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Disinvestment: A Route to the Economic Development in Present Scenario

KEYWORDS: Disinvestment, Liberalization, Privatization, Public Sector Enterprises, RBI, SEBI

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ABSTRACT *The Government of India is following a policy of economic liberalization after 1991 and concept of disinvestment has been more or less accepted by at least all the parties whenever they are in Government. Disinvestment has supposed to be the tool in the hands of Government to improve the functioning and profitability of public sector enterprises and also raise funds to mitigate its fiscal deficits and improve the efficiency of the public enterprises. In order to raise resources and encourage wide public participation, a part of the government share holding in the public sector, would be offered to mutual funds, financial institutes, and general public and employees.*

The goals of disinvestments are clearly identified and classified into short term and long term. Disinvestment may be undertaken to reduce or mitigate fiscal deficit, bring about a measure of economic stabilization or to improve efficiency in public enterprises through structural adjustments. it is in this context the PSUs have been demanding that a part of the disinvestments proceeds should be allowed to be retained by PSUs in order to help them upgrades their technology to become competitive.

Disinvestment in Public Sector Enterprises

Public sector undertakings in India were viewed as a mechanism for structural transformation of the economy and for growth with equity and social justice. Eventually, the perception that public sector should acquire the commanding heights of the economy led to Government involvement in diverse areas of economic activity, many of which could have been performed by the private sector. The public sector thus lost its original role and strategic focus, which shifted to supply of goods and services on subsidized rates and creation of employment. This led to inefficiencies, neglect of resource mobilization for modernization, increased dependence on unproductive borrowings, lack of motivation to improve efficiency and increase in fiscal deficit of the Government. After 1991 the Government of India is following a policy of economic liberalization and concept of disinvestment has been more or less accepted by at all the parties whenever they are in Government. The fact that the parties changed their tune when they are out of power probably is only an occupational hazard of our Indian style of democracy. The process of disinvestment in India began in 1992 under the aegis of new economic liberalization policy put forward then Finance Minister, Dr. Manmohan Singh. The Disinvestment Commission was formed initially headed by Shri G.V. Ramakrishna and recently it has been reconstituted. At present, there is a separate a Department of Disinvestment.

The new economic policy initiated in July 1991, clearly indicated that the public enterprises have shown a very negative rate of return on capital employed. On account of this phenomenon many public sector enterprises have become more a burden than an asset to the government. The objective of such policy is to improve the efficiency of the system.

Further, the government is of the view that the public enterprises have not generated internal surplus on account of heavy of the private sector and the market economy. The motives for such perceptible change in the attitude of the government are as follows.

1. PSUs seldom take advantage of a competitive profit maximizing market environment.
2. They are encouraged with numerous non-commercial objectives.
3. They operate in non-competitive markets,
4. Their management is more bureaucratic.
5. They are impeded by the executive, legislative and event the judiciary wings of the system in day-to-day management decisions.
6. They lack initiatives to improve performance ("the carrot is stale and the stick is almost broken").
7. The accountability for performance is hazy,
8. The final sanction of going bankrupt is non-existent.

Motives behind disinvestment

There are mainly two motives in support of disinvestments.

1- One is to provide fiscal support.
2- The other is to improve the efficiency of the public enterprises.

The argument for fiscal support emphasis that the resources raised through disinvestments must be utilized for repaying past debts and there by bringing down the interest burden of the government.

The second argument is to improve the efficiency of the public enterprises through disinvestments is the contribution that it can make to improve the efficiency of the working of them.

Objective of disinvestment

The following are the main objectives of disinvestments policy of the government.

- To reduce the financial burden on government.
- To improve public finances.
- To introduce, competition and market discipline.
- To find growth.
- To encourage wider share of ownership.

As part of the economic reforms, the public sector reforms are also initiated to improve their efficiency and productivity. In this direction disinvestments and privatization are gaining attention.

The new industrial policy provides that "in order to raise resources and encourage wide public participation, a part of the government share holding in the public sector, would be offered to mutual funds, financial institutes, and general public and employees".

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public enterprises through structural adjustments. it is in this context the PSUs have been demanding that a part of the disinvestments proceeds should be allowed to be retained by PSUs in order to:

- Help them upgrades their technology to become competitive.
- Build competence and strengthen their R&D.
- Rationalize and retain their work force.
- Initiate diversification and expansion programmes.

Need for disinvestment/ privatization
There is a concept that private ownership leads to better use of resources and their more efficient allocation.

1. Throughout the world, the preference for market economy received a boost after it was realized that the state could no longer meet the growing demands of the economy and the state shareholding inevitably had to come down. The state in business argument thus lost out and also the presumption that direct and comprehensive control over the economic life of citizens from the central government can deliver results better than those of a more liberal system that directly responds according to the market driven forces.
2. Another reason for adoption of privatization policies around the globe has been the inability of the governments to raise high taxes, pursue deficit inflationary financing and the development of money markets and private entrepreneurship.
3. Further, technology and W.T.O. commitments have made the world a global village. Unless industries, including public industries do not quickly restructure, they would not be able to survive. Public enterprises, because of the nature of their ownership, can restructure only slowly and hence the logic, of privatization gets stronger. Besides, techniques are now available to control public monopolies like power and telecom, where consumer interests can be better protected, by regulation / competition, and investment of public money to ensure protection of consumer interests is no longer a convincing argument.
4. The objectives of the disinvestment programme vary from improving efficiency of the public sector enterprises to transformation of the society.

Importance of Disinvestment
Presently, the Government has about Rs. 2 lakh crores locked up in PSUs. Disinvestment of the Government stake is, thus, far too significant. The importance of disinvestment lies in utilization of funds for:

- Financing the increasing fiscal deficit
- Financing large-scale infrastructure development
- For investing in the economy to encourage spending
- For retiring Government debt- Almost 40-45% of the Centre's revenue receipts go towards repaying public debt/interest
- For social programs like health and education

Disinvestment also assumes significance due to the prevalence of an increasingly competitive environment, which makes it difficult for many PSUs to operate profitably. This leads to a rapid erosion of value of the public assets making it critical to disinvest early to realize a high value.

There are primarily three different approaches to disinvestments (from the sellers' i.e. Government's perspective)

Minority Disinvestment
A minority disinvestment is one such that, at the end of it, the government retains a majority stake in the company, typically greater than 51%, thus ensuring management control.

Historically, minority stakes have been either auctioned off to institutions (financial) or offloaded to the public by way of an Offer for Sale. The present government has made a policy statement that all disinvestments would only be minority disinvestments via Public Offers.

Examples of minority sales via auctioning to institutions go back into the early and mid 90s. Some of them were Andrew Yule & Co. Ltd., CMC Ltd. etc. Examples of minority sales via Offer for Sale include recent issues of Power Grid Corp. of India Ltd., Rural Electrification Corp. Ltd., NTPC Ltd., NHPC Ltd. etc.

Majority Disinvestment
A majority disinvestment is one in which the government, post disinvestment, retains a minority stake in the company i.e. it sells off a majority stake.

Historically, majority disinvestments have been typically made to strategic partners. These partners could be other CPSEs themselves, a few examples being BRPL to IOC, MRL to IOC, and KRL to BPCL. Alternatively, these can be private entities, like the sale of Modern Foods to Hindustan Lever, BALCO to Sterlite, CMC to TCS etc.

Again, like in the case of minority disinvestment, the stake can also be offloaded by way of an Offer for Sale, separately or in conjunction with a sale to a strategic partner.

Complete Privatization
Complete privatization is a form of majority disinvestment wherein 100% control of the company is passed on to a buyer. Examples of this include 18 hotel properties of ITDC and 3 hotel properties of HCI.

Disinvestment and Privatization are often loosely used interchangeably. There is, however, a vital difference between the two. Disinvestment may or may not result in Privatization. When the Government retains 26% of the shares carrying voting powers while selling the remaining to a strategic buyer, it would have disinvested, but would not have 'privatized', because with 26%, it can still stall vital decisions for which generally a special resolution (three-fourths majority) is required.

Points in favor of disinvestment
The points favoring the disinvestments of PSUs, especially the loss-making PSUs are as under.

- The problem with our public enterprises is not the quality of their assets or manpower, but the overall decision-making environment. Under private management, these enterprises would realize their true potential, thus realizing the ultimate goal of the disinvestments programme. Optimal utilization of the investment locked-up in the PSUs.
- The successful privatization of non-critical PSUs would pave way for better governance, improve the overall work environment etc. and government should regulate the business rather than doing business itself.
- Yet another gain of privatization has been the stock market discovery of the latent worth of public sector enterprises. the market capitalization of PSUs zoomed up to Rs. 1,66,000 crores in may 2002- a raise of almost 76%.
- Disinvestment of loss-making PSUs would entail the infusion of fresh capital by the strategic partner and would be under excellent management control with specific accountability and ability to take quick decisions.

Disinvestment process
The disinvestments process is related to the procedure adopted by the government. The procedure involves the valuation of shares and modalities to be adopted for sale of such shares. There are three broad methods, which are used for valuation of shares.

1. **Net asset value method:**
   This will indicate the net assets of the enterprises as shown in the books of accounts. If shows the historical values of assets. It is cost price less depreciation provid-

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ed so far on assets. It does not reflect position of profitability.

2. **Profit earning capacity value method:**
The profit earning capacity is generally based on the profits actually earned or anticipated. It is excess of earnings over expenditure. it does not really indicate the intrinsic value of the enterprises.
3. **Discounted cash flow method:**
This technique is popularly used to evaluate viability of an investment proposal. In this method the future incremental cash flows are forecasted and discounted into present value by applying cost of capital rate. This method indicates the intrinsic value of the enterprises. This method is a far more comprehensive and complicated method of reflecting the expected income flows to the investors.
Out of these three methods the discounted cash flow method is greatest relevance though it is the most difficult.

Disinvestment Procedure
Proposals for disposal of any PSU, based on recommendations of DC or CCD.

- After CCD clears, selection of advisor through competitive bidding process.
- The advisor assists GOI (government) in the preparation and issue of EOI (expression of interest) in newspapers.
- After receipt of EOI from interested parties, prospective bidders are short-listed.
- Due diligence (DD) by concerned PSU.
- Based on DD by PSU, the advisor prepares information memorandum for giving it to the short-listed bidders who has entered into a confidentially agreement.
- Advisor, with the help of legal advisor, prepares share purchase agreement.
- Discussions among advisors, govt. & representatives of PSU.
- Valuation of the PSU in accordance with the standard national practice.
- The share purchase agreement (spa) is finalized based on the reactions received from the prospective bidders.
- These agreements are then vetted by the minister of law and are approved by govt.
- Thereafter these are sent to prospective bidders for inviting final bidding bids.
- The bids received are examined, analyzed and evaluated by the IMG and placed before the CCD for final approval of bids.
- After the transaction is completed, all papers and documents relating to it are too turned to the C&AG (controller and auditor general of India, to enable C&AG to undertake an evaluation of the disinvestments, for placing it in parliament and releasing it to the public.

In the disinvestments process mentioned above, the DOD (department of disinvestment) is assisted at each stage by an IMG (inter ministerial group) comprising, officers from the ministry of finance, department of public enterprises, and the administrative ministry, department of controlling PSUs (dep't. of (HI&PE) and officers of department of disinvestments.

SEBI's role
As per regulation 10 of the se13i (acquisition of shares) regulation, 1997 no acquirer shall acquire shares or voting rights in a company, unless such acquirer makes a public announcement to acquire shares of such company in accordance with the regulations.

Hence SEBI's takeover code gets triggered when a person (strategic partner) acquires more than 15% of the voting equity shares is required to make a public offer to purchase shares not less than 20% of the equity of the company. This provision has a great impact on the strategic sale transaction. For instance, in such case the strategic partner would be required to buy another 20% of the shares from public, which means sp, has to buy total 45% of the shares & advisors.

RBI's role
After the completion of the several successful disinvestments in PSUs by GOI, RBI has issued guidelines governing the provisions of bank finance for PSU disinvestments exempting the banks from the restrictions earlier imposed on lending against shares and lending for acquisition of corporate control. Nowadays all PSU disinvestments are funded primarily by pledging of the shares acquired through the disinvestments with additional/third party security of varying degrees as appropriate from bidder to bidder.

As a safety policy, the government insists that the successful bidder remains committed to not disturbing the status quo with the PSU for at least 3 years that means the shares initially purchased from government are subject to a contractual 'lock-in', requiring the winning bidder not to sell these shares.

Even a financial pledge of these shares has to be approved by the government and enforcement to the pledge requires government approval. RBI guidelines impose a condition that the bank finance may be extended only for acquiring shares from the government and under open offer prescribed under the SEBI takeover code. Subsequent acquisition can't be funded and hence put and call options will not enjoy bank funding.

RBI guidelines permit bank finance only for disinvestments approved by the government and therefore, bidders for state levels PSUs are excluded from access to bank finance. RBI has also directed to banks not to lend unless the bidder has an excellent track of record of servicing the loans from the banking systems.

Findings

- First of all a disinvestment proposal of loss-making PSUs needs to seriously address the task of reviving a survival of loss-making PSUs.
- Rather than sticking to the controversial decision of disinvestments of profit-making PSUs, particularly oil companies, the ministry of disinvestment should take-up first the loss-making PSUs, which have still chances of survival.
- GOI should have a clear plan and unhesitating will to cede the control and acknowledge that employment increases with industrial and commercial health.
- There is no point in sleeping over the problem those disinvestments of oil major companies (profit making PSUs) like HPCL/BPCL has been postponed/deferred, there are chances of survival if an immediate step is taken by privatization of those PSUs.
- The ugly episode involving VSNL's decision to invest in Tata Teleservices is still fresh in public memory. The best assurance would be to sell out completely and use the proceeds to invest in infrastructure or retire costly debt.
- The transaction documents should take care of the eventualities by insertion of suitable clause in the spa so as to avoid the resale of PSUs within few months of take over control as it happened in case of resale of Mumbai centaur property by the original buyer, Sahara group, within four months of acquiring the hotel.

Disadvantage
The drawbacks of disinvestments of PSUs, with particular reference to disinvestments of huge profit making and dividend paying PSUs are under as follows:

- The dividend payout by PSUs is highest in the year 2002. Besides disinvestment proceeds, the government has profited handsomely from high dividends in the year 2002.the quantum of dividend received (excluding from banks) is worth more than rs.3380 crores for the year end-

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- there would be chances of assets stripping of profit-making PSUs
- selling of the huge profit making and dividend paying PSUs would result in killing a goat for one time best meal once only, rather than feeding it well and getting precious milk for years.
- Disinvestment of oil PSUs particularly when war clouds are moving around IRAQ a major supplier of oil products to the world at large, would proved to be a hazardous decision.

Selling profit-making PSUs would be equivalent losing regular source of income to the government.

Expected Advantages

Disinvestments would expose the privatized companies to market discipline, thereby forcing them to become more efficient and survive or cease on their own financial and economic strength. They would be able to respond to the market forces much faster and cater to their business needs in a more professional manner. It would also facilitate in freeing such companies from Government control and introduce corporate governance in the privatized companies.

Disinvestments would result in wider distribution of wealth through offering of shares of privatized companies to small investors and employees.

Disinvestments would have a beneficial effect on the capital market, the increase in floating stock would give the market more depth and liquidity, give investors easier exit options, help in establishing more accurate benchmarks for valuation and pricing, and facilitate raising of funds by the privatized companies for their projects or expansion, in future.

Opening up the public sector to appropriate private investment would increase economic activity and have an overall beneficial effect on the economy, employment and tax revenues In many areas, e.g., the telecom and civil aviation sector, the end of public sector monopoly arid privatization has brought to consumers greater satisfaction by way of more choices as well as cheaper and better quality of products and services. With the quantitative restrictions removed and tariff levels revised owing to opening of world markets/WTO agreements, domestic industry has to compete with cheaper imported goods. In the bargain, the common man now has access to a whole range of cheap and quality goods. This would require Indian industries to become more competitive and such restructuring would be easier in a privatized environment.

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