

# EMERGING ISSUES OF DISINVESTMENT IN PUBLIC ENTERPRISES (PEs)

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## **Abstract**

There has been phenomenal and tremendous growth of PE's in India. They were established to attain the 'commanding heights' of the economy of the country and achieve rapid growth of industrialization and economic development. Some of these PEs later became 'white elephant' and started incurring losses. Several of them became chronically sick industries. The Govt. declared the disinvestment process, which began in 1991 with the sale of minority stakes in some PE's, shifted focus to strategic sales during 1999-2000 to 2003-04. The present UPA Govt.

announced that , all disinvestment will be considered on a transparent and consultative case-by-case basis. The Govt. has approved the constitution of a “National Investment Fund” comprising of proceeds from disinvestment. The present paper is an attempt to discuss some important issues such as restructuring, valuation of equity, Mechanism of disinvestment, Application of disinvestment proceeds, Parliamentary approval and political issues.

## **1. INTRODUCTION**

In 1991, the government of India adopted the policy of economic reforms and. declared the policy of disinvestment in selected PEs. It was decided that 20 per cent of equity of such enterprises will be disinvested and they will be sold to financial institutions, banks and employees etc. The main objectives of the disinvestment policy of the Government, as per statement laid in both the houses of parliament on December 9, 2002, -Modernization and up gradation of PEs,

Creation of new assets, Generation of employment, Retiring of public debt, Setting up a Disinvestment Proceeds Fund and Formulating the guidelines for the disinvestment of natural assets companies.

1.1 The objective of present study is to discuss some notable emerging issue of in disinvestment. The study is based on both qualitative and quantitative secondary data. The paper has classified into four parts. Introductory part is given in 1<sup>st</sup> part. 2<sup>nd</sup> part is an analysis of target and achievement of disinvestment, Issues has discussed in part three, and conclusion is given in part four.

## **2. Target and Achievement:**

The Government has been setting the targets of disinvestment in PEs and has been announcing it through its budgets. It may be found that the achievements in this regard have not been satisfactory. Details of targets and achievements of disinvestment in PEs are given in the Exhibit 1 below:

**Exhibit-1****Target and Achievement of Disinvestment**

(Rs in crore)

<b>Year</b>	<b>No. of Companies in which equity sold</b>	<b>Target</b>	<b>Achievement</b>	<b>Achievement as % Target</b>
1991-92	47	2,500	3038	121.5
1992-93	35	2,500	1913	76.5
1993-94	-	3,500	-	Nil
1994-95	13	4,000	4843	121.1
1995-96	5	7,000	362	5.2
1996-97	1	5,000	380	7.6
1997-98	1	4,800	902	18.8
1998-99	5	5,000	5371	107.4
1999-00	2	10,000	1860	18.6
2000-01	4	10,000	1871	18.7
2001-02	10	12,000	5632	46.9
2002-03	6	12,000	3348	27.9
2003-04	-	14,500	15,547	107.22
2004-05	-	4,000	2,765	69.13
<b>Total</b>	<b>48*</b>	<b>96800</b>	<b>47832</b>	<b>49.42</b>
<b>Average</b>		<b>6914</b>	<b>3,417</b>	<b>49.42</b>

Source: GOI, Public Enterprise survey (Various issues)

\* Total No. of Companies in which disinvestment has taken place so far.

It is clearly evident from the data of the above Exhibit that the amount realized of total disinvestments from 1991-92 to 2004-05 stood at Rs 47832 crore against a hefty target of Rs 96,800 crores. The amounts realized against the target set were only 49.42 per cent. The investment made by central Government as on March 31, 2002 was of the order of Rs 452250 crores. The total amount realized from disinvestment worked out to be a smear 10.58 per cent of the total investment. The achievement of disinvestment has been falling short of the target. Except in 1992, 1995, 1999 and 2004, the achievements have been unsatisfactory.

**2.1 Reasons for Slow Achievements:** The reasons for such a low proportion of disinvestment achievement as against the target set were identified and presented below:

- 1.The unfavorable market conditions are the main responsible for this downward trend of disinvestment.
- 2.The amount realized through disinvestment were not paid to the enterprise concerned for its expansion and improving

efficiency but the Government has been using such disinvestment proceeds to bridge the budget deficit.

3. The Government is not transparent about its approach towards sequencing the restructuring and methods of disinvestment of PE's.

4. The offers made by the Government for disinvestment of PE's are not attractive and stringent bureaucratic procedures discourage the private sector interest.

5. The Government does not have a comprehensive policy on disinvestment of its PE's.

6. The valuation process, procedures and surplus employees are other major attributes. It was estimated that there were 19.94 lakh employees in the PE's and nearly 25% of them are surplus.

### **3. Emerging Issues**

There are various issues in the process of disinvestment, Let us discuss some notable issues :

**3.1 Restructuring:** An issue on which there has been much debate is whether PEs restructuring is to be done prior to

disinvestment or is to be done after disinvestment by the private management. Experience suggests that a healthy and competitive PE can fetch better price in the market in comparison to a sick PE. But then the question arises about the advisability of further putting money in PE's, and the capability and the competence of the present management to undertake the restructuring, which they had done before. While a restructured PE would most likely fetch better price in the market, one should make a cost-benefit analysis to find out the extent of incremental social and financial benefit the Government would receive by selling the restructured units. However, the experience in the market has shown that at the pre-disinvestment stage, Government should undertake organizational, financial and labour restructuring to enhance the value of the unit and leave the business restructuring to the strategic buyer who should decide what to drop and what to retain depending upon the objective of this strategic purchase. It appears to be unlikely that restructuring of the PEs would be undertaken properly timely, and boldly. In fact, the Government will have to take active interest and take quick decision in this regard. With the present Government system and bureaucracy as it is, the objective of effective restructuring may not be possible. Therefore, there is a need for constituting a professionally oriented agency such as Public Enterprises Restructuring Authority. For this, the

Government may enact a special act through Parliament This Authority should be vested with sufficient power for taking policy, financial, technical decision etc.

**3.2 Valuation of Equity:** Valuation is a sensitive issue.

Valuation is not a scientific process and is affected by various assumptions and considerations. These come handy to those who want to politicize the disinvestment transaction. We find that there was no appropriate pricing of shares and complete transparency in the valuation of shares. In all the cases of strategic sale, sale of equity in Modern Foods, BALCO, VSNL, there was a lot of criticism. Since the valuation was not transparent. VSNL's 25% shares were sold to TATA Group in Rs 1439 crores and the management was handed over to TATA Group. TATA Group has also purchased 20% shares of this company in open market by paying Rs 1,151 crores. So Tata's total holding in VSNL is 45%. After having this holding Tata Group decided to purchase 20% to 26% shares of Tata Tele Services in 1,200 crores. TATA has 100 per cent shareholding in Tata Tele Services. This, 1,200 crores rupee will be paid from Reserve and surplus of VSNL, whose management is in the hands of Tata Group. This reserve was created out of profits of VSNL. It was an undistributed profit of VSNL before disinvestment. On this money there was a claim of the shareholders (Govt./Public). This should be distributed as Bonus to shareholders of VSNL. Right price for

ITDC hotels were not charged. One public sector hotel in New Delhi was sold for Rs 70 crores. After one month, the private owner of the same, sold a very small portion of the hotel for commercial complex in Rs 70 crores. The cost of disinvestment in Balco is eye-opener. Balco was sold to Sterlite Industries for Rs 551.5 crores. The price settled was really much less. The global adviser undervalued the company by Rs. 302 crore. The C&AG in its audit review pointed out its undervaluation.

**3.3 Mechanism of Disinvestments:** The moot question which arises in disinvestment is as how to disinvest. There are several methods of disinvestment, which have been followed from time to time by the government. During the initial period the government continued to disinvest 3 to 5 per cent of the equity in different non strategic PEs every year. These incremental disinvestment, or more popularity known the minority privatization was more governed by the compulsion of financing the fiscal deficit of the government. This policy was based on the assumption that the induction of private share holders will alter the corporate culture in these enterprise and provide them a stronger commercial consideration in response to normal shareholder's expectations.

Another method of disinvestment is to sell the equity as widely as possible in the market so that the government

stake will come down to 49 percent and the balance 51 per cent will be held by the public. The best management will be elected by the shareholders democratically and there will be no concentration of economic power. However due to problems persisting with the primary and secondary market for a long time and the low market price of the PEs stocks, this could not be pursued.

During last few years, there was also a discussion to create a cross- holding within the sector by selling the equity of the non-strategic PEs to other PEs like ONGC, IOC, etc., who has large amount of reserves. Through this method the public sector character of the PEs could be maintained and more autonomy in management could be provided. This policy was opposed by the rich PEs and also the bankers and could not make much headway.

During 1998-99, the finance ministry came out with a novel method of disinvesting PEs stock by selling it to a special purpose vehicle (SPV). According to this proposal, financial institutions and banks would float SPV in form of mutual fund and subscribe the equity of profit making PEs in excess of 49%, and retail these shares to the public at the opportune time when the market picks up. It was thought that the PEs would be outside the definition of PEs and therefore can manage their affairs more professionally with more autonomy. However due to political compulsion like loss

of control, tax problem, etc., this proposal could not be implemented.

During the 1999-2000, a proposal of disinvestment was mooted through the issue of Golden share concept. According to this concept, Government will disinvest all the 100 per cent shares to the private individual and retain only one share with itself known as golden share. The golden share will have power to have a nominee in the board and the power to veto all types of management decisions, which, according to government will go against the interest of the public.

However, this proposal could not be implemented because it needed amendment to the Indian Companies Act, which permits only the issue of equity share and preference share and not golden share. After a lot of deliberation and experiments with different forms of disinvestment, the Department of Disinvestments proposed strategic sale of almost all PE's in the non-strategic areas to highest bidders who will be allowed to purchase up to 74% of Government equity in the company. Initially the government stake in this PE's could be brought down to 51% and later on further to 26%. It was believed that the perception of shareholders value in these PEs would change automatically once the government reduces its stake to fewer than 51%. In 2002-03, the disinvestment mechanism was broadened to include offer for sales of residual shares in privatized PE's and a minority

portion of government equity in select PE's. There was an initial public offering by Maruti Udyog Ltd. In June 2003, which received an overwhelming response from institutional and retail investors. This was followed by offers for sale of residual shares of privatized PE's, viz., CMC Ltd., IBP Ltd. and Indian Petro Chemicals corporation Ltd., and a portion of government equity in Dredging corporation of India Ltd., GAIL and ONGC.

The real problem lies in proper selection of the mechanism keeping in mind the prevailing market condition, the image of the PE concerned, the political approach and opposition, return to the stakeholder, wider participation of the employees, as well as public, in general.

The strategic sales of PEs, though tried in several cases, have not been quite successful and invited criticism from the C&AG, the political parties, the academicians as well as the public, in general, as it could not fetch the reasonable price. The latest method adopted, i.e., offer for sale through IPO has been more successful. Moreover, there should be greater involvement of employees as well as small investors in this process, whether mechanism is adopted. It will be more relevant and beneficial to offer their equities to employees of the PE concerned as it was done by Margaret Thatcher, the PM of U.K and was welcome by all and sundry.

**3.4 Application of Disinvestment Proceeds:** The market and the institutional investors normally link the PEs disinvestment with the fiscal correction exercise of the Government. This puts the Government at a disadvantageous position in terms of getting the best price for the share. The market perceives that the center would divest its share even at a low price, if only to meet fiscal gap. This sends a wrong signal to the market. It is for this reason that in the past Government had to withdraw from the market after offering its shares in some companies. Regarding utilization of disinvestment proceeds, there has been apprehension about its proper use. Either it should be used for the repayment for Government debt, which was initially taken to finance this PEs, or this money should be used for restructuring loss-making PEs. The fact lies in that the disinvestment proceeds have been mainly used for meeting budgetary deficit. The Disinvestment Commission had recommended, in its first report that, entire proceeds should go into the disinvestment fund. It will not be used to meet budgetary deficits or revenue gaps. About three years back Government announced that it would set up disinvestment fund and the disinvestment proceeds will flow to this fund. The fund has not been established so far. Every finance minister during 1990s has taken credit, in his budget, for disinvestment. However, from 2001-02 the center has not assumed any receipt from

disinvestment in the budget. As and when there is disinvestments, it will be included in the Government receipt to make the financial position much better later on. There have been only promises on the part of Minister concerned that the investment proceeds will be properly used for meeting expenditure in social sectors, restructuring using PE's and retiring public debts. However, it has also been reiterated from time to time that disinvestment proceed will be used for providing additional budgetary support for the plan, primarily in the social and infrastructure sectors. But, in practice, it appeared to be tall talk and unfulfilled promises. In fact, the money realized that the disinvestment become a part of the consolidated fund of India. With the result, it remains unknown as to where this money has been used. So the Government has not provided any clear-cut statement on this issue. Another important issue in this regard is that the disinvestment proceeds should be separated from the capital receipts in the budget. The Disinvestment Commission has, in fact, made this important suggestion on, long back but the Government has separated it so far.

**3.5 Parliamentary Approval:** Public corporations are established by special statute of a state or central government. A legislative act is passed by defining the sphere of work and mode of management of the undertakings. A public corporation is a separate legal entity created for a

specific purpose. It is rightly stated by president Roosevelt, "A public corporation is clothed with the powers of the government but possessed of the flexibility and initiative of private enterprise." In India DVC, ONGC, FCI, Air India, Indian Airlines are some of the corporations established by special acts of parliament. The question of parliamentary approval arose in the previous session of parliament, which saw a heated debate in Rajya Sabha over disinvestment policy of the government. A point was made that when certain companies were nationalized, they were done through legislation, and therefore legislation is required to undo what has been done. In India, most of the PEs have been established under the enabling provision of the Companies Act, 1956, which stipulates that if government share-holding is 51 per cent or more it becomes a government company (there are some exceptions like FCI, ONGC etc., a mentioned above, which have been created by specific Acts).

The Delegation of Financial Power Rules of the Ministry of Finance, which lay guidelines for New Service/New instrument of service for taking budgetary approvals, stipulates that for setting up a new company or splitting up an existing company, approval of parliament is required. It also lays down a detailed schedule indicating monetary limits, depending upon paid up capital of the company, beyond which parliamentary approval is required for additional

investment or loan to an existing company. The logical conclusion is, when a Government company is set up with Parliament's approval, it can be dismantled only with its express approval. One notable feature regarding disinvestment during 2003-04 has been severe opposition, in parliament, to the strategic sale in PEs, which are being run as public corporations. The Supreme Court, in its judgment dated September 16, 2003, in the case of disinvestment in Hindustan Petroleum Corporation Ltd. (HPCL) and Bharat Petroleum Corporation Ltd. (BPCL) restrained the Central Government from proceeding with disinvestment that would have resulted in HPCL and BPCL ceasing to be Government companies without appropriately amending the statutes concerned. Several cases were substantially filed challenging strategic sale in other PEs in various high courts. Government has petitioned the Supreme Court to transfer all these cases to itself for a definitive verdict on the common issues. The Courts in India have held that PEs are "state" within the meaning of Article 12 of the Constitution. The Supreme Court has lifted the corporate veil and held that a Government company may symbolize the state, "It is immaterial for the purpose whether the corporation is created by statute or under the statute. The test is whether it is an instrumentally or agency of the Government and not as how it is created. When Government is disinvesting the shareholding in a PEs, it is

basically shedding its property right. A question arises whether it is being done with due process law. Article 300 A of the Constitution stipulates that no person will be deprived of his property save by the authority of law. How do we interpret the 'property right of state'? Can the 'property right of people of India', inherent in a Government company be shed without the authority of law? The constitutional tradition of most advanced democracies provide that the privatization must be approved by parliament. French constitution states that the rules governing nationalization of enterprise and transfer of ownership of public enterprise to private sector shall be set by law.

**3.6 Political Issues:** There was no coordination between Disinvestment Ministry and concerned ministry in which disinvested PEs comes. There was a quarrel between Disinvestment Minister, Arun Shourie and Pramod Mahajan, when the question of disinvesting the equity of HPCL and IPCL came in parliament; Arun Shourie was on one side and Petroleum Minister Ram Nayak was on another side. Even on many cases different components of NDA Government were not unanimous on disinvestment of particular PE. Any plan of disinvestment initiated by Arun Shourie is neither based on cost nor it is backed by efficiency that is why this disinvestments policy faced criticism by different components of National Democratic Alliance Government. Even coordinator

of NDA Government, George Fernandez, criticised and rather obstructed the new disinvestment plans of PEs started by Arun Shourie to be implemented. George Fernandez also raised question on the working of marketing system of two public sector oil refineries. In 2004, UPA Government came in power and formed the Government. But in pressure of leftist parties the government has closed down the Ministry of Disinvestment and Disinvestment Commission. UPA Government has initiated review of disinvestment of 15 PEs under the administrative control of the Ministry of Heavy Industries and Public Enterprises. Along with the review of disinvestment cases, the previous government had decided to sell-off, would also be drawn up. Due to these controversies investors / bidders are hesitating to purchase the shares of PEs offered for strategic sale.

#### **4. CONCLUSION**

However, the decision of disinvestment of selected PEs of the then NDA Government, for which even the road map was prepared, is being reviewed by the present UPA Government, led by Dr. Manmohan Singh. The leftist group, which is supporting the government, is oppose to disinvestment, as such, on the ideological ground. With the result, the present ground has not only scaled down the target from Rs 14,500 crore in 2003-04 to only Rs 4000 crore in 2004-05, but also decided not to undertake the disinvestment of profit making

PEs. Thus, the momentum regarding disinvestment gathered during the NDA Government, has definitely slowed down. With the result, the prospect of disinvestments appears to be slowed down in the near future.

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