

Public Sector Undertaking & Disinvestment of Equity Shares



Management

KEYWORDS :

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ABSTRACT

The founding fathers of our republic used the public undertaking as an essential and vibrant element in the building-up of India's economy. One of the basic objectives of starting the public undertaking in India was to build infrastructure for economic development and rapid economic growth. Since their inception, public enterprises have played an important role in achieving the objective of economic growth with social justice. However economic compulsions, viz., deterioration of balance of payment position and increasing fiscal deficit led to adoption of a new approach towards the public undertaking in 1991. Disinvestment of public sector undertakings (PSUs) is one of the policy measures adopted by the government of India for providing financial discipline and improve the performance of this undertaking in tune with the new economic policy of Liberalisation, Privatisation and Globalisation (LPG) through the 1991 Industrial Policy Statement. The aims of disinvestments policy are:

(i) Increasing resources to meet fiscal deficit; (ii) encouraging wider public participation including that of workers; (iii) penetrating market discipline within public enterprises; and (iv) improving performance.

Introduction

Public sector undertakings (PSUs) are companies established by the central government under the Companies Act or as statutory corporations under specific statues of parliament. PSUs were established in the early 1950s for rapid industrial and economic growth, to create necessary infrastructure, for employment generations, to promote balanced regional development and to assist the growth of other industries. In 1950s 58 industries were reserved for the public sector undertakings, which was brought down to 18 in 1991 and now it is 4. There are 35 PSUs in the BSE-200 index accounting for almost two-fifth of market capitalization, with an aggregate market capitalization of Rs. 3,84,600 crore.

Disinvestment:

Disinvestment is a process in which the public undertaking reduces its portion in equity by disposing its shareholding. "Disinvestment" as per SEBI (substantial acquisition of shares) guideline, means the sale by the central government/state government, of its shares or voting rights and/or control, in PSUs. The government retains partial control with it and disposing its holding to some extent. The disinvestment reduces government participation in the company. There are two approaches to disinvestment programme.

- According to first approach, whenever government sell its equity holding to PSUs to public or private parties, financial institutions and mutual fund etc. It is called disinvestment.
- According to second approach, when PSUs are generally directed by the government to issue their equity share to public, private parties, financial institution and mutual fund with a view to reduce its control, that is also taken as disinvestment.

Criteria for Disinvestment

The decision regarding disinvestment or liquidation viewed in the light of following criteria:

- Whether the objectives of the company are achieved
- Whether there is decrease in number of beneficiaries
- Whether serving the national interest will be affected because of disinvestment
- Whether private sector can efficiently operate and manage the undertaking.
- Whether the original rate of return targeted could not be possible to achieve.
- Whether socio-economic objectives lots its purpose.

Objective of Disinvestment

The government has been disinvesting its equity holding in

PSUs largely since 1991 with the following major objectives.

- Revenue Collection- The government is making a way out of necessity to raise revenues for bringing down the fiscal deficit as commitment made to the IMF.
- Improvement in Efficiency-This is being undertaken to ensure greater accountability and improved efficiency. These financial institutions and mutual funds are expected to off load them into the secondary market. This will enable to the investor to demand more accountability and efficiency from the management of PSUs.
- Market Discipline- Disinvestment is resorted to meet budgetary targets and to bring the PSUs to meet the market discipline, competitiveness and to emphasize on profit-ability and maximization of stakeholders wealth.
- Mobilization-With the help of disinvestment pogram, government would be in a position to generate sufficient resources. Out of such funds, government can make available some funds as loan to PSUs.
- Direct Participation of Public-Such disinvestments would enable the public, to participate in the equity of PSUs.
- Encourage Employee Ownership-This would encourage the employees to buy shares pf PSUs. This may motive them to work harder and improve the work culture.
- Reduction of Bureaucratic Control-This may provide more autonomy to the management of PSUs.

Disinvestment Strategy

Government adopted following disinvestment strategies for proper revenue collection from disinvestment:

- Selection of Companies to be offered-The list of companies offered in the first phase of disinvestment had to be limited to those companies whose investments in market appreciates without much difficulty and price reasonably.
- Pricing of the Equity-The Pricing formula adopted for the referral price was average of NAV (Net Asset Value) and PECV (Profit-earning capacity value) at 10%industry capitalization rate. This was as existence at that time.
- Rationale for Disinvestment Mechanism-A direct offer of shares to the public was not feasible because even with most sophisticated valuation skill a fair issue price on company basis was possible to determine since the PSUs were unknown to the market. The risk of over-pricing or under-pricing on a company specific basis was real but clearly unaffordable.

Following methods are identified for valuing the shares for disinvestment by PSUs.

1. Net Asset Value (NAV)
2. Profit-Earning Capacity Value (PECV) method at capitaliza-

tion rate of 4% to 8%

3. Discounted Cash Flow (DCF) method based on about 5 years discounted rate.

Disinvestment Process

In the process of disinvestment, a major step taken by the government has been to set up the disinvestment commission for working out the terms and conditions as well as modalities pertaining to disinvestments of public equities. The disinvestment process is conceived with its focus on transformed the existing state owned undertaking into undertaking that are truly public owned.

- Trade Sale --- This recommendation involve 100%change of ownership through direct sale of shares at a fixed price.
- Strategic Sale --- The strategic sale transaction of a government company will consist of two elements:
 - (a) Transfer of a block of shares to a strategic Partner, and
 - (b) Transfer of management control to the strategic partner. A strategic sale may involve selling of a (i) substantial stake with management control, or (ii) minority stake supplemented by technology transfer arrangement. Some time joint-venture route may be selected with or without management control by the government. In strategic sale, precaution is taken to safe guard the interest of the government, nation, company, employee of the company, through execution of the agreement by insertion of relevant clauses in it. Simultaneously, the government also tries that transaction should yield best value of share transfer to the strategic partner.
- Offer of Shares --- This measure involves partial sale of equity ownership at fix price by book building process.
- Closure or Sale of Asset --- In Case, there is no 'investor interest' in the company, the commission is of the view that there would be no option but to close down the operations of the company and liquidate all its assets and liabilities.

Merits of Disinvestment Process

The disinvestment process is advocated for the following reasons:

- The basis problem with PSUs is neither the quality of assets nor the skilled manpower, but the overall decision making system. These enterprises would realize true potential only when they are privatized. In Private Sector, the decision making process is quick and decisions are linked with the competitive market changes.
- The disinvestment process would bring in better corporate governance, exposure to competitive, corporate responsibility, improvement in work environment etc.
- The market participation in capital of PSUs through stock exchanges would enable the market to discover the latent worth of PSUs.
- The Loss making PSUs can be successfully revived by asking the strategic partner to infuse fresh capital and exercising excellent management control over sick PSUs.

Demerits Of Disinvestment Process

The disinvestment of PSUs is criticized for the following reasons:

- Selling of profit-making and dividend paying PSU would result in loss of regular source of income to the government.
- There would be chances of 'asset stripping' by the strategic partner. Most of the PSUs have valuable assets in the shape of plant and machinery, land and buildings etc. It may be possible that the strategic partner may very well dispose of

these assets, make money, leaving the PSUs as a sick enterprise.

- The Government's Policy or disinvestment includes the disposal of both profit making, as well as, potentially viable PSUs.

Disinvestment Procedure

The Step-by-step disinvestment procedure is as under:

- Proposals for disposal of any PSU, based on recommendations of Disinvestment Commission (DC) or Cabinet Committee On Disinvestment (CCD)
- After CCD Clears, selection of Advisor through competitive bidding process.
- The Advisor assists Government of India in the preparation and issue of 'Expression of Interest' in newspaper.
- After receipt of 'Expression of Interest' from interested parties, prospective bidders are short-listed.
- 'Due Diligence' by the concerned PSE.
- Based On 'due diligence' by PSE. The advisor prepares 'Information memorandum' for giving it to the short listed bidders who has entered into a 'Confidentiality Agreement' Advisor, with the help of legal Advisor, Prepares Share Purchase Agreement.
- Discussions among advisors, Government and Representatives of PSUs.
- Valuation of the PSU in accordance with the standard national practice.
- The 'Share Purchase Agreement' and 'Share Holder's Agreement' are finalized, based on the reactions received from the prospective bidders.
- These Agreements are then vetted by 'Minister of Law' and are approved by Government.
- Thereafter, these are sent to prospective bidders for inviting for final bidding.
- The bids received are examined and evaluated by the 'Inter Ministerial Group' and placed before the CCD for Final Approval of Bids.
- After the Transaction is completed, all papers and documents relating to it are to be turned to the 'Comptroller and Auditor General of India', to enable to undertaken an evaluation of the disinvestments, for pacing it in Parliament and releasing it to the public.
- In the disinvestment process maintained above, the 'Department of Disinvestment' is assisted, at each stage by 'Inter Ministerial Group' comprising officers from the 'Ministry Of Finance' Department of Public Enterprises, The Administrative Ministry, Department controlling PSUs and Officers of Department of Disinvestment and Advisors.

Conclusion:

The studies on Disinvestment of public sector undertakings have revealed the following conclusions:

1. There is no clear-cut framework or policy for disinvestment in India.
2. The entire proceeds of disinvestment are been used to mitigate the gap fiscal deficit instead of using them for development of social sector & building infrastructure.
3. The government has not been concentrating on the timing of disinvestment as a result most of the private sector investors are shying away form the process because of the unattractive offers made by the government.
4. There is no transparency in the entire process of disinvestment in India.
5. The government has done a little or more so failed to attract foreign suitors for the disinvestment process in India.

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