

## Privatization

# For Public Good!

Irrespective of whether the government's primary objective is to bring efficiency into CPSEs or to generate revenue through divestment, it is becoming increasingly evident that privatization is the way to go.



**Nirupama Soundararajan**  
Senior Fellow & Head of Research,  
Pahle India Foundation, New Delhi

**E**ver since the July 2019 Budget, there have been significant announcements about Central Public Sector Enterprises (CPSEs). First, the disinvestment target was raised to ₹105,000 cr for 2019-20. Second, the cabinet recently announced the strategic disinvestment of over 30 CPSEs, including that of Bharat Petroleum Corporation Limited (BPCL), Air India and its five subsidiaries, and Shipping Corporation of India Limited (SCI) amongst others. Third, stock exchanges and CPSEs have reached an impasse with regard to the fines the

former has levied for the latter's violation of corporate governance norms laid down by the Securities and Exchange Board of India (SEBI).

For many years now, with the exception of maybe one or two years, India has never met her disinvestment targets. There have been many reasons for this. The main reason that has often been cited has been the lack of value for investors. The lack of demand from investors has often led to one CPSE buying stake of another. The Life Insurance Corporation's role in bailing out many such disinvestment deals as the inves-



# HISTORY OF DISINVESTMENT IN INDIA

The IPOs



1990-98

A lot of PSUs got listed via auction to financial investors, GDR and public offers in the 1990. HPCL, BPCL, Mtnl, ONGC, sail, gall etc.

Golden Opportunity Missed



2004-09

ONGC was a big ipo and others like gall, maruti and ntpc and some more in 2004-2005. HPCL and BPCL privatization stalled. Only two small sized IPOs of Power Grid and REC in the IPO frenzy of 2006-2008. IFCI bids not accepted. Golden Opportunity missed

All out - Buybacks, CPSE to CPSE, ETF, OFS



2014-19

Disinvestment done through all possible routes. Offer for sale of Coal India, IOC, NTPC, and NMDC. IPOs like GIC, HAL. The new route utilized the most - ETFs - CPSE and Bharat 22 ETF, SUUTI stake sale. Enemy Property shares sale, CPSE to CPSE sale - HPCL sold to ONGC and REC to PFC.

CPSE to CPSE cross holdings/  
Privatization

1999-04

Gail sold to ONGC, IOC stake sold to IOC etc. Bangaigaon Refineries, Madras Refineries to IOC, Kochi Refineries to BPCL, Modern Food to Hindustan Unilever, Bharat Aluminium, Hindustan Zinc in to Sterlite, VSNL to Tatas, ITDC hotels sold to private parties, ICI sold to Asian Paints.

Disinvestment Back again through  
OFS/FPO

2009-14

Focus Back to disinvestment. Coal India the big IPO, NMDC, ONGC, NTPC, Oil India and other OFS/FPO mainly subscribed by government institutions like LIC. CPSE to CPSE sale - IOC sold to ONGC/Oil India.

2019-24



Strategic Sales ?  
Privatization ?  
Stop ?

Source: Nooreshtech.co.in

tor of last resort have both been discussed and criticized abound. So much so that in the July Budget Speech, the definition of government shareholding of CPSEs was amended to include indirect ownership through other CPSEs. Hence the government's focus on strategic disinvestment.

*Strategic disinvestment is guided by the basic economic principle that the government should discontinue its engagement in manufacturing / producing goods and services in sectors where the competitive markets have come of age, and such entities would most likely perform better in the private hands due to various factors e.g. technology up-gradation and efficient management practices; and would thus add to the GDP of the country.*

PIB 194727

India's economy has slowed down. There are no two ways about this. Financing India's growth has become a challenge. The financial sector, both banking and non-banking institutions are under severe stress. The non-per-

forming assets problem has discouraged banks from lending to most sectors. As a result of slowdown in credit flow, the economy too has slowed down, and all this with the government announcing its intent to help India become an ₹5 tn economy. With the growth rate of the economy falling to as low as 5% per annum, it is no surprise that both direct and indirect tax collections have fallen.

Recently Pahle India Foundation released a research study titled "Unlocking Revenue Through Central Scheme Consolidation" that looks at largest expenditure head of the government, the Cen-

trally Sponsored Schemes (CSS) and the Central Sector (CS) schemes. The study makes many observations, but the most pertinent in this context is that we seem to be deficit financing the cost of welfare schemes. Tax revenues as a percentage of Gross Domestic Product (GDP) were expected to decline as per 2019-20 Budgeted Estimates (BE). Disinvestment as a percentage of GDP is barely 0.5%.

If we were to interpret the 2019-20 (BE) figures, it would mean that, while tax revenues have dropped to 11.7% of GDP, our expenditure on schemes has gone up from 5.5% to 6% of GDP, even as the economy has slowed down. The only way that the government will be able to maintain fiscal deficit as a percentage of GDP at 3.5% or thereabouts is if they are able to meet their disinvestment target of ₹105,000 cr by the end of the financial year, failing which the fiscal deficit numbers will increase.

The macro figures are important to understand why disinvestment has become an impor-

tant objective for the government. It is an important source of off-balance sheet revenue. However, piecemeal disinvestment has not worked.

*The resources unlocked by the strategic disinvestment of these CPSEs would be used to finance the social sector / developmental programs of the government benefiting the public. The unlocked resources would form part of the budget and the usage would come to scrutiny of the public. It is expected that the strategic buyer / acquirer may bring in new management / technology / investment for the growth of these companies and may use innovative methods for their development.*

PIB 194727

The government must only be in those sectors that are strategic (nuclear, space, defence) or in those crucial sectors in which private sector is yet to make an entry or are hesitant to do so. This is also in line with the idea of having nationalized businesses. The role of the government could be that of an investor (who accrues returns on public money), an owner (wherein they exercise their ownership rights in terms of appointments of boards and management control), or as a sovereign (where the company is an extension of the government). In India however, there is a lack of clarity on what the role of the government is in CPSEs, rather it is an unhealthy mix of all three, leading to conflict and poor governance.

The Report of the Committee on Corporate Governance (2017), commonly referred to as the Kotak Committee Report discusses corporate governance for all entities, including CPSEs. They note:

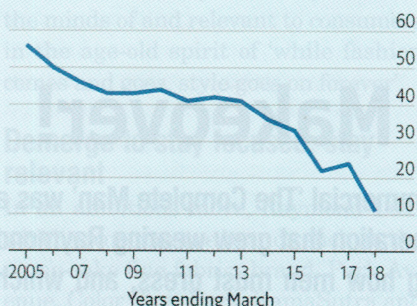
Year	Disinvested (in Rs cr)
2014-15	26,068
2015-16	23,996
2016-17	35,468
2017-18	1,00,057
2018-19	85,000
2019-20	90,000 (proposed)

Source: moneylife.in



## Public pain, private gain

India, share of profits\* from government-controlled companies, %

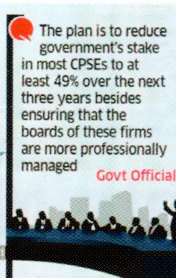
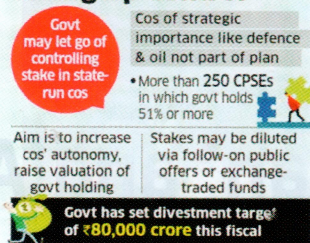


Source: Edelweiss Source: The Economist \*BSE 500 index

The Committee acknowledged that PSEs also face unique challenges that make their governance more complex than in the private sector, given that (i) most PSEs pursue multiple and diverse objectives in line with their broader social welfare objectives (unlike private enterprises which may focus on value maximization for their shareholders); (ii) PSEs may also have certain structural issues arising due to conflicts of interest that are inherent in cases where the same entity is both the owner and regulator; (iii) Protracted decision making in PSEs owing to accountability at multiple levels. Nonetheless, there is a need for moving to enhanced governance standards.

The Committee Report has also recommended that there be no difference in governance standard for listed private and government entities and that all of them should comply with SEBI's Listing Obligations and Disclosure Requirement (LODR) Regulations. Many listed

## Giving Up Control



## Lending a Hand



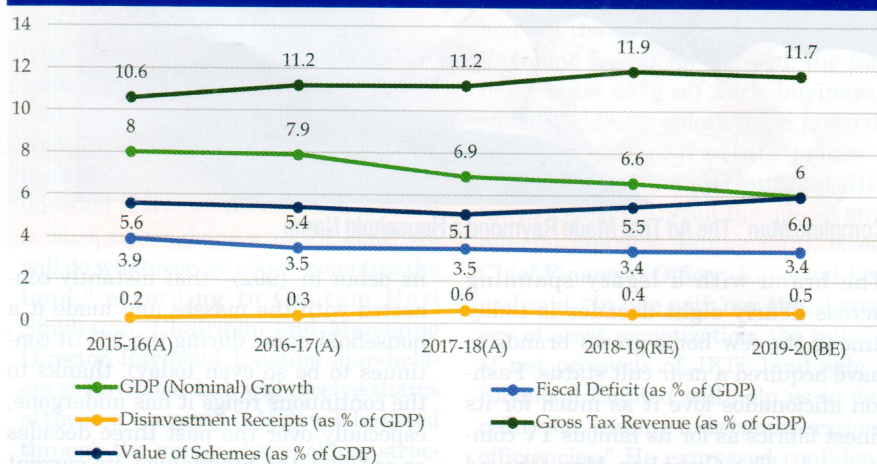
CPSEs have failed to do so, thereby incurring the fines levied on them by the exchanges. This is not the first time that recommendations have been made to improve the corporate governance norms of CPSEs. In May 2014, the Report of the Committee to Review Governance of Boards of Banks in India, popularly known as the PJ Nayak Committee, recorded similar observations for public sector banks in India.

The Central Government is a good example of a bank shareholder which has suffered deeply negative returns over decades. It is therefore in the Government's own interest to provide clarity in the objectives set for bank boards and to thereby improve governance and management. The Report proposes that the Government distances itself from several bank governance functions which it presently discharges. For this purpose it recommends that the Bank Nationalisation Acts of 1970 and 1980, together with the SBI Act and the SBI (Subsidiary Banks) Act, be repealed, all banks be incorporated under the Companies Act, and a Bank Investment Company (BIC) be constituted to which the Government transfers its

holdings in banks. The government's powers in relation to the governance of banks should also be transferred to BIC.

It has been over five years since this recommendation. If the government wants to reap the benefits of being a shareholder it is important for CPSEs to be run efficiently. For this to happen, CPSEs must be corporatized. Boards must be appointed professionally and the government and line ministries must stay away from management decisions. The government can continue to remain a shareholder and exercise the same rights that all shareholders do. In short, irrespective of whether the government chooses to remain the single largest shareholder or the majority shareholder, the government should not hold management control. While this is not privatization in its true sense, it could be one way to bring in efficiency into the management. Unfortunately, this has not seemed to work. For what reasons may be, the Indian government has rarely been successful in corporatizing CPSEs, banks included. The only option available to them is to privatize. Strategic disinvestment with management control will hopefully generate adequate investor demand. A major impediment in the past has been that of labor unions. However, it is not inconceivable for private sector bidders to come up with suitable solutions to assuage the fears of labor unions. Options such as voluntary retirement and mandatory upskilling are all plausible solutions. In the end, irrespective of whether the government's primary objective is to bring efficiency into CPSEs or to generate revenue through divestment, it is becoming increasingly evident that privatization is the way to go. ■

## Macro Variables Compared to CSS and CS Schemes



Source: "Unlocking Revenue through Central Schemes Consolidation: Pre-Budget 2020." Pahle India Foundation, November 2019

Reference # 20M-2019-12-09-01