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RESEARCH ARTICLE

DISINVESTMENT OF PUBLIC SECTOR UNDERTAKINGS IN INDIA AND ITS EFFECT - A CRITICAL ANALYSIS ALONG WITH CASE STUDIES

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Abstract

In the words of a layman, the term “investment” can be used to denote conversion of money or cash into securities, debentures, bonds, etc. or buying or construction of assets or subsidiaries. “Disinvestment” or “Divesture” is just the opposite of the concept mentioned above and is the subject matter of this research. To be more specific, this research paper deals with the selling or liquidating of an asset or affiliate by the Government only. The Government is forced to take such decisions when it gets an indication that the public sector undertakings are having a negative rate of return on capital employed. Such situations arise when the PSUs turn into a liability for the Government rather than an asset. This research paper delves into the various aspects involved in the disinvestment of public sector undertakings and tries to find out the actual effect of such disinvestment. It tries to trace the future of such undertakings after the disinvestment process with the help of two very important case studies. After going through the research paper, one will be able to conclude whether disinvestment of PSUs is a boost for the Indian economic system or does it hamper the growth of the country economically.

Research Objective:-

The major objective behind writing this research paper is to analyze the complete process of disinvestment of the Public Sector Enterprises and outline the effect of the same. The effect of disinvestment of PSUs depends upon the development status of a country. For a developing country such as India, health, education and medicine requires utmost attention and selling of the shares in the PSUs aids the government to provide this attention to the designated areas. The research paper also involves a comparative study of both the old policies of disinvestment followed in India as well as the new policies incorporated by the government. The study will basically facilitate the understanding as to whether the government has been able to cover the loopholes which were evident in the old process.

Research Methodology:-

The researchers have selected the topic keeping in mind the significant and critical need to discuss and analyse the whole process of disinvestment of PSUs in India with respect to the present conditions, circumstances, economical and legal sphere. A clear idea on the effect of the same was necessary to be traced. The method of research utilised for the purpose of this research paper is the doctrinal method and involves both a qualitative as well as a quantitative

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approach. The material information has been collected from both legal as well as non-legal authorities like national legal instruments, real-life cases of disinvestment, books of both national as well as international repute, international law journals, international journals on the subject of economics, reports, internet references and opinion of research scholars, academicians and experts who have dealt with the subject in depth. The researchers have dived deep into the topic for the purposes of the proposed analysis and dealt with every aspect involved in the process of disinvestment of the Central Public Sector Enterprises as well as the State Public Sector Enterprises.

Hypothesis:-

The researchers have hypothesized that the participants in the disinvestment process of Public Sector Undertakings have a higher probability of achieving individual gains and milestones. Through this research, there shall be an attempt to establish that along with the individual gains there is also an overall economic development in the country through the process of disinvestment of Public Sector Enterprises. The researchers have tried to establish the abovementioned win-win situation through a detailed analysis and case studies. The researchers have delved deep into the idea that for a country to prosper there is a necessity of expansions in the areas of education, health and medicine is for the development of a country and for that purpose it is legitimate that a part of the extra resources required for supporting such activities is derived out of the sale of shares of the PSUs established by the Government. The overall hypothesis is centred on the idea that the benefits of disinvestment outweigh the drawbacks, and there is an attempt to establish the same.

Introduction:-

Public Sector Undertakings

The beginning of industrialisation in India saw many businesses being established by the Government by incorporating companies or corporations. The shares of these corporations and companies were completely owned by the Central and the State Governments. The main objective behind starting such companies and corporations was to initiate development and provide employment in various regions of the state and union territories. A major exercise of identifying the backward regions in the country was conducted by the government and thereafter many industries were established in such areas. These various companies and corporations started by various State Governments and the Central Government came to be known as Public Sector Undertakings or Public Sector Enterprises.

Subsequent Developments

Though some of these companies failed, the majority of them flourished and the most prosperous companies were called the ‘Navratnas’. The Government had introduced the ‘Navratnas’ scheme in order to identify the Central Public Sector Enterprises who had a competitive edge over the other PSUs for facilitating them to become global powerhouses. At present there are eight Public Sector Enterprises which qualify as the ‘Navratnas’ fulfilling the specified conditions. The companies which failed and collapsed eventually became sick companies and were unattended, but the Government decided against the winding up of such companies due to the fear of becoming unpopular with the electorate. The Union Government though had different plans for such sick Public Sector Enterprises. Through the Union Budgetary allocation, the Government provided such companies with the necessary financial support. For example, the scheme of ‘voluntary retirement’ induced to provide labour related payments. Thus, the practicability of these companies did not get any attention from any of their nodal ministries of the individual Governments. Another strange facade of these companies was that they avowed their rights in important lawsuits that they should be treated on par with the Government, as they were absolutely held by them and should be treated as a part of the state instrumentality.

Post Liberalization

Liberalization opened the doors of the India market to the foreign competitors and investors. The market was open for one and all to explore and make money as per their capabilities. The closed net which was placed to protect the domestic industries was cut through which paved the way for an extensively competitive Indian market. Investors from the foreign countries found it enticing to invest in the market and reap benefits from this fruition. A different kind of approach from the Government was seeing its evolution. An important thought struck the government whereby it realised that establishing business ventures and taking any kind of business risk need not be done by them. Such risk could be taken by the private entities. It encouraged the concept of public-private partnership not only with regard to the small-scale projects but also for huge infrastructure projects such as airports or metro railways. Public-private partnership was being regarded as the need of the hour and the government was in no mood to establish or incorporate any new company. The State industrial development corporations of the Government contended to provide the functioning clearances and allot lands owned or assimilated by them.

Why Disinvestment?

Liberalization and increase in the budget deficits of the Central and the State Governments led to the formation of a new policy in order to make the Public Sector Undertakings self-sufficient and retain their competitiveness in the market. The government had the aim of facilitating such PSUs to become a global joint Moreover, it wanted to free itself from the huge debts and budget deficits. The Government's thought process was that after freeing such companies and corporations from the shackles of the Government, the companies would not only contribute in a much better manner but also increase the cash inflow in the market which in itself had the potential to be a boon for the economy. Thus, supplementary resource mobilisation could be channelized by ensuring that these companies chalk out their own future growth areas, their capital needs identifying expansion plans and so on. A win-win situation was projected to be achieved in the Indian economic scenario.

Old Policy of Disinvestment:-

Public Sector Disinvestment Commission

The policy of disinvestment has been followed by Central Governments successively since the 1990-91. In order to carry out the policy of disinvestment, the Ministry of Industry (Department of Public Enterprises) Government of India formed a Public Sector Disinvestment Commission via a resolution dated 23-08-1996, initially for a period of three years. It was a self-governing, non-statutory advice-giving body which was headed by Shri G.V. Ramakrishna as its Chairman. It constituted of 4 part time members.

Terms of Reference of the Commission

The resolution, through which the Public Sector Disinvestment Commission was formed, put forth certain important terms of reference under paragraphs 3, 4 and 5. It basically provided the tasks to be performed by the Commission - to chalk out a comprehensive and long term disinvestment programme within 10 years, to fix the degree of disinvestment in each of the Public Sector Undertakings, prioritisation of the Public Sector Undertakings referred to it by the Core Group in terms of the overall disinvestment programme, to recommend the appropriate mode of disinvestment for each of the identified PSUs, to suggest a preferable mix of the various alternatives taking into account the market conditions, to assist the Government in order to create awareness among the people at large about the Government's disinvestment policies and programs so that a sense of commitment is developed within people, to publicise the disinvestment proposals on a wide scale so as to ensure a higher number of public participation, to advise Government on possible capital restructuring of enterprises by marginal investments, etc; thesewere some of the major tasks enlisted in the said Resolution. The whole disinvestment process was to be conducted under the supervision of the Commission but the final say on the same would be that of the Government. It was also mandatory for the Commission to protect the interests of the stakeholders, workers etc. while advising the Government.

Modification of the References

The terms of reference of the Commission were modified via a resolution dated 12-01-1998 whereby paragraphs 3, 4 and 5 of the previous resolution were modified. The new terms added were as follows: -

1. The Commission would advise the Government upon the disinvestment of only those PSUs which will be referred to it by the Government.
2. The Commission would carry out only those activities with regard to the disinvestment process of a referred PSU as directed by the Government.

The Procedure

The Government followed broad procedure as enumerated below for the purpose of analysing the recommendations of the Commission in order to carry out the disinvestment: -

1. The task of processing the recommendation was to be done by the Finance Ministry taking into the account the comments from the concerned administrative machinery.
2. The recommendation was to be submitted to the Core group of Secretaries for consideration.
3. The recommendation of the Core group of Secretaries shall be then taken to the Cabinet for its decision.
4. The Core group was to be headed by the Cabinet Secretary and its permanent members would be the Finance Secretary, Revenue Secretary, Expenditure Secretary, Secretary Department of Public Enterprises, Secretary Planning Commission and Chief Economic Advisor (Ministry of Finance).

In 1999, the Department of Divestment was set up which was provided with the responsibilities as provided to the Ministry of Finance earlier. Basically, the role of the Ministry of Finance with regard to disinvestment process was assigned to this newly formed department and the MOE was relieved of such responsibilities.

New Policy of Disinvestment:-

Modifications to the Policy

The new policy of disinvestment in India not only focuses on increasing the participation of citizens of India in owning part of the shares of the Public Sector Undertakings but it also ensures that these PSUs are majorly under the control of the Government. It is based upon the principle that Public Sector Undertakings are the wealth of the nation and therefore it shall rest with them. To put it in other words, people of the nation at large should have the capacity to invest in the PSUs. The new policy also provides that while conducting the process of disinvestment, the Government has to retain majority of the shares in the PSUs, i.e. at least 51% of the shares and it shall also retain the control over the management of such PSUs.

Approach for Disinvestment

On 5th November 2009, the Government of India implemented a new plan of action for disinvestment in profit making government companies. Firstly, the listed Central Public Sector Enterprises were mandated to be made complaint by 'Offer for Sale' by Government or by the CPSEs by issuing fresh shares or combining both. Secondly, unlisted CPSEs which had earned net profits for the three preceding consecutive years were to be listed. Thirdly, for the purpose of follow-on public offers, the need for capital investment of CPSE was to be considered on a case-to-case basis. Lastly, the Department of Disinvestment was entrusted with the work of identifying CPSEs in consultation with the respective administrative ministries and submit proposal to the Government in cases whereby there arises a requirement for an Offer for Sale of Government equity.

Privitisation of VSNL:-

Background

Videsh Sanchar Nigam Ltd. (VSNL) was incorporated as a public sector enterprise in the year 1986. It is world's largest international wholesale carrier and provides connection to almost 400 mobile operators worldwide. The company deals with managed services, undersea cables, landing stations, centers and leased lines, and their market is spread across India. A network of earth stations, switches and submarine cable systems is also run by them. It also offers international telecommunications services including mobile, IP and voice services. A number of investments had been done by VSNL in globally promoted projects like international undersea cables and satellite communications.

Issues Faced

As stated above, VSNL had made various investments one of which was made in ICO Global Communications ltd. An amount of US$150 million was invested by VSNL. However, on August 1999, ICO filed an application for bankruptcy and the amount invested has been considered as a write off. Moreover, the amount of revenue which VSNL had been earning from the from the US Based companies was 67% in 1997 which dropped down to 38% in 2001. This took place because of the US Federal Communication Commission which had in August 1997 issued a benchmark which was required to be maintained by the US carriers to establish accounting rates with non-US carriers. As a result, the accounting rate of US carriers with VSNL came down from $0.425/minute to $0.340/minute in 2000-01. Since, the prices did not fall at the same rate in India there was an increased imbalance which got created between incoming and outgoing traffic.

India was to review VSNL's monopoly in 2004. However, on becoming a part of the World Trade Organisation (WTO) and due to increased pressure from WTO, the monopoly was removed in the year 2002 and with the removal of restraint on ILD, any communication consortium could set up landing points in India and go in for direct agreements with basic land line operators. This took away the privilege which VSNL had as a dominant player of the Indian segment.

Prior Disinvestments

The disinvestment process which began in 1992 was divided into three phases as it did not have any blueprint. They were: a) the offloading of shares to domestic investors (b) the offloading of shares in the international market (c) strategic sale. In 1991-92 VSNL disinvested equity of the face value of Rs. 12 crores in favour of various financial institutions, banks and the public held another 15%. The shares were listed in the stock exchanges of Mumbai, Kolkata, Delhi and Chennai. As of 1995, the share of the GOI had come down to 82.02%. This accompanied the allocation of shares from the GOI as a bonus offer. The Indian investors share-holding persisted around 16.5% in 1999-2000 which came down to 9.97% as on March 31,2001.

A reserve price of Rs. 1,218,375 was fixed by the Government for its 25% stake in VSNL. In order to curtail the monopoly related losses faced by VSNL, it was made mandatory for the Government held BSNL and MTNL to use VSNL as their ILD carrier for the next two years on the ground that it would offer most competitive terms in the market. There was still an uncertainty as to whether MTNL and BSNL would go on using VSNL as their international traffic. Another difficulty faced by VSNL was regarding the real estate owned by VSNL as properties valued at Rs. 778 crores would not be available to VSNL as they would be disassociated after disinvestment. Therefore, there was an increasing need to bring about a fresh market-oriented approach for the proper functioning of the organizations. Though VSNL had a reserve of 4500 crore it failed to utilize it properly clearly because of the lethargic decision-making process and the typical drawbacks faced because of being controlled by a state-owned enterprise. All these factors provided fuel to the Government to steadily move ahead with the process of disinvestment.

Bidding Process

Only those companies and consortia which had a net worth of more than 25,000 crores were allowed to participate in the process. Such a condition was placed forth keeping in mind the negative attributes attached to the result if there was a non-compliance with the condition. Promoters who had more than 10% equity stake in the total equity of the company were allowed to participate. Even though the process was open for international companies it did not work out as only 49% capital of the foreign direct investments were made in the telecom sector. Though Reliance had bid for Rs 1347 crores it lost to TATA Group who had bid for Rs 1439 crore. The total recognition from VSNL was expected to fetch the Government Rs. 3689.25 crore after factoring in Rs. 1,887 crores as dividend and Rs. 363 crores as dividend tax. Rs. 1300 crore required for the extra 20% stake were obtained through zero coupon non-convertible debentures backed by securities from Tata sons and Tata power. After disinvestments and the acquisition of equity by the Tatas, the Government share had fallen to 26%, The Tata group had 45% and an extra 1.97% had been distributed to employees. Most of the Tata acquisition of 20% stake in the open market came from the overseas holders.

Consequences of the Privatisation

The acquisition of a strategic stake in the Videsh Sanchar Nigam Ltd. by Tata Group seems to have hit a jackpot. After the takeover, the Tatas had 45% shares whereas the Government had 26%; 1.96% was given to the employees. It was held by various analysts that with this acquisition it will be able to play a dominant role in the internet services and the International Long-Distance services. It will equally play a dominant role in the National Long-Distance Segment. With the group having a presence in the cellular and basic services, it became the first fully integrated telecom player in the country. The privatization led to better expenditure management as the sale of 25% stock led to an inflow of Rs. 368.9 crores. Though it may be argued by some that the Government had lost it claim over assets and shareholding it is established that this will be compensated by the higher cash returns generated from the sale. Moreover, earlier the Government was just selling minority shares in VSNL. However, with the incorporation of a strategic sale the price earning increased and resulted in greater valuation.

The financial benefits given to VSNL include a five-year recompense of license, entry and revenue sharing fees and exemptions from performance bank guarantees, all which the Tata group will get. What is more, VSNL has also premeditated to go full steam ahead with its NLD services, ii\stead of picking up a license for the same, the Tata group can now avail itself of this shortcut. The group had earlier made an approx. investment of Rs. 1000 crore, for rolling out these facilities. This could now be brought down considerably.

Acquisition of Indian Petrochemical Corporation Ltd. by Reliance Industries Ltd:-

Background

The Indian Petrochemical Corporation Ltd. was known as one of the ‘Navratnas’ Public Sector Undertakings of India and its disinvestment caused a complete disorder in the stock markets. On principle, the idea of this disinvestment had been floating since December 1998 however, there was an abundance of contradictory and politically sensitive interests. Thus, the whole procedure of disinvestment through calculated sales never saw light of the day until November 2001. The Central Government that year renewed the process for disinvestment of IPCL by going in for sale of a 51% equity stake, of which 26% would go to a strategic partner. The balance 25% equity would be sold in the market later, giving the first 'right of refusal' to the planned partner.

Stage 1 - Acquisition of IPCL by Reliance Petro-Investments Ltd

The Government chose UBS Warburg as the global advisor to provide assistance in the transaction. Pathak & Associates were selected as the legal advisors and asset valuing was dispensed to Deloitte and Haskins & Sells. The valuation of shares in IPCL by was done through four methods, namely – (i) Discounted Cash Flow, (ii) Adjusted Balance Sheet, (iii) Comparable Companies and (iv) Adjusted Asset Valuation. The Ministry of Disinvestments formed an Evaluation Committee which endorsed the reserve price of Rs. 845 crores for 26% equity (or Rs.131 per share) using the discounted cash flow policy. The same was considered the most appropriate valuation methodology for a going concern. Eventually in December 2001, likely investors submitted their expression of interest in IPCL. Reliance Petro-investments Ltd., Indian Oil Corporation Ltd, (IOCL) and Nirma Chemical Works Ltd. were shortlisted from an admittedly long list of lucrative parties, and they completed the due-diligence isometrics, finally submitting their financial bids on 29th April 2002.

Part and Procedure of Acquisition

On 18th May 2002, Reliance got through what surely was a hard-fought contest. The Cabinet Committee on this divesture cleared the sale of 26% equity and management control of IPCL to Reliance for Rs. 1491 crores or Rs. 231 per share, which was at a premium of 74% to IPCL's last traded share price. IOCL had offered Rs. 128 per share (Rs. 826 crores for 26% stake) while Nirma offered Rs. 110 per share (Rs. 711 crore). As per the Securities and Exchange Board of India (SEBI) regulations, Reliance also had to propose an open offer for further 20% stake in the company at Rs. 231 per share, the same price at which it acquired the government equity. This offer which was open from July 24th 2002 to August 22nd 2002, was oversubscribed 1.76 times. Reliance incurred a cost of another Rs. 1147 crores in addition to the Rs. 1491 crores paid for acquisition of Government's stake, taking the total acquisition cost to Rs 2638 crore. On 4th June 2002, Reliance formally assumed control of IPCL with Mukesh Ambani taking over as the Chairman of the company.

Stage 2 – Merger of IPCL and RIL

On March 11, 2007, nearly five years after the Reliance group of Industries assimilated Indian Petrochemicals Corporation Limited from the government, IPCL was merged with the group's flagship company, Reliance Industries Ltd. (RIL). RIL's net worth thus amplified to over Rs. 50,000 crore. RIL and IPCL board also approved a provisional dividend of Rs. 11 per share and Rs. 6 per share, respectively. JM Morgan Stanley and DSP Merrill Lynch were the financial advisors, while Amarchand & Mangaldas and Suresh A. Shroff & Co. were the legal advisors for this merger.

The IPCL share prices had not gone up expressively as had been expected, since RIL's takeover of the company. Investors had thus anticipated the merger to take place as early as in 2005. Analysts were of the view that it was extremely feasible for IPCL to merge with RIL as both had substantial synergies. Post-merger, Reliance could offer end-to-end product solutions, which would therefore, give it a pan-Indian and perhaps Asian dominance. The merger was aimed at resulting in substantial tax savings for the merged entity as Reliance bought certain products from IPCL and vice-versa. Analysts also said the merger would help Reliance increase its revenue from chemicals by as much as 4% to 48% of the total.

RIL Chairman Mukesh Ambani said that the merger would definitely create a value through synergies and scale that would enhance the competitive advantages of RIL. In his opinion, it would add to the earnings of the shareholders of RIL and would provide the shareholders of IPCL an opportunity to participate in RIL's spread out business portfolio.

The merger eventually came into effect from April 1, 2007 and IPCL shareholders received 1 share of RIL for every 5 shares of IPCL held by them. The proportion of 1:5 was reached upon on the basis of an evaluation report by Price Waterhouse Coopers and Ernst & Young. The valuation was done on the basis of the market price, the net asset value and the earnings. The Chairman and his associates ultimately ended up holding nearly 53% of the stakes in the merged entity after the alteration of preferential warrants. The promoters subscribed to preferential warrants to scale up their stake by 4% from 50.4%.

Consequences of the Merger

According to a statement from RIL, its share capital increased from Rs. 1393.5 crore to Rs. 1453.6 crore post-merger. RIL's associate companies hold 47.3% of IPCL's equity share capital. These shares were exchanged for equity shares of RIL, then having market value of Rs. 3700 crores, and constituted 2% of the enhanced equity share capital of RIL. RIL's subsidiary Reliance Petro-investments used to hold the IPCL shares; after the merger, the subsidiary got the RIL shares in return for the IPCL shares, creating capital stock. The RIL shares held by Reliance Petro-investments amounted to roughly 2% of RIL's thinned equity (about 3 crore shares). These shares were eventually offered to financial and strategic investors present in a global scale.

Conclusion:-

Through the various abovementioned case studies one can very well conclude that the participants in the disinvestment process of Public Sector Undertakings prosper and achieve their individual milestones. As seen in the case of VSNL, the Tata Group ensured that a sluggish Government run company is not only altered into a dynamic entity but is also transformed into a competent participant in the market. Not only the individual parties but also the domestic economy prospers with the help of disinvestment. For the development of any country, the expansions in the areas of education, health and medicine is of utmost requirement. It is therefore extremely very legitimate that a part of the extra resources required for supporting such activities is derived out of the sale of shares of the PSUs established by the Government. The same has also been confirmed by Dr C. Rangarajan. Another important merit of disinvestment is that the resources raised from the process of such disinvestment can be utilised by the Government to pay off past debts and thereby reduce the burden of interest upon itself. The process of disinvestment of the Public Sector Enterprises ensures the presence of professionalism as the working of these enterprises is governed by professional people guided by market mechanism instead of being under the supervision of bureaucrats. There is an increase in both productivity as well as the efficiency of such enterprise. It also leads to the decrease in the number of sick public sector enterprises. This process will also enable the enterprises to attract foreign investment. The point to be noted here is that capital inflow through direct foreign investment is way better than foreign aid or commercial borrowing from abroad. Though one can point out certain drawbacks of this process such as non-consideration of the interests of the workers, exercise of monopolistic power by private companies, etc, he or she should take into account the new disinvestment policy whereby provides for both, safeguarding the interests of the workers through various schemes such as Voluntary Retirement Scheme as well as retraining the exercise of monopolistic control by private companies in the market with the help of Monopolistic and Restrictive Trade Practices Commission. Though such facilities in the disinvestment process are just the claims of the government, if the same are followed on a strict basis, the process would do wonders for the Indian economy.

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