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STUDY TO ANALYZE EFFECTIVENESS OF DIFFERENT APPROACHES TO DIVESTMENT UNDERTAKEN BY GOVERNMENT OF INDIA

Article Particulars

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Abstract

The divestment programs by Government of India have been going on for a quarter of a century, and GOI has used traditional methods like Strategic sale or privatization, IPOs to FPOs and its unique use of ETFs as a way of disinvesting from the CPSEs and Bharat 22 ETFs. The study is to analyze the effectiveness of different approaches to divestment undertaken by Government of India.

Keywords: *Divestment, privatization, Bharat 22 ETF, CPSE*

Introduction

India is beleaguered by its inefficient and impotent public sector. Barring a very few vast majority of Public sector units (PSU) incur heavy losses. They continue to exist due to state granted monopoly, excessive assets and government bailouts. According to economic report, during the period of 1986-1991, State owned enterprises made 39% of GDP as gross investment, but generated only 14% of GDP. This low return on investment and economic crisis paved way for government to concede the demands of privatization and snub even harder resistance from labor unions. Government of India slowly began divesting from PSUs as part of economic reforms of 1991.

Divestment commission was set up in 1996 to formalize a process for divestment, examine and suggest withdrawal from non-strategic sectors. To expedite disinvestment, the department of divestment was formed in December 1999, which later was made the ministry of disinvestment in September 2001. This was shifted to the ministry of finance as one of the departments under it in 2004. According to the current divestment policy, "government has to retain majority shareholding, i.e., at least 51% and management control of the PSUs". The policy thereby limits the scope of divestments andaimsan easy exit for the government from non-strategic sectors. As per the department for divestment policy even strategic investment is limited to less than 50% ownership and management control. Simply allowing ownership of less than 51% in PSU will be the first step in the right direction.

It is also important to realize that ownership is not a substitute for regulation. Therefore, instead of creating PSUs in non-priority sectors, the government's focus should be in strengthening the regulatory framework that ensures efficient market conditions. For instance, Air India, India's flag carrier airline, was a monopoly for long. However, liberalization of aviation sector in 1994 paved way for the entry of a number of new private carriers. Air India's market share has reduced to less than 15%, there is no longer a need for the government to run the airline and spend taxpayers' money in bailing it out year after year. Hence, the government should consider exiting the airline business and instead create regulations that would ease the entry and operations of all players. The regulations should also ensure consumer's necessities are met. As of 31st March 2016, there were as many as 320 CPSEs (excluding 7 insurance companies). According to public enterprise survey in 2015-16, 165 CPSE made a total profit of Rs. 1,44,523 crore The number of profit-making CPSEs as on 2015-16 stands at 165 with a total profit of. (Source: Public Enterprise Survey 2015-16)

Literature Review

- John Davies, managing director & global head of Exchange Traded Products, S&P Dow Jones Indices: "Nowhere else exchange-traded fundshave been used for divestment. India's use of ETFs is original, unique".
- Amitabh Kant, Government think-tank NitiAayog: "We have recommended 34 sick PSUs for strategic disinvestment".
- Civil Aviation Minister Ashok Gajapathi Raju said Air India's books are "bad", and "business as usual" is not going to help it, but the government wants the airline to survive and hence privatize.
- AmritPandurangi, formerly the head of Deloitte Touche Tohmatsu India "It's a right decision, but this has to be executed correctly; if not, it will become a bigger mess than what it already is".

Objective of the study

- The study is to analyze the effectiveness of different approaches to divestment undertaken by Government of India.

Data

- Study is based on Secondary data collected from various sites of Ministry of Finance, Department of investment and public asset management (DIPAM).

Different approaches to divestment

Minority Disinvestment

A minority disinvestment is one in which the government retains a majority stake in the PSU, usually greater than 51% stake and ensuring management control.

Traditionally, minority stakes have been either auctioned off to financial institutions or offloaded to the public by way of an Offer for Sale.Government relied on minority sales via auctioning to institutions in mid- late 90s. Government divested 16.69 shares of CMC to GIC Re. Some other companies were Andrew Yule, Balco, etc.

Government has made a policy statement that all minority disinvestments would only be disinvested via Public Offers such as IPO or FPO.Minority sales via Offer for Sale include recent issues of Power Grid Corporation of India Ltd., Coal India, Cochin Shipyard, NTPC, etc.

Majority Disinvestment

A majority disinvestment is one such that the government sells off a majority stake in company to strategic investor or institution; post disinvestment government retains a minority stake in the company. These strategic partners could be other CPSEs themselves, a few examples being Bongaigaon Refinery & Petrochemicals Ltd (BRPL) to Indian Oil Corporation (IOC), Madras Refinery (MRL) to Indian Oil Corporation (IOC), and Kochi Refineries Ltd (KRL) to Bharat Petroleum Corporation (BPCL). Alternatively, strategic partners can be private entities, like the sale of Modern Foods to Hindustan Lever, BALCO and Hindustan Zinc to Sterlite, CMC to TCS etc.

Complete Privatization

Complete privatization is another form of disinvestment where the full control of the company is passed on to the buyer. 18 hotel properties of ITDC and 3 hotel properties of HCIwere divested by the way of complete privatization. Disinvestment and Privatization are often loosely used interchangeably. Main difference between the two is - Disinvestment may or may not result in Privatization. When the Government retains 26% of the shares carrying voting powers while selling the remaining to a strategic buyer, it would have disinvested, but would not have ‘privatized’, because with 26%, it can still stall vital decisions for which generally a special resolution (three-fourths majority) is required.

Exchange Traded Fund (ETF)

Latest approach by Government of India for divestment is the sale of shares by the way of Exchange Traded Fund (ETF). When the Government floats its disinvestment offers one at a time, the investor response is often dependent on market conditions. So if markets are soaring and the sector to which the PSU belongs is favored, the offer gets lapped up. But if markets are downbeat the offer bombs, prompting LIC or another state institution to do the rescue act.

The CPSE ETFs are open-ended funds with no lock-in period. They can be bought and sold on a stock market just like any stock. They are pure equity investments. ETFs are passive funds which mean that the proportion of the underlying assets remains the same. The CPSE ETF boards 10 of India's largest companies which have a near-monopolistic position in India.

Conclusion

Economic reforms initiated in 1991 which required the role of the government versus the market was sought to be redefined provided the fillip for the divestments initiatives by government of India. Divestment sought market discipline to be injected in PSUs' decision-making, loss-making public enterprises were sought to be revived and additional resource needs for containing the fiscal deficit and capital expenditure generated. However, over the period of time, the policy of divestment has become easy tool to raise resources to cover the fiscal deficit with little focus on market discipline or strategic objective. Divestment is an important aspect for improving the structure of incentives and accountability of PSUs in India. It is the approach towards divestment that defines the incentive for any PSU to run efficiently. An ad-hoc approach towards divestment only reduces the incentive for the firm's managers to make significant investment in the enterprise. Therefore, it is essential for governments to ensure that divestment in PSU is not limited to raising revenues.

The primary requirement for the divestment policy is to define the priority sectors for the government based on its strategic interests. Considering the limited resources with the government and its diverse role, it is evident that the government has a low capacity to manage PSUs. Use of scarce resources, including land and financial capital, has high opportunity cost and the justification for investment in PSUs has to be in terms of generation of adequate social and strategic returns. Additionally, financial returns should not be the sole reason for investment in PSUs. They must serve social/strategic purposes. The key role of a PSU is to maintain competition in the sector and limit excessive monopoly. Besides, government ownership is required for sectors with strategic relevance such as defense, natural resources, etc. The government should, therefore, exit non-strategic sectors such as hotels, soaps, airlines, travel agencies and the manufacture and sale of alcohol.

The outlook towards strategic divestment should move from the current policy of emphasizing on public ownership and retaining majority shareholding to looking at the strategic interest. . Eventually, the objective should be to limit the government ownership to strategic sectors. It is time that divestment is not seen as an option to cover for short-term fiscal gains; instead, it should be part of a strategic plan to improve the production of goods and services in India.

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