Disinvestment: the need of the hour in India

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Disinvestment is a concept that was introduced in the nineties in India but has not been leveraged fully to unleash the potential of the public sector in terms of its impact on the capital market and its own working. Most public sector undertakings (PSUs) were set up in India in a complex situation where there was a dearth of industrial participation in the Indian economy. These companies had been the pillars of the Indian economy, but in the wake of economic policies in 1991, they had a negative rate of return on capital employed. This was not a good sign of a thriving economy coupled with the policy of globalization. The government had to restructure these companies and one way out was to handover a part of holding to private persons through the disinvestment route which also brought in funds.

The Statement of Industrial Policy of July 24, 1991 stated that in order to raise resources and encourage wider public participation, a part of the government's shareholding in the public sector would be offered to mutual funds, financial institutions, general public and workers. Thus, disinvestment of the Government's equity in CPSEs started in 1991-92, when minority shareholding of the Central Government in 30 individual CPSEs was sold to selected financial institutions (LIC, GIC, UTI) in bundles. The shares were sold in bundles to ensure that along with the attractive shares, the not so attractive shares also got sold.

Disinvestment policy of the Government has been pursued with the dual objective of unlocking value as well as furthering private participation in the nation's growth. While pursuing disinvestment, Government has to retain majority shareholding, i.e. at least 51% and management control of the Public Sector Undertakings. There are two main reasons in support of disinvestment. One is to provide fiscal support and the other is to improve the efficiency of the enterprise. The argument for fiscal support emphasizes that the resources raised through disinvestment must be utilized for retiring past debts and there by bringing down the interest burden of the government. The second argument in support to improve the efficiency of public enterprises through disinvestment is the contribution that it can make to improve the efficiency of the working of them.

The Government of India approved, what could be a milestone in the history of the disinvestment process, an action plan on 5th November 2009 for disinvestment in profit making Government companies. This included the following features:

- Already listed profitable CPSEs (not meeting mandatory shareholding of 10%) are to be made compliant by 'Offer for Sale' by Government or by the CPSEs through issue of fresh shares or a combination of both.
- Unlisted CPSEs with no accumulated losses and having earned net profit in three preceding consecutive years are to be listed
- Follow-on public offers would be considered depending on the needs for capital investment of CPSE, on a case by case basis, and Government could simultaneously or independently offer a portion of its equity shareholding
- All cases of disinvestment are to be decided on a case by case basis
- The Department of Disinvestment is to identify CPSEs in consultation with respective administrative Ministries and submit proposal to Government in cases requiring Offer for Sale of Government equity

Disinvestment – A boon or bane?

In an ever growing economy, investment by the government alone would not suffice. It is of absolute necessity that even private capital is entertained at the maximum level. After 1991, the private inflow of capital has been increasing, and the phenomena of disinvestment have constantly supported this inflow of private money. The money received from the process of disinvestment can be utilized to compensate the deficit finance.

The PSUs which have undergone this disinvestment were (prior to the disinvestment) low productivity companies. Thus when the decision making capacity was given to private players, there has been a huge turn over with respect to optimum utilization of resources, capacity to invest, and profit. This is because the focus has been shifted to the PSU's as a profit making company.

India has been shifting its base from a welfare and socialistic state to a capitalistic economy. Further, given the pressures of fiscal consolidation at the levels of both the central and state governments, these entities have to be made viable and have to stand on their own and remain profitable at the end of the day. Disinvestment opens the doors to get in the private sector to run the companies more on commercial terms.

One issue which is debated however relates to the use of these funds. Presently, the disinvestment proceeds are a part of the Budget and in a way help to shore up the deficit which should not be the case. It has been argued that these funds should be earmarked for specific purposes, probably outside the budget so that it would be linked with a productive activity given that money is fungible and that once it enters the Budget, it cannot really be distinguished from other sources of funds.

Disinvestment till Date

The disinvestment process started in 1991-92, total receipts from disinvestment since then to 2011-2012 stood at Rs 1,002 billion, out of which only Rs 232 billion was accrued in 2010-11 and 2011-12. Rs 235 billion were received in 2009-10, maximum amount of receipts in a particular fiscal. In fact all government companies in the banking and petroleum sector have been divested and are listed. The Union budget for 2012-13 proposes to raise Rs 300 billion through disinvestment.

Table 1: Summary of Receipts from Disinvestment – From 1991-92 to 2011-12

Rs Billion	
Receipts through sale of minority shareholding in CPSE's	822
Receipts through sale of majority shareholding of one CPSE to another CPSE	13
Receipts through strategic sale	63
Receipts from other related transaction	40
Receipts from sale of residual shareholding in disinvested CPSE's	64
Total Receipts	**1,002**

Source: Dept of Disinvestment

In terms of importance, these enterprises are critical in the market. As on 31st July 2012, CPSEs constitute about 20% of the total market capitalization of companies listed at BSE. The CPSE with the highest market capitalization is Oil & Natural Gas Corp Ltd at Rs.2, 445 billion.

Table 2: Market capitalization of CPSE's (Rs billion)

As on 31st July 2012	
Total Market Capitalization	59,515
Market Capitalization(CPSE)	12,438
ONGC CORP Ltd	2,445
COAL INDIA	2,269
NTPC Ltd	1,295

Source: Dept of Disinvestment

Given the size of these enterprises and their potential in the capital market, a disinvestment programme on its own can spur the secondary market especially at this time when the global flow of funds has slowed down and stock markets across the world are cautious. The Indian government is likely to kick start the disinvestment process for the current fiscal by next month. The disinvestment target for 2012 – 13 has been set at Rs 300 billion. The government has already identified a host of companies for disinvestment in the current fiscal. These include Hindustan Copper, Oil India, SAIL, BHEL, HAL and RINL. The focus this time would be on the qualified retail investor window, where foreign retail investors can participate in domestic issues

The offer for sale (OFS) and Institutional Placement Programme (IPP) model were introduced by SEBI in January this year to help corporate increase the public shareholdings. The government is also planning to pursue the concept of Exchange Traded Fund (ETF), after the OFS and IPP model, in order to meet the target for this fiscal. The ETF, which is an investment fund traded on stock exchanges like stocks, would have an underlying benchmark which could be an index on the stock exchange. ETFs would enable investors to diversify over an entire sector or market segment in a single investment.

To conclude, it may be argued that disinvestment in India, though slow, has helped considerably the government to unlock value of central PSEs, though admittedly the process needs to be hastened to ensure that the market is able to benefit from this exercise. Progressively, the government should move away from commercial activity and leave it best to the private players who are driven more by markets. Even globally the thought process is that the proportion of the GNP due to Government economic activity should be reduced to the extent possible. This is possible even for natural monopolies where effective regulatory surrogates for competition have been created to protect consumers.