UNIT 26 PRIVATISATION IN INDIA

Structure

26.0 OBJECTIVES

This unit explains privatisation debate in India. After studying this unit, you will be able to answer the following:

- Reasons behind the debate of privatisation ;
- Why are public sector enterprises (PSEs) in India so inefficient ?
- The environment under which PSEs are working in India;
- Rationale behind the privatisation;
- Various techniques of privatisation;
- Identifying areas of privatisation in India;
- Progress towards privatisation; and
- Problems in India's privatisation experience.

26.1 INTRODUCTION

No country in the world has lately been immune from the trend of restructuring of its economy because of a compelling combination of circumstances. India at one time had a huge public enterprise sector. It consisted of nearly 1,300 enterprises, owned and managed by the central government, state and union territory governments, and local governments in the country. These had dominated many sectors of the economy by including: surface irrigation; water supply in rural and urban areas; railways; river transport; ports; postal services; telecommunications; mining (including hydrocarbons and coal); one-third of registered manufacturing (particularly steel, petrochemicals, capitals goods, pharmaceuticals, fertilizers); power generation and distribution; oil and gas production and marketing; air transport; one-third of bus transport; storage; and banking and insurance. As you may be aware, same of these sectors have been transferred to private sector recently.

26.2 REASONS FOR POOR PERFORMANCE OF PUBLIC SECTOR ENTERPRISES (PSEs)

Why are public enterprises in India so inefficient? The answer lies in the *environment that public enterprises in India operate in*, and in effect this environment has on the *public enterprise managers' incentives* to develop new, better and less expensive products, develop new markets, minimise capital and current costs, and maximize profits. Descriptions which illustrate this environment include: the government's deep involvement in the actual management of public enterprises, with the *concerned administrative ministries'* tendency to function as if they were a kind of super management on top of the Board of Directors; *Parliament's involvement in public enterprises'* affairs in several ways, including through numerous *questions and enquiries* ranging from questions of overall performance and policy issues to the minutest details of *day-to-day functioning*; and expansion of the horizon of *Article 26 of the Constitution* to treat even industrial, manufacturing and commercial public enterprises as '*state*' and thereby subject them to the various obligations that go with such a treatment.

26.3 PRIVATISATION

'Privatisation, is a term that is employed to convey a variety of ideas. The idea that it most prominently suggests is *'denationalisation'* (in the sense of transferring the ownership of a public enterprise to private hands). Another idea in vogue is '*liberalisation and deregulation'*; which unleash forces of competition. In this context, the concept of privatisation becomes wider to be understood, not merely in the structural sense of who owns an enterprise, but in the *substantive sense of how far the operations of an enterprise are brought within the discipline of market forces*. For convenience, a distinction could be made between *micro* (roll back as producer state); *macro* (roll back of state as producer, regulator, facilitator, and welfare provider); and *mega* (roll back in all dimensions including non-economic regulations). Micro privatisation referring to producer state essentially deals with public enterprise.

26.4 RATIONALE BEHIND PRIVATISATION

A few factors seem to have brought the issue of privatisation on the forefront. They are as under:

1) The *monopoly* status of public sector enterprises (PSEs) bred inefficiency.

2) *Lack of competitiveness* affects PSEs performance very adversely.

3) *Bureaucracy* was also responsible for poor performance of PSEs. It was certainly not always upto turning such enterprises around.

4) Restructuring of the PSEs by way of privatisation became very *common in developed* countries like UK and U.S.A.

5) A lot of *intellectual discussion and debate* started on privatisation all over the world and pressure of public opinion also exerted influence.

6) Some aid giving agencies even started forcing the pace by linking aid with privatisation.

7) Suggestions from management of public sector enterprises themselves led to fresh thinking towards privatisation.

26.4.1 Arguments in Support of Privatisation

Advocates of privatisation claim that it will lead to an *improved economic performance. The reasons for such a view are* the following:

i) *It will improve the environment* public enterprises operate in and thereby strengthen their managers' incentives to be efficient. These in turn can contribute to making the Indian economy substantially more efficient.

ii) Privatisation may create conditions for *substantial additional investment*, which may help in generation of a large number of productive employment opportunities, which in turn may contribute to removing poverty.

iii) *Consumers may* gain from privatisation.

iv) Privatisation can be of help in *reforming public enterprises*. These enterprises are engaged in innumerable activities such as manufacturing steel; building ships; generating and distributing electric power; running domestic and international airlines; exploring, producing and refining oil; operating domestic and international telecom network; running hotels; manufacturing polyester film; making condoms; producing fruit pulp and juice; running banks as also life and general insurance and electronic entertainment business; and so on. *Privatisation will allow the government to concentrate on things, which it has failed to do, but which it alone can do.*

v) Privatisation can be of *major help in reducing India's huge public sector deficit*. This can happen in three ways: (a) the proceeds from the sale of public enterprises can be used to finance the public sector deficit, (b) the proceeds can be used to *reduce the outstanding public debt*, both domestic and external; and (c) will reduce the *burden of interest payments* and thereby the deficit.

vi) Privatisation is expected to ensure generation of revenue to finance *social infrastructure and eradication of poverty.*

Check Your Progress 1

1) Give four reasons responsible for poor performance of public sector units in India.

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2) Distinguish between '*micro*' and '*macro*' privatisation.

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3) Mention four reasons in favour of privatisation in India.

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26.5 TECHNIQUES OF PRIVATISATION

Various experts have categorised privatisation into the following techniques:

1) *Public offering of shares:* all or part of a shares of the public limited company are offered for sale to the public as a running concern.

2) *Private sale of shares:* all or part of the shares of a state owned enterprise are sold to a private individual or a group of purchasers in the private corporate sector.

3) *New private investment in a state owned enterprise:* primary share issues are subscribed by the private sector or public.

4) *Sale of Government or state enterprises assets:* the assets of the public sector are sold as private sale instead of shares.

5) *Reorganisation or fragmentation into smaller units:* a holding company with a number of subsidiaries can be privatised separately.

6) *Management/Employee buy out:* the management or the employees acquire the controlling interest in the unit in which the shares are purchased on credits extended by Government or financial institutions.

7) *Lease and management contract:* the ownership remains with the Government while the lessee assumes full responsibility for operations and maintenance. Under management contract, the owner pays for the management and operational control.

26.5.1 Modes of Privatisation

In terms of policy initiative in the Indian context, privatisation is generally conceptualized in three broad ways, viz., *greenfield privatisation; cold privatisation* and *disinvestment or divestiture* (in particular distressed privatisation). The features of each of these modes are summarized below:

1) **Greenfield Privatisation**

Under this method the *barriers to entry*, including '*reservation*' for the public sector are removed and private sector is encouraged to enter. Under this mode actions move on the following lines:

a) removing barriers of entry for the private sector and it is allowed to do economic activity hitherto reserved for public sector;
b) not allowing any new investment or new activities on the part of the public sectors agencies;
c) preferential treatment being given to the private sector for increasing the level of its activities;
d) in enterprises where private and public sectors have been functioning side-by-side, such as the *joint sector*, the relative share of the private sector may be increased.

2) **Cold Privatisation or Proxy Privatisation**

Under this method public enterprise made to behave as private enterprises by:

a) giving financial autonomy to seek financial assistance directly from the bank/capital market;
b) giving autonomy to make investment decisions;
c) entering into a *Memorandum of Understanding (MOU)* for providing freedom to fix prices, output etc.;
d) making subsidies explicit;

e) taking recourse to corporations, i.e., converting a department enterprise into a corporate entity to ensure distancing.

3) **Disinvestment or Divestiture**

Disinvestment or divestiture is effected by *sale or transfer of shares* held by the government directly or through its agencies in enterprises (i.e., public activities organized under enterprise form) to the private sector. When a loss-making enterprise is turned over to the private sector because the government can no longer support and sustain it, this can be termed '*distressed privatisation*.'

It may be mentioned that alternative approaches are possible to analyzing techniques. For instance the techniques can be divided into:

a) privatisation of *financing* (that is charging for government services);
b) privatisation of *production or provision* (contracting out construction and maintenance or giving franchises to private sector);
c) *denationalization* or *load-shedding* (that is sale of shares or assets held by government); and
d) liberalization (removing restrictions and promoting competition).

Check Your Progress 2

1) Mention five techniques of privatisation.

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2) Distinguish between '*greenfiled privatisation*' and '*proxy privatisation*'.

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3) Define the term '*disinvestment*'.

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26.6 AREAS OF PRIVATISATION

Privatisation might be worth trying in a few cases as a means of shedding some unimportant or *low-priority activities* which need not have been in the public sector at all in the first instance; and that it might also be appropriate to try privatisation, if possible — *as an alternative to closure-in the case of loss-making enterprises* for which a package of remedial measures within the fold of the public sector is not feasible. As for privatisation as a solution to the public sector efficiency problem, it does not really solve but evades the problem: it would surely be much better to try a partial privatisation of style before attempting the privatisation of ownership.

26.7 INDIA'S PRIVATISATION EXPERIENCE

26.7.1 Disinvestment Strategy in Public Sector Undertakings in India

Disinvestment in the state owned enterprises has been adopted by both developed and developing countries during the last two decades as part of market oriented reforms. The process of disinvestment in equity was initiated by the Government of India (GOI) during 1991-92 as part of a package of Public Sector Undertaking (PSU) reform. For framing proper strategies of disinvestment of shares of PSUs, a Committee under the chairmanship of Dr. C.Rangarajan was appointed in 1993 by the Government of India. Further, Government of India constituted a five-member *Public Sector Disinvestment Commission* in August 1994 under the Chairmanship of Shri G.V. Ramkrishna for drawing a long-term disinvestment programme for the PSUs referred to the Commission. The Commission had wide ranging terms of reference and was asked to determine the extent of disinvestment in each PSU, the modalities of disinvestment and the order in which the process would be undertaken. The long-term strategy of the Disinvestment Commission had four objectives : (i) strengthen PSUs, where appropriate, in order to facilitate disinvestment, (ii) protect employees' interest, (iii) broad base ownership, and (iv) augment receipts for the government.

As a broad approach, the Commission was in favour of prior restructuring of the PSUs before disinvestment, based on global experiences that restructuring before disinvestment enhances share value and maximizes share proceeds.

The Commission was in favour of adopting a case-by-case approach in terms of unit specific disinvestment strategy after taking into account various aspects of the units, e.g., industry category, competitive position and profitability. Accordingly, the Commission broadly classified the PSUs into two categories for disinvestment. viz., *the core group and the non-core group*. The PSUs in the *core group* are defined as having a considerable market presence. In these PSUs, as the private sector is yet to mature fully, the public sector disinvestment would be limited to a maximum of 49 per cent for the time being. *The non-core group* industries are defined as the units where private sector players have already made huge investments. With the aim of enhancing the intrinsic value of PSU shares, the Disinvestment Commission recommended that the core as well as non-core PSUs should be restructured prior to disinvestment.

The Commission had made recommendations for a graded delegation of autonomy for three categories of PSUs, namely, '*general autonomy to all PSUs, additional powers to 'moderate performers and additional autonomy to strong performers*'. Further, it had made the following recommendations regarding the policy decisions to be delegated to the Board for greater autonomy of all the PSUs.

1) Professionalising the Board through outside recruitment.
2) Provisions of elected Directors to represent minority shareholders.
3) Selection of top management without having to go to the Appointment Committee of the Cabinet.
4) Rationalising salaries and incentives of top management for attracting talents.

5) Autonomy in price fixation of products and services.
6) Accountability through performance assessment at regular intervals.
7) Setting up of pre-investigation Board for evaluating projects in terms of commercial viability.
8) Strengthening the investor interface by transparent system of information disclosure.

While the above recommended areas of autonomy would apply to all the PSUs, the Boards of *'moderate performers'* among the PSUs would have additional power to transfer assets to a subsidiary and also have freedom of investment decisions subject to certain conditions. The investment limits for these PSUs could be fixed on the basis of the company's turnover and requirement of funds in the medium term. Further, the *'strong performers'* among PSUs have been recommended by the Commission to have power to form joint ventures without prior approval of the Government and have full freedom with regard to investments subject only to the condition that these projects are appraised and financed by banks or institutional lenders or where the total requirements of funds are met from internal accruals.

For granting autonomy, nine well-performing PSUs under the core category have been identified by the Government. These PSUs, popularly known as '*navratnas*', are BHEL, BPCL, HPCL, IPCl, IOC, NTPC, ONGC, SAIL and VSNL. The Union Cabinet has approved the autonomy package for these nine high performing PSUs, accounting for nearly 75 per cent of the profits of the entire PSUs, giving them total freedom to incur capital expenditure, raise resources and enter technology contracts. The Government also announced a package of financial and operational autonomy for 97 profit making public sector enterprises (called *'mini-ratnas'*) other than the '*navrathnas*'. However, the degree of financial freedom to these PSUs will be less than granted to the *'navratnas'*.

For ensuring smooth implementation, the Commission recommended the formation of a *Standing Empowered Group (SMG)*, comprising the Department of Public Enterprises, Administrative Ministry of the PSU along with the CEO of the concerned PSU. The group is intended to provide continuity to the process of disinvestment in various PSUs. However, the Disinvestment Commission has recommended only companies to be disinvested and the mode of disinvestment rests with the Government. The Disinvestment Commission has also evolved guidelines for modality of sale including retailing PSU shares to small investors and employees and selection of intermediaries that would lead to transparent and competitive procedures for disinvestment. The Commission also made specific recommendations for disinvestment in respect of a number of PSUs in its various reports. Thus, the Disinvestment Commission set the ground rules and the basic parameters for disinvestment. We can learn from experience and modify the modalities as we go along.

As part of the country's economic reforms programme*, the Sick Industrial Companies Act (SICA)* 1985 was amended in December 1991 to bring public enterprises under the purview of the *Board for Industrial and Financial Reconstruction (BIFR).* Consequently, until the end of 1998, 138 cases of sick public enterprises were registered with the BIFR. The BIFR has recommended winding up in 14 of these cases. But none of these public enterprises has been wound up so far. There have been cases of public enterprises whose control and management has been transferred to the private sector, but a substantial proportion of their equity, enough for managerial intervention, has continued to remain in the public sector. *India's privatisation experience also includes cases of complete or true privatisation, under which the control and management of a public enterprise are transferred to the private sector* (though some public sector equity holding, without managerial intervention, may continue).

A major initiative for turning India towards privatisation needs to be launched. In this context certain steps required to be taken are:

i) The people will have to be convinced that, given the extremely high opportunity costs, India cannot afford public sector misadventures in areas like, running hotels, manufacturing polyester film, making condoms and producing fruit pulp and juice). That properly belongs to the private sector.

ii) The Government should announce a properly structured and articulated privatisation policy for India. The policy will need to clearly address at least the following issues: *why privatise*?; *what to privatise*?; when to privatise?; which organization will serve as the nodal agency for privatisation and what will be its composition, powers and responsibilities? What are the institutional mechanisms that will be put in place to gain public enterprise employees' support for privatisation?; and what is the role that India would like foreign investors to play in its privatisation programme?

iii) Privatisation is a difficult process, it involves reconciling the government's political objectives and the business needs of given public enterprise and tap generate efficiencies. It will therefore be absolutely necessary to come up with training programmers designed to equip selected public enterprise managers and government officials in India with the knowledge and skills required for managing the various component of the privatisation process.

iv) The proposed initiative will address the issue of evaluating India's post-privatisation experiences. This will involve rigorous work on estimating the impact of privatisation on: (i) *efficiency and investment*, (ii*) public finance and balance of payments*, (iii) *employment*, (iv*) management practices and strategies*, and (v) *managers' skills, attitudes and behaviours*. Evaluations of post-privatisation experience along these lines may generate ideas that may help India maximize the gains from privatisation.

26.7.2 Problems Associated with Privatisation

Privatisation is not a very easy option. Problems are there and it is always not very easy to overcome them. Some of the major problems (see G.S. Gupta, 1996) are:

1) choice of PSEs for privatisation
2) opposition from employees
3) pricing of assets/or equity
4) extent of disinvestment
5) mode or preference of selling
6) political instability

These problems are very complex and it is not possible to find out an easy way out. The question of permission to be given to foreign investors, particularly in the consumer goods sector, is very difficult to decide. Disinvestment should be done, but in favour of whom? Should it be in favour of financial institutions or to be sold to general public? *If management control is retained by the Government then improvement in efficiency will be doubtful.* Sometimes, it is also feared that owing to political considerations the very policy of privatisation might to reversed. There has been sustained pressure from the organisation of employees against the policy of privatisation and disinvestment.

Check Your Progress 3

1) State in brief the disinvestment strategy as being followed in India.

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2) Make suggestions for delegation of more autonomy to PUSs in India.

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3) Highlight the major problems associated with privatisation in India.

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26.8 LET US SUM UP

Although the academic debate on en masse privatisation is still going on, the government has already made moves in that direction, since it is realised that without it the pace of liberalisation and marketisation of the economy would not attain the take off stage. Some of these are: (i) permitting the entry of the private corporate sector in such core sectors as steel, telecommunications, power, airlines, ports etc; (ii) no fresh budgetary support for public enterprises; (iii) issue of equity to the public by the identified PSUs; (iv) outright of sale identified PSUs. As the momentum picks up there is a need to formulate a comprehensive privatisation policy. The policy needs to address at least the following issues: why privatise? what to private? when to private? which organisation will serve as the nodal agency for privatisation and what will be its composition, powers and responsibilities? What are the institutional mechanisms that will be put in place to gain public enterprise employees' support for privatisation? And, what is the role that India would like foreign investors to play in its privatisation programme?

Privatisation does not remove problems from the public domain. Monopolies require regulation, can be water and electricity. The complex political interests and economic incentives within the country militate against the process of privatisation. The process of disinvestment is going on since 1991 and yet it remains more or less where it started. If meant to be meaningful, privatisation need to be pursued more systematically within a carefully designed framework of action.

26.9 KEY WORDS

Denationalisation: Mirror image of nationalisation, i.e., transfer to private control of equity hitherto owned by the state.

Departmental Enterprises: Those production units, which are organised as a department of a government.

Disinvestment: Selling of the government equity, partially or wholly, to private interests.

Government Company: An undertaking in which a government owns 50 per cent or more equity.

Sell-off: Transfer of total or majority ownership of the government in a unit to private enterprise.

26.10 SOME USEFUL BOOKS

Datt, Ruddar and K.P.M. Sundharan (2000): *Indian Economy*, S.Chand & Co., New Delhi (Chap.13)

Ganesh. G. (1998): *Privatisation Experience Around the World* (chapters 1,2 & 7) Mittal Publications, New Delhi.

Gouri, Geeta (1996): Privatisation and Public Sector Enterprises in India : Analysis of Impact of a Non-Policy, *Economic and Political Weekly*, Nov. 30.

Gupta, Anand (1996): Political Economy of Privatisation in India, *Economic & Political Weekly*, September 28.

Gupta, G.S. (1998): Privatisation : Theory, Practices and Issues, *The Indian Economic Journal*, Vol. 46, Oct.-Dec. (No.2).

Ramanadhan, V.V. (1989): *Privatisation in Developing Countries* (chapters 1, 8 and 20), Routledge, London.

Dingra, I.C. (2000): *The Indian Economy: Environment & Policy:* Sultan Chand & Sons, New Delhi (Chap.19).

Tandon, Pankaj (1997): Efficiency of Privatised Firms : Evidence and Implications, *Economic and Political Weekly*, December, 13.

26.11 ANSWERS/HINTS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progresss 1

1) See Section 26.2

2) See Section 26.3

3) See Section 26.4

Check Your Progress 2

1) See Section 26.5.

2) See Sub-sction 26.5.1

3) See Sub-section 26.5.1

Check Your Progress 3

1) See Sub-section 26.6.1

2) See Sub-section 26.6.2

3) See Sub-section 26.6.3