of oil and in utilisation of natural gas. These were also to be facilitated by the comprehensive amendments in
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The industrial sector has been the focus of much of the economic reforms carried out over the last decade. The slowdown in industrial production over the past seven years is therefore of particular concern. The reforms of the 1990s, which had removed entry barriers to investments, opened trade, provided free access to foreign technology, opened up foreign direct investment, and removed barriers inhibiting access to capital markets were expected to result in sustained high growth in industrial production.