St. Xavier's College (Autonomous), Kolkata
XAVIER'S FINANCE COMMUNITY

Presents

DISCOVERING INDIA'S AMBITIOUS PRIVATIZATION DRIVE

CONTENTS

Introduction

"The government has no business to be in business"

Hon'ble PM Shri Narendra Modi (February 2021)

Public Sector Undertakings have always played an integral role in the growth and development of a country. Not only do they help in the promotion of Heavy Industries with massive gestation lags, Government Undertakings also play integral roles in generating income, capital formation, creating jobs, promoting a strong industrial base, contributing to economic growth, and developing infrastructure.

Despite such indispensable factors, the Government has been focusing on a policy of Privatization and Disinvestment. Beginning with the LPG Policy of 1991 brought about by the then Finance Minister Dr. Manmohan Singh, several government entities have been sold off to the private sector since. These range from Bharat Aluminium Company Ltd in 2001 and Maruti Udyog Ltd in 2002, to several airports and banks in recent years.

The Government, in its new Public Sector Enterprise policy, made it clear that barring four strategic sectors where the government would have a limited role, all other public sector units can be privatized. The government seeks to move ahead with its push to "monetize and modernize" the government-owned under-utilized and unutilized assets of the country. According to PM Narendra Modi, there is a ₹2.5 trillion investment opportunity in over 100 assets that are up for monetization.

The thin line between Privatization and Disinvestment

Privatization refers to the transfer of ownership, management, and control of public sector enterprises to the private sector. In this process, more than 51% of the shareholding of the enterprise is transferred to private stakeholders.

Disinvestment, on the other hand, refers to a strategized and planned to sell off or liquidating of some assets held by the government or a PSU. Under disinvestment, parts of the equity of PSUs, or only some assets are sold off to the private sector.

Thus, the key difference between the two is that under privatization, a majority stake is sold off to the private sector, thus transferring control and management of the enterprise. Under disinvestment, the government is able to retain control in its own hands, while at the same time managing to raise funds and sell off several non-performing assets.

Why the push towards Privatization and Disinvestment?

There exist two principal reasons as to why Governments push for Privatization and Disinvestment.

Firstly, most PSUs are loss-making. Thus, the ideological reason is obtaining the superior efficiency that is said to be associated with the private sector relative to the public sector. For the year ended 31st March 2019, 70 Public Sector Units (PSUs) were in a loss, with their total stress amounting to over Rs 31,000 crore collectively. The number of loss-making PSUs increased from 70 to 84 for the financial year 2019-20. Out of these, 30 had been incurring losses continuously for several years, with cumulative losses of Rs 1,06,879 crores incurred over the years.

Reasons for the huge financial stress on these PSUs encompass a wide variety of issues. These include, but aren't limited to the following-

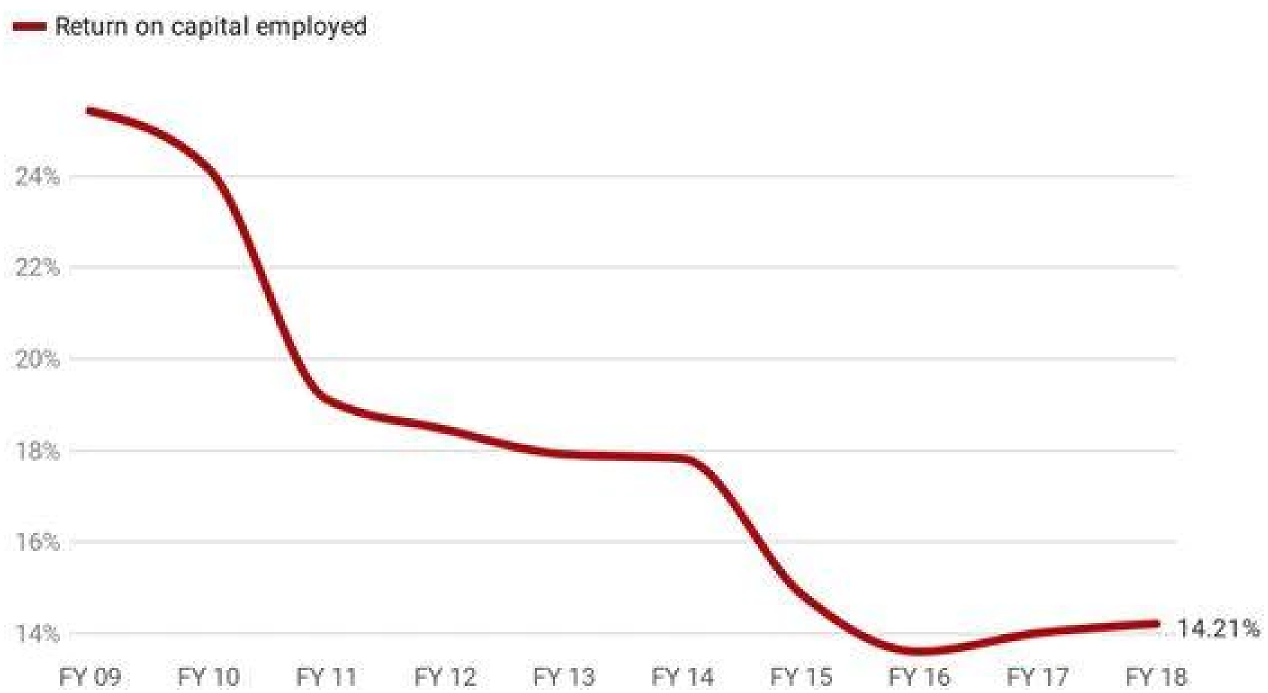
- Old and obsolete plant and machinery, outdated technology, low capacity utilisation, excess manpower, weak marketing strategies, stiff competition, heavy interest burden, as well as high input costs are some of the reasons for the losses in several PSUs cited by ex-Minister of State Babul Supriyo in the Lok Sabha.
- Quite often, the core idea behind the establishment of PSUs is not to make profits. PSUs are primarily established in sectors the private sector would not ideally engage in due to a variety of reasons, including long gestation lags, high degrees of uncertainty, or non-lucrative profits. At the same time, PSUs are often used by the governments as a means to promote their social policies, without focusing on profit making. As a result, even if a company is loss-making, governments continue to pour in money to sustain operations, in the name of public welfare.
- Apart from the above, the Government has on several occasions sucked out the

accumulated cash reserves from PSUs in the name of special dividends to meet its short-term fiscal deficit. As a result of the same, money that should have been put to use for the growth and betterment of the entity is unable to be utilized for the same. At the same time, profit-making PSUs are, on various occasions, made to buy stakes in loss-making ones to meet disinvestment targets, and this often contributes to the financial stress of the profit-making PSUs. As a result, profit-making PSUs are used as a means to offset the losses being incurred by a non-performing PSU.

TOP 10 LOSS MAKING GOVERNMENT COMPANIES

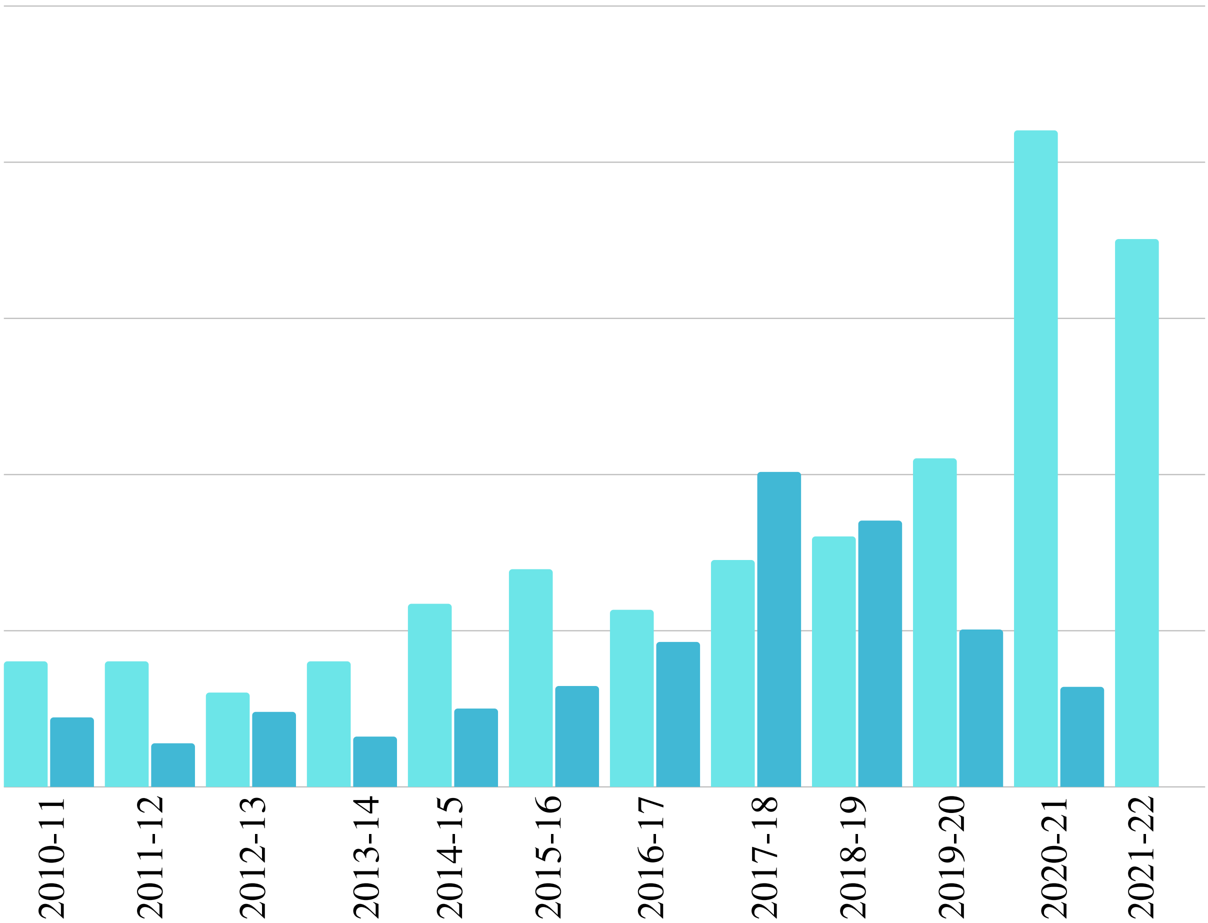
Company Name	Net Loss(in Rs. Cr.)	% Share
BSNL	-(7,993)	25.57%
Air India	-(5,338)	17.07%
MTNL	-(2,973)	9.51%
Hindustan Photo Films (Provisional)	-(2,917)	9.33%
Western Cold Field	-(1,757)	5.62%
Bharat Coking Coal	-(1,391)	4.45%
Rashtriya Ispat Nigam	-(1,369)	4.38%
India Infrastructure Finance	-(1,155)	3.69%
Eastern Coalfield	-(931)	2.98%
STCL	-(657)	2.10%
Other CPSE	-(4781)	15.29%
Total	-(26,480)	84.71%

**Source - Public Enterprises Survey 2017-18*



PSU's Lost half of the efficiency in the last 10 years

Another practical reason for the disinvestment push is that the government's finances are strained and it looks to augment its resources by selling government assets, notably PSUs. With widening fiscal deficit gnawing at the volatile economy, the government turns to disinvestment as one of the tools to plug the gap. The fiscal deficit for the financial year 2020-21, in absolute terms, was Rs 18,21,461 crore, or 9.3% of GDP. Revenue deficit for the same year stood at 7.42% of GDP. Projections by the government expect the fiscal deficit for 2021-2022 to be Rs 15,06,812 crore, or 6.8% of GDP, while the revenue deficit is targeted at 5.1% of GDP. Privatization can provide a long-term solution for the country's fiscal deficit. It can be a revenue-generating device for the government, and at the same time be a great tool to manage resources much better. The government has identified several PSUs that it aims to privatize. However, the government has time and again failed to achieve its highly ambitious disinvestment targets. For the years 2020-21, just over 15% of the target was actually achieved. The disinvestment target for the year 2021-2022 stands at Rs. 1.75 lakh crore, and is heavily dependent on the IPO by LIC, which is expected to garner Rs 1 lakh crore in itself.



Disinvestment - Targets Vs Actuals

: Source: Business Today

Recent Developments

A. Budget 2021

In the budget for the financial year 2021-22, the government estimated to raise Rs 1.75 lakh crores from stake sale in public sector companies and financial institutions, including 2 PSU banks and one general insurance company.

Unveiling the Strategic Disinvestment Policy, Finance Minister Nirmala Sitharaman said four sectors - Atomic Energy, Space, and Defence; Transport and Telecommunications; Power, Petroleum, Coal and other minerals; and Banking, Insurance, and Financial Services would be strategic sectors, where there will be the bare minimum presence of the Central Public Sector Enterprises (CPSEs). The remaining CPSEs in the strategic sectors will either be privatized, merged, made subsidiaries of other CPSEs, or closed. In non-strategic sectors, CPSEs will either be privatized or be closed.

In her Budget speech, the FM said that strategic disinvestment of Bharat Petroleum Corporation Limited, Air India, Shipping Corporation of India, Container Corporation of India, IDBI Bank, BEML, and Pawan Hans, among others would be completed in 2021-22. The legislative amendments required for launching the IPO of LIC were also brought about in the Parliament.

B. National Monetization Pipeline

The creation of the National Monetisation Pipeline (NMP) is the Government of India's pioneering initiative to establish a medium-term pipeline along with a roadmap for "monetization-ready" assets. Developed in the backdrop of the unprecedented Covid-induced economic and fiscal shocks, the NMP lists out assets and asset classes, under various infrastructure ministries, which will be monetized over a period of time.

Unveiled in August 2021 by Finance Minister Nirmala Sitharaman, the 4-year National Monetization Pipeline aims to unlock over Rs 6 lakh crore by the year 2025. It focuses on engaging the private sector in brownfield projects, by a transfer of the right, and not of ownership. Major assets to be monetized include natural gas and petroleum pipelines, highways, railways, as well as power transmission lines amongst various other sectors like aviation, ports, mining, and telecom.

Upcoming Privatizations

A. Air India - A Revival Attempt

The talks to privatize India's flagship carrier, Air India, were first brought up in 2017, and have been continuing ever since. For the last two years, the government has been trying to divest its 100% stake in Air India, the flag carrier airline of India and its subsidiary Air India Express as well as sell its 50 percent share in Air India SATS Airport Services, a joint venture with Singapore-based ground handling firm SATS.

Air India held a monopoly position and remained strong till the 1990s, being the only Indian airline flying domestically as well as internationally. After 1991s policies when the government opened the market for the private players, the brand started to unravel and cracks started appearing. Travelers got a new choice with the competitive pricing by each airline that was aggressively advertising their services. Air India couldn't keep up with the growing competition and gradually lost its market shares and incurred losses.

In 2001, the Managing Director of Air India was charged with corruption due to which Air India made losses of Rs. 57 crores. The airline was already making losses by then.

In 2007, the then UPA government decided to merge Air India and Indian Airlines. This was done with the idea that losses of Air India could be covered up by the profits made by Indian Airlines, forming a "synergy". But the exact opposite of what was expected happened and the accrued losses of the airlines increased, which was recorded to be Rs. 63 crore in 2002-03 to a whopping Rs. 7000 crore in 2010-11.

As of 2014, Air India operated on 370 routes, of which only 9 were solely profitable.

In June 2017, the privatization of Air India was finally approved by the government. The eligibility criteria were also set and the bidder's net worth must be more than Rs. 5,000 crore. The efforts of the government failed as no buyer showed interest in buying the debt-laden airline.

The most recent proposition by the government in 2020 is the complete ownership of the airline and the eligibility of the buyer with a reduced net worth of Rs. 3500 crores. The government aims to finish the privatization process for the airline in the fiscal year 2021-22.

B. Bharat Petroleum Corporation Limited - A Well-Timed Decision

After the approval of Bharat Petroleum's disinvestment plan by the government on 16th November 2019, privatization is moving into the next phase.

The first strategic disinvestment is of the government's shareholding of 53.29 percent in BPCL along with transfer of management to a strategic buyer. The second is the disinvestment of BPCL's shareholding in Numaligarh Refinery (NRL) along with the transfer of management control to a Central Public Sector Enterprise operating in the oil and gas sector.

After the stake sale in NRL, the company announced an interim dividend of ₹5 per equity share of face value ₹10 for the financial year 2020-21.

Although the BPCL privatization process has slowed down due to Covid-19, the sale can reap an amount of $7 billion and suitors are still working on potential bids.

The government is selling BPCL not because it is a loss-making entity but since they are facing a huge fiscal deficit. Privatization is the best option to minimize the deficit and raise the necessary capital.

While the BPCL privatization is part of the country's efforts to raise capital to make up for the fall in tax revenues as the pandemic hit the economy, the administration has other priorities including Life Insurance Corporation of India's IPO, which could be the country's largest-ever.

C. Life Insurance Corporation - Meeting Targets

The performance of LIC during the year 2006 to 2010 indicates that there has been tremendous amount of potential in the insurance business which has led the government owned corporation to be the biggest institutional stakeholder and a prudent investor in India, with a 74.71% market share in acquiring the new insurance policies.

The government has decided to uptake the strategy of disinvestment, where they will sell a part of their share and not the entire 100%. The Cabinet Committee on Economic Affairs has cleared the plan for IPO of Life Insurance Corporation (LIC) and has proposed to list LIC by March FY22.

A ministerial panel will determine the price and quantity of government stake that will be divested in this IPO.

LIC IPO is a portion of the strategic action of the Finance Ministry with a target of INR 1.05 lakhs crores for disinvestment for the financial year 2019-2020.

LIC booked a noteworthy income of INR 1.76 lakh crores from the dividend component for the financial year 2017-2018. The current market for disinvestment is not only tough but complex too and with a high target of disinvestment, it was decided to take help from LIC by way of IPO.

If everything goes according to the plan, then it will be a huge success for the Indian Government to be able to bring in fresh money into the Indian economy by attaining foreign investments as well as effectively bringing strong competition in the insurance industry.

Is Privatization always the Right Solution?

A common belief is that privatizing a Public Sector Undertaking will always lead to better management and performance, as the skills and benefits associated with the private sector are brought in.

Throughout history, and across geographies, we have seen numerous instances wherein entities were privatized with the motive of improving their performance. To analyze whether privatization really improves the performance and efficacy of the entities in concern, numerous studies are performed. One kind of study compares the performance of private firms with that of PSUs, while another compares the performance of PSUs before and after privatization. However, factors such as the sample, location, time period, sectors, the effect of business cycles, as well as how sustainable the improvement in performance really is, prevent studies from providing a definitive answer to the issue, and an unqualified opinion can only be given after careful analysis on a case-to-case basis.

Many have cast doubt on the supposed superior efficiency of the private sector. A study conducted in 1997 on the UK's privatization experiment by Stephen Martin and David Parker concluded that the evidence is mixed. However, one comprehensive study covering 11 high-profile cases of privatization, including British Airways and British Gas, found no evidence of any systematic improvement in performance.

There are also several **concerns** with privatization, the most notable being that it could lead to job losses. Different research reports over the past 20 years show that business restructuring exercises after privatization do initially lead to job losses.

However, this is usually made up for in the long run, once new entrants to the markets increase the demand for labour. Privatization also seeks to ensure that

businesses become more sustainable, creating an environment where they can grow, invest and create jobs well into the future.
Another concern of privatisation is that the focus of the entity shifts to profit making only, in clear contrast with the ideal objectives of a PSU, which often operate in losses to ensure welfare and accessibility. Privatisation usually increases the likelihood of higher costs being borne by consumers.

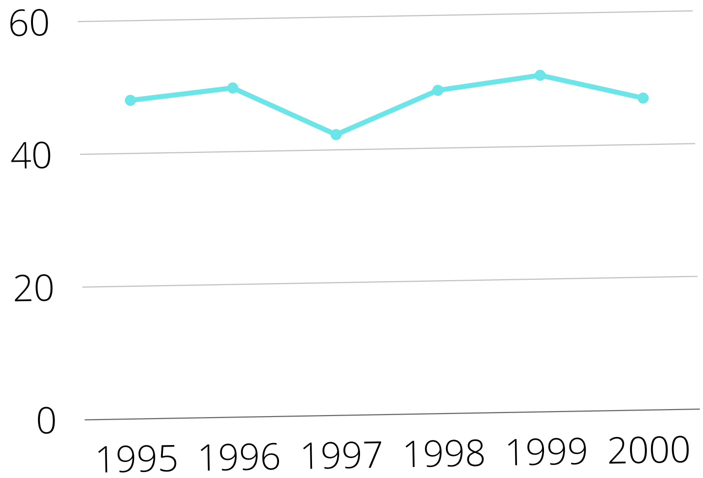
"The superior performance of the private sector thus reflects the failure to take into account negative externalities associated with private ownership and positive externalities associated with public ownership."

- Professor T.T. Ram Mohan (IIM Ahmedabad)

At the same time, privatisation has proven to be a huge success for several entities, especially in the long run. The examples of Delhi Discom and Maruti Suzuki are one of the best in India's history to illustrate the improvement in performance of the entities.

Delhi Discom

The power sector in Delhi previously faced major issues such as increasing Transmission & Distribution (T&D) losses, frequent & long power cuts, and a debt-ridden distribution board. The following graph shows the increase in T&D losses before privatization-

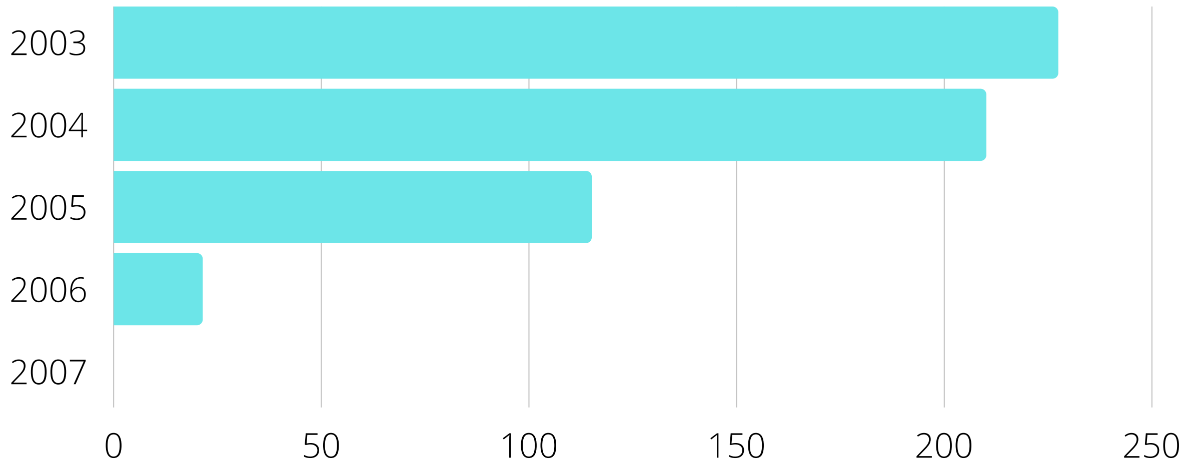


T & D Losses

: Source: Annual Report (2002-03) on the Working of SEBs, Planning Commission

As we can see, the T&D losses were at an increasing trend and reached an all-time high of 50% in 1999. Such loss in power transmission had to be compensated for by purchasing power from outside. This created an additional financial burden, hence doubling the losses in almost 5 years.

In 2002, the Delhi Government sold a 51% stake in power distribution (DISCOM) to 3 private companies. The effect of this was that over the years, the T&D losses decreased and stood around 14.7% in 2013. This increased the revenue inflow and by 2004 the DISCOMS declared profit. The consumers on the other hand enjoyed better services and faster grievance redressal, which is the hallmark of the private sector. Consumer satisfaction increased by 15.68% from 2006 to 2009. With this, even the government had to release lesser subsidies to the DISCOMS, as shown by the graph below-



Subsidy Amount Released to DISCOMS

: Source: Power Sector Reforms, IDFC, 2010

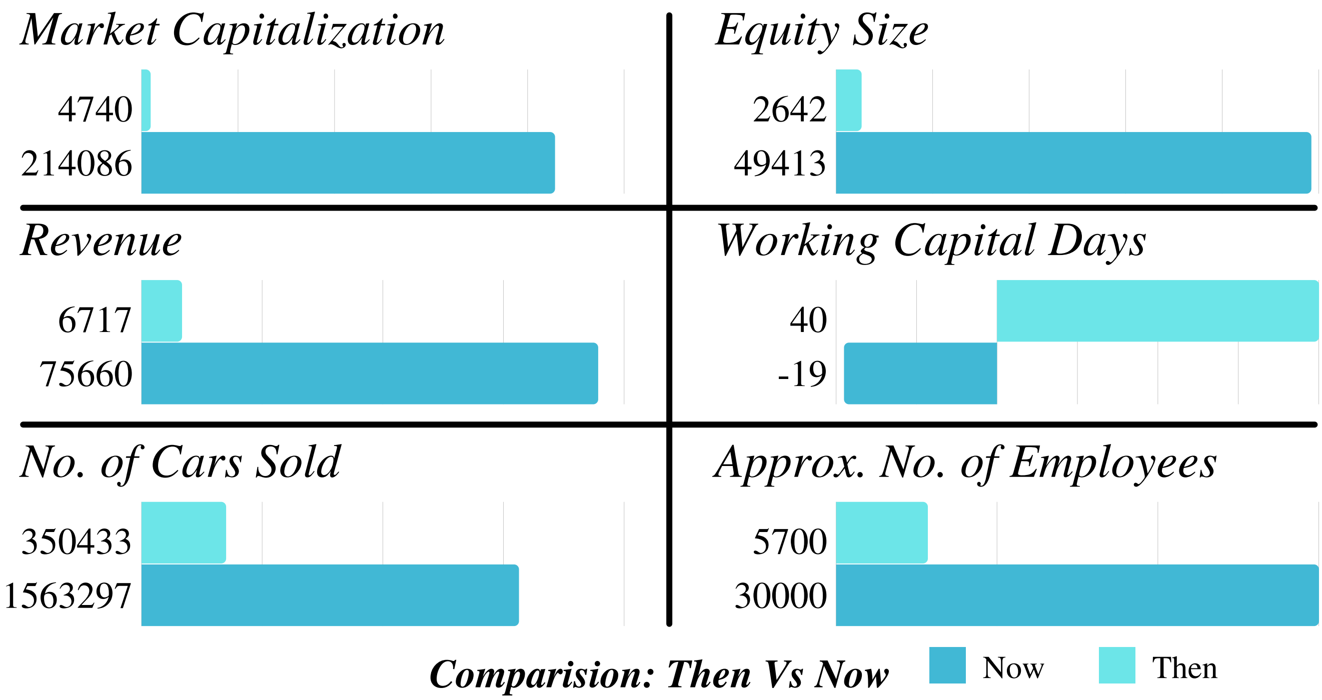
Though in the later years a few clashes between the government and private entities were seen due to an increase in retail tariffs, political differences, untrue figures, etc. there is no doubt that privatization proved to be a boon for the power distributor in Delhi.

Maruti Suzuki

The history of Maruti Suzuki can be traced back to 1981, with the founding of Maruti Udyog by the Government of India. A year later in the autumn of '82, India's Maruti went through a merger with Japan's Suzuki, becoming the current Maruti Suzuki India Ltd.

Several factors contributed to the government's loss of control over Maruti and the eventual disinvestment of the investment. Over the years, Suzuki increased its stake in the first joint venture from 26 to 40% in 1987 and then to 50% in 1992, making it an equal partner alongside the government. However, control of the company remained largely in the hands of the government. At the end of the 90s, relations between the two owners became more complicated in terms of the management of the company. After Suzuki's appeal to the Delhi High Court against the government,

their leadership appointment was dismissed, the company launched an international arbitration search against the government.
In 2003, Maruti's IPO was a big success, with the issue being oversubscribed at 13 times its size. The government raised another Rs 1,000 crore approximately by divesting its 27.5 per cent stake through the IPO.



: Source: ValueSearch

As the numbers in the tables show, Maruti Suzuki has continued to do well in the hands of private ownership.
To sum up, Privatization does bring with it efficiency, professional management, and technology. There is a definite need for private participation in nation-building to gain their expertise, technology, capital and efficiency. At the same time, the schemes must be carefully crafted out, keeping in mind the cons and concerns which they bring along. Carefully analyzed schemes, keeping in mind the right balance are integral for the growth and development of not only the company but the nation as a whole.

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