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Calling out the DPSUs

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In the last couple of weeks there were two significant announcements on disinvestment of two faltering public sector units[1]. First, the government's decision against disinvesting Air India for the want of takers. The second is LIC's bid for IDBI. The debate around using LIC as a bail out investor is often discussed as is the poor state of India's public sector enterprises. However, the gaping hole in public discourse has been around defence PSUs (DPSUs). The DPSUs have for long been treated as a breed that is obviously more superior to other PSUs only by virtue of the sector that they serve in. They have been the most protected of all PSUs with practically no competition even today and with all the advantages of a monopoly without calling it as much. They manufacture for one buyer who is obligated to buy from them. Yet, their profitability (for the handful that are infact profitable) does not come from their manufacturing prowess but from their huge cash assets that earn interest. It is time to call them out.

The balance sheets of DPSUs scream of dismal productivity and profitability. Take for instance the DPSUs' profit before tax (PBT) and profit after tax (PAT) figures. There are 9 DPSUs, and their PAT figures range between INR 1,223 – 2,61,563 lakhs (refer Appendix 1). Now, if we were to deduct the value of their 'other income' from their total revenue, then the PAT is either miniscule or mostly negative. Mazagon Dock Shipbuilders Limited (MDSL) and Garden Reach Shipbuilders and Engineers Limited (GRSE) will show losses as high as INR 23,107 lakhs and INR 21,532 lakhs respectively. This leads us to the second tell-tale sign.

The difference between revenue from operations and other income is important to examine. The 'other income' under revenue in the balance sheet is largely made up of interest income on financial assets, sale of scrap, and adjustment of trade receivables or trade payables. The interest income forms anywhere between 5 – 20 per cent of total revenue across all DPSUs. MDSL and GRSE top this with 18 per cent and 20 per cent respectively (refer Appendix 1). This means that anywhere between 5 - 20 per cent of total revenue is generated outside of main business revenue, a clear indication of poor productivity.

[1] First appeared in Business Standard, 28th July 2018.

The inventory to total revenue ratio is another measure of productivity. The average inventory held as a percentage of revenue is around 59 per cent for DPSUs. Hindustan Aeronautics Limited (HAL) and MDSL hold inventories at 115 per cent and 114 per cent of revenue from operations respectively (refer Appendix 1). A high figure means that what is being produced is not sold. This is a strange place for DPSUs to be in, especially HAL, which is for all practical purposes the only aviation manufacturer in the country. Even for other PSUs such as Bharat Heavy Electricals Limited (BHEL) and Gas Authority of India Limited (GAIL) this figure is 24 per cent and 3 per cent respectively. For private sector companies, such as L&T and Mahindra, the figure is 3 per cent and 6 per cent. What is therefore flummoxing is that the figures for purchases of new inventory for HAL and MDSL as a percentage of total revenue is 36 per cent and 45 per cent respectively (refer Appendix 1). The question that begs to be asked is why these DPSUs spend as much as one third their earnings on new inventory when clearly the old is unused.

The productivity of DPSUs is not flattering, but let us set that aside for a second. Any PSU is believed to be tasked with welfare for the sector rather than accruing profits. In the recent context, it is believed that DPSUs are primary business providers for MSMEs through their backend supply chains. This argument is easily debunked with a quick look at the trade payables. Of the seven out of nine DPSUs that provide the break-down of total trade payables, those to MSMEs across board are as low as 1 - 2 per cent of total trade payables (refer Appendix 1). The only exception to this is Bharat Earth Movers Limited (BEML) where it is 4 per cent. Clearly DPSUs are nowhere close to being major business providers for MSMEs. Infact even their annual reports mention MSMEs sparingly. While DPSUs may have empanelled thousands of MSMEs, and the intent is true, the amount of business that is actually being generated from MSMEs is negligible.

If rumours are to be believed the Ministry of Defence has supposedly decided not to pump in any more money into DPSUs in order to ensure more private sector participation, but this is not the solution to improving DPSU productivity. According to Mr. Jaitley, gradual disinvestment of the DPSUs is one way to increase operational efficiency (Business Standard 4th Aug 2017). Infact, a 1st March 2016 PIB press release documents the government's approval to divest 10 per cent of HAL through IPO. So far nothing seems to have moved on this front. This is not surprising. Why should the success of DPSU disinvestment be any different from the disinvestment of other PSUs?

In the meantime other solutions should be considered. First, the government must muster the political will to close down ailing units and sell the fixed assets of sick units. Existing employees may either chose voluntary retirement or a mandatory period of upskilling so that they may be absorbed by the remaining players in the industry. Second, existing behemoths could be fragmented and restructured to bring them down to manageable sizes and assigned one platform for them to specialise in. Third, any order given to DPSUs must necessarily contain the caveat of having to mandatorily collaborate with the private sector, atleast until such time that DPSUs' operational efficiencies increase. The competitive edge that DPSUs have over private sector players is their infrastructure. In the interest of building self-reliance in defence, this infrastructure must be shared with the private sector. India has options for procurement – DPSUs, private sector or import. With the ridiculous delays in DPSU production and no long term covenant for private sector, is it surprising that we turn to imports? The only other option is to leave our armed forces ill equipped.

Appendix 1 Data from DPSUs' Annual Reports 2016-17 (Statements of Profit and Loss)[2]

S. NO.		HEADS	DEFENCE PUBLIC SECTOR UNDERTAKINGS									OTHER PSUs		PVT COMPANYS	
		BALANCE SHEETS:	BDL	BEL	HAL	MDSL	GSL	MIDHANI	BEML	HSL	GRSE	BHEL	GAIL	L & T	M & M
1		TOTAL NON-CURRENT ASSETS:	112386	313466	1136887	148033	93546	37440	88267	16931	168213	1833624	4712548	2455557	2688232
2		TOTAL CURRENT ASSETS:	725584	1402147	4014753	1749106	128080	72664	382745	74942	288288	6123020	914451	6833002	1245599
	a.	Inventories	224001	485576	2134039	402865	47022	20604	197446	8398	49646	737238	169838	176286	271560
3		CURRENT LIABILITIES:	568609	871482	2559067	1496843	96606	24801	170079	70139	344636	2012567	837472	4848669	945895
		Trade Payables-	151030	134659	160467	89826	3652	6603	49685	19678	36796	870916	271601	2403183	715626
	a.	MSME	1602	1558		1316	79	105	1820		633			14200	17884
		% of Trade Payables to MSMEs	1%	1%	-	1%	2%	2%	4%	-	2%	-	-	1%	2%
	b.	Others	149428	133101		88119	3573	6498	47865		36057			2388983	625107
	c.	Foreign				391					106				
		PROFIT & LOSS STATEMENTS:													
4		TOTAL REVENUE:	518656	961145	1959945	429430	110237	83309	289711	63912	115796	3047108	5005926	682732	4843853
	a.	Revenue From Operations	488662	914044	1855521	352974	105545	80971	283466	62904	93041	2947499	4888299	6630135	4709604
	b.	Other Income (interst on deposits)	29994	47101	104424	76456	4692	2338	6245	2104	22755	99609	117627	197185	134249
		Other income as % of Total Revenue	6%	5%	5%	18%	4%	3%	2%	3%	20%	3%	2%	29%	3%
		PBT- OTHER INCOME	50287	155841	253834	8316	13054	16297	3584	3273	-20666	-36826	453328	478599	384501
		Inventories as % of Rev. from Operations.	46%	53%	115%	114%	45%	25%	70%	13%	53%	25%	3%	3%	6%
		Inventories as % of Total Rev.	43%	51%	109%	94%	43%	25%	68%	13%	43%	24%	3%	26%	6%
5		PROFIT BEFORE TAX (PBT)	80281	202942	358258	84772	17746	18635	9829	5377	2089	62783	570955	675784	518750
6		PROFIT AFTER TAX (PAT)	52405	154762	261563	53349	11741	12631	8445	5377	1223	49586	350291	545374	395565

[2] Compiled from Annual Reports 2016-17 of all 9 DPSUs.

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