1. Public Sector Reforms: Twenty Five Years of Reforms vis-a-vis Disinvestment

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GENESIS OF PUBLIC SECTOR ENTERPRISES

India chose a mixed economy model over socialism and capitalism at the time of its Independence in 1947. It was believed that such a model would have the good features of both socialism and capitalism and avoid their shortcomings. Considering the fact that the leaders of the day were heavily influenced by the economic model of the socialist USSR and viewed the private sector with some suspicion, the focus on creating monolithic government-owned enterprises to capture the commanding heights of the economy was only to be expected. Long gestation period of the core industries, lack of resources and skills with the private sector, the onerous fight against poverty and hunger and the need for planned development of the economy were the major reasons offered for the indispensability of government-owned enterprises. The 1960s and 1970s saw an indiscriminate nationalization of private sector enterprises in the name of poor and social justice. The reasons were more political than economic. Private banks were nationalized first in 1969 and then in 1980. General insurance was nationalized in 1972. Nationalization of private enterprises was challenged on various grounds in the Supreme Court of India and was struck down as unconstitutional, but the legal challenge was finally overcome by amending the Constitution multiple times. Socialistic tendencies and political pressures also ensured that the government took over private enterprises which were going bankrupt or closing down due to lack of profitability. For example, Jessop and Co. Limited, which was incurring losses, was nationalized in 1973.

STRUCTURE OF PSES IN INDIA

The PSEs in India are basically categorized under four broad types based on their ownership structure. These include departmental undertakings like India Post and Railways, statutory corporations like Industrial Finance Corporation of India) and LIC; government-owned companies like Coal India Limited and Indian Oil Limited and autonomous bodies set up as registered societies like Council for Scientific and Industrial Research and Indian Council of Medical Research. We, in this essay, however, deal with PSEs in the limited sense in which it is understood, i.e. a government owned company.

Overview of Public Sector Enterprises in India

Central Public Sector Enterprises (CPSEs) collectively continue to be a significant component of the Indian economy, though individually their operations range from monopolist to inconsequential in the industries they operate in. Compared to five CPSEs with a total investment of 229 crore at the end of first Five Year Plan, the total number of CPSES (including statutory corporations) as on 31 March 2016 was 320 with a total investment of 11.71 lakh crore. The total turnover of CPSEs is about 15% of India's GDP. The total foreign exchange earned in the year 2014-16 was 277.215 crore and the amount for the year 2014-15 was ₹84.732 crore.[1]

The CPSEs have, over a period of time, built a large capital base and some of them generate high profits. Some of the listed CPSEs are not c profitable but also command massive valuation. As per the Department of Investment and Public Asset Management, the fifty CPSEs listed on the stock exchanges contributed about 11% of the total market capitalization and two of them figured in the top ten companies by market capitalization as on 31 August 2016. The total market capitalization of these companies was 13,27,485.51 crore at BSE on that day. The following table highlights their financial performance:
Table 1: Profit/Loss and dividend of CPSEs

	Parameter (all figure in crore)	**2015-16**	**2014-15**	**2013-14**
1	Net profit of profit making CPSE	1,44,523	1,30,364	1,49,636
2	Net loss of loss making CPSE	-28,756	-27,498	-22,241
3	Cash loss (of loss-making PSEs)	-15,530	-8,114	5,964
4	Dividend declared	70,954	56,527	65,115

Source: Department of Public Enterprises. Public Enterprise Survey, Annual Report 2015-16

The CPSEs are still a big employer, though new employment generation has stopped. As on 31 March 2016 the total number of employees with the CPSEs was slightly less than 13 lakh. Out of this, the number of scheduled caste and other backward caste employees was over 2 lakh each and the number of scheduled tribe employees was over 1 lakh."

Before the liberalization of the Indian economy, the CPSEs operated mostly as government monopolies-Life Insurance Corporation (LIC), Air India and Indian Airlines, National Thermal Power Corporation, BSNL and MTNL-the list can be really long. A vast area of enterprises was not available for the private sector. Even in areas where private sector was allowed, there were very strict licensing requirements. Over the period of time, this restriction has been progressively relaxed. We now have the private sector competing with the public sector in all the industries, but for a negative list, which is still reserved for the public sector. As a result, the significance of the PSEs in the Indian economy has gradually come down.
HISTORICAL PERSPECTIVE

PSE disinvestment in the last twenty-five years

Disinvestment, as commonly understood, is the selling or liquidation of an asset by the government. Disinvestment can be of the following types:

* Sale of minority stake by the government, subject to the condition that the residual stake of the government does not go below 51%.

* Sale of a majority or a large part of government shareholding with the transfer of management and control to the buyer. This has been termed as 'strategic disinvestment.

Outright sale/privatization.

* Closure of non revivable units.

The first-ever disinvestment of CPSEs took place in the year 1991-92.

The 'Statement of Industrial Policy announced on 24 July 1991 had a statement on the public sector. It said:

Public enterprises which are chronically sick and which are unlikely to be turned around will, for the formulation of revival/rehabilitation schemes, be referred to the Board for Industrial and Financial Reconstruction (BIFR), or other similar high level institutions created for the purpose. Social security mechanism will be created to protect the interests of workers likely to be affected by such rehabilitation packages. In order to raise resources and encourage wider public participation, a part of the government's shareholding in the public sector would be offered to mutual funds, financial institutions, general public and workers. Boards of public sector companies would be made more professional and given greater powers. There will be a greater thrust on performance improvement through the MoU system through which managements would be granted greater autonomy and will be held accountable.

It also said that the portfolio of public sector investments will be reviewed with a view to focus the public sector on strategic, high-tech and essential Infrastructure.

The 1998-2004 NDA-I government came closest to having a well- articulated disinvestment policy which said that the government will go beyond minority stake sale to strategic disinvestment and outright privatization of CPSEs except for a few sectors which it considered of strategic importance. But, the government's shock defeat in the 2004 general elections led to a major reassessment of the CPSE disinvestment policy. As was to be expected, apart from the political opposition, the NDA-I had also faced a very strong resistance from the employees of the CPSES.

The NCMP of the UPA led by Congress that was in government from 2004 to 2014 went back on disinvestment. Apart from the embedded socialistic tendencies of the Congress which favours CPSEs occupying the 'commanding heights' of the economy, the fact that the Left parties- CPI (M), CPI, Forward Bloc, etc. were the second biggest group led to forsaking of the disinvestment policy of the NDA-I. Since the defeat of NDA-1 eluded any simplistic explanation, a lot of its initiatives suspected of contributing to its defeat, including aggressive disinvestment agenda, were sacrificed at the altar of political realism. Disinvestment, therefore, has never been an article of faith for any government and has been resorted only to augment the government resources.

The constitution of National Investment Fund (NIF) on 3 November 2005 was one of the ways in which the UPA government tried to differentiate its disinvestment policy from its predecessor. According to the notification, all the proceeds from disinvestment were henceforth to be credited to a fund called the NIF, which was to be of permanent nature and would be maintained outside the Consolidated Fund of India. The NIF was to be professionally managed by selected public sector mutual funds to provide sustainable returns to the government, without depleting the corpus. The most important part was the provision which said that 75% of the annual income of the fund will be used to finance selected social sector schemes that promoted education, health and employment, and the residual 25% would be used to meet the capital investment requirements of profitable and revivable CPSEs that yield adequate returns in order to enlarge their capital base to finance expansion/diversification. NIF was first restricted in 2009 and then again in 2013; later on, the areas in which the fund could be invested were considerably widened.

Table 2: Disinvestment target and achievement since the beginning (in crore)

Year	Budgeted Receipt	Achieved Receipt	Year	Budgeted Receipt	Achieved Receipt
1991-92	2,500	3037.74	2004-05	4,000	2,764.87
1992-93	2,500	1,912.51	2005-06	No target fixed	1,569.68
1993-94	3,500	Nil	2006-07	No target fixed	Nil
1994-95	4,000	4,843.10	2007-08	No target fixed	4,181.38
1995-96	7,000	168.48	2008-09	No target fixed	Nil
1996-97	5,000	379.67	2009-10	No target fixed	23,552.96
1997-98	4,800	910	2010-11	40,000	22,762.73
1998-99	5,000	5,371.11	2011-12	40,000	14,035.27
1999-00	10,000	1,860.14	2012-13	30,000	23,857.25
2000-01	10,000	1,871.26	2013-14	54,000	21,321.04
2001-02	12,000	5,657.69	2014-15	58,425	24,337.77
2002-03	12,000	3,347.98	2015-16	69,500	32,209.73
2003-04	14,500	15,547.41	2016-17	56,500	

Note Excludes other receipts of the government from CPSE disinvestment.
Source: www.bsepsu.com

Hurdles/Challenges for Disinvestment

The CPSEs provide the respective ministers and top bureaucracy with an empire which is a source of personal and professional enrichment and a medium through which favours can be dispensed and loyalty bought The reluctance of administrative ministries to the disinvestment of CPSES made complete sense. No individual or institution would want to see its influence, budget and importance wither away. Their resistance was reminiscent of Winston Churchill's statement in London in 1942 where he declared that he had not become the King's First Minister in order to preside over the liquidation of the British Empire.
The biggest hurdle that the disinvestment process faced during 1991- 2016 period was a very strong opposition from the management and the employees of the enterprises that were divested. As soon as any forward movement on disinvestment was detected, CPSEs across all industries virtually declared a war on the government. The employees of BALCO went on a strike against its disinvestment that continued for sixty-seven days. The 'beleaguered enterprise received support from even those quarters that were explicitly exempted from the exercise. For example, the labour unions of Indian Railways opposed the disinvestment of CPSEs even when it was clear as daylight that Railways would not be touched. Divided polity over the issue compounded the problem. Political parties of all hues, ever ready to milk any opportunity politically, jumped into the fray on the side of those opposed to disinvestment.

The potential buyer in the case of strategic disinvestment or outright privatization wanted a free hand to run the enterprise, whereas the employees wanted a protection of their service conditions. Since the CPSEs were generally overstaffed or properly staffed, it was very natural that retrenchment figured prominently in the strategy of the new management to revive the enterprise or boost profits. Job reservation was also an important issue to be negotiated. CPSEs are governed by the extant reservation policies of the government. After strategic sale and privatization, the new management would not be bound by it. The new positions created would not be filled as per the reservation rules and regulations. Disinvestment, therefore, was opposed on the ground that the total pool of jobs under the reserved category would fall because of it.

Till date, excluding the ITDC and HCI hotels, only ten companies have been privatized out of which IBP Petroleum was sold to other CPSES, which meant that the reservation policies continue to be applicable to it.
The remaining nine are as follows:

Table 3: Number of employees at CPSEs at the time of their privatization

	Company	**No. of employee at the time of privatization (approx)**
1	Lagan Jute Machinery Company Limited	400
2	Modern Food Industry (India) Limited	2,042
3	Bharat Aluminum Company Limited	6,436
4	CMC Limited	3,208
5	HTL Limited	1,100
6	Indian Petrochemicals Corporation Limited	13.543
7	Paradeep Phosphates Limited	1,150
8	VSNL	2.991
9	Hindustan Zinc Limited	2,848
	Total	**33,718**

Source: Government of India. Department of Investment and Public Asset Management. White Paper on Disinvestment of CPSEs

Adding the ITDC employees would take the total figure to around 38,000 So through the process of disinvestment about 19,000 positions (as per the current law of 50% reservation), including executives as well as non- executives, went out of the reservation pool.

Governments tried to circumvent the problem of opposition from employees through various means. One was allotting a small part of equity at a discount to the employees of the enterprise being divested, but this could work only for enterprises that were profitable and were being listed on the stock exchanges. It could not be followed for enterprises that had eroded their net worth or were sick and could not be revived.

Valuation has also proved to be a vexed issue. There is no single agreed method to value a company and each method has its own set of assumptions that are open to questions. The problem was exacerbated in the case of public sector enterprises because of information gap insufficient and unreliable data, lack of similar companies to facilitate.

Table 4 : Status on allotment of shares to the employees of CMS/VSNL/HZI/IPCL

		CMC	**VSNL**	**HZL**	**IPCL**
1	No. of shares	1,51,50,000	28,48,44,517	42,25,31,900	24.82.25,000
2	No. of shares allotted to employees	9.19.326	52,64,555	61,89,830	1,13,70.678
3	Pricing	1/3rd of the listed market value or 1/3rd or the strategic sale price per share, whichever is lower but not less than 10 (face value)	1/3rd of the price offered by the strategic partner or one third of the listed market value calculated on the average of the closing price on BSE for 30 days, whichever is less, subject to minimum of par value of 10 per equity share	1/3rd of the listed market value or strategic sale price, whichever is lower subject to minimum of face value	1/3rd of the offer price or the price quoted by the strategic partner at the time of disinvestment, whichever is lower.

4	Cost to the government	12.04 crore (sale price of 66 per share against strategic sale price of 197 per share)	₹18.88 crore (sale price of 10 per share against strategic sale price of 40.50 per share)	₹18.88 crore (sale price of 10 per share against strategic sale price of 40.50 per share)	197.85 crore (sale) price of 757 per share against strategic sale price of 231 per share)
5	Offer employees to	June/July 2002	February 2002	November 2002	April 2004

Source: Government of India, Department of Investment and Public Asset Management. 'White Paper on Disinvestment of CPSEs.

relative valuations, etc. Added to it was the lack of clarity regarding the purpose of disinvestment-whether it is to maximize revenue for the government or ensure that the disinvested entity revived under the new owner or some other objectives? It made all disinvestment exercises open to the allegation of cronyism. For CPSEs already listed on the stock exchanges, valuation for further dilution of stake was not a problem, but. as soon as the disinvestment was announced, the market participants took positions to benefit from it which adversely affected the stock price. The role of LIC in subscribing to CPSE shares has also been questioned. While LIC maintained that all its decisions regarding investments were taken after due diligence, it is believed that it has acted as a white knight and bailed out many disinvestment programmes by subscribing to the bulk of shares under instructions from the Ministry of Finance. Legal challenges to the disinvestment process were only to be expected. According to the 'White Paper on Disinvestment of CPSEs' issued by the Department of Disinvestment in 2007, ninety-six disinvestment related cases had been filed between December 1999 and 30 June 2007.

FUNDAMENTAL QUESTION

Need for Public Sector Enterprises (PSEs)

There is considerable confusion in the minds of people and policymakers regarding the economic model that the country needs to follow. Fed on the staple diet of Fabian socialism for a large part of the post-Independenc era, it is common to find people distrust private sector for their pro motive. In order to evolve any clear action plan for the future, certa questions need to be answered unambiguously.

Should the government be doing business?

The primary function of the government is to maintain law and ord national defence, enforcement of contracts and provision of public good like health and education which have positive externality. Roles beyال this have been taken up by various governments at various points in the tenures due to the exigencies of the time. Governments face a real talent and resource constraint and therefore it should be devoted to functions that are sovereign in nature and cannot be delegated to the private sector. If the sole purpose for the existence of a CPSE is profit, then the government should exit the field and leave the market for private enterprises.

What is the basic purpose of PSEs?

The basic purpose of PSEs cannot be earning profits for their owners (government). The citizens have vested the governments with the power to levy taxes on them to meet their resource requirements. The non-profit guals of PSEs can be balanced regional development, investing in long gestation projects, promotion of a particular industry, etc. A question that begs an answer is whether establishing PSE is the best way to promote such government policies. Even if the governments chose to deploy its best people to run and manage the CPSEs, the principal-agent problem, lack of transparency and accountability, diffused responsibility and bureaucratic methods would lead to suboptimal results.

How can a government realize its goal of downsizing and simultaneously run the PSEs?

There is large government paraphernalia to manage the CPSEs. If the aim of the government is to reduce its size, it is imperative that the government disinvests the CPSES.

Case for Disinvestment

Efficiency, transparency and accountability

The operations of publicly traded companies are transparent and there are established accountability mechanisms. A privately held company would report only to the Ministry of Corporate Affairs (MCA) in India and will be required to furnish only limited information annually to the MCA. Contrast this with a company that is publicly traded. Apart from its obligations to the MCA, it will also come under SEBI-the stock market regulator of the country. A host of rules and regulations pertaining
to corporate governance, quarterly results, etc. will become applicable. Primary supervision will also be exercised by the stock exchange where the company is listed. A third level of supervision is provided by the analysts who track the company and its stocks. Though it has no statutory or penal powers but its hawk eye view on the performance of the company and its prompt disclosure to the market participants that reward or penalize a stock based on its performance keeps the management on its toes. Once a company is listed on the stock market, it is benchmarked against its peers domestically as well as globally. It leads to efficiency in operations and management, and where it does not, listing highlights the failure of the enterprise. It makes the case of strategic sale politically more feasible as people are outraged by the wastage of public money. The intention to be publicly traded shows the willingness and openness to be judged.

Level playing field

In sectors in which CPSEs are present, policies are made in such a manner that they favour CPSE over private players. A classic example in this case would be the issue of land acquisition. According to section 2(1) of the Right to Fair Compensation and Transparency in Land Acquisition. Rehabilitation and Resettlement Act, 2013, the provisions of the Act would apply when the appropriate government acquires land for its own use. hold and control, including PSUs and for public purpose. Setting up a power generation project would qualify as public purpose according to section 2(1)(b)(i) of the Act. Now, if the power generation project is to be established by a PSE it would not require prior consent of the people affected by the project, but if the same project is to be set up under a PPP or as a private venture the land acquisition would need the prior consent of 70% and 80%, respectively, of the people if the venture want the government to acquire land for it.

Similarly, the government subverts larger public interest in promoting its interest as the owner of CPSEs. For example, in the case of power purchase agreements, the government as the investor is concerned wit the return on its investment and therefore the pricing for the CPSE producing power is done on a cost plus basis. The power-generating CPSE has no incentive to keep its cost down and project delays leading cost escalation are a routine feature. The power distribution companies which are mostly state government owned are forced to purchase this higher cost power.

Resource Generation

The resource need of the government is huge. Our physical and social infrastructure are still a big constrain and humongous money needs to be invested in the sector. According to the 12th Five Year Plan. the total investment required for the infrastructure sector during the plan period (2012-17) to achieve 9% growth was expected to be around 65 lakh crore (at current prices) and at least 50% was to come from budgetary support (Centre as well as states). Listing CPSEs would generate funds for the government to meet its share. The number of unlisted PSEs as on 30 June 2016 was 169 out of which 142 were profit making. As these companies are gradually listed, apart from the various benefits of public listing, it will also provide funds to the government. In the Budget for 2016-179 the finance minister had set a target of mopping up 56,500 crore through disinvestment. Of this, ₹36,000 crore was to come from sale of minority stakes and 20,500 crore from strategic sale. According to the Economic Survey for the year 2015-16, the total accumulated loss of sick units, as of 2013-14, was ₹1.02 lakh crore. Disinvestment would also ensure that sick and loss-making CPSEs are no longer a drain on public money.

HOW TO GO AHEAD

While it is true that in the last twenty-five years of economic reforms, the direction of economic policies has not changed irrespective of the political dispensation in power at the Centre, it cannot be said to be true for the sub-area of disinvestment policy as well. Political consensus on the issue of disinvestment still continues to be elusive. The political costs associated with any disinvestment exercise are clear and present while the benefits are not only not apparent but also open to questions. This explains the
cautious approach of various governments on the issue. If disinvestment. or for that matter economic reforms, has to succeed, there has to be a very strong commitment for it right at the top of the political executive.

All CPSEs need to be thoroughly assessed and put into one of the four categories of disinvestment-minority sale, strategic sale, privatization and liquidation. In all the four cases, the timing is of essence as the value of the disinvestment proceeds would depend on the state of the domestic and global economy as well as that of the capital markets. Minority stake can be sold in companies that still need to retain public character-for example ONGC, Coal India. Minority stake sale should be the exception as it fetches lower valuation than strategic sale and outright privatization.

For companies that are in sectors where private sector is well developed and the industry is competitive, the government can choose to exit it completely. The choice between strategic sale and privatization should be contingent on valuation. If for reasons that have been identified above, a CPSE is not commanding the valuation comparable to its private sector peers, the government can sell a majority stake and pass on the control and management to the buyer and sell the residual stake when its value increases. It can also be followed in CPSEs where the government believes that it needs to influence decision-making. The government, in such cases can retain up to 26% of the stake in the CPSE. Complete privatizatio can be done of companies that are operating in consumer or servic industry where complete commodification has taken place.

The CPSEs are valuable public assets with the government and t government has a fiduciary duty to use it in the best interest of citizens. Given the fact that most of the conditions, justified or not, the establishment of the CPSEs no longer hold true after seven decad of Independence and the growth of a robust and vibrant private seca the government should consider exiting the enterprises, provided value is right, and focus its talent and skills in areas where its prese is still lacking. Except the policy of reservation, no other conten issue needs resolution.

ANNEXURE

Year-wise summary of past CPSE disinvestments (as n 6 August 2016)

Year	Strategic sale to private entity	Public offer (excluding fresh capital raising)	CPSE to CPSE sale	Anction to financial investors	Auction to private catity	Sale to employees	Institutional placement Buyback programme	Buyback	Block deals	Exchange traded fund	Sale of bonus debentures	Total
1991-92				3,037								3,037.74
1992-93				1,912.51								1,912.51
1993-94												0.00
1994-95				4,843.10								4,843.10
1995-96				168.48								168.48
1996-97		379.67										379.67
1997-98		910.00										910.00
1998-99		783.68	4182.74	404.72								5,371.14
1999-00	105.45	1,020.00	459.27									1,584.72
2000-01	554.03		1317.23									1,871.26
2001-02	2,089.41		1153.68			25.19						3,268.28
2002-03	2,335.72					12.26						2,347.98
2003-04	342.06	15,128.26			77.10							15,547.42
2004-05		2,700.06				64.81						2,764.87
2005-06				1,567.60		2.08						1,569.68
2006-07												0.00

2007-08		1,814.45		2366.93								4,181.38
2008-09												0.00
2009-10		21,305.91	2247.05									23,552.96
2010-11		22,762.73										22,762.73
2011-12		14,035.27										14,035.27
2012-13		23,857.25										23,857.25
2013-14		3,102.62	5340.00				358.21	2,131.28	7388.93	3,000.00		21,321.04
2014-15		24,277.16				60.61						24,337.77
2015-16		19,574.51						4,483.22			8152.00	32,209.73
2016-17		2,735.34				262.48						2,997.82
Total	**5,426.67**	**1,54,386.91**	**14,699.97**	**14,301.08**	**77.10**	**427.43**	**358.21**	**6,614.50**	**7388.93**	**3,000.00**	**8,152.00**	**21,483.80**

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