NIPFP Working Paper Series

# History of disinvestment in India: 1991-2020

No. 373
17-March-2022

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# History of disinvestment in India: 1991-2020

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March 14, 2022

**Abstract**

This paper presents the history of disinvestment in India between March 1991 to December 2020. The history can be divided into four broad phases: 1991-1999 (Phase I), 1999-2004 (Phase II), 2004-2014 (Phase III), and 2014-2020 (Phase IV). There have been relatively few strategic sales, and governments have largely preferred the minority sale route.

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# Acronyms

| | |
|---|---|
| ADR | American Depository Receipt. |
| AISAM | Air India Specific Alterantive Mechanism. |
| AM | Alternative Mechanism. |
| BALCO | Bharat Aluminium Company Limited. |
| BCPL | Bengal Chemicals & Pharmaceuticals Limited. |
| BHEL | Bharat Heavy Electricals Limited. |
| BIFR | Board for Industrial and Financial Reconstruction. |
| BJP | Bharatiya Janata Party. |
| BPCL | Bharat Petroleum Corporation Limited. |
| BRPSE | Bureau for Reconstruction of Public Sector Enterprises. |
| CA | Chartered Accountant. |
| CAG | Comptroller and Auditor General of India. |
| CBI | Central Bureau of Investigation. |
| CCD | Cabinet Committee on Disinvestment. |
| CCEA | Cabinet Committee on Economic Affairs. |
| CCPA | Cabinet Committee on Political Affairs. |
| CEPI | Custodian of Enemy Property of India. |
| CGD | Core Group of Secretaries on Disinvestment. |
| CIL | Coal India Limited. |
| CMC | Computer Management Corporation. |
| CMP | Common Minimum Program. |
| CONCOR | Container Corporation of India. |
| CPSE | Central Public Sector Enterprise. |
| CS | Company Secretary. |
| CVC | Central Vigillance Commission. |
| CWC | Central Warehousing Corporation. |
| DAP | Di-Ammonium Phosphate. |
| DC | Disinvestment Commission. |
| DCF | Discounted Cash Flow. |
| DEA | Department of Economic Affairs. |
| DIPAM | Department of Investment and Public Asset Management. |
| DOD | Department of Disinvestment. |
| DOP | Department of Pharmaceuticals. |

| | |
|---|---|
| DOT | Department of Telecommunications. |
| DPE | Department of Public Enterprises. |
| EC | Evaluation Committee. |
| EGOM | Empowered Group of Ministers. |
| EOI | Expression of Interest. |
| ETF | Exchange Traded Fund. |
| FII | Foreign Institutional Investors. |
| FIR | First Information Report. |
| FSNL | Ferro Scrap Nigam Limited. |
| FY | Financial Year. |
| GA | Global Advisor. |
| GAIL | Gas Authority of India Limited. |
| GDP | Gross Domestic Product. |
| GDR | Global Depository Receipt. |
| GIC | General Insurance Corporation. |
| HAL | Hindustan Antibiotics Limited. |
| HCIL | Hotel Corporation of India Limited. |
| HLL | Hindustan Lever Limited. |
| HNL | Hindustan Newsprint Limited. |
| HPCL | Hindustan Petroleum Corporation Limited. |
| HPIL | Hemishphere Properties India Limited. |
| HTL | Hindustan Teleprinters Limited. |
| HZL | Hindustan Zinc Limited. |
| IBC | Insolvency and Bankruptcy Code. |
| IBP | Indo Burma Petroleum Limited. |
| IEM | Independent External Monitor. |
| IM | Information Memorandum. |
| IMG | Inter Ministerial Group. |
| IOC | Indian Oil Corporation. |
| IOCL | Indian Oil Corporation Limited. |
| IP | Insolvency Professional. |
| IPCL | Indian Petrochemicals Corporation Limited. |
| IPO | Initial Public Offer. |
| IPR | Industrial Policy Resolution. |
| IRDA | Insurance Regulatory and Development Authority. |
| ITDC | Indian Tourism Development Corporation. |
| IVCOL | Indian Vaccines Corporation Limited. |

| | |
|---|---|
| JPC | Joint Parliamentary Committee. |
| JVA | Joint Venture Agreement. |
| KAPL | Karnataka Antibiotics & Pharmaceuticals Limited. |
| LIC | Life Insurance Corporation of India. |
| MCA | Ministry of Corporate Affairs. |
| MFIL | Modern Food Industries (India) Limited. |
| MHA | Ministry of Home Affairs. |
| MOD | Ministry of Disinvestment. |
| MoF | Ministry of Finance. |
| MoHFW | Ministry of Health and Family Welfare. |
| MOIL | Manganese Ore (India) Limited. |
| MOL | Ministry of Law. |
| MoU | Memorandum of Understanding. |
| MPS | Minimum Public Shareholding. |
| MTNL | Mahanagar Telephone Nigam Limited. |
| MUL | Maruti Udyog Limited. |
| NACIL | National Aviation Co. of India Limited. |
| NAV | Net Assets value. |
| NBCC | National Buildings Construction Corporation Limited. |
| NCLT | National Company Law Tribunal. |
| NCMP | National Common Minimum Programme. |
| NDA | National Democratic Alliance. |
| NFO | New Fund Offer. |
| NHPC | National Hydroelectric Power Corporation Limited. |
| NIF | National Investment Fund. |
| NIP | New Industrial Policy. |
| NLC | Neyveli Lignite Corporation Limited. |
| NRF | National Renewal Fund. |
| NRI | Non Resident Indian. |
| NTPCL | NTPC Limited. |
| OCB | Overseas Corporate Bodies. |
| OFS | Offer for Sale. |
| ONGC | Oil and Natural Gas Corporation Limited. |

| | |
|---|---|
| PAC | Public Accounts Committee. |
| PAP | Phosphatic Acid Plant. |
| PECV | Price Earning Capacity Value. |
| PESB | Public Enterprises Selection Board. |
| PIM | Preliminary Information Memorandum. |
| PPL | Paradeep Phosphates Limited. |
| PSU | Public Sector Undertaking. |
| | |
| QIB | Qualified Institutional Buyer. |
| | |
| RBI | Reserve Bank of India. |
| RFP | Request for proposal. |
| RIL | Reliance Industries Limited. |
| RINL | Rashtriya Ispat Nigam Limited. |
| ROC | Registrar of Companies. |
| | |
| SAIL | Steel Authority of Limited. |
| SAP | Sulphuric Acid Plant. |
| SCI | Shipping Corporation of India. |
| SCOPE | Standing Conference of Public Enterprises. |
| SEBI | Securities and Exchange Board of India. |
| SHA | Shareholders' Agreement. |
| SJVN | Sutlej Jal Vikas Nigam Limited. |
| SPA | Share Purchase Agreement. |
| SPV | Special Purpose Vehicle. |
| SUUTI | Specified Undertaking of the Unit Trust of India. |
| | |
| TA | Transaction Advisor. |
| TRAI | Telecom Regulatory Authority of India. |
| TYCIL | Tyre Corporation of India Limited. |
| | |
| UPA | United Progressive Alliance. |
| | |
| VRS | Voluntary Retirement Scheme. |
| VSNL | Videsh Sanchar Nigam Limited. |
| | |
| WACC | Weighted Average Cost of Capital. |
| WB | World Bank. |
| WTO | World Trade Organization. |

# Executive summary

1. This paper presents the history of disinvestment in India. It covers the period between March 1991 to December 2020. The history can be divided into four broad phases based on the different government regimes. Each phase is described in detail in the report.

2. **Phase 1 (1991-1999)**: This was the first time the idea of disinvestment was conceptualised in India. It was largely a result of poor performance of CPSEs and a fiscal and balance of payment crisis that hit India in 1991. Disinvestment of public sector enterprises was part of the overall liberalisation and globalisation policies adopted in India. However there was no appetite to do large scale privatisations as were undertaken in the UK, France and other parts of the world in the 1980s. Possibly for this reason, government preferred the use of expression 'disinvestment' over privatisation to avoid adverse connotations.

   Several commissions (like the Disinvestment Commission) were set up to outline what disinvestment would mean in India, which public sector enterprises would be selected, and how the process would be carried out.

   This phase saw disinvestment through auction of shares, and two GDRs. However, out of the total target of INR 34,300 crore set between FY92 to FY99, the government was able to realise INR 16,809 crore. An average of 8.87% of shareholding was diluted in 39 CPSEs with no transfer of control to private parties. At the same time, investment in public sector enterprises increased. Towards the end of FY 1999, investment in CPSE stood at INR 2,39,167 crore against INR 99,315 crore as on March 31, 1990. The government also carried out cross holding transactions in the public sector oil companies.

3. **Phase 2 (1999-2004)**: This was the first time in India when privatisation (referred to as "strategic sale" by the government) took place. A dedicated Department of Disinvestment was created to expedite the process of privatisation, which was later elevated to the status of ministry.

   This phase saw 12 strategic sales which consisted of 10 privatisation deals and 2 CPSE to CPSE sales. Also, there were slump sale of 20 hotel properties. Despite this between FY 2000 and FY 2004, the government could realise INR 24,619 crore out of a target of INR 58,500 crore. Similar to Phase 1, cross holding transactions in the oil sector continued which lead to debate on the autonomy of public sector firms in making investment decisions. In 2002, a prohibition was imposed on CPSEs to participate in the disinvestment of PSUs.

   The process of strategic sales witnessed several controversies. These were on: (i) methods of valuation, (ii) legal disputes challenging the transactions, (iii) adverse audit remarks of the CAG, and (iv) labour unrest. While lot of noise was generated

on loss of jobs due to privatisation, no retrenchment took place. Some of the disputes regarding these transactions, especially the ones related to the sale of hotels, continue till date. This phase also saw some missed chances of strategic sales in the oil sector and an initial attempt to privatise Air India.

4. **Phase 3 (2004-2014)**: This phase saw the return to a policy of retaining the autonomy and *public* character of CPSEs. There was an explicit policy decision to undertake disinvestment only on a case by case basis and profit making CPSEs would remain with the public sector. In addition, whatever revenues were earned from disinvestment would explicitly be designated for social sector schemes.

   One of the goals of the government in this phase was to encourage CPSEs to access capital markets and to meet the increased minimum public shareholding requirement. As a result there was a pivot towards minority stake sales. This resulted in two new methods of disinvestment: offer for sale through the stock exchange (OFS-SE) and exchange traded funds (ETFs). There was also an increase in the number of public offers in this period, as well as on the use of buybacks as a method of disinvestment.

   Overall, this phase saw no strategic sales. The target of INR 1,93,000 crore was not realised. Instead, the government raised INR 1,14,045 crore.

5. **Phase 4 (2014-2020)**: The election of the NDA government phase began with great expectations of a return to strategic sales as seen in Phase 2 when the previous NDA government was in power. However, when the government first announced a disinvestment policy in 2016, promoting public ownership and efficient management of investment in CPSEs were its core objectives. Subsequently the phase saw the Department of Disinvestment being renamed as Department of Investment and Public Asset Management (DIPAM) with the expansion of its mandate to manage government investments along with disinvestment, and a larger role for the NITI Aayog as an advisor on strategic disinvestment.

   The phase witnessed five main methods of disinvestment - compulsory buybacks, OFS-SE, CPSE to CPSE sales, ETFs, and public offers. In addition, the government expanded the scope of disinvestment and added new avenues like sale of enemy shares, asset monetisation, and the sale of holdings in SUUTI (a statutory special administration for the management of the restructured Unit Trust of India in 2002). The government has given a clearance for strategic sales of 34 firms, out of which 8 CPSEs have been sold to another CPSE. Exceptions were made to the prohibition on CPSEs to participate in disinvestment (made in Phase 2) to carry out the CPSE to CPSE sale transactions.

   Until FY2020, the government had realised INR 3,05,357 crore out of its target of INR 4,26,925 crore. Of these, 78% of the disinvestment proceeds have come from sale of minority stake.

   In October 2021 the government approved the strategic sale of Air India Ltd. and its subsidiaries to Talace Pvt. Ltd., a wholly owned subsidiary of Tata Sons Pvt.

Ltd. The handover of the corporation was completed in January 2022. This was certainly a long-pending sale which successive governments had tried to undertake. However, since our research does not cover disinvestment transactions concluded after 31 December 2020, the discussion of the most recent developments are outside the scope of our work.

6. While privatisation remains a highly emotive issue in India with apprehensions like transfer of public resources to private hands and job loss, policy has always viewed privatisation as a way to raise resources. Retaining the public nature of the CPSEs has been considered to be important, and efficiency arguments in favour of the private sector have not been as important. As a result, there have only been 10 privatisations in the last three decades out of total 249 operational CPSEs as on March 31, 2019. Over the years, the trend of disinvestment through sale of minority stake and one CPSE buying shares of another CPSE continued. Unless there is a change in the view of the respective roles of the public and private sector, one can expect the current policy to continue.

# 1 Phase I

## 1.1 The historical role of CPSEs

Before looking at the history of disinvestment, it is necessary to understand why investments were made in the public sector, what measures were taken to improve firm efficiency and why they did not succeed in their objectives.

After India gained independence, the government adopted the Industrial Policy Resolution (IPR), 1956 with the objective of building sufficient industrial capacity for the nation (Government of India, 1956). The IPR noted that the state must play a 'predominant and direct' role in setting up new industrial undertakings in order to formulate a 'socialistic pattern of society' in India (Planning Commission of India, 2005).

The IPR called for a three-fold classification of industrial sectors. Industries in Schedule-A of the Policy were reserved for the state.[1] Schedule-B of the IPR, covered industries where the government could set up units drugs and antibiotics etc. The remaining industries were left open to the private sector. After the IPR was adopted, the government established many CPSEs and their role in the economy expanded quickly.[2] The government's total investment in CPSEs, which stood at INR 81 crore in 1956, had increased to INR 99,315 crore by 1990 (Department of Public Enterprises, 2005).

Between 1965 and 1985, many private sector companies were nationalised through Acts of Parliament. Examples of such companies include some of the petroleum sector CPSEs like Indian Oil Corporation Limited (IOCL), Hindustan Petroleum Corporation Limited (HPCL), Bharat Petroleum Corporation Limited (BPCL), the erstwhile MUL, Andrew Yule and Co. Ltd., etc. The reasons for nationalisation differ with each case. In case of MUL and Andrew Yule and Co. Ltd., they were nationalised 'in the public interest' as they were performing poorly. The companies that were nationalised in the petroleum sector were the undertakings by foreign companies like Burmah Shell, Caltex and Esso. They were nationalised "*... in implementation of the policy for progressively securing the ownership and control of the production of the nation's petroleum resources are vested in the State and thereby so distributed as best to subserve the common good ...*" (Andhra Pradesh High Court, 1981).

By the early 1980s it was realised that production in public sector firms was significantly lower than their capacities. Some of the reasons for this trend are noted (Department of

[1]This included arms and ammunition, atomic energy, iron and steel, machine tools, coal and lignite, heavy electrical plants, mineral oils, mining of major minerals, aircraft and aviation, railways, ship-building, telephony and power.

[2]A CPSE is an entity whose majority (51% or more) of the paid up share capital is held by the central government or other CPSEs.

**Table 1** Financial performance of CPSEs for FY 1989-90.

| Group | Number of enterprises | Capital employed (INR crore) | Accumulated losses (INR crore) | Net profit/ loss for FY1989-90 (INR crore) | Ratio of net profit to capital employed | Number of employees (in thousands) |
|---|---|---|---|---|---|---|
| Profit making | 131 | 72,130.1 (85.5%) | 2780.3 (21.7%) | 5740.8 | 8.0 | 1431 |
| Loss making | 98 | 12,210.9 (14.5%) | 10,052.8 (78.3%) | | -16.1 | 790.5 |
| Total | 229 | 84,341 | 12,833 | 3781.7 | 4.5 | 2221.5 |

Public Enterprises, 1991):

1. Outmoded technologies
2. Over employment
3. Lower priority for fresh investments due to their presence in competitive sectors
4. Poor project management
5. High debt-to-equity ratio

To analyse the performance of CPSEs and suggest measures to improve their functioning, the government instituted a committee headed by Dr. Arjun Sengupta (Ministry of Finance, Government of India, 1984). It recommended that the number of core industries be reduced from 17 to 7 to enable greater public sector participation. It highlighted the need for greater autonomy among CPSEs, for instance allowing CPSEs in the non-core industries to raise funds without government clearances. It recommended an arrangement based on the French model, where government entered into Memorandum of Understandings (MoUs) with a public firm to improve its performance. The objective was to fix production targets under the MoUs which CPSEs must meet.[3] The government adopted the MoU system from FY 1986-87.

## 1.2 State of India's public finances in 1991

In 1991 India faced a financial crisis. The Gulf War in 1990 and the resulting oil shock added to the woes of balance of payments (Government of India, 1991a). The situation

[3] It also imposed obligations on the government such as provision of equity.

**Table 2** Timeline of Phase I

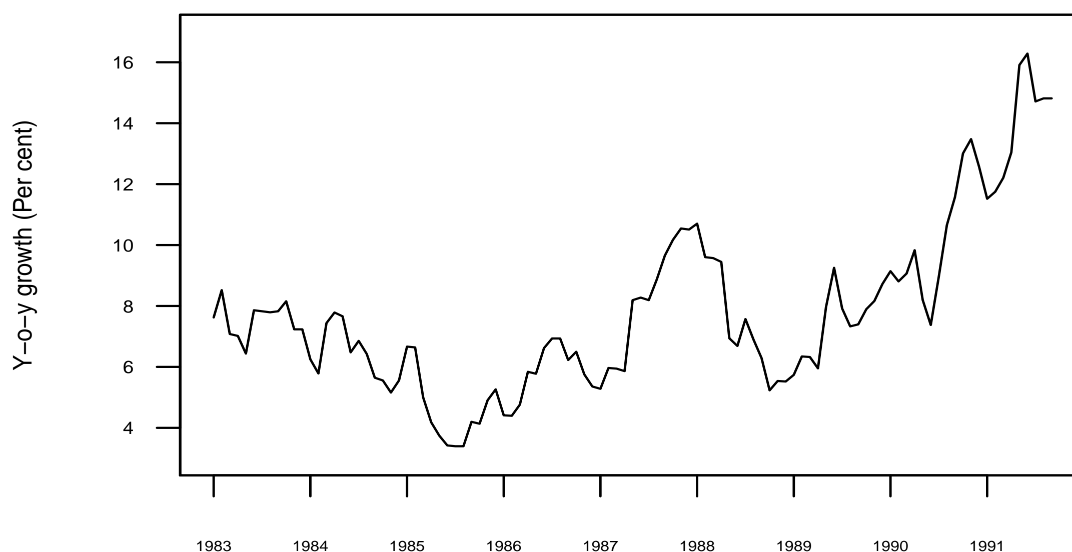
| Year | Event |
|---|---|
| 1991 | Interim budget of FY 1991-92 announced government to disinvest shares in CPSEs. |
| 1991 | New Industrial Policy was announced. |
| 1991 | DPE conducted a detailed analysis of 58 sick CPSEs. |
| 1991-92 | Disinvestment of first set of 31 CPSEs. |
| 1992 | Rangarajan Committee on disinvestment of shares was constituted. |
| 1992 | National Renewal Fund was set up to protect employees affected by rationalisation. |
| 1994 | Public Accounts Committee submitted report on disinvestment carried out in FY 1991-92. |
| 1994-95 | Recommendations of Rangarajan Committee were implemented. |
| 1996 | Lok Sabha election was held, BJP came to power but government collapsed after 13 days. |
| 1996 | United Front government was formed with the support of Congress and H.D.Deve Gowda elected as the Prime Minister. |
| 1996 | Disinvestment Commission was constituted and first set of 40 firms were referred. |
| 1996-97 | First GDR issue of a CPSE was carried out – shares of VSNL were listed on London Stock Exchange. |

**Table 3** Timeline of Phase I

| Year | Event |
|---|---|
| 1997 | I.K.Gujral elected as the Prime Minister. |
| 1997 | Ratna system was introduced to provide autonomy to selected CPSEs. |
| 1997 | Disinvestment Commission started submitting recommendations and 10 more firms were referred to it. |
| 1998 | Lok Sabha election was held, NDA government came to power but collapsed after 13 months. |
| 1998 | 10 firms were referred to the Disinvestment Commission. |
| 1999 | Cabinet passed resolution on classification of strategic and non-strategic firms. |
| 1999 | Lok Sabha election was held and NDA government was re-elected. |
| 1999 | 4 firms were referred to the Disinvestment Commission. |
| 1999 | Disinvestment Commission submitted final report, total 53 firms recommended for disinvestment, including 24 strategic sales. |
| 1999 | Disinvestment Commission's term came to an end. |

became worse with repatriation of thousands of Indians whose remittances had helped to manage the balance of payments (Ramesh, 2015). India's foreign exchange reserves were sufficient enough for only two weeks of imports. Short term liquidity crisis had set in which could have resulted in medium and long term insolvency (Ramesh, 2015). As the economic situations worsened, the inflation rate soared as high as 10.31% by March 1991 (See, figure 1).

**Figure 1** Inflation in India CPI (annual) from 1981-91




**Source: World Bank**

The CPSEs role of 'commanding the heights' of the economy was also under stress. As on March 31, 1990 there were 244 CPSEs owned by the government with a total investment of INR 99,315 crore. Of these, 98 had accumulated losses in excess of INR 10,000 crore which accounted for 78% of the accumulated losses of all public enterprises (Department of Public Enterprises, 1991).[4] Over employment and outdated technology were considered as the two major reasons for losses in CPSEs. For instance, there were 32 sick entities that the government had earlier taken over from the *private sector* to protect employment (Department of Public Enterprises, 1991).[5]

Even on the political front, there was instability and unrest in India.[6] In November 1990, the V. P. Singh led National Front government lost the vote of no confidence and Chandra Shekhar became the Prime Minister. But his government lasted only for seven

[4]Out of these, 83 firms were in the competitive sector and 15 were monopolies.

[5]These firms continued to incur losses and accounted for around 54% of the employment and about 27.5% of the capital employed in 83 entities.

[6]Implementation of Mandal Commission recommendations lead to nation wide protest and violence.

months when the Congress withdrew its support. As a result, general elections had to be held within a span of only sixteen months.[7] The government, therefore, could not present the full budget.[8]

During the election campaign, the former Prime Minister, Rajiv Gandhi was assassinated. The Congress party won the tenth Lok Sabha election and in June 1991 it formed the government with the support of allies from the Left. The Common Minimum Program (CMP) of the newly elected government laid down its objectives. Although the challenges associated with public sector were acknowledged, the CMP emphasised the role of CPSEs as an important component of the Indian economy. Further, it resolved to restructure CPSEs, provide them corporate autonomy and take measures to rehabilitate sick units (Disinvestment Commission, 1997a).

## 1.3 Conception of disinvestment in Indian policy thinking

The role of the private sector to invest in the public sector had started to take root in policy thinking. For example, in 1987, the Tata Group partnered with IOCL to set up an oil refinery in Karnal, Haryana. The joint venture agreement would include IOCL with 24% stake, the Tata companies with 24% stake and the rest to be offered to the institutional investors and general public including Non Resident Indians (NRIs) (Economic and Political Weekly, 1987).

Looking at the growing challenges of public sector firms, the government brought out a *White paper on the Public Sector* in March 1990. Later, the Department of Public Enterprises (DPE) submitted a note on the White Paper to the Cabinet Secretariat.[9] The note for the first time conveyed the government's intention to divest shares in favour of the general public and employees, but resolved to retain the public nature of the firm. However, the note mentioned that closure or divestment would be considered as a last resort, where turnaround was not possible (Public Accounts Committee, 1994).

While India adopted the path of gradual disinvestment, countries in the western world like Germany and the United Kingdom adopted whole-sale privatisation to improve the efficiency of public enterprises. Possibly for this reason, the government preferred the use of the expression 'disinvestment' over *privatisation.* Further, inference can be drawn from a parliamentary debate held in 2001, when Arun Shourie, the then Minsiter of Disinvestment clarified that the expression "disinvestment" was used because the government intended only piecemeal sale of minority shares (Lok Sabha, 2001a).[10] The impression that owner-

[7]Last general elections (IX) were held in November 1989.

[8]Dr. Yashwant Sinha was the Finance Minister.

[9]Public Accounts Committee (1994) have given details on the White Paper and the DPE Note, but their copies are not available online.

[10]Response to questions raised in Lok Sabha during the parliamentary debate on disinvestment of

ship of assets is being transferred to private hands would have generated skepticism among the public (Trivedi, 1993).

Due to high levels of fiscal deficit, the government decided to raise resources through partial disinvestment in selected CPSEs (Public Accounts Committee, 1994). As a result, the Cabinet Committee on Political Affairs (CCPA) gave its approval to the decision of disinvestment and the first public announcement was made in the interim budget of FY 1991-92. Para 20 of the interim budget stated (Government of India, 1991a):

> *"It has been decided that Government would disinvest upto 20 percent of its equity in selected public sector undertakings, in favour of mutual funds and financial or investment institutions in the public sector. This disinvestment, which would broad-base the equity, improve management and enhance the availability of resources for these enterprises, is also expected to yield Rs 2,500 crore to the exchequer in 1991-92."*

## 1.4 Disinvestment by auctioning of shares

The immediate concern of the government was to improve the financial situation. Hence, the government sought to prepare a roadmap to facilitate disinvestment. In this section, we trace the evolution of policy thinking of the government during this time.

### 1.4.1 New Industrial Policy and disinvestment

Faced with immediate economic crisis, India needed a paradigm shift in economic philosophy. On July 24, 1991, the government issued the New Industrial Policy (NIP) which focused on five areas — industrial licensing, foreign investment, foreign technology agreements, public sector policy and the Monopolistic and Trade Practices Act. This was a milestone in the Indian history of economic reforms, popularly known as the *liberalisation, privatisation and globalisation* model. Some argue that geopolitical conditions like decline of communism and the Soviet block had a deep impact leading to a change in economic thinking (Kapur, 2009).

The NIP listed reasons for the downfall of government companies and acknowledged that many of the CPSEs had become a *burden* rather than an asset to the government.[11]

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Hindustan Zinc Ltd.

[11] Reasons were poor productivity, over-manning, outdated technology and inadequate human resources development.

As a new approach to public enterprises, the NIP set out the priority areas for future.[12] For disinvestment, the NIP announced its plan to dilute shareholding in selected enterprises. The government decided to follow the same position set out in the interim budget — divest upto 20 % of its equity in selected public sector undertakings to yield INR 2,500 crore to the exchequer (Government of India, 1991c). The government also decided to refer sick public units to the Board for Industrial and Financial Reconstruction (BIFR) and amended the *Sick Industrial Companies (Special Provisions) Act* to enable this in 1991.[13]

While the announcements indicated a shift in thinking, the NIP did not look at *privatisation* as a measure to address the problems of public sector. As far as the public sector was concerned, the focus remained on how to strengthen and revive the firms. For instance, the government resolved to strengthen the Public Sector Undertakings (PSUs) in reserved areas of operation or high priority areas or generating reasonable profits through MoU and greater degree of autonomy (Government of India, 1991b). Consequently, in both 1991-92 and 1992-93 there was an increase in the number of MoUs (See, Table 27).[14]

Pursuant to the NIP, the disinvestment process for FY1991-92 was initiated with the formation of the selection committee known as the Core Group which consisted of the Finance Secretary, Secretary of Department of Economic Affairs (DEA) and Secretary, DPE. Going forward the Core Group, as a practice, consulted the secretaries of the administrative ministries, heads of public firms and merchant bankers to determine the *reserve price* of the firms.

Out of total 244 firms, 31 CPSEs with good track record based on net asset value criteria were selected (see, Table 26), (Department of Public Enterprises, 1992).[15] Initially, DPE had selected 41 CPSEs but the CCEA gave approval to 31 CPSEs.[16] Interestingly, Air India was part of the initial list. However, the prime objective was to select *'those companies which the investment market could appreciate without much difficulty and price reasonably'*(Department of Public Enterprises, 1992). However, there were signs of *agency problems* which affected disinvestment decisions. Resistance came from certain administrative ministries and departments for including certain firms in the basket of disinvestment. For instance, Department of Telecommunications (DOT) opposed the inclusion of shares of Mahanagar Telephone Nigam Limited (MTNL) and VSNL. Since communication com-

[12]The priority areas included essential infrastructure goods and services, exploration and exploitation of oil and minerals, technology sector where private investment is low and strategic sector like defence equipment.

[13]Earlier the government companies were exempted from the application of this Act.

[14]MoU system was an attempt to manage CPSEs by objective than control through procedures. It followed a rating system (excellent, very good, good, fair, poor and excluded) to indicate the performance of a public firm.

[15]DPE followed a detailed exclusion procedure for selection of firms like, firms under construction, section 25 companies, companies with insignificant size, low level of profitability and firms with strategic presence were not included in the list.

[16]Reasons for exclusion were lack of suitable buyer, low share valuation, strategic reasons, etc.

panies were performing well, they were retained in the list to make the deal attractive for buyers. The then Finance Secretary observed that (Public Accounts Committee, 1994):

> *"... the Note to the Cabinet had been circulated to all the Ministries. As far as the view of the Ministry is concerned, it was on whether the enterprises whose shares are sold should be represented in the Cabinet. In a mechanical kind of way, there is a tendency for individual enterprises to tell us not to sell ..."*

### 1.4.2 Committees set up for disinvestment

Several committees were constituted in the process of disinvestment to address issues like valuation of shares, handling labour problems, review of health of public firms and to create a better policy approach towards the disinvestment program. In August 1991, a committee for valuation of the shares was constituted, headed by the Secretary, DPE. This was popularly known as the 'Suresh Kumar Committee'.[17] Shares of different companies were bundled together. This was because the shares were unknown to the market and it was difficult to determine the 'fair price' of each share. Also, good firms were bundled with less good firms to enable a broader based disinvestment.[18] The level of disinvestment varied from 5% to 20% but the average rate of shares sold was 8%. Disinvestment was carried out in two rounds in December, 1991 and February, 1992 which received 9 bids and 19 bids respectively. Individuals were not allowed to participate in these two rounds of disinvestment, and shares were offered to only public sector mutual funds and financial institutions. This was done because it was felt that such investments would be risky for individuals. The first disinvestment target of INR 2500 crore was achieved (See, Table 27).

Since over staffing was one of the main reasons for rising losses in public firms, rationalisation of the work force was necessary. For this, Voluntary Retirement Scheme (VRS) packages were designed. However, rationalisation of work force could have triggered resistance from workers unions, hence confidence building measures were necessary. Towards the end of the year 1991, the Ministry of Labour constituted a Special Tripartite Committee consisting of promoter, management and representatives of the workmen (Department of Public Enterprises, 1994). Further, in February, 1992 the National Renewal Fund (NRF) was set up with an initial corpus of INR 200 crore to protect the interest of public sector

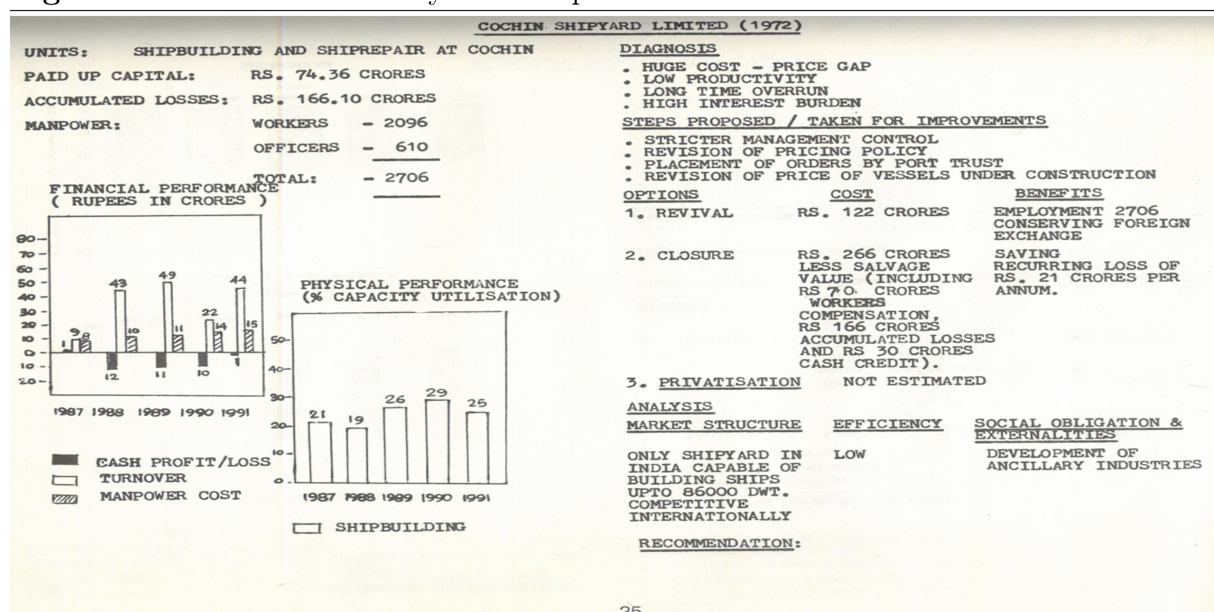
[17]Valuation Committee consisted of Secretary, Department of Chemicals and Petrochemicals, Department of Electronics, and Department of Petroleum and Natural Gas. Also, it included heads of the public firms — chairman cum managing director of Maruti Udyog Ltd, Bharat Petroleum Corporation, Andrew Yule & Co. Ltd, and Indian Petrochemicals Corporation Ltd. Strategic Consultants Pvt. Ltd was appointed to advise on pricing of shares.

[18]As per the Ministry of Finance (MoF), Controller of Capital Issues, Guidelines were not suitable for valuation of shares marked for disinvestment. Instead, Net Assets value (NAV), Discounted Cash Flow (DCF) and Price Earning Capacity Value (PECV) methods were proposed to be used and the average of the two higher values so obtained to be taken as the reserve price.

workers affected due to rationalisation of the workforce (Department of Public Enterprises, 1992). From year to year, a budget provision was made for this fund to be spent on VRS and redeployment of surplus workforce (see, Table 8).

In December 1991, on the lines of the NIP where government had announced the of review sick units, the DPE concluded a detailed review of 58 chronically loss making CPSEs (Department of Public Enterprises, 1991).[19] For the fist time, an exercise was conducted which included diagnosis, steps taken/proposed, various options with cost and benefits, market structure against each CPSE for finding appropriate solutions. While the solution listed three options — revival, closure and *privatisation*, however, the third option was not estimated/contemplated for any of the firms, for example, see figure 2.

**Figure 2** Review of chronically sick companies



COCHIN SHIPYARD LIMITED (1972)

UNITS: SHIPBUILDING AND SHIPREPAIR AT COCHIN

PAID UP CAPITAL: RS. 74.36 CRORES

ACCUMULATED LOSSES: RS. 166.10 CRORES

MANPOWER: WORKERS - 2096

OFFICERS - 610

TOTAL: - 2706



DIAGNOSIS

- HUGE COST - PRICE GAP
- LOW PRODUCTIVITY
- LONG TIME OVERRUN
- HIGH INTEREST BURDEN

STEPS PROPOSED / TAKEN FOR IMPROVEMENTS

- STRICTER MANAGEMENT CONTROL
- REVISION OF PRICING POLICY
- PLACEMENT OF ORDERS BY PORT TRUST
- REVISION OF PRICE OF VESSELS UNDER CONSTRUCTION

| OPTIONS | COST | BENEFITS |
| --- | --- | --- |
| 1. REVIVAL | RS. 122 CRORES | EMPLOYMENT 2706 CONSERVING FOREIGN EXCHANGE |
| 2. CLOSURE | RS. 266 CRORES LESS SALVAGE VALUE (INCLUDING RS 70 CRORES WORKERS COMPENSATION, RS 166 CRORES ACCUMULATED LOSSES AND RS 30 CRORES CASH CREDIT). | SAVING RECURRING LOSS OF RS. 21 CRORES PER ANNUM. |
| 3. PRIVATISATION | NOT ESTIMATED | |

ANALYSIS

| MARKET STRUCTURE | EFFICIENCY | SOCIAL OBLIGATION & EXTERNALITIES |
| --- | --- | --- |
| ONLY SHIPYARD IN INDIA CAPABLE OF BUILDING SHIPS UPTO 86000 DWT. COMPETITIVE INTERNATIONALLY | LOW | DEVELOPMENT OF ANCILLARY INDUSTRIES |

RECOMMENDATION:

25

**Source: DPE Monograph, 1991**

In February 1992, the committee on disinvestment of shares in PSUs (popularly known as *Rangarajan committee*) was constituted. For the first time, a detailed plan was devised to carry out a disinvestment exercise in India. Since disinvestment was likely to be used to raise resources, the committee cautioned against the annual ritual of setting budgetary targets. The committee advised that disinvestment should be used to improve overall economic efficiency of the firms. However, the practice of setting annual targets continued over the years.[20]

Three methods of disinvestment methods were discussed: public offer, auction of shares

[19]Sourced from the NIPFP library, digital copy of the report may not be in circulation.

[20]Since FY 1991-92 Union Budgets have set annual disinvestment targets till now except for a few years in Phase 3.

among a large group, and transfer of controlling interest to a specific buyer or group of persons, commonly known as *strategic disinvestment* (Reserve Bank of India, 1993).[21]

On the issue of *pricing of shares*, the committee made an important observation - that pricing is determined by investor perception - and therefore, outcome of disinvestment should not be judged merely on the yardstick of correct pricing. However, pricing of shares and value realisation still remains a contentious issue having a strong influence on disinvestment decisions. Full privatisation was recommended in non-reserved sectors, however, due to lack of political consensus, no decision was taken (Naib, 2004).[22] Finally, keeping in view the global experience and the challenges in the government set up, a full time *standing committee on disinvestment* was recommended to supervise disinvestment and take timely decisions. This was the genesis of the disinvestment commission or the DC.

### 1.4.3 Controversies

From the very outset the disinvestment process was gripped in controversy and public scrutiny. Findings of the Comptroller and Auditor General of India (CAG) report for FY 1991-92 found errors in the first two rounds of disinvestment held in December, 1991 and February, 1992 respectively. It estimated a loss of INR 3,442 crore to the exchequer due to reduction in original *reserve price* of shares sold. Although the calculated loss was debatable, it triggered public uproar and the disinvestment program was subjected to an inquiry by the Public Accounts Committee (PAC). In April 1994, the PAC report was made public which found irregularities on several grounds like arbitrary reduction of original reserve price without consulting the Cabinet, faulty bundling of shares, hasty decision and wrong timing of disinvestment to meet budget target, absence of claw black provision and non-adherence to procedures (Public Accounts Committee, 1994).[23]

Simultaneously, the Central Bureau of Investigation (CBI) had initiated inquiry to look into the allegations of breach of rules on onward sale of shares by two institutions who purchased the bundle of shares and sold them to brokers before listing on the stock exchange (Public Accounts Committee, 1994).[24] Although this was not an ideal beginning for the

[21]The committee was originally headed by Dr. V. Krishnamurthy, Member Planning Commission. The committee could not complete its work and was reconstituted under the chairmanship of the Reserve Bank of India (RBI) Governor, Dr.C. Rangarajan.

[22]The committee recommended 51% government ownership in reserved sectors and in exceptional cases 26% public shareholding where enterprises had a dominant market share or separate identity was needed for strategic reasons.

[23]In view of the PAC, terms of disinvestment should have had claw back provision which allowed government to realise a part of the huge profits made by the buyer in the future after sale of shares of the CPSEs. However, the government defended that such provision would have turned away the prospective bidders.

[24]The two institutions were: Allahabad Bank and SBI Capital Markets Ltd.

disinvestment program, the government anticipated challenges to arise out of the experiment. For instance, the then Finance Secretary admitted before the PAC proceedings that as *bureaucrats* they had no prior experience of such an exercise and lacked expertise in valuation of shares, but due care was taken to arrive at a reasonable decision.

### 1.4.4 Targets and transactions

As the program recovered from controversies, it was faced with unfavourable market conditions. In FY 1993-94, the disinvestment process suffered because of poor response from the bidders (Department of Public Enterprises, 1992). As a result, in March 1994, shares of only 7 CPSEs could be off loaded, but the proceeds were realised in the next FY (Public Accounts Committee, 1994). The next FY 1994-95 witnessed several reforms based on the recommendations of the *Rangarajan committee*. For instance, NRIs, Overseas Corporate Bodies (OCB), and Foreign Institutional Investors (FII) were allowed to bid for shares, minimum bidding amount was lowered to enable wider participation by public (see, Table 28). A detailed plan was also drawn on how to reserve shares (maximum 5%) and sell them to employees of CPSEs. Poor market conditions continued in FY 1995-96 and the government collected only INR 362 crore against the ambitious target of INR 7000 crore (see, Table 28).

In FY 1996-97, only one firm i.e.,VSNL could be divested through a Global Depository Receipt (GDR) issue, and the disinvestment target was again missed (Department of Public Enterprises, 1996). This was the first GDR issue of a public firm and VSNL's shares were listed on the London Stock Exchange. Even in FY 1997-98 unfavourable market continued to put a brake on the disinvestment program. While the budget speech set a target of INR 4,800 crore (see, Table 29) and plans were made for GDR issues in several CPSEs, only one GDR issue of MTNL could take place.[25]

However, this did not deter the government from setting a higher target (INR 5,000 crore) in the next FY 1998-99. Since GDRs did not yield a good response, the focus was on domestic market and profit making oil and petroleum stocks.[26] Most of the disinvestment proceeds came from sale of minority shares in three oil companies — Gas Authority of India Limited (GAIL), Oil and Natural Gas Corporation Limited (ONGC) and Indian Oil Corporation (IOC) (see, Table 29 and Box 1). And finally after consecutive failures in the past three FYs, the target was met (see, Table 4).

[25]Following four firms were originally selected for disinvestment: MTNL, IOC, CONCOR and GAIL.
[26]Petroleum sector accounted for 52.18 % of the total net profit of all public firms taken together.

**Box 1 Cross holding in oil CPSEs**

In 1997, the government proposed a policy of cross holding in public sector oil companies. This was in order to ensure vertical integration among the companies and increase operational efficiency by creating presence in both upstream and downstream markets. The Sengupta Committee in 1998 had recommended a set of mergers to consolidate smaller CPSEs with larger ones e.g. Kochi Refineries Ltd. was to be merged with BPCL, IOCL to buy shareholding in Bongaigaon Refineries and Petrochemicals Ltd. etc (Standing Committee on Petroleum and Chemicals, Lok Sabha, 2003). During Phase 1 i.e., before March 1999, ONGC purchased 9.82% shareholding of government in GAIL; IOCL purchased 10% government shares in ONGC; and ONGC acquired 12.11% in IOCL.

On these transactions, the government provided clarification that disinvestment in these firms were carried out pursuant to specific requests from these CPSEs (Disinvestment Commission, 1997a). Possibly this was done because in the past CAG had questioned government's decision to dilute shares of profit making companies to meet budgetary targets. While cross-holding transactions started in Phase 1, they continued in Phase 2 and Phase 4, discussed later in this paper.

**Table 4** Budget targets and actual realisation

| Year | Target (Rs.crore) | Amount realised (Rs.crore) |
|---|---|---|
| 1991-92 | 2500 | 3038 |
| 1992-93 | 2500 | 1913 |
| 1993-94 | 3500 | NIL |
| 1994-95 | 4000 | 4843 |
| 1995-96 | 7000 | 362 |
| 1996-97 | 5000 | 380 |
| 1997-98 | 4800 | 902 |
| 1998-99 | 5000 | 5371 |
| Total amount | 34,300 | 16,809 |

**Source: Public Enterprises Survey 1999-2000**

## 1.5 Institutionalising disinvestment

By 1996, disinvestment had taken root in the Indian policy thinking. The government had even promoted disinvestment through foreign participation, as can be seen with the example of VSNL's GDR issue. The relatively stable five year term of the previous

government had given way to a series of coalition governments. However the scope of the policy on disinvestment was changing. Successive governments realised the need for institutionalising and rationalising the disinvestment process.

### 1.5.1 Elections and coalition governments

The year 1996 marked several political changes. In the general elections, the Congress lost its majority and the outcome was a fractured mandate. The Bharatiya Janata Party (BJP) emerged as the largest party and Atal Bihari Vajpayee was sworn in as the Prime Minister. However, he failed to prove majority on the floor of the house and the government collapsed in thirteen days. With the support of the Congress, a coalition consisting of thirteen parties formed the government, known as the 'United Front' government. H.D. Deve Gowda was appointed as the Prime Minister. The CMP of the new government promised: *"the United Front government will identify public sector companies that have comparative advantages and will support their drive to become global giants"*. The political intention was clear that profit making entities would not be sold to private players, rather they would be strengthened and supported (Disinvestment Commission, 1997a).[27]

However, the incumbent government noted the mounting losses in public firms, which shot up from INR 3,040 crore in FY 1991 to INR 4,910 crore in FY 1995. Mostly the losses were incurred in deregulated sectors with intense competition, where public firms had no specific role (Disinvestment Commission, 1997a).[28] The other reason for rising losses was attributed to withdrawal of budgetary support. While the planned outlay on CPSEs decreased from 32% in 1990 to 13% in 1995, government felt the need to further reduce the burden on the budget (Disinvestment Commission, 1997a). Given this dilemma in August, 1996, the United Front government set up the DC to address some of these problems. This was a major milestone in the first leg of India's disinvestment journey.

On the political front crisis continued. Congress withdrew its support in early 1997, and the Prime Minister H.D. Deve Gowda-led United Front coalition government lost the vote of no confidence. The government lasted for only 10 months. In April 1997, I.K. Gujaral was appointed as the new Prime Minister who continued the United Front government with the support of the Congress party. However, he resigned soon after and in 1998, within a span of two years, the country went through another general election (Lalwani, 2018).[29]

With a grand alliance of fourteen parties, the BJP formed the government, known as the National Democratic Alliance (NDA). Atal Bihari Vajpayee, was again elected as the Prime

[27] For sick and potentially sick companies, the CMP decided to take the route of *rehabilitation.*

[28] Major losses were accounted in sectors like fertilisers, heavy engineering and consumer goods which had big private players. Although this affected both the profit making and loss making companies, it brought fair competition which was beneficial to consumer interests.

[29] XIIth Lok Sabha elections.

Minister, however, within 13 months, the government fell due to withdrawal of support from the AIADMK. However, the NDA government announced two major policy decisions in this short duration. *First*, in the budget of FY 1998-99, announcement was made to bring down the government shareholding generally to 26%, however, implementation was to take place only on a case to case basis. *Second*, in March 1999, the Cabinet passed a resolution classifying strategic and non-strategic sectors for the purpose of disinvestment. Possibly this was done to streamline the earlier classification of industries done on the basis of strategic group, core group and non-core group.[30] In the year 1999, NDA government was re-elected.[31] Interestingly, NDA is the only government which carried out *privatisation* — transfer of controlling interest to private parties under the disinvestment program.[32]

### 1.5.2 Disinvestment Commission and disinvestment

Even after liberalisation, public sector in India continued to be an important component, unlike the experience in other countries which went for *wholesale privatisation*. The Disinvestment commission endorsed a pragmatic approach (not ideological) so that gains and surplus from the public sector firms could be commensurate with resources spent on them (Disinvestment Commission, 1997a). Before drawing recommendations on individual firms, the commission conducted a study of global experience and observed that in many countries private ownership was more efficient than state ownership, and even in the public sector competition was needed to achieve efficiency (Disinvestment Commission, 1997b). While government's immediate priority was to raise resources, the commission's focus was on a long term disinvestment strategy and *efficiency gains*. Given the prevailing challenges, the commission cautioned the government that success of the disinvestment program of India was dependent on political consensus and will (Disinvestment Commission, 1997b). Box 2 shows the steps adopted by DC to arrive at its recommendations.

**Box 2 Firms classification and key recommendations**

Before the recommendations were given on each firm, the commission segregated the firms referred by the government into different baskets based on the following parameters (Disinvestment Commission, 1997a):

- *Net profits*: Firms were classified on the basis of consistent profits in the last five FYs. Other conditions like competition, future growth in sales were also considered. Firms were put in two baskets: *first*, strong performers based on

[30] Strategic sector would include arms, ammunition and allied items of defence equipment, defence aircraft, warship, atomic energy and railway transport. All other sectors were considered as non-strategic.

[31] Elections for XIIIth Lok Sabha were held in the month of September-October, 1999.

[32] See, Phase 2 of this paper.

consistent profits and strong growth prospect, *second*, medium performers with profitability but moderate prospect of growth.

- *Industry classification*: This was done to determine the attractiveness of the industry in which the firm operated. Three classes were created - high, medium and low based on the current and future profitability, level of competition and impact of government policies on the operations of the company.

- *Accumulated reserves*: Reserves could be used for certain types of capital restructuring which can further help in disinvestment.

- *Listing and trading*: Three categories were created - disinvested and listed; disinvested and not yet listed; and not disinvested so far.

The DC report was divided into two parts. The first part dealt with general recommendations and the second part listed specific recommendations for each firm. Following are some of the important general recommendations:

- *Manner of disinvestment*: No disinvestment in strategic sectors like, arms and ammunition, atomic energy, certain specified minerals and railway transport. Disinvestment upto 49% in core group i.e., capital intensive sectors where the market could move towards oligopolistic structure with entry of private players. Finally, disinvestment upto 74% in non-core group, where large number of players exist with sufficient competition.

- *Establishment of disinvestment fund*: Proceeds of disinvestment should be parked in a separate fund for specific purposes like financial restructuring and VRS packages to avoid its undifferentiated use for reducing fiscal deficit.

- *Revamping* MoU *system*: More qualitative parameters should be used in place of annual targets as they may cause perverse incentives, like deliberate setting of low targets both by the firm and its administrative Ministry to obtain excellent rating.

- *Autonomy to firms*: Decision should be taken more by the board of the CPSE and not by the government. For this purpose, the firms to be divided into three categories: strong performers, moderate performers and all firms to decide the level of autonomy.

- *Broad ownership*: To create dispersed shareholding, employees should be rewarded through shares reserved for them. Also, discount to be given to retail investors to ensure wider participation.

In September 1996, the government referred 40 CPSEs out of 254 CPSEs, which consisted of 32 firms with track record of consistent profits and 8 firms with fluctuating net profits or losses. More firms were referred to the commission over the next three years (see, Table 5). Out of those 40 firms, 15 firms were listed; 6 were not listed but

the government had diluted its shareholding; and 19 firms with no prior disinvestment. Recommendations were drawn for the referred firms on the following criteria – extent of restructuring required; classification of firms i.e., core or non-core; size of the company and the phasing of disinvestment; equity fund raising program of firms, classification of industry as high, medium and low potential; and alternative modalities of disinvestment (Disinvestment Commission, 1997a). Some firms which were earlier classified as core group were reclassified as non-core based on the prevalent market structure and presence of private players in the sector.

In February 1997, the commission submitted its first report and the first firm was recommended for *privatisation*.[33] During the tenure of the commission a total of 12 reports were submitted with recommendations on 58 firms.[34] The last report was submitted in August 1999.

**Table 5** Firms referred to Disinvestment Commission

| Year | No. of enterprises |
|---|---|
| September, 1996 | 40 |
| March, 1997 | 10 |
| July, 1998 | 10 |
| January, 1999 | 4 |
| Total | 64 (8 firms were withdrawn) |

**Source: Disinvestment Commission Report 1, 1997**

In line with the recommendations of the commission, in the budget of FY 1997-98 the government emphasised the need of reducing budgetary support to public sector firms. The then Finance Minister P.Chidambaram in his speech said:

> *"The essence of a long-term disinvestment strategy should be not only to enhance budgetary receipts, but also minimise budgetary support towards unprofitable units while ensuring their long-term viability and sustainable levels of employment in them."*

Contrary to this aspiration, investment in CPSEs only increased in the coming years, (see Table 6).

[33] In Modern Foods India Ltd. the commission recommended sale of 74% stake to private players.
[34] DC did not examine 6 CPSEs since they were registered with BIFR.

**Table 6** Investment in CPSEs

| Year | No. of enterprises | Investment (INR crore) |
|---|---|---|
| As on 31.3.1997 | 242 | 2,13,610 |
| As on 31.3.1998 | 240 | 2,31,024 |
| As on 31.3.1999 | 240 | 2,39,167 |
| As on 31.3.2000 | 240 | 2,52,745 |
| As on 31.3.2001 | 250 | 2,74,198 |
| As on 31.3.2002 | 240 | 3,22,815 |
| As on 31.3.2003 | 240 | 3,35,647 |
| As on 31.3.2004 | 242 | 3,49,994 |
| As on 31.3.2005 | 237 | 3,57,849 |
| Total | | 25,57,049 |

**Source: DPE Survey, 2004-05**

*Challenges faced by Commission*

In the month of August, 1997 the DC submitted the fourth report. By then it had recommended disinvestment in 15 CPSEs with the recommendation of strategic sale in majority of the firms.[35] To avoid communication gap, the Commission had once suggested the government to invite the chairman to the cabinet meetings to offer clarifications on the recommendations, but it never materialised. While the government accepted recommendations for disinvestment in four blue chip firms through offer of minority shares, it did not act upon recommendations for strategic sale.[36] Also, no decision was taken by the government on the general recommendations made by DC i.e., creation of disinvestment fund, setting up pre-investigation board, professionalising the board of CPSEs, etc. Looking at the indecisiveness of the government, the DC highlighted the need for timely implementation of its recommendations and observed (Disinvestment Commission, 1997d):

> "*The decisions announced so far on the Commission's recommendations suggest that Government's present approach seems to be oriented towards getting budgetary receipts by offer of shares in profit making PSUs and will not solve any of the issues relating to reducing the budgetary dependence of PSUs or achieve the larger objectives of disinvestment. The credibility of the disinvestment process as a whole will suffer and the impression of disinvestment as a short term budgetary measure intended mainly to raise resources to cover fiscal deficit would be difficult to avoid.*"

[35]The commission had submitted its first report in February, 1997. Since then there was no formal communication from the government about its position on the recommendations. However, the commission conducted a review of progress in disinvestment based on the available information.
Strategic sale means the sale or transfer of controlling stake (usually more than 50% stake) in the CPSE. 'Privatisation' of a CPSE refers to its 'strategic sale'.

[36]The four firms were MTNL, GAIL, IOC and CONCOR.

The main argument of the commission was that disinvestment should be *de-linked* to annual budgetary exercises because the budget has its own time constraints, whereas disinvestment may be timed as per the market conditions (Disinvestment Commission, 1997d). Disinvestment has been an emotive issue in India with several misconceptions among the people. The commission, therefore, insisted that the government dispel them and establish credibility about the disinvestment program (see, Box 3). For instance in tbe U.K., meetings and seminars were held, politicians, financiers, business people, and journalists were briefed, and finally, voters were educated about the rationale behind privatisation (Moore, 1992). However, it is not clear what steps were taken in India to educate citizens about the rationale behind disinvestment.

**Box 3 Common misconceptions about disinvestment**

*Misconception 1: Disinvestment is a short term budget balancing measure by disposing of valuable public assets built over the years.*
Measures: Selling shares through a transparent process like public offer and not confining actions to selected profit making companies can ward off criticism on this count (Disinvestment Commission, 1997c).

*Misconception 2: Disinvestment is seen by organised labour and the trade unions as a threat to job security.*
Measures: Right sizing of employees is in the longer term interest of employees, as over staffing could result in closure of firms and permanent job loss. For this, government must design attractive VRS packages with continuing stream of income by proper investment of the lump sum amount and insurance benefits (Disinvestment Commission, 1997c).

*Misconception 3: Disinvestment is perceived as a prelude to withdrawal of state role in critical areas of the economy.*
Measures: Government should not take an ideological, but priority based approach towards disinvestment. For this, it must stick to priorities so public resources can be utilised for larger goals for the good of the economy and maximum welfare of the people (Disinvestment Commission, 1997c).

*Push for strategic sale*

While the commission pushed for strategic sale, its origin can be traced back to the

1993 *Rangarajan Committee* which listed transfer of controlling interest to a specific firm or group of persons based on a negotiated price as one of the methods of disinvestment (Reserve Bank of India, 1993).[37] In 1997, the commission in its first report discussed strategic sale as a method to sell substantial stake with management control to a single party. Further, it laid down guidelines on selection of intermediaries and strategic partner. Although the commission did not use the expression 'privatisation', the intended outcome of strategic sale was transfer of controlling interest to a private player. However, in recent times the government has used the strategic sale route to transfer shares to another CPSE.[38]

In view of the commission, strategic sale was a *win-win* situation as it could fetch better price for the government and higher valuation for the buyer due to transfer of control (Disinvestment Commission, 1997c,e). Strategic sale was also promoted as it was viewed as a medium to bring in new technology and right size staff which were inevitable for enhancing the efficiency of the firms. For this, the commission advised the government to prepare a time bound *complete exit* plan from the disinvested firm and make it public at the time of bidding, so the prospective bidders have sufficient clarity about future.

In September 1997, the first approval of strategic disinvestment was given when the government decided to dilute 50% stake in MFIL.[39] Also, the process of strategic disinvestment in BALCO was initiated towards the end of 1997. By August 1999, the commission had given recommendations on 53 CPSEs, out of which no decision was communicated or taken in 30 cases.[40] Out of 32 strategic sale/trade sale, no decision was taken/communicated in 22 cases (see, Table 7) (Disinvestment Commission, 1999c). Even where decisions were taken, the progress was slow. In August 1998, the commission recommended a sale of 40% stake in Air India followed by an immediate infusion of INR 1000 crore. This however did not materialize until the year 2021.

[37]See, page 6 of the report.
[38]CPSE to CPSE sale has been discussed in Phase 4.
[39]In January 1999, the stake to be divested was raised to 74%.
[40]Since September, 1996 total 72 cases were referred to the commission, 8 firms were withdrawn by the government, and 6 firms were referred to the BIFR.

**Table 7** Recommendations by DC and action taken by government from August, 1996 to 1999

| Modality of Investment | No. of PSUs | Action taken |
|---|---|---|
| Trade sale | 8 | Being implemented: R-Ashok, U-Ashok, HCIL, MFIL, MSTC |
| Strategic sale | 24 | Being implemented: HTL, BALCO, KIOCL, EIL, IPCL |
| Offer of shares | 5 | Being implemented: GAIL, (Implemented in case of CONCOR and MTNL) |
| No disinvestment | 1 | Accepted: RITES |
| Disinvestment deferred | 11 | Accepted in case of 8 firms |
| Closure/sale of assets | 4 | Being implemented: EPIL |
| **Total** | 53 | |

**Source: Disinvestment Commission Report XI, July 1999**

*Dilution of powers*

Since the inception of the commission in August 1996, it was vested with the overall role of monitoring and supervising the disinvestment function, decide pricing, timing and selection of financial advisers. However, in January, 1998, the 'United Front' government amended the original terms of reference which revoked its supervisory power and reduced its role to an advisory body (Department of Public Enterprises, Government of India, 1998). After amendment to the terms of reference, the commission was not required to monitor the implementation process carried out by the CPSE.

Although no official reason was provided for the sudden amendment, the commission's critical views on slow progress in implementing the recommendations could be a reason (Naib, 2004). For instance, the commission questioned the *agency problem* when government withdrew certain firms after reference, on objections raised by the administrative ministries (Disinvestment Commission, 1998a).[41]

[41] On the objection raised by the Department of Defence Production and Supplies, the government withdrew four firms from the commission: Bharat Earth Movers Ltd, Bharat Electronics Ltd., Garden Reach Ship Builders, and Hindustan Aeronautics Ltd.

In another instance, due to poor domestic and international market conditions, the commission pushed for strategic deals, but involvement of multiple ministries in the implementation process caused inordinate delay. To overcome this, a single implementation machinery was recommended which was not set up (Disinvestment Commission, 1999a). Also, there were instances when the commission was not consulted like disinvestment of oil companies through cross holdings and GDR issue in VSNL which were possibly carried out to meet the budgetary targets. Further there were instances when government sought second opinion on the recommendations of the commission which lead to criticism.[42]

For all these reasons, the commission highlighted the inconsistency in the approach of the government and slow progress on its recommendations. Possibly this lead to amendment described earlier. While the commission insisted that the government restore its original power, the amendment was not rolled back. The term of the commission ended in November, 1999 and it was not extended. No reason was made public for not extending the term of the commission.

We will now look at the impact of disinvestment on the governance and workforce of CPSEs.

### 1.5.3 Rationalisation of workforce and autonomy in CPSEs

As part of the disinvestment strategy, the DC recommended that rationalisation of work force was necessary prior to privatisation of a firm. Towards the end of FY 1997, more than 97,000 employees had opted for VRS with the assistance of NRF. Although the government was aware that over staffing was one of the main reasons for losses in the public sector and a recurring burden on the budgetary support, retrenchment of workers could have had socio-economic issues with political ramifications. Therefore, caution was exercised and measures were taken to smoothen the process of right sizing. For instance, government had set up employees assistance centres at various locations and employees resource centres at the factory level, for *psychological* and financial counselling of employees (Department of Public Enterprises, 1996).[43]

[42]In October 1997, government appointed a global advisor in the case of ITDC to examine the recommendations of the commission. In the opinion of the commission, this was not in line with the original terms of reference for the commission.

[43]Later in the year 2000, both NRF and the scheme of employee counselling were abolished.

**Table 8** Disinvestment and employees

| Year | NRF budget (INR crore) | Number of employees taken VRS |
|---|---|---|
| 1992-93 | 200 | |
| 1993-94 | 539.23 | 33,472 |
| 1994-95 | 251.90 | 13,830 |
| 1995-96 | 217 | 10,833 |
| 1996-97 | 222.81 | 46,238 |
| 1997-98 | 306.91 | 4,998 |
| 1998-99 | 401.26 | 23,512 |
| Total | 2139.11 | 1,28,384 |

**Source: PE Surveys from 1991-99**

Phase I also witnessed policy changes for better autonomy in the public firms. In the FY 1997-98, pursuant to the CMP which called for more autonomy to CPSEs to support them to become global giants, the 'Ratna' system was introduced. Initially, nine companies were chosen by DPE to be given increased autonomy, mostly oil and communication companies due to their profitable track record (Department of Public Enterprises, Government of India, 1997).

While allowing greater autonomy was a promising step, the executives in public sector also faced consequences arising from their decisions before several authorities which impacted risk taking ability of executives (Disinvestment Commission, 1997a) and (Ministry of Finance, Government of India, 2017). Adopting a futuristic outlook, the DC recommended setting up an independent specialised *pre-investigation board* to evaluate the decisions taken by the executives and the possibility of malfeasance (Disinvestment Commission, 1997a).[44] The objective was to create an internal review process before being subject to investigation by external agencies like CBI or Central Vigillance Commission (CVC). However, the recommendation was not implemented.

Over the years bureaucrats have favoured status quo due to apprehension of facing investigation by multiple authorities (Sahu, 2019). These were referred to as 4 C's (CAG, CVC, CBI and courts) (Ministry of Finance, Government of India, 2017). In events like disinvestment, the problem could grow more complex if disputes linger on for years. For instance, in case of Hindustan Zinc, while disinvestment was completed in 2002, the legal dispute is pending before the Supreme Court (Press Trust of India, 2020b).

[44]The pre-investigation board would have included retired top executives from the financial sector, former heads of leading PSUs and professionals with relevant business experience.

**Box 4 Ratna system**

In July 1997, nine companies were selected — BHEL, BPCL, HPCL, IOC, IPCL, NTPC, ONGC, SAIL and VSNL (Department of Public Enterprises, Government of India, 1997). These firms were provided increased autonomy in the following respects:

- Incur capital expenditures without any ceiling,
- Enter joint ventures,
- Obtain technology and know how without prior approval from the administrative ministry,
- Raise debt from domestic and international capital markets,
- Restructure schemes relating to voluntary retirement, compulsory retirement, personnel management and training.
- Create posts like non-board level directors, where the directors can have pay scale similar to board members but not part of the board (Department of Public Enterprises, Government of India, 1997).

While the board and the administrative ministry were required to monitor these firms on a quarterly basis, at the apex level, a Committee of Secretaries was constituted headed by the Cabinet Secretary, to supervise their performance.

In October 1997, *Miniratna* scheme was created which consisted of two categories. Category I included those firms which made profits in the last immediate three years continuously, with profit of at least INR 30 crore or more in all or at least one year and a positive net-worth. Category II included firms which have had profits in the last continuous three years and positive net-worth. Also, these firms were needed to be free from budgetary support and government guarantees to qualify under the scheme.

## 1.6 Summarising Phase 1

Economic stress ushered several reforms in India and disinvestment was one of them. Although there was no 'policy document' on disinvestment, it evolved through union budget speeches. The initial phase was marked with gradual reduction in government holding through sale of minority shares and no privatisation. For the major portion of this phase (from 1991-1996) shares were sold using the 'auction route' and prices of shares were fixed by the Core Group based on the advise of merchant bankers. Between 1996 and 1999 few GDR issues in telecom firms and cross holding in oil majors were undertaken. It was only post August 1996, that the expertise of the DC was available to the government, which

gave lot of impetus to strategic deals. However, by then political instability had set in which possibly affected the decisions. In sum, within a duration of eight years, an average 8.87% shares were diluted in 39 CPSEs with no *transfer of control* to private parties. This was different from countries in the west who adopted whole sale privatisation. For instance, in U.K. within the first 10 years of its privatisation program from 1977 to 1987, 22 major public firms were privatised (Rhodes et al., 2014).

Although it was the government's first attempt to use disinvestment to address the problems of public sector firms, one of the main aims was to raise resources by selling shares. Despite recommendations from expert committees like *Rangarajan* committee and DC to de-link disinvestment program and budgetary targets, this correlation gained momentum. Despite several efforts, the target amount could not be achieved due to poor market conditions. Total budgetary target set for this duration was INR 34,300 crore, but less than half of it (INR 16,809 crore) was realised. Possibly due to widening fiscal deficit and growing losses in public firms, government yielded to short term measures like diluting minority shares of profit making companies and disinvestment of oil companies through cross holding.

Also, India had just begun moving away from years of state driven capitalism, therefore, any sudden measure like *privatisation* could have had negative political consequences. As pointed out by the DC, that success of Indian disinvestment program hinged on political will and consensus. Further, public suffered from misconceptions about disinvestment which needed to be dispelled to build credibility of the disinvestment program. However, it is not clear whether government took measures to address the problem of *perception* and ensure wider public participation.

On one hand the phase did not see any privatisation, on the other, investment in public firms soared. Interestingly, this was against the intention of the government to reduce budgetary support which was one of the main concerns of the public sector. Towards the end of FY 1999, investment in CPSE stood at INR 2,39,167 crore against INR 99,315 crore as on March 31, 1990. Steps were taken to strengthen the operational autonomy and efficiency of CPSEs – several MoUs were signed between the government and the firms since 1991 (see, Table 27, Table 28 and Table 29). Government's position was that firms governed by the MoUs registered higher gross margin compared to previous years.[45] However, this rating was questioned for setting *deliberate* low targets by administrative ministries and firms to obtain better ratings in annual audits (Disinvestment Commission, 1997a). One issue that remained to be tackled was the liberalisation of the financial sector in order to provide further capital to the public sector enterprises (Gouri, 1996).

Constitution of the DC was a milestone in this phase which reflected government's intention to promote disinvestment. While the commission had only recommendatory

[45]In 1997-98, collectively the MoU signing firms earned a gross margin of INR 55,779 crore compared to gross margin of INR 39559 crore in the previous year — 41% growth.

powers unlike a body like *Treuhandanstalt* in Germany which implemented privatisation, DC institutionalised disinvestment process in India to some extent from 1996 to 1999 (Ganesh, 2001).[46] For the first time a systematic procedure was followed where firms selected for disinvestment were referred to a separate body like DC which provided detailed recommendations based on economic rationale.

However, once recommendations were given, it was the prerogative of the government to implement them. Decisions taken by the government were not limited to economic reasoning and got influenced by political will (Jain, 2017). Several delays and misses were witnessed at the implementation stage. Although the government was advised from time to time to set up a full time implementing machinery to expedite the process of disinvestment, no decision was taken. There were several reasons for the delay. As discussed, one of the reasons could be political instability and coalition governments which consisted of too many stakeholders to arrive at a consensus. Agency problem like resistance from administrative ministries and concerned departments also contributed to the delay.

Although the DC was under the purview of the government, it did not refrain from highlighting problems like, slow progress on decisions and government's ad-hoc steps misaligned with the long term disinvestment strategy. Possibly such observations had consequences and ultimately lead to the dilution of its powers in January 1998. The commission's term expired in November 1999.

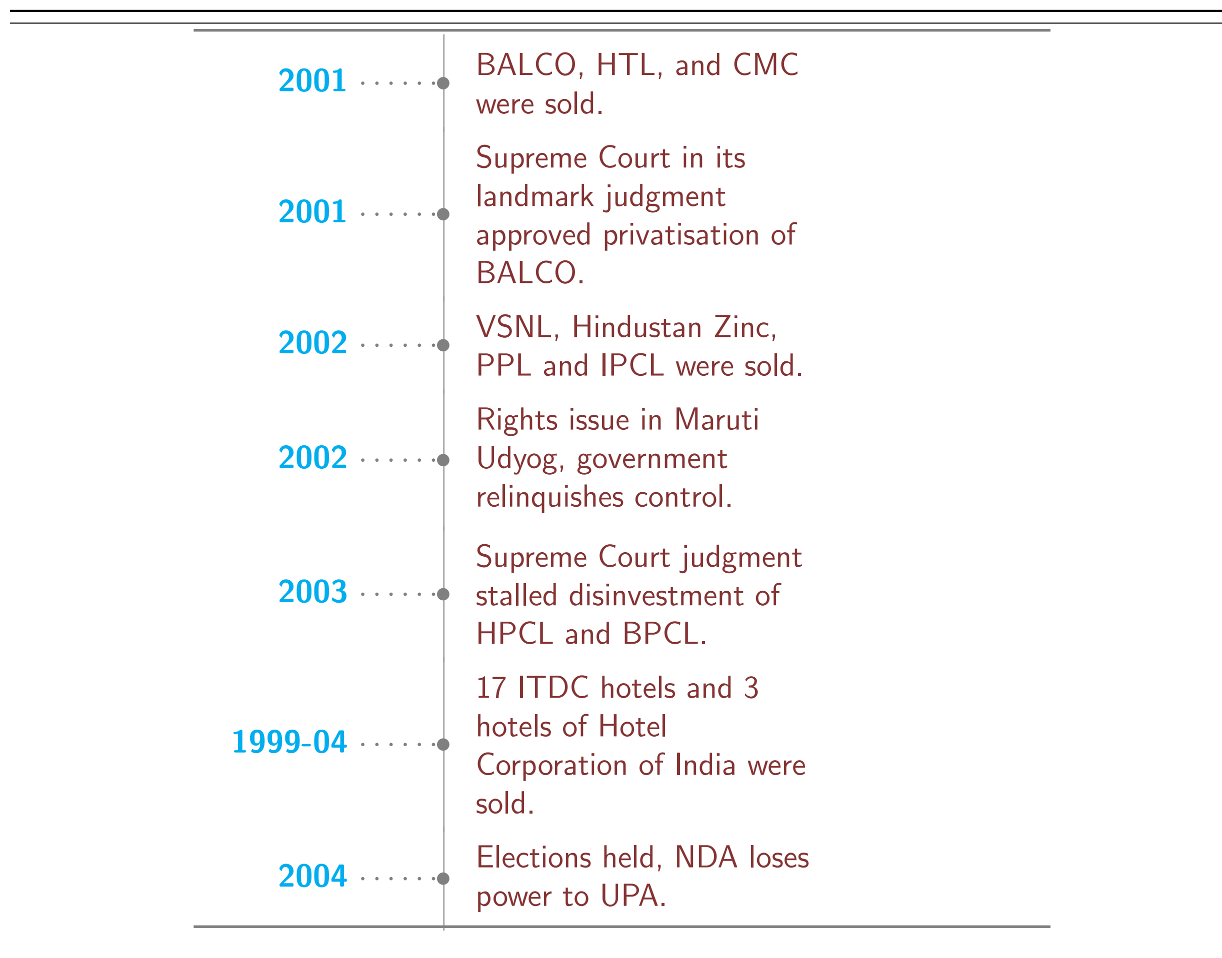
A table summarising the key events in Phase 1 of disinvestment is provided as Table 2. Some summary statistics regarding disinvestment in Phase 1 is provided in the Annexure.

[46] *Treuhandanstalt* or Treuhand was a public agency established in 1990. It consisted of federal government, state government, commercial banks, major West German firms, trade unions, and two non German European businessmen. Ownership of all state owned enterprises was transferred to Treuhand. Within a gap of four years, it sold over 8,000 enterprises, see, (Carlin and Mayer, 1994).

# 2 Phase II

**Table 9** Timeline of events in Phase 2

| Year | Event |
|---|---|
| 1999 | NDA formed the government. |
| 1999 | Department of Disinvestment was set up. |
| 2000 | Budget specified strategic sale as disinvestment policy for the first time. |
| 2000 | First strategic sale conducted i.e. Modern Food Industries Ltd.. |
| 2001 | Department of Disinvestment given the status of Ministry. |
| 2001 | Disinvestment Commission was revived. |
| 2001 | Government issued a policy document 'Disinvestment: Policy and Procedures'. |




## 2.1 Overview

Similar to the first phase, the second phase began with its own set of economic challenges. The East Asia Economic crisis in 1998 affected demand for Indian exports and services. The geopolitical conditions in the sub-continent were unstable and India's nuclear tests in 1998 lead to trade sanctions from countries like the U.S. and Japan. In the middle of 1999, war broke out with Pakistan in Kashmir. The fiscal deficit stood at 5.9 % of the Gross Domestic Product (GDP) and the economy was facing both lower food and industrial production (Government of India, 1999). Within a few months of the Kargil war, general elections were held between September - October, 1999 and NDA won the election.

While the Congress party manifesto explicitly declared that it would implement the recommendations of the DC on strategic sales without any delay, the newly elected NDA government's election manifesto was silent on issues like disinvestment or privatisation (National Democratic Alliance, 1999). However the NDA government in its previous stint, had stated in the budget speech of FY 1999-2000 that it planned to privatise non-strategic

firms either through gradual disinvestment or strategic disinvestment. For the first time, the government announced its intention to 'privatise' public firms (Government of India, 1999).

## 2.2 Policy of NDA government towards disinvestment

In this section, we discuss the major policy decisions of the government, like setting up a separate department for disinvestment activities, revival of the Disinvestment Commission, and creation of the first policy procedure document for carrying out disinvestment, with special focus on strategic disinvestment. However, similar to the previous phase, the practice of setting disinvestment targets as part of the budgetary exercise continued. Also like Phase 1, cross holding transactions in the oil sector and one CPSE buying shares of another CPSE took place.

### Setting up Department of Disinvestment

As a first major step, in December 1999, the government set up a separate department — Department of Disinvestment (DOD) under the MoF whose mandate was to deal with disinvestment of CPSEs. For this, the DOD was vested with the power to decide on the recommendations of the DC and take all steps like appointment of advisers and pricing of shares, for implementing the decisions. Since 1991 DPE was the nodal body to handle disinvestment activities and from April 1999 till the formation of DOD, DEA managed the affairs. For the first time a full department was dedicated for the work of disinvestment. A few years later, in the budget speech of FY 2001-02, the Finance Minister announced that DOD was set up to streamline and speed up the privatisation process. It was clarified that (Government of India, 2001):

> *"...To maximise returns to government, our approach has shifted from the disinvestment of small lots of shares to strategic sales of blocks of shares to strategic investors. The Government has already approved privatization of 27 companies in which the process of disinvestment is expected to be completed during the course of the year. These companies include among others VSNL, Air India, and Maruti Udyog Limited..."*

Further, in the Budget Speech of 2000-01, the government expressed its intention to bring down its share holding in non-strategic areas even *below* 26%, if needed. It also sought to revive potentially viable firms, close down non-viable firms and focus on strategic deals of identified firms. Given this major policy departure from the previous approaches, the creation of a separate department, like DOD was expected to convey clear signals to

the domestic and international community about the government's commitment towards privatisation both in policy and action.

The DOD coordinated the whole process of disinvestment and presented each proposal to the Cabinet Committee on Disinvestment (CCD), the highest decision making body in disinvestment (See, Box 5). In 2001, the DOD was given the status of Ministry of Disinvestment, but later in 2004 when the United Progressive Alliance (UPA) government came to power, it was converted back into a department under the MoF.

### Revival of Disinvestment Commission

In November 1999, the DC had ceased to exist. By then it had submitted recommendations on total 58 CPSEs, but no final decision had been taken for most companies.

In July 2001, a new Disinvestment Commission was constituted under the chairmanship of Dr. R.H.Patil. The commission had new members but with the same terms of reference as the previous commission. Since the government had decided to refer all non-strategic firms to the DC except the oil majors i.e., ONGC, IOCL and GAIL, the government had to prioritise firms to be taken up first. The decision was made to select those firms which could fetch maximum revenue to the government with minimum impediments and where bleeding of government resources had to be stopped immediately (Department of Disinvestment, Ministry of Finance, 2003). Compared to the approach of the previous commission, the newly constituted commission did not venture into the appraisal of the disinvestment program but confined itself to specific recommendations on the identified firms. The commission gave recommendations on a total of 39 firms. It recommended immediate outright or phased strategic sale in 17 firms.

All CPSEs in non-strategic sectors were subject to review by the new DC including the ones already reviewed by the earlier Commission.[47] Depending on the nature of the firm, the Commission suggested different approaches of disinvestment. For instance, in the case of Central Warehousing Corporation (CWC), it first recommended repeal of the Warehousing Corporations Act, 1962 followed by setting up multiple companies to take over lines of business of CWC and State Warehousing Corporations, for finally acquiring the government shareholding through competitive bidding. Another example was in the case of Indian Vaccines Corporation Limited (IVCOL), where government had selected IPCL, a public sector petroleum refinery, as the promoter of IVCOL to leverage its project management experience.[48] The DC recommended the government to disinvest its stake in favour of IPCL under a right of first offer.[49] In 2002, Reliance Industries acquired

[47] While DC had the mandate to review all firms, only four firms were selected for fresh review by them.

[48] The government had signed a joint venture with PMSV, a French company, to manufacture vaccines in India.

[49] Only when IPCL rejects the offer, the government would sell its stake of 40.1% to a private bidder.

IPCL, and presently it holds one-third stake in IVCOL.[50] Further, in case of Numaligarh Refineries Ltd., the recommendation was not to privatise to avoid any political disturbance to the Assam Accord (Disinvestment Commission, 2004).

### Policy procedures on disinvestment

Another important development was in July 2001, when the government issued a policy document 'Disinvestment: Policy and Procedures'. This was a compendium of policy statements of past budget speeches and other policy announcements. It spelt out guidelines on eligibility of bidders, valuation and advisors. While the disinvestment program was initiated in 1991, India lacked a 'documented framework or manual' on how to carry out disinvestment. The announcements in budget speeches mostly constituted the disinvestment policy.

As several privatisation deals were carried out in the second phase, the government faced allegations like lack of due process and transparency. Even the policy document faced criticism and the Standing Committee on Finance recommended the government to frame a better policy (Standing Committee on Finance, 2002).[51] In February 2003, the DOD issued a revised *Disinvestment Manual* which laid down a detailed process and steps followed in every disinvestment transaction, (See, Box 6 and Box 5) (Department of Disinvestment, Ministry of Finance, 2003). Faced with stiff opposition and multiple litigation in phase II, the government used this document as an opportunity to offer its justification for why privatisation was needed and what it had done to privatise.

**Box 5 Steps for strategic disinvestment/privatisation**

- Step 1: DC recommendations handed over to the administrative ministry for comments. It coordinates between the CPSE and DOD.
- Step 2: Recommendations and comments placed before the Core Group of Secretaries on Disinvestment (CGD).
- Step 3: Disinvestment proposals placed before the CCD
- Step 4: Once CCD clears the proposal, Global Advisor (GA) is appointed through competitive bidding process.[a]
- Step 5: Appointment of legal advisor and asset valuers.
- Step 6: Advertisement issued for inviting Expression of Interest (EOI) from bidders.

[50] Source: CMIE Pace.

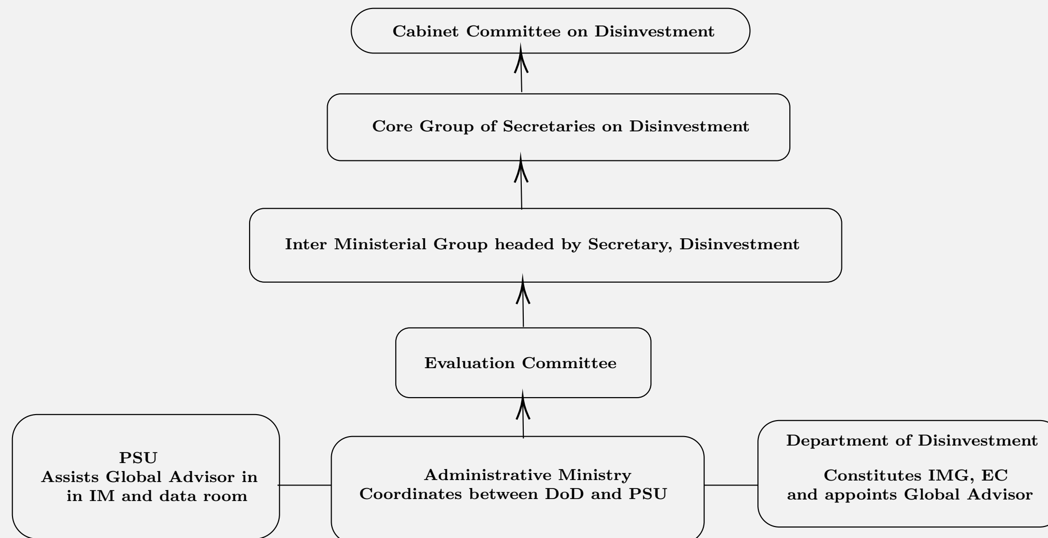
[51] In opinion of the Standing Committee, disqualification criteria for a buyer/bidder was weak and the government had failed to value land separately in determining the reserve price.

- Step 7: Prospective bidders are short listed based on the receipt of EOI.
- Step 8: Advisers conduct due diligence of the PSU and prepares IM. IM is handed over to bidders after confidentiality agreement is executed.
- Step 9: Drafting of share purchase and share holders agreements.
- Step 10: Prospective bidders undertake due-diligence of the PSU.
- Step 11: Valuation of shares done by GA and of assets by asset valuer independently. Both valuation are handed over to the Evaluation Committee (EC).
- Step 12: Share purchase agreements and shareholders agreement may be modified based on the response from the prospective bidders. Then the agreements are vetted by the Ministry of Law (MOL) before they are approved by the government.
- Step 13: Final agreements sent to the prospective bidders for inviting final bids.
- Step 14: Recommendations sought from the Inter Ministerial Group (IMG) which is placed before the CGD.
- Step 15: CGD's recommendations placed before the CCD for final decision on the selection of strategic buyer and execution of agreements (Standing Committee on Finance, 2002).

The Ministry of Disinvestment (MOD) is involved in the above process at every step.

[a] GA is responsible for overall disinvestment activities, like preparing Information Memorandum (IM), inviting bids, negotiation with bidders.

**Box 6 Hierarchy of decision making**




- CCD takes the final decision and is headed by the Prime Minister. It is also represented by different Ministers including the administrative ministry of the firm to be divested (Comptroller and Auditor General of India, 2006).
- CGD is headed by the Cabinet Secretary and includes Secretaries of select ministries, administrative ministry and Planning Commission.
- IMG is headed by Secretary, DOD, DPE, administrative ministry/department and the head of the concerned PSU to be disinvested.
- EC consists of Additional Secretary, Joint Secretary and Financial Advisor of the administrative ministry and Joint Secretaries of select ministries.

Although most of the privatisation deals of Phase II were over between 1999-2003 before the revised document was released, it was expected to give clarity to the policy makers both at the central and state level for future disinvestment. Some of the primary objectives set out in the new document were to release scarce public resources locked up in non-strategic sectors so it can be used in high priority sectors; unlock taxpayers money in the public sector by transferring the commercial risk to the private sector; unlock workforce in managing PSUs to utilise them in social sectors; and curb further investment in non-viable firms.

## Budgets and targets

While the government's disinvestment policy saw a major shift in this phase, similar to Phase 1, disinvestment targets continued to be part of the budgetary exercise. While the government's preferred method of disinvestment was strategic sale which fetched INR

**Table 10** Realisation from privatisation deals during Phase-II

| Name of company | Year | Amount realised (INR crores) | Method of sale |
|---|---|---|---|
| Modern Food Industries Ltd. | 1999-00 | 105.45 | Strategic sale to private entity |
| | 2002-03 | 44.07 | Strategic sale to private entity |
| Bharat Aluminium Co. Ltd. | 2000-01 | 551.5 | Strategic sale to private entity |
| Hindustan Teleprinters Ltd. | 2001-02 | 55 | Strategic sale to private entity |
| Videsh Sanchar Nigam Ltd. | 1999-00 | 75 | Public offer |
| | 2001-02 | 25.19 | Sale to employees |
| | 2001-02 | 1439.25 | Strategic sale to private entity |
| Paradeep Phosphates Ltd. | 2001-02 | 151.7 | Strategic sale to private entity |
| Hindustan Zinc Ltd. | 2002-03 | 6.19 | Sale to employees |
| | 2002-03 | 445 | Strategic sale to private entity |
| | 2003-04 | 323.88 | Strategic sale to private entity |
| India Petrochem. Corp. Ltd. | 2002-03 | 1490.84 | Strategic sale to private entity |
| | 2003-04 | 1202.85 | Public offer |
| CMC Ltd. | 2001-02 | 152 | Strategic sale to private entity |
| | 2002-03 | 6.07 | Sale to employees |
| | 2003-04 | 190.44 | Public offer |
| Lagan Engineering Co. Ltd. | 2000-01 | 2.53 | Strategic sale to private entity |
| Maruti Udyog Ltd. | 2003-04 | 993.34 | Public offer |
| **Total** | | **24,619** | |

Source: Dataset on disinvestments created by the authors.

4,761.22 crore, it could not meet the budget target (See, Table 10 and Table 11).[52] Total target between 1999-2004 was set at INR 58,500 crore, but even through the route of strategic sale the government could realise only INR 24,619.65 crore.

**Table 11** Target versus realisation: Phase II

| Year | Budget target (INR crore) | Amount realised (INR crore) |
|---|---|---|
| 1999-2000 | 10,000 | 1585 |
| 2000-01 | 10,000 | 1871 |
| 2001-02 | 12,000 | 3268 |
| 2002-03 | 12,000 | 2348 |
| 2003-04 | 14,500 | 15,547 |
| **Total** | **58,500** | **24,619** |

Source: Dataset on disinvestments created by the authors. Targets taken from the Union Budget Speeches.

[52]Figure based on dataset created by authors based on annual reports of the companies. It excludes CPSE-to-CPSE sales and sale of hotel properties.

## 2.3 Revisiting strategic sales

Phase 2 of disinvestment in India has so far been the only period where transfer of managerial control of CPSEs to private entities took place. While there were total 16 strategic deals which included CPSE to CPSE sale and slump sale of several hotel units, our focus is on those ten deals where ownership was transferred to a private player through share transfer.[53] In this section, we discuss the process and terms of sale – whether they shared any common feature, valuation methods used to determine the pricing, and finally, the controversies and challenges that arose in the execution of these sales. Some of these controversies can serve as lessons for future privatisation decisions. Further, details of the individual deals have been covered in the Annexure.

### 2.3.1 Process and terms of sale

For all the privatisation deals, the government adopted the auction route, except in the case of *MUL*, where government exited a public sector firm through issue of right shares and use of public offer route (see, Box 7). The typical process of the strategic sale deals included: determination of reserve price, inviting EOIs, inviting bids from selected bidders, and selection of final buyer based on the highest bid criteria. Once the buyer was finalised, negotiations were held on the terms of Shareholders' Agreement (SHA) and Share Purchase Agreement (SPA). Both these principal documents governed the relationship between the buyer and the government. These agreements were executed between the President of India through the secretary of the concerned administrative ministry, buyer and the CPSE. Box 5 lays down the detailed process followed in the strategic deals.

**Box 7 Case of Maruti**

In 1981, MUL was created after nationalisation of the existing companies Maruti Ltd. and Maruti Technical Services Ltd., promoted by Mr. Sanjay Gandhi. Given the need for technical collaboration with foreign car manufacturers, the government signed a Joint Venture Agreement (JVA) with Suzuki in 1982. In terms of the agreement, Suzuki held 26% shares with an option to acquire another 40% (Mukherjee, 2014). Pursuant to the JVA, in 1987 Suzuki acquired 40% stake in MUL and another 10% in 1992 which permitted Suzuki to gain 50% ownership. In 2000, when the NDA government announced its plan to privatise firms through strategic sale, the JVA with Suzuki provided the following clause which restricted auction of government shareholding in Maruti (Baijal,

[53] In addition to the 10 deals, 17 hotel properties of Indian Tourism Development Corporation (ITDC) and 3 hotel properties of Hotel Corporation of India (HCI) were sold to private players.

2008):

> *Restriction on Transfer of Shares: No shares held by the Government may be transferred by the government to any party unless the written consent of Suzuki has been obtained prior to the consummation of such transfer.*

As a result of this contractual requirement, dilution of government shareholding in Maruti was possible only through negotiation route. The government did not call for bids, like in the case of other public sector firms. Later in 2002, a right issue was held which transferred control and MUL became a subsidiary company of Suzuki Motors Co. Ltd. of Japan. Eventually, the government exited the firm through the route of public offer.

Although each deal was different depending on factors like the sector in which the firm operated, market conditions, level of competition, financial health of the firm and extent of shares government agreed to sell, most of the deals exhibited certain standard terms. These terms were part of the SHA. Some of these terms were conceptualised to address the concerns raised with privatisation like loss of jobs, asset stripping, etc. For instance, since privation was perceived as an immediate cause of job loss, all the agreements provided the following clause:

> *Clause 7(e) says that the strategic buyer shall not retrench any part of the labour force of the company for a period of one year from the closing date of the transaction.*

No retrenchment was allowed unless severance benefits was higher of either the VRS scheme of government or benefits applicable under the law.

Further, there was a prohibition on asset stripping for a period of three years and after three years selling any asset beyond 20% of total assets required affirmative vote of the government. These protections were incorporated to protect interest of all stakeholders for a peaceful transition (Lok Sabha, 2001b).

To protect the interest of both the parties, there was 'post closure adjustment obligation' in case of unlisted firms where if there was depletion in the net worth of the CPSE between the last audited financial statements and the final date of purchase of shares, either party was supposed to compensate the other. But such obligation was not there in case of listed firms, where buyers were expected to know of the financial conditions of the CPSE from the stock price available in the public domain. However, this clause later resulted in several disputes and controversies (See, section 2.3.2).

Further, all the deals provided an exit strategy for the government through exercise of call and put options. This was possibly done to make the deals attractive to prospective

bidders since they preferred government's exit after transfer of management control. Under the call option the buyer had a right to buy certain amount of shares from the government at a specified rate on or before a specified date. Whereas put option vested right with the government to sell certain amount of shares at a specified rate on or before the specified date. Over the years, these exit options were exercised by either parties resulting in further dilution of government shares and even complete exit from few firms, like MFIL and Maruti.

**Methods of valuation**

Four methodologies — DCF, comparable companies, balance sheet valuation and asset valuation – were used to fix the reserve price (See, Box 8). Reserve price is the minimum or floor price below which bids cannot be accepted.[54] While GA used the first three methods independently, the asset valuer determined the value of the fixed assets using asset valuation method (Comptroller and Auditor General of India, 2006). A hypothetical liquidation situation was considered to make certain adjustments like, VRS and capital gains tax to the value arrived under the DCF method. Both the valuation reports were placed before the EC for listed and unlisted CPSEs to determine the business value and in majority of the deals EC had recommended the DCF method. Once the business value was finalised, GA added the value of non-core or surplus assets of the firm to fix the reserve price (Comptroller and Auditor General of India, 2006).[55] For listed firms, market value of shares in the last six months was also used as an indicator to determine the reserve price. There were three listed firms: Computer Management Corporation (CMC), VSNL and IPCL.

**Box 8 Methods used for valuation**

1. *Discounted cash flow method*: This is used to assess how much a going concern business is likely to earn in the future. Future cash flows are converted into net present value using a discounting factor based on cost of debt, equity and debt equity ratio. The higher the discounting rate, the lower is the firm value.

2. *Comparable companies method*: Relevant sample of comparables is created to derive average multiples for determining the value. Due to poor availability of correct comparables, this method is used along with the DCF method, but it helps in discovery of the correct market view.

[54] Evaluation Committee fixed the reserve price and was kept confidential. No advisors were privy to the reserve price.

[55] Expert valuers determined classification of assets into core and non-core categories. Non-core assets are usually those assets which do not generate cash for the firm.

3. *Balance asset valuation method*: Under this approach, the value of the firm is represented by the value of assets appearing in the balance sheet. Due to depreciated value of assets and lack of mark to market accounting in the public firms, this method may not reflect correct valuation of the firm.

4. *Asset valuation method*: A hypothetical liquidation scenario is contemplated to calculate the amount that can be realised by selling off all assets and paying off all liabilities. For this purpose, capital gains tax and VRS liability are also considered. This method helps to capture value of all those assets of the public firms which are either under utilised or non-utilised (Comptroller and Auditor General of India, 2006).

To illustrate, in the case of BALCO, four methodologies were used to determine range of valuation for 100% equity including asset valuation methodology. Once range of value was fixed, it was applied to value 51% equity which was to be transferred.[56] Since BALCO was a going concern, EC adopted DCF method as the appropriate methodology. A reserve price of INR 514 crore which included a premium fee for transfer of management control was fixed.[57] Similarly, DCF method was used to fix the reserve price in other deals. However, in the case of Paradeep Phosphates Limited (PPL) asset valuation method was used instead to fix the reserve price. While reserve price was fixed in all the deals, MFIL was the only deal where no reserve price was fixed, and a range of values was arrived using four different methodologies.[58]

### 2.3.2 Sale related controversies

Given privatisation was a major shift from the previous policy of disinvestment through sale of minority stake, controversies arose both prior to and post disinvestment. As a result, most of the deals were punctuated by political opposition and multiple litigation. For instance, by the end of calendar year 2002, around 40 cases were filed against the government in several courts across the country challenging the privatisation deals, out of which 21 cases got dismissed, and 7 cases out of remaining 19 cases got transferred to the Supreme Court (Department of Disinvestment, Ministry of Finance, 2003). Further in 2006, when the CAG audited the privatisation deals and raised several objections, it continued the controversies even after the end of Phase 2. In this section, we discuss some

[56]Four methods were DCF method, comparables method, balance sheet method and asset valuation method.

[57]Although the advisor viewed premium to be between 10-15%, Evaluation Committee recommended a premium fee of 25%. on the base value of equity.

[58]CAG audit report (2006) noted that the government did not provide any reason for not fixing the reserve price.

of the common controversies and challenges which government had to face in carrying out the strategic deals. Based on the experience of these challenges, the incumbent government has brought in changes to the procedure of strategic sale (See, Phase 4).

**Pre-disinvestment controversies**

Even before the strategic sales were concluded, there were questions and criticism that created news and uproar. In some of the companies selected for sale, the government needed to undertake restructuring prior to disinvestment due to financial stress.[59] For instance, prior to disinvestment, BALCO went through restructuring. Since it had a bloated capital structure, its unutilised free reserves was used to reduce the capital which raised INR 244 crore for the government. As government held the entire shares, there was no change in its shareholding post restructuring (Department of Disinvestment, Ministry of Finance, 2007).[60] While it made BALCO more attractive to buyers, it posed questions on government's decision to spend resources prior to raising resources. Another bone of contention was deviation from the recommendation of DC since it had recommended dilution of 40% stake, but the government sold 51% shares. On this issue, the government argued that the chairman of the DC, G.V.Ramakrishna in a letter dated June 12, 1998 advised to transfer management control because aluminium prices were tumbling and 40% may not have attracted buyer.[61]

Further, the decision to sell BALCO met strong resistance. On March 03, 2001 the opposition moved a motion in the Lok Sabha to disapprove the disinvestment of BALCO. Since the allegation was that government was planning to sell a profit making CPSE to a private entity at a throwaway price, the opposition demanded a Joint Parliamentary Committee (JPC) probe (see, Box 15).[62] Fierce parliamentary debate continued for seven hours and at the end the motion was put to vote and defeated.[63]

A debate arose over possible creation of private monopoly during the disinvestment of HZL when government decided to allow Binani Zinc, the only big private player in the concerned market, to participate in the bid.[64] Another contention was that despite

[59] In case of PPL, preference shares and loan were converted into equity shares. But the restructuring took place at a very advanced stage of the deal 10 months after calling of the EOIs and only 23 days before inviting the financial bids. In the opinion of the CAG a timely restructuring would have had made the disinvestment more successful.

[60] BALCO's paid up capital of INR 488.85 crore was reduced to INR 244.42 crore.

[61] Arun Shourie, Minister of Disinvestment, referred to the letter dated June 12, 1998 during the debate on the motion to disapprove disinvestment of BALCO. The said letter was also referred in the Supreme Court's judgment in the matter of *Balco Employees Union V. Union of India.*

[62] Government defended the decision to privatise and clarified that it only implemented the recommendations of the DC which was set up by the United Front government.

[63] Debate on the motion started at 13.53 hrs and ended late evening at 20.42 hrs. 119 votes were cast for the motion and 239 votes against the motion.

[64] HZL was a dominant player in mining and smelting segment, whereas Binani Zinc was the only smelting company in the private sector.

commission's recommendation to not to transfer ownership, the government decided to privatise HZL. However, the situation had changed since 1997 when the recommendations were made. Events like finalisation of the Competition Bill which aimed to prevent abuse of monopoly and not dominance per se along with government's announcement of strategic disinvestment in the budget of FY 2000-01 indicated a shift in the policy (Baijal, 2008).

The apprehension of private monopoly resurfaced in the IPCL sale because Reliance and IPCL were the dominant players in the market of polymers. Although the debate of monopoly was resolved at the time of disinvestment of HZL, the commission gave certain conditions to address the concern of monopoly (Baijal, 2008). For instance, the commission recommended conditions like transfer of 25% equity along with management control and the requirement of prior government consent in case the strategic buyer exited from the company in the future. Government's decision to disinvest a profit making company coupled with the apprehension of private monopoly in the market invited opposition. Further in May 2002, the Standing Committee on '*Disinvestment in Petroleum and Petrochemicals Sector*' recommended government not to sell IPCL since it was a profit making Navratna company and the deal would have severely affected competition in the petrochemicals sector (Standing Committee on Petroleum and Chemicals, Lok Sabha, 2002).

In the case of VSNL, its monopoly status was seen as a violation of General Agreement on Trade of Services (GATS) which stipulated that internet providers and long distance telephony should not be under the control of state-run monopolies. The National Telecom Policy, 1994 also provided for role of market in the telecom sector. Hence there were concerns that VSNL's monopoly status would violate the law and also hinder the competitive growth in the telecom sector. To address these concerns, before the disinvestment of VSNL had commenced, the Cabinet Committee on Economic Affairs in September 2000 decided to revoke the monopoly status of VSNL by 2004. The buyer of the company thus knew that VSNL's monopoly status had a sunset clause.

Several controversies arose in the Maruti deal before it was privatised. Pursuant to the JVA between government and the Suzuki Co. of Japan, in 1987 Suzuki acquired 40% stake in MUL and another 10% in 1992 which permitted Suzuki to gain 50% ownership. Suzuki paid a premium of INR 269 per share but it did not pay any control premium. A dispute arose as the government expected payment for dilution of its stake and parting control over a public firm with a foreign entity. Again in 1998, when the NDA government announced its intention to exit MUL, it triggered labour unrest and minor strikes (Becker-Ritterspach, 2009).

**Valuation debate**

In 1993, the *Rangarajan Committee*, which was India's first committee on disinvestment, cautioned that although valuation is determined by buyer's perception, it invited *universal criticism* where disinvestment has taken place. (Reserve Bank of India, 1993) As

predicted, valuation remained one of the most controversial aspects of privatisation and the government faced allegations for underpricing and causing losses to the ex-chequer.

In the case of BALCO, the opposition argued that the government made a grave error by not valuing each asset which caused huge loss to the ex-chequer. However, the government responded that four methods were used to value the deal which included the asset valuation methodology. However, since BALCO was being sold as a going concern and not liquidated, EC considered DCF as the appropriate method in line with accounting practices and global norms. The then, Minister of Law and Justice, Company Affairs and Shipping, Arun Jaitley who defended the government during the Lok Sabha debate in March 2001, made the following remarks on the allegation of under valuation (Lok Sabha, 2001b):

> *Proof of valuation is in producing a better valuer. Proof of valuation is not ill-informed suggestions. Please bring a better valuer if one exists. And the answer is, 'No, I cannot produce a better valuer but I will go ahead and only discredit...*

Later, when the sale was challenged before the Supreme Court, one of the issues was the determination of 'reserve price'. However, the court limited itself to the procedure and held that since valuation was done using a recognised methodology, followed by competitive bidding and the highest bidder was granted the deal, there was no need to venture into the question of facts. This decision came as a relief to the government since valuation remained the bone of contention in most of the deals (Supreme Court of India, 2001).

Another dispute arose when government tried to sell IPCL's Vadodara plant to IOCL. As per IPCL, the valuation of the plant was INR 1200 crore, but IOCL valued it at INR 300 crore. Since parties could not agree on the valuation, the deal fell apart (Chowdhary, 2001). Later, the government included the Vadodara plant as part of the deal before it was sold to Reliance.

Interestingly in the case of MFIL, which was the first firm to be privatised, no reserve price was fixed. Also, this was the only firm where no reserve price was fixed, but the government did not provide any clarification to this effect (Comptroller and Auditor General of India, 2006). Further, MFIL was referred to the BIFR immediately after sale which triggered apprehensions about its closure. Later the government clarified that the buyer, Hindustan Lever Limited (HLL), revalued the firm based on a new accounting procedure which lead to erosion of MFIL's net worth (Lok Sabha, 2001d).[65]

Finally, PPL was a unique case where the firm was sold at a price (INR 151.70 crore) less than the reserve price (INR 176.09 crore) which sparked controversies. To settle the

[65] MFIL did not make provisions for outstanding receivables more than five years old. This approach was immediately changed after privatisation to align with the accounting procedures of HLL.

concerns, the Minister of Disinvestment, Arun Shourie clarified before the Parliament that PPL was consistently incurring losses with huge outstanding liabilities and despite several restructuring measures taken in the past, the financial health of the firm could not be improved.[66] As a result, the CCD agreed to accept the bid price which was lower than the reserve price (Lok Sabha, 2002a).

**Legal disputes**

As some of the deals ended up in court rooms, the judiciary played a substantial role in shaping the fate of strategic sales. In the BALCO deal, the transaction was challenged on several grounds, but the Supreme Court decided not to venture into 'policy matters' like disinvestment and upheld the sale (Supreme Court of India, 2001).[67] The *first* contention was that one of the mines of BALCO was located in Korba district of Chattisgarh on a land acquired and provided by the state government to the firm. Hence, it was challenged that transaction violated the MP Land Revenue Code and was against the basis on which the land was acquired and allotted to BALCO (Lok Sabha, 2001b). *Secondly*, it was argued that since BALCO was part of the 'state' under Article 12 of the Constitution, its workers enjoyed protection under Article 14 and 16 which was lost due to disinvestment. The Supreme Court rejected both the contentions.

Regarding the allegation of violation of land use, the court found that change of management or in the shareholding did not mean transfer of land from one company to another. On the issue of workmen protection, the court held that earlier rights of protection under Article 14 and 16 of the Constitution neither prohibited government to disinvest a firm nor there was any principle of natural justice which entitled workers a right of continuous consultation at every stage of the disinvestment. Finally the court held that:

> *The decision to disinvest and the implementation thereof is purely an administrative decision relating to the economic policy of the State and challenge to the same at the instance of a busy-body cannot fall within the parameters of Public Interest Litigation.*

In the case of MUL, it was a joint venture between the government and a foreign company, Suzuki Co. Ltd. of Japan. While the foreign partner, sought greater involvement in the management of the company, it did not go down well with the government. Eventually several differences arose in the manner of business expansion culminating in a legal dispute over the appointment of the managing director by the government which was

[66]PPL was incurring a loss of INR 10-12 crore every month. Further, it had outstanding liabilities of INR 856.34 crore as on March 31, 2001 and an outstanding government of India loan of approximately INR 200 crore. PPL received thrice financial restructuring package in 1994, 2000 and 20002.

[67]Two petitions were filed before the Chattisgarh and the Delhi High Court respectively which were transferred to the Supreme Court.

allegedly done without consultation with Suzuki. For relief, Suzuki approached the Delhi High Court which approved the appointment, but also instructed government officials not to make any provocative statement against Suzuki.[68] Eventually Suzuki invoked the arbitration clause under the JVA agreement. The outcome of the arbitration process was a revised JVA where the government and Suzuki planned a roadmap for the government's exit from MUL (Mitra, 1998).

The hotel deals had also attracted the attention of the courts. The sale of Hotel Agra Ashok, an Indian Tourism Development Corporation (ITDC) hotel that had been sold to a private bidder, had reached the Supreme Court. The workers' unions argued that the disinvestment was arbitrary and illegal. They also challenged the non-implementation of VRS for the employees. In the case of *All India ITDC Workers Federation v. Union of India*[69] the court noted that the service terms for the employees had not changed after privatisation. It also observed that VRS will not be applicable to the employees since the hotel property did not have a VRS scheme even before disinvestment. Hence the court declined to interfere in the implementation of the government's policy decision.

'Post closure adjustment' proved to be a major legal issue in the sale of both of Hotel Corporation of India Limited (HCIL)'s Mumbai based hotels. In case of Centaur Juhu, a dispute arose while calculating the adjustments towards doubtful debts, leave encashment, gratuity, insurance claim and advances paid to suppliers. Although the government was a party to the dispute, the Financial Adviser, Ministry of Civil Aviation was appointed as the Arbitrator and the proceedings began in March 2006 (Department of Disinvestment, Ministry of Finance, 2007). The arbitrator ruled that the buyer was required to pay the advances. In case of Centaur Vile Parle, the buyer and the government disputed over the amount of the claim and they also went in for arbitration. A retired High Court judge was appointed as the arbitrator. He passed an award directing the buyer to pay INR 1.88 crores towards adjustment. The buyer appealed to the Bombay High Court. The High Court set aside both orders in the cases of HCIL's hotels. While the facts were specific to each case, the common reason for the High Court's orders were that the arbitrators had failed to consider material facts placed before them.[70]

**Adverse audit remarks**

Similar to Phase 1, CAG observations grabbed public attention and led to further

[68]1998 (93) CompCas 771

[69](2006) 10 SCC 66

[70]Centaur Juhu case — *Siddhivinayak Realties Pvt. Ltd. v. V Hotels Limited*, Order dated 10 May 2013 in Arbitration Petition No. 667 of 2011. Centaur Airport case — *Sahara Hospitality Ltd. v.* HCIL, Order dated 8 May 2015 in Arbitration Petition no. 810 of 2011.
Separately the state government of Maharashtra also claimed premium towards the repurposing of the hotel property of Centaur Juhu. The property was on lease from the state government and it violated a rule that a specific portion of the land must have a garden which is open to the sky, (See Annual Report of HCIL, 2012-13).

controversies. In July 2001, the CAG in their preliminary report raised objections on the first privatisation deal (sale of MFIL), on issues like appointment of global advisor, valuation of plant and machinery, land and buildings, non-valuation of intangible assets and selection of strategic partner (Lok Sabha, 2002b).[71] Although it was a preliminary report, it invited criticism. For instance, Outlook published a story '*Suspicion mould on this bread*' which speculated the possibility of review of the disinvestment process followed by the government (Kang, 2001).

In September 2002, after more than a year from the date of closure of the BALCO deal, the CAG released a preliminary report which revealed shortcomings.[72] This gave further ammunition in the hands of those who had opposed the deal. As a result, BALCO privatisation was back in news with headlines like '*Bad penny*' and '*CAG questions BALCO sell off*' (Kang, 2002) and (Press Trust of India, 2002).

Although the privatisation deals were over by 2004, fresh controversy was sparked in 2006, when the CAG released the audit report on nine strategic deals — MFIL, CMC, PPL, Indo Burma Petroleum Limited (IBP), HZL, BALCO, Hindustan Teleprinters Limited (HTL) and VSNL (Comptroller and Auditor General of India, 2006). Audit report found anomalies in the manner of privatisation on several grounds.[73] Out of several issues, 'land' remained the major bone of contention for lack of proper title deeds and registered documents and non-removal of encumbrances prior to privatisation which resulted in adverse findings. For instance, the audit examination revealed that BALCO, VSNL, PPL and IPCL did not have unencumbered titles to real estate like land and buildings in their possession which depressed the valuation of the firms. Further in the case of VSNL, IPCL and PPL, the CAG remarked that issues like unsettled contingent liabilities and taxation liabilities impacted the participation of bidders (see, Box 9).

**Box 9 Contingent liabilities**

In the case of VSNL, there was a contingent tax liability of INR 1,402.80 crore which arose because income tax department disallowed certain deductions. When the Income Tax Appellate Tribunal ruled in favour of VSNL, the department went in appeal before the High Court. Although at the time of disinvestment, the government decided to

[71] In August 2001, the government sent a detailed reply to the audit observations.

[72] The preliminary report found irregularities like undervaluation, insufficient time given to valuer to determine the price of assets, non-consideration of enhanced installed capacity in disinvestment negotiation. As per the CAG's observation, the deal was undervalued by INR 302 crore using DCF method and by INR 262 crore applying asset valuation method. Further, the asset valuer was given only 19 days, whereas at least 45 days were required.

[73] We have discussed the specific audit objections for each deal in the Annexure.

withdraw the case, there was a gap of almost one year between the date of approval of disinvestment and decision to withdraw the case. To be precise, the government approved the disinvestment of VSNL on February 01, 2001 whereas the Ministry took the decision to withdraw the appeal on December 26, 2001. Finally, the decision of government was communicated to bidders on January 31, 2002 and the financial bids were opened a day later on February 1, 2002. The CAG was of the opinion that if this issue was sorted out earlier, this could have conveyed better certainty to the market and attracted more bidders (Comptroller and Auditor General of India, 2006).

Again in the case of IPCL, there was deferred taxation liability of INR 750 crore and contingent liabilities amounting to INR 168 crore which were not resolved before inviting the EOIs.

'Post closure adjustment' claim was another issue government grappled with in several deals (like BALCO, HTL, PPL). Under the shareholders agreement either party was required to compensate the other party against any increase/decrease in the net asset value of the company between the date of due diligence and the final date of closure of deal. During the sale of HTL and PPL, the buyer raised a claim amount which was 'more' than the consideration amount.[74] Since the government refused to settle the claims, eventually it lead to legal disputes.

The CAG also criticised various aspects of the sale of HCIL's hotels. They noted that various relaxations were made by the ministry with regards to following timelines. The method of valuation of the property was at variance with valuation methods used for other deals — the CAG noted that the DCF method was not correctly used in these cases (Comptroller and Auditor General of India, 2005).

Also, there were irregularities highlighted in the engagement of intermediaries in all the audited deals, like there was a huge time gap between the appointment of GA and execution of formal contract. For instance, in BALCO, the GA was issued a letter of appointment in July 1999, but the agreement was signed in February 2001.

Finally, the CAG highlighted lack of competition in the bidding process. Out of total 75 EOIs received only 22 bidders submitted financial bids in the final round of bidding. For instance, only in the case of IPCL and IBP, more than two financial bids were submitted (See, Table 12). In the opinion of the CAG, several preparatory steps like ensuring clear titles to assets and pre-disinvestment restructuring were not taken before calling for EOI which could have made the deals attractive to the bidders (Comptroller and Auditor

[74]In HTL deal, the buyer raised a claim of INR 56.49 crore, whereas the consideration amount was INR 55 crore. During the sale of PPL, the claim was of INR 151.55 crore against the consideration amount of INR 151.70 crore.

General of India, 2006).

**Table 12** Bidding process in strategic deals

| Events | MFIL | BALCO | HTL | CMC | PPL | VSNL | IBP | IPCL | HZL |
|---|---|---|---|---|---|---|---|---|---|
| No. of EOIs received | 10 | 7 | 6 | 14 | 4 | 6 | 15 | 4 | 9 |
| No. of parties short listed | 10 | 5 | 4 | 14 | 4 | 6 | 15 | 3 | 9 |
| No. of parties conducted due diligence | 4 | 3 | 4 | 11 | 3 | 4 | 12 | 3 | 7 |
| No. of financial bids received | 1 | 2 | 2 | 2 | 1 | 2 | 7 | 3 | 2 |

Source: (Comptroller and Auditor General of India, 2006)

**Labour unrest**

Disinvestment is generally perceived as a threat to job security. Even the Disinvestment Commission back in 1997 had flagged this concern as one of the common misconceptions associated with disinvestment (Disinvestment Commission, 1997c). As a result, privatisation created uncertainty among the workmen and staff who were apprehensive about their employment prospects in the newly privatised company. However during Phase 2, there were no layoffs but existing employees were offered VRS packages. Typically, the government imposed a restriction on retrenchment in the shareholders agreement for the first year post sale unless certain conditions were met.[75] On the contrary, in some of the deals, the shareholders agreement imposed an obligation on the buyer to implement the pending 'wage revision' after sale of shares. For instance, within one month of privatisation of PPL, the wage was revised with arrears of past 5 years (Lok Sabha, 2002a).

In MFIL's case, a debate arose when a newspaper article published that employees in the Delhi factory were forced to accept VRS. However, the government clarified in response to a Lok Sabha question that MFIL introduced a VRS package in June 2000 after signing a memorandum of understanding with the employees union, which was more generous than the VRS offered by the government. Further, the wages were increased which was not possible without privatisation (Lok Sabha, 2001e).

However, the biggest labour unrest was witnessed in the case of BALCO, when 7000 workers at the Korba plant in Chattisgarh went on a strike. Protest was spearheaded by BALCO's workers unions under the banner of BALCO *Bachao Andolan* with repre-

[75]Severance benefits had to be higher of either the VRS scheme of government or benefits applicable under the law.

sentatives from several labour unions including All India Trade Union Congress (Mishra, 2001). The political battle grew intense as Chattisgarh was a Congress ruled state and the then Chief Minister Ajit Jogi threatened to cancel the mining and land lease granted to BALCO (Gangopadhya, 2001). The strike lasted for 67 days and ended on May 9, 2001, when the new management promised a back pay of two months and assurance of no lay offs (BBC, 2001). As a result of the strike, BALCO had to incur a loss estimated around INR 200 crore and later during an interview with India Today, the chairman of Sterlite Industries (Strategic purchaser), Anil Agarwal, admitted (Mishra, 2001):

> *It was the biggest challenge of my life. It's like buying a second-hand car. Sometimes you have to spend money on unexpected repair of such cars.*

BALCO turned out to be a test case to measure response of CPSE employees towards future privatisation deals. While the apprehension of job loss followed by unrest and wide protests almost hijacked the deal, no retrenchment took place. One could argue it was the outcome of the protest, however, new management introduced a VRS scheme between July-August, 2001. Total 981 applications were received and 956 of them were accepted (DIPAM, Ministry of Finance, 2016). Despite losses due to strike, an ex-gratia payment of INR 5000 was made to each employee. In October 2001, a long term wage agreement for five years was entered with the employees (DIPAM, Ministry of Finance, 2016).[76]

Unlike the BALCO case, HZL did not see the kind of protests that were seen in BALCO's case, although the buyer was the same (Sterlite). Even though the Indian National Trade Union Congress which controlled HZL's labour union had called the government to reconsider its decision, it did not translate into a strike. Experience from BALCO had showed that despite widespread agitation, the government had not change its stand, labour strikes ended in negotiation and the Supreme Court upheld the constitutionality of disinvestment program and refused to interfere in policy matters. Combination of these factors did contribute towards a smooth transition in the HZL transaction. In fact, labour union leaders garlanded the members of the Sterlite group on their arrival at HZL's plant (Baijal, 2008). Although several employees opted for VRS, there was no retrenchment due to privatisation (Lok Sabha, 2003a).[77]

[76]By 2003, the situation again became tense and questions were raised in the Parliament on pending VRS dues (Lok Sabha, 2003b). Total 1099 VRS applications were accepted and security deposit of some employees were withheld since they refused to vacate the company's accommodation. Some employees levelled allegation against the company for coercing them to opt for VRS. Also, a committee was constituted to look into the complaints of employees of privatised firms (Ramachandran, 2003). In sum, there continued to be a rift between management and the employees.

[77]HZL had a total strength of 8322 employees at the time of disinvestment. Once the new management announced a VRS package, 2287 employees availed it, 16 retired and 74 employees resigned. With the recruitment of 133 new workers, the net work force strength stood at 2244 employees, almost half of what it was prior to the disinvestment.

Again in the case of MUL, when the NDA government announced its intention to exit MUL in 1998, it triggered labour unrest and minor strikes (Becker-Ritterspach, 2009). In October 2000, workers went on a strike for 89 days which drew national attention (Annavajhula and Pratap, 2002). While disinvestment was only one of the reasons for the strike, it drew the attention of Parliament which had a debate on the issue. Only after the new incentive scheme was in place, the strike ended in January 2001, but 92 contractual workers were dismissed. Further, workmen had to agree not to go on strike in future and signed 'good conduct undertaking' which was later rescinded post heated debate in the Lok Sabha (Becker-Ritterspach, 2009).

**Long drawn disputes**

Although with the transfer of management control, the event of privatisation was concluded during Phase 2, few disputes associated with the deals either continue till date or got resolved only recently. While these precedents may have had an adverse impact on privatisation, they can also serve as learning experience for future decisions. We discuss below some of these disputes.

In the case of HZL which was privatised in 2002, a peculiar problem arose, when in 2013 the buyer (Sterlite) exercised the put option to buy the remaining shares from the government. A difference of opinion arose within the government over the need of prior Parliamentary approval before selling the residual stake. While the Finance Ministry opined that HZL being a private firm needed no Parliamentary permission, the Ministry of Mines opined otherwise because HZL was acquired under a special legislation (Press Trust of India, 2013).

Finally, a petition was filed before the Supreme Court to restrain the government from selling the residual shares and a CBI probe was demanded on the ground of alleged corruption in the 2002 strategic deal. In 2015, the Supreme Court allowed a CBI investigation followed by court's stay order in 2016 on the sale of remaining stake. Presently the dispute is pending before the Supreme Court while it allowed the parties to pursue arbitration as stipulated under the shareholders agreement.

Privatisation of VSNL was completed in 2002, but it gave rise to two long-drawn disputes, out of which one is still pending. The *first* dispute was related to VSNL's monopoly status in the telecom market which had been guaranteed by a decision of Cabinet until 2004. However, in July 2000, the DOT informed the new owners i.e. The Tata Group that VSNL would be de-monopolised by March 2002. The Tatas contended that the monopoly status was a promise made to them as part of the strategic sale and therefore, took the matter to the Bombay High Court. While the government offered compensation in lieu of the potential losses caused to the Tata Group, the Tata Group sought additional compensation. However, the High Court rejected the claim on the ground that it did not have jurisdiction under the Telecom Regulatory Authority of India (TRAI) Act, 1997 and

advised the parties to go for mediation.[78] The Tata Group filed a petition against this order which is currently pending.

The *second* dispute was related to land. VSNL had 773.13 acres of surplus land which was not separated/demerged before carrying out disinvestment which lead to several complications. Since the ministry instructed not to value the surplus land, it was not included in the valuation of the firm. However, a clause was incorporated in the SHA that post disinvestment the surplus land would be demerged to a separate company which would have shareholding identical to VSNL's capital structure prior to disinvestment. Although a special purpose vehicle named Hemishphere Properties India Limited (HPIL) was incorporated to carry out the land demerger, the event of demerger never took place because Tata Communication was not ready to bear the capital gains tax and stamp duty liability. In 2016, the Income Tax Act was amended which exempted erstwhile public sector companies, like VSNL from capital gains tax arising from a demerger transaction (Government of India, 2016c). And finally in 2019, the Ministry of Corporate Affairs (MCA) approved the demerger plan (Business Line News Bureau, 2019).[79] In sum, the VSNL land dispute took 17 years to get resolved.

In the case of HTL, the government had to grapple with a 'post closure adjustment claim' of INR 56.49 crore raised by the buyer which exceeded the disinvestment proceeds of INR 55 crore. Although the deal was completed in October 2001, the dispute stretched till 2012.[80] In 2002, the buyer raised a claim which the government refused to settle and the matter went to the Arbitral Tribunal. [81] In 2007, the Tribunal ruled in favour of the buyer, but the government challenged the award before the Delhi High Court. One of the contentions raised by the government was that as a result of the impugned award which required the government to pay INR 55 crores together with interest @ 9% per annum, the contract was rendered *without consideration* because it exceeded the price paid by the buyer. However in 2012, the High Court dismissed the appeal and upheld the arbitral award (Delhi High Court, 2012).

As Phase 2 witnessed privatisation of 20 hotels, some of them got shrouded in disputes and controversies. In 2014, an First Information Report (FIR) was filed with the CBI alleging irregularities of a criminal nature with the sale of Laxmi Vilas Palace Hotel in Udaipur, Rajasthan by ITDC in 2001. The then Disinvestment Secretary, the CEO of the asset valuation and financial advisory firms which acted on the deal and the buyer company were named in the FIR. While the CBI concluded its probe and submitted that there was

[78] See *Tata Communications Ltd. v. Union of India*, 2010 (6) Bom CR 208.

[79] Under the demerger plan, Tata Communication is exempted from the stamp duty liability.

[80] Post closure adjustment claim shows the difference arising from the audit of financial statements between the date of due-diligence conducted by the buyer and the date of final closure of the deal. This right was given to the parties to protect its interest and raise claim against any changes in the financial position (net-worth) of the firm which affects the valuation.

[81] Besides HTL, the government had to face post-adjustment claims in other deals like PPL, BALCO which was flagged by the CAG in their audit report (Comptroller and Auditor General of India, 2006).

no evidence of criminal wrong doing, in September 2020, a special CBI court in Rajasthan's Jodhpur district, rejected the report and ordered the registration of a criminal case against the then Disinvestment Minister, Arun Shourie and few retired bureaucrats, who were involved in the privatisation deal in 2002 (Mukherjee, 2020). Further, it also ordered the Udaipur district collector to take possession of the hotel and appoint a receiver for the property. The collector also has to ensure that the hotel is run by a central government institution with experience in this industry (Mandhani, 2020).

### 2.3.3 Missed chances

Despite several challenges like litigation and stiff political opposition, the government managed to privatise 10 public firms in this phase. However, there were two more attempts at privatisation which could not materialise, due to irregularity in the manner of disinvestment and buyer exiting from the deal, respectively. Two of these firms (HPCL and BPCL) were from the petroleum sector and the third one was Air India. Interestingly, while HPCL and BPCL continue to remain in the public sector (the latter currently being considered for strategic sale), the strategic sale of Air India was completed in 2022.

*Case of HPCL and BPCL*

Both these petroleum majors were originally private firms, but later the government nationalised them under different acquisition laws.[82] In 2003, the government suffered a set back when it attempted to disinvest shares in HPCL and BPCL. To challenge the disinvestment decision, writ petitions were filed on the ground that under the acquistion Acts, oil distribution business was vested with the state so that the distribution subserves the common general good. Unless the laws were not amended with the approval of the parliament, selling off these companies would mean the state losing control over the business and that was contrary to the object of the enactments. However, the government argued that these oil companies held the acquired assets like any other company incorporated under the Companies Act and not for and on behalf of the government. Further, it was argued that there was no express or implied prohibition in the acquisition statutes on the transfer by the government of its shares in these companies.[83]

The Supreme Court held that since these public firms were originally acquired under specific central legislations, therefore, prior Parliamentary amendment was needed before disinvestment (See, Box 10). In sum, disinvestment in the oil majors got stalled. Several years later in 2016, the NDA government repealed the original acquisition legislations which has reopened the way for strategic disinvestment in the oil majors (Government of

[82]The Burmah Shell (Acquisition of Undertakings in India) Act, 1976 and The Caltex [Acquisition of Shares of Caltex Oil Refining (India) Limited and of the Undertakings in India of Caltex (India) Limited] Act, 1977.

[83]See, section 7 of the Acquisition of Undertaking Acts.

India, 2016b).[84] However, this decision had an adverse effect on disinvestment. Later, the UPA government tried to carry out closure and disinvestment in compliance with the Supreme Court's decision by enacting laws such as the Tyre Corporation of India (Disinvestment of Ownership) Act, 2009, but neither closure nor sale took place.

**Box 10 Center for Public Interest Litigation v. Union of India**

In 2003, the Supreme Court in *Center for Public Interest Litigation v. Union of India* held that HPCL, BPCL and IOCL could not be sold to private bidders, unless the laws that were enacted in the 1970s to enable their establishment were repealed or revised.[a] Since the Parliament had set up these companies by legislating Acquisition of Undertaking Acts and other laws, the argument was that prior Parliamentary approval was needed. The court held that the preambles of the Acquisition of Undertakings Acts mandated the setting up of the government companies, and privatisation would have altered their status and defeated the objective of the enacting laws. Hence, the Parliament must approve any strategic sale of a CPSE by enacting a law.

Although MUL, which was also created under a legislation and later privatised without the Parliamentary approval, the court refused to interfere because the deal had concluded.

[a]2003 (7) SCC 532

Recently, this precedent has been cited in the dispute that arose over the exercise of put option in the case of HZL where Sterlite is seeking to buy the remaining shares from the government.

*Privatisation of Air India*

Phase 2 witnessed the first attempt to privatise Air India and made some progress, but eventually the deal fell apart. In 1953, the Air Corporations Act was enacted which nationalised the airline industry and created two bodies corporate: Indian Airlines (for domestic routes) and Air India International (for foreign routes). However by the 1970s, it was clear that both the companies were not prepared to serve the demand for international travel (Mazumdar, 2009).[85] As one of the solutions to improve its performance, manage-

[84]The two repealed legislations were: The Burmah Shell (Acquisition of Undertakings in India) Act, 1976 and The Caltex [Acquisition of Shares of Caltex Oil Refining (India) Limited and of the Undertakings in India of Caltex (India) Limited] Act, 1977.

[85]Despite the official policy which mandated 50% of inbound and outbound air capacity from India to be serviced by Air India, a large portion of the international air traffic and passengers from India were being serviced by foreign airlines.

ment of the company was entrusted to experts from the private sector. For instance, J R D Tata served as the chairperson of Air India for many years, but members of the Parliament opposed this measure as 'privatization of management' (Lok Sabha, 1986). To meet the increasing demand, in 1991 the government allowed private air-taxi operators to fly chartered non-scheduled commercial flights in India and finally in 1994, the Parliament passed the Air Corporations (Transfer of Undertaking and Repeal) Act, 1994 which allowed private players to operate full fledged airlines.[86]

As a result of these reforms, the public sector airlines steadily lost market share and their total passenger numbers declined by 10.2 lakh between 1991 and 1993 (Mazumdar, 2009). In 1998, the DC recommended privatisation of Air India due to various reasons like declining market share, consistent past losses, low fleet utilisation, old aircrafts, high maintenance costs and high employee to aircraft ratio (Disinvestment Commission, 1998b). However, the Commission was of the view that inaction by the government would have caused total dominance of foreign airlines and challenge to the foreign exchange deficit. Hence, it recommended the government to infuse equity of INR 1000 crores and bring down its shareholding to 40%.[87] Further, it recommended sale of the hotels which belonged to its subsidiary Hotels Corporation of India and hive off engineering and maintenance unit into a separate undertaking.

The government expressed its inability to infuse the recommended equity and instead submitted a separate proposal for infusion of INR 110 crores as interest subsidy towards working capital for the FY 1999-00 (Parliamentary Standing Committee on Transport and Tourism, Rajya Sabha, 2000). In May 2000, the CCD decided to pursue strategic sale of Air India in terms of the recommendations of DC with a cap of 26% on foreign shareholding (Parliamentary Standing Committee on Transport and Tourism, Rajya Sabha, 2000). Pursuant to this, the DOD initiated the task and an IMG was set up.[88] In June 2000, four parties express their interests, but since the bid carried a stipulation for foreign bidders to have joint venture with an Indian company, two out of three bidders failed to meet the criteria and dropped out of the bidding process.[89]

However, news of the proposed disinvestment of Air India met stiff opposition, including from the members of the ruling coalition and the Civil Aviation Minister himself (Katakam, 2001). The principle objections were — *first*, presence of the foreign party with

[86]Many of the air-taxi operators scaled up their operations to serve as full-service airlines such as Jet Airways, Sahara Airlines etc.

[87]Disinvestment Commission recommended sale of 40% equity to a strategic partner, 10% to domestic institutional investors and remaining 10% to retail investors and employees.

[88]IMG consisted of: Pradip Baijal, Secretary (Disinvestment); Sanat Kaul, Joint Secretary, Ministry of Civil Aviation; S. Talwar, Joint Secretary, Deptt. Of Public Enterprises; S.Behura, Joint Secretary, Deptt. Of Economic Affairs. M.P. Mascarenhas, MD, Air India; and S.Ranganathan, Director Finance, Air India.

[89]The four parties were: Delta Airlines of USA, Air France, Hinduja Group of UK and Singapore Airlines in consortium with Tata Group. Delta Airlines and Air France withdrew from the bidding. Morgan Stanley was appointed as the technical adviser to the disinvestment transactions.

26% shareholding; *second*, disinvestment without national aviation policy in place; *third*, adverse effect on the service conditions of 17,836 employees; and *finally*, non-consideration of the option of restructuring as recommended by the Commission (Parliamentary Standing Committee on Transport and Tourism, Rajya Sabha, 2000).

While the disinvestment of Air India was in process, in 2001, the Managing Director of the firm was suspended over the charges of alleged corruption, but the suspension was later revoked. The Managing Director rebutted the charges and argued that he was suspended to stall the process of disinvestment (Katakam, 2001). Following the exit of the foreign bidders, Hinduja Group also backed out in July 2001. Although Tata-SIA consortium had commenced the due-diligence process, it also exited in August 2001, owing to the stiff opposition to the proposed disinvestment (McMillan, 2001). With the exit of the last bidder, Arun Shourie, the Minister of Disinvestment confirmed in response to a question in the Parliament that the plan to privatise Air India had failed (Lok Sabha, 2001c). He stated the following reasons for failure:

> *"...intensity of opposition to the privatisation of Air India from various quarters including certain sections of political groups, trade unions and the media; slowdown of the world economy affecting the international airline business; and SIA's investments in Australasia demanding more attention and requiring commitment of substantial financial resources."*

In 2007, the UPA government decided to merge Air India and Indian Airlines into one entity — National Aviation Co. of India Limited (NACIL) with the hope that combined financials and expertise could redeem the firms, but the losses continued.[90]

### 2.3.4 Cross holdings in oil sector and autonomy

As mentioned in Phase 1, the government in 1997 started a policy of encouraging oil sector CPSEs to buy stakes in each other. This was done to encourage vertical integration and improve performance.[91]

In 1999, 1.5% of stake in IOCL was sold to ONGC and 1.67% stake of ONGC was sold to IOCL. The next year saw a transfer of managerial control (55%) of Kochi Refineries Ltd. to BPCL as well as 51% stake in Madras Refineries Ltd. was sold to IOCL. Bongaigaon Refineries Ltd. was also sold to IOCL. In 2001, IBP Ltd. was put under the control of

[90]In October 2021, Talace Pvt. Ltd., a wholly owned subsidiary of Tata Sons Pvt. Ltd. was chosen as the strategic buyer. Ownership was handed over in January 2022.

[91]The government also encouraged CPSE to CPSE sales in other sectors such as the sale of Jessop & Co. to Indo Wagon Engineering Ltd. in 2003 for INR 18 crore.

IOCL. Between 1999-2004, the government realised a total revenue of INR 3188 crore from these cross-holding transactions.

In 2003, the Standing Committee on Petroleum and Chemicals examined the mergers and acquisitions in the oil sector. While the committee recommended no disinvestment in public sector oil companies for its strategic nature, it also raised several questions of autonomy associated with the cross holdings. For instance, it questioned whether the swapping of shares that took place in July 1999 was done at the instance of the government. In view of the committee, the guidelines issued by the government which imposed certain conditions on the Navrantna public sector firms to invest in equity of another firm as violative of the provisions of the Companies Act which vested such decisions with the board of directors.[92]

While the government argued that CPSE to CPSE sales were carried out to improve firm autonomy, the Standing Committee noted that the Articles of Association of various CPSEs including the merged oil companies have a clause which reads as follows (Standing Committee on Petroleum and Chemicals, Lok Sabha, 2003):

> *Notwithstanding anything contained in any of these articles, the President may from time to time issue such directives or instructions as may be considered necessary in regard to the finances, conduct of business and affairs of the Company and the Company shall give immediate effect to such directives or instructions so issued.*

A CPSE is bound to follow the clauses of the 'articles of association' as per section 10 of the Companies Act, 2013. Hence, the government could technically overrule the company's internal decisions. On being questioned, the Ministry of Petroleum submitted to the committee that government being the majority owner possessed the right to issue such directives in public interest. However, it was submitted that the power is used sparingly without encroaching on the functional autonomy of the firms (Standing Committee on Petroleum and Chemicals, Lok Sabha, 2003).

In September 2002, the DOD issued a memorandum whose relevant portion is extracted as follows (Standing Committee on Petroleum and Chemicals, Lok Sabha, 2003):

> *Government of India has now decided that henceforth, as a general policy, Central Public Sector Undertakings and Central Government owned Cooperative Societies (i.e. where Government's ownership is 51% or more), should not be permitted to participate in the disinvestment of other PSUs as bidders.*

[92] The guidelines issued in July, 1997 required the Navranta PSUs to invest in equity of another company subject to the condition that the investment should not either exceed Rs. 200 crore in one project or 5% of its network in a single project or 15% of the network in all such projects put together.

Looking at this prohibition imposed on the CPSEs to invest in other public sector firms, the committee found the embargo as not only arbitrary but also anti-competitive. Further, it observed that government in such matters should perform the role of a referee instead of a player (Standing Committee on Petroleum and Chemicals, Lok Sabha, 2003).

## 2.4 Summarising Phase 2

As India entered the Phase 2 of disinvestment reforms, the economy had started its expansion and GDP growth rates rose from 3.84% in 2000 to 7.9% in 2004. The government promoted a policy of strategic sales which increased private sector participation in major industries. Many of the firms that underwent strategic sales were in sectors such as, telecommunications, metals (aluminium and zinc), petro-chemicals, automobiles, and fertilisers.

Although the announcement on privatisation was made during the immediately previous term of the NDA government, which might have had a symbolic effect, execution took place only during Phase 2. As the NDA government assumed power for the second time in 1999, several crucial policy decisions were taken. To begin with, a dedicated disinvestment department was created to expedite the process of privatisation, which was later elevated to the status of ministry. Also, for the first time, the President during the address to the joint session of Parliament explicitly announced that disinvestment of public sector firms in non-strategic sectors was no longer a choice but an 'imperative' (Department of Disinvestment, Ministry of Finance, 2003). Possibly these measures were taken to convey to the world at large that government possessed the requisite political will to privatise public sector firms, unless they were engaged in strategic functions.

Other policy decisions included revival of the Disinvestment Commission which recommended 17 new firms for privatisation, but only some of those firms recommended by the previous commission were privatised. A total of 12 strategic disinvestment transactions were carried out between 1999 and 2004 of which control and management of the company was transferred to the private sector in 10 firms. Rest of the sales included 2 CPSE to CPSE sale and slump sale of 20 hotel properties belonging to the ITDC and HCIL.[93] While the NDA government criticised the past governments for using disinvestment to bridge budgetary deficits, the practice of setting disinvestment targets in union budgets continued. Despite some successful privatisation deals where majority stake was sold, government could realise INR 24,619 crore against the target of INR 58,500 crore fixed for the period between 1999 and 2004.

To bring transparency and accountability, the government introduced India's first dis-

[93]The trend of one CPSE buying shares of another CPSE continued in the future phases of disinvestment.

investment procedure manual which has been improved upon over the phases. Further, the government announced the setting up of a 'disinvestment proceeds fund' to utilise the proceeds for targeted social sector reforms and generation of employment opportunities, however, no such fund was created. In the absence of such mechanism, it was not possible to map the utilisation of proceeds to the targeted expenditure like social sector or retiring of public debt (Comptroller and Auditor General of India, 2006).

As privatisation was new to the Indian political economy and given its sensitive nature, Phase 2 was mired with controversies, political opposition and litigations. One of the repeated allegations the goverment had to face was undervaluation of firms and selling the national assets at a throw away price. While the government defended the valuation exercise citing adherence to the international norms, the final price depended on the perception of the buyers.[94] Besides, the government argued that unlike the erroneous policy of minority stake sale in the past, privatisation in non-strategic sectors was necessary to revive economic efficiency of the public sector firms. Some relief came in 2001, when the Supreme Court in the BALCO deal held that the courts cannot interfere in economic policy matters like disinvestment. Similarly on the aspect of valuation, the apex court took the position that unless there was an error in complying with the valuation procedures, it did not have jurisdiction to question the facts of valuation.

Apprehension of job loss was associated with most of the deals, and major labour unrest broke out during the sale of BALCO, when almost 7000 workers went on a strike for 67 days. But the Supreme Court's decision clarified that neither transfer of management control to private players can be equated with job loss nor the right of job protection can prohibit government to disinvest a firm. However to address the concern of job loss, every strategic deal imposed a contractual prohibition on the strategic partners not to retrench workforce for one year from the date of execution of agreement, unless certain conditions were met. While Phase 2 did not witness retrenchment due to privatisation, the government declared several VRS packages. As on March 2005, 5.53 lakh employees had opted for VRS (Department of Public Enterprises, 2005).

The Supreme Court's decision in BALCO was expected to pave a way for future strategic decisions. However in 2003, the government had to miss the opportunity to disinvest HPCL and BPCL when the apex court held that a public sector firm created out of nationalisation under a statute cannot be privatised, unless the concerned statute was amended through parliamentary nod.

Another highlight of Phase 2 was the audit observations of the CAG. From preliminary reports in MFIL and BALCO deal, to final report on the strategic deals which was released in 2006 during Phase 3, the CAG flagged objections on multiple grounds like, improper valuation of firms due to non-consideration of surplus assets (land and building),

[94] Mostly DCF method was used to fix the reserve price as the firms were sold as a going concern. This method assess how much a going concern business is likely to earn in the future.

irregularity in appointment of intermediaries, non-segregation of core and non-core assets before disinvestment. As witnessed in the case of VSNL where surplus 770 acres of land was not demerged before privatisation, the dispute dragged on and was settled only in 2019 after a gap of 17 years. Although the objections fuelled political controversies, they provided key learnings for the future disinvestment exercise (Sridhar, 2006).

Although Phase 2 had its own share of problems and controversies, some of which continued for more than a decade, this is the only phase in the history of Indian disinvestment, when privatisation was carried out. The 'Economic Survey' of 2019-20 stated that over the years, the productivity of these privatised firms improved significantly which substantiates the economic rationale behind privatisation (Ministry of Finance, Government of India, 2020). Since labour overheads and productivity remained a major concern in the public sector firms, transferring ownership to private players also witnessed positive effects on labour productivity (Chhibber and Gupta, 2017). Despite these benefits, the apprehension of political costs associated with disinvestment was probably the reason for 'strategic sale' to take a back seat in the next phase of disinvestment.

# 3 Phase III

**Table 13** Timeline of events in Phase 3

| Year | Event |
|---|---|
| 2004 | UPA-1 coalition comes to power. Introduces NCMP. |
| 2004 | BRPSE constituted. |
| 2005 | NIF constituted. |
| 2009 | UPA comes to power without needing support from other political parties. |
| 2010 | Coal India IPO: biggest IPO in Indian history. |
| 2012 | OFS through stock exchange mechanism launched. |
| 2013 | First issue of ETFs. |
| 2014 | Elections are held and the UPA lose power to the NDA. |

## 3.1 Background

The general elections of 2004 delivered a fractured verdict which came as a surprise to many observers (Financial Express, 2004). The Congress party and its coalition partners (collectively called the UPA) formed the government with support from the Communist parties. Dr. Manmohan Singh was appointed the Prime Minister. The Communist parties withdrew their support to the UPA in July 2008. But in the elections in 2009 the UPA came to power without needing the support of other parties and Dr. Singh continued as the Prime Minister. The differences in the political composition of the governments in the first and second terms were reflected in the government's policy on disinvestment.

The UPA government had come to power at a time when the economic situation had started to improve — the GDP growth rate had increased to 7.9% in 2003-04 from a low of 3.8% in 1999-2000. In the Budget Speech of 2004-05, the Finance Minister said that the government sought to maintain high GDP growth rates (between 7-8%) and eliminate

the revenue deficit by 2008-09. The UPA also had to bring changes to its policy on disinvestment after the economy was under strain due to the financial crisis in 2008. A broad timeline of the phase is given at Table 13.

## 3.2 Policy choices on disinvestment

In its first term, the UPA's economic policy focus was on redistribution of wealth through social sector schemes (Government of India, 2004). When the government was formed, the members of the UPA had formulated the National Common Minimum Programme (NCMP). As far as disinvestment was concerned, there were five main objectives (Department of Disinvestment, Ministry of Finance, 2007):

1. Full managerial and commercial autonomy would be given to profitable CPSEs.
2. Privatisation would be considered only on a case to case basis. Generally, profit making CPSEs and Navaratna CPSEs would not be privatised. They would remain within the public sector.
3. Loss making companies to be sold or closed.
4. Revenues from privatisation would be used for designated social sector schemes
5. Public sector companies would be encouraged to enter the capital markets.

All the proposals of the NCMP were adopted without change in the Budget of 2004-05. The government was criticised for not having a formal policy on disinvestment (as opposed to the NCMP). The Lok Sabha Standing Committee on Finance recommended that a White Paper should be issued to bring out and clarify the government's policy on disinvestment (Lok Sabha, 2005). This White Paper was released in July 2007 and it reiterated the policy positions taken by the NCMP. The policy decisions on disinvestment taken by the government are elaborated in the following paragraphs.

### 3.2.1 Retaining the autonomy and public character of CPSEs

The government was keen on retaining the public character of CPSEs. In the Budget speech of 2004-05, the Finance minister said: "*As long as government retains control over the PSE, and its public sector character is not affected, government may dilute its equity and raise resources to meet the social needs of the people.*" This made it clear that the CPSEs would not be privatised by means of strategic sale. The government promoted the retention of public character in CPSEs in four ways:

1. Calling off strategic sales announced by the previous government;
2. Increasing investments in CPSEs;
3. Reducing the number of disinvestment transactions; and
4. Expanding the list of Navratna and Mini Ratna companies and adding a new category i.e. Maharatna companies.

The strategic sales of 13 companies that were initiated by the previous government were formally called off in February 2005 (Department of Disinvestment, Ministry of Finance, 2007).

The CPSE's public character was reinforced by the government investing more money into CPSEs. Total investments in CPSEs had increased from INR 3,49,209 crore in March 2004 to INR 5,28,951 crore in March 2009. By March 2014, these investments stood at INR 9,92,971 crore. The total equity infusion in CPSEs by the government between the years 2004-2009 was INR 77,932 crore and loans worth INR 14,448 crores were advanced to CPSEs by the government during the same period. In the first term of the UPA, all of the Budget Speeches carried details on how much money the government would invest in the public sector by means of equity infusions and loans. These details were not covered in any of the Budget Speeches during Phase 2. This practice of reporting investments in CPSEs stopped after 2009 i.e. after the first term of UPA ended.

The government conducted only five disinvestment transactions during the years 2004-2009 which yielded INR 8500 crores. These five transactions comprised of three public offers, one auction to financial investors and one sale of shares to the CPSE's employees.

The concept of Navratna and Mini Ratna CPSEs were introduced during Phase 1 in 1997 to enable greater managerial and commercial autonomy among CPSEs. The list of companies included in these categories was expanded to 14 in the Navratna category and 73 Mini Ratna CPSEs by 2013-14 (Department of Public Enterprises, 2014). In February 2010, the government announced a new category of CPSE called 'Maharatna' CPSEs. These companies enjoyed the existing autonomy provided to Navratna companies. In addition to this, they were also given powers to undertake capital expenditure without being subject to any ceiling. Also, authority was given to engage in mergers and acquisitions as long as it falls within the growth plan of the CPSE and the public character of the CPSE remained unchanged (Department of Public Enterprises, Government of India, 2010). Seven CPSEs were designated as Maharatna CPSEs.

The view on retaining the public character of CPSEs began to change in the second term of the UPA. In 2010 a Working Paper was issued by the DEA, MoF which prepared a list of 27 CPSEs that could be chosen for strategic sales. The paper noted the previous

stance of the government and noted that disinvestment could commence once again to generate revenues for government and promote efficiency in the public sector (HAC Prasad, R Sathish, 2010). However the Budget Speeches of 2010 and 2011 reiterated the government's policy of retaining the public character of CPSEs. None of the strategic sales suggested by the DEA in its Working Paper materialised except for Air India whose sale was approved in 2021.

### 3.2.2 Revival of sick CPSEs

The government noted that the revival of poorly-performing CPSEs is a key step towards increasing the competitiveness of the CPSE in the open market. It took the following steps to strengthen the financial position in sick CPSEs.

The existing law i.e. Sick Industrial Companies (Special Provisions) Act, 1985 mandated that the directors of a sick company (i.e. negative net worth in the preceding three financial years) have to refer the company for restructuring to the BIFR. Since 1991, 73 CPSEs had undergone the statutory restructuring process under the direction of BIFR (Department of Public Enterprises, 2005). The accumulated losses of these 73 companies stood at INR 82,352 crore (Department of Public Enterprises, 2014). Only four CPSEs were taken up by BIFR under the statutory scheme between 2004 and 2014. As of June 2005, revival scheme was sanctioned in 16 CPSEs and winding up was recommended for 29 CPSEs. However, as of 2016 (when the BIFR was closed), only one CPSE i.e. Mandya National Paper Mills Ltd. was wound up (Ministry of Heavy Industries and Public Enterprises, 2017). The other companies either continued to function or were amalgamated with other CPSEs as part of the restructuring package.

While the BIFR was deciding on the restructuring mechanism for sick companies, the government set up the Bureau for Reconstruction of Public Sector Enterprises (BRPSE) in December 2004 as a part-time advisory body to address the task of strengthening, modernisation, reviving, and restructuring of CPSEs. It was an inter-ministerial body which took decisions after consultations and its decisions did not have the force of law unlike those of BIFR. BRPSE constituted of a chairperson, three non-official members and three official members. The permanent invitees were the chairperson of Public Enterprises Selection Board (PESB), chairperson of Standing Conference of Public Enterprises (SCOPE) and chairperson of ONGC.

The threshold for declaring 'sickness' under the Sick Industrial Companies Act was losses exceeding the company's entire net worth in the preceding financial year. This definition had been criticised for triggering corrective actions at a very late stage of sickness (Ravi, 2015). Whereas the BRPSE had a lower threshold for sickness which considered restructuring proposals for companies which had losses in any financial year of more than 50% of its average net worth during the four years immediately preceding it. The directors

of the company were obligated to file an application to BIFR if the definition of sickness was met, but in case of BRPSE the reference was made by the administrative ministry of the CPSE. However, the government clarified that the processes in BIFR and BRPSE were to run separately and there were no linkages between the two (Standing Committee on Industry, Rajya Sabha, 2005). In many cases, BIFR and BRPSE proceedings ran parallel to each other e.g., Bengal Chemicals and Pharmaceuticals Ltd., Fertilizer Corporation of India Ltd. etc.

The Rajya Sabha Standing Committee on Industry noted the potential issues that could arise out of having two separate bodies to decide on the method of revival of sick CPSEs would result in "different opinions, successive appeals and costly delays. Even after deciding, the revival packages ... failed in several cases" (Standing Committee on Industry, Rajya Sabha, 2006). Table 14 has been reproduced from the Public Enterprises Survey and shows the number of firms subject to processes under BIFR and BRPSE.

| Year | No. of sick CPSEs as defined by BIFR | No. of sick CPSEs as defined by BRPSE | Aggregate annual losses (in INR Crore) |
|---|---|---|---|
| 2004-05 | 90 | 81 | 9003 |
| 2005-06 | 81 | 75 | 6845 |
| 2006-07 | 74 | 83 | 8526 |
| 2007-08 | 46 | 78 | 10303 |
| 2008-09 | 46 | 73 | 14621 |
| 2009-10 | 46 | 69 | 16231 |
| 2010-11 | 45 | 63 | 21817 |
| 2011-12 | 44 | 64 | 61514 |
| 2012-13 | 44 | 63 | 62767 |
| 2013-14 | 45 | 58 | Not provided |

Table 14: Firms subject to processes under both BIFR and BRPSE

Three companies i.e. Bharat Ophthalmic Glass Ltd., Bharat Yantra Nigam Ltd. and Spices Trading Corporation of India Ltd. (STCL) were recommended for closure by BRPSE. Of these, only the first two have been wound up. STCL was amalgamated with State Trading Corporation of India Ltd. In other cases, a mix of measures were adopted. For example, in many companies like HMT Ltd., a revival package was sanctioned with budgetary support. In some cases e.g. National Textiles Corp. Ltd. the age of superannuation was increased from 58 to 60. In other cases, the sick CPSE was merged with a healthy one e.g. Spices Trading Corp. of India Ltd. 19 companies were 'turned around' based on the recommendations of BRPSE and became profitable.

### 3.2.3 Disinvestment proceeds towards social sector schemes

Another important feature of this period was the setting up of the *National Investment Fund*. In December 2005, the National Investment Fund (NIF) was set up to act as a fund to collect proceeds from disinvestment of CPSEs. The money obtained from the fund was to be used to support certain specific social sector programs that were run by the central government. The fund had the following characteristics:

1. The fund was constituted to receive proceeds from disinvestments.
2. It would then contribute 75% of its income towards specific targeted social sector programs in education, health and employment.
3. The remaining 25% was to be spent on meeting capital investment requirements of profitable and revivable CPSEs. The money would be spent on enlarging the capital base for CPSEs and finance their expansion and diversification.

The NIF was restructured twice. In the year 2009, there was a change in the policy of utilisation of disinvestment proceeds. This one-time exception, in operation from year 2009 till 2013, was made where the proceeds from the disinvestments were to be used for select social sector schemes allocated by the Planning Commission and Department of Expenditure. The NIF was further restructured on 17th January 2013 and the policy was revised.[95]

The NIF was not without its criticisms. Both the 13th and 14th Finance Commissions questioned the effectiveness of the fund. The 13th Finance Commission noted that further government investments would crowd out the private markets in the social sector space. Instead, it pointed to the various government programs such as National Action Plan on Climate Change, 2009 where the funds could be applied (Finance Commission of India, 2009). The 14th Finance Commission went a step further and called for the closure of the fund. It noted that, since the fund diverted money from the Consolidated Fund of India, it would not be devolved among the states. The states had also contributed assets like land etc. to the CPSEs and they also should receive a portion of the receipts from disinvestment based on the devolution formula proposed by the Commission (Finance Commission of India, 2014). The NIF continues to exist even after the UPA lost power in 2014. As recently as 2019, the Union Budget credited INR 2000 crore towards the NIF.

[95]Under the revised policy NIF proceeds were to be utilised for: a) subscribing to the shares being issued by the CPSEs including public sector banks and insurance companies, on rights basis so as to ensure 51% ownership of the government; b) preferential allotment of shares of the CPSEs to promoters i.e. government to ensure 51% shareholding; c) recapitalisation of public sector banks and public sector insurance companies; d) investment by the government in Regional Rural Banks, IIFCL, NABARD, Exim Bank; e) equity infusion in various metro railway projects; f) investment in Bhartiya Nabhikiya Vidyut Nigam Limited and Uranium Corporation of India Ltd.; and g) investment in Indian Railways towards capital expenditure.

### 3.2.4 Pivot towards minority stake sales

As laid out by the NCMP, the emphasis of the disinvestment policy during Phase 3 was to undertake disinvestment by making minority stake sales. This part describes the conceptual details behind traditional and newer concepts of conducting minority stake sales. We also look at some broad economic factors that led to an increase in the number and size of disinvestment transactions.

The traditional methods of making minority sales have been public offers and sales to employees. Making public offers is useful when the government wishes to dilute its stake in the company but not give up the controlling interest. The Public Enterprises Survey noted some reasons as to why more and more CPSEs were going ahead with their plans to list in stock exchanges (Department of Public Enterprises, 2014):

1. The listed companies are mandated by company law/ SEBI/ Stock Exchanges to comply with higher level of disclosures. This will bring greater transparency and credibility;
2. With the induction of independent directors, management accountability, competencies and performance are enhanced;
3. Investor centric research on a regular basis provides a third party professional assessment of risks as well as future prospects to management to help it benchmark its business model with the industry; and,
4. Expectations of investors (shareholders) will bring productive pressure upon the management to perform more efficiently to unlock the true value of the enterprise.

In addition to this, newer methods of disinvestment such as Offer for Sale (OFS) transactions through stock exchange and issues of Exchange Traded Funds (ETFs) were promoted as methods of meeting the legal requirement of minimum public shareholding for listed companies. Buybacks were used by the government to reduce its shareholding in CPSEs.

*Offers for sale*: In 2009, the government approved the route of offer for sale of shares or issue of fresh shares or a combination of both as a method of disinvestment in profitable listed entities to meet the minimum public shareholding of 10%.[96] Later in 2012, the Securities and Exchange Board of India (SEBI) introduced the OFS through the stock exchange mechanism which allowed the government to off-load their existing shares in

[96] In August 2014, the requirement of 10% was revised to 25%.

listed public sector companies directly using a dedicated segment of the stock exchange (SEBI, 2012).[97]

Prior to 2012, the promoters (including government) would generally offer their shares for sale to public through public offer by issuing prospectus, or through block deals (SEBI, 2005). The process of public offer remains cumbersome, which requires filing of a detailed prospectus with SEBI and the Registrar of Companies (ROC) making it time consuming and expensive. Block deals raised questions of transparency in bulk sale of shares by promoters and its unintended impact on the stock price (SEBI, 2018). These questions became more relevant in the sale of shares of CPSEs due to greater public scrutiny.

With the introduction of the OFS route through stock exchange, it simplified the process of disinvestment in the following ways:

- It requires only a notice to be sent to the stock exchange disclosing all the details required under the SEBI Guidelines, 2012. No offer documents needs to be filed with the SEBI or ROC.
- It is faster because it involves less formalities and the entire process, beginning from announcement till completion of settlement, can be completed within 4 days.[98]
- It allows the government to cancel the OFS through stock exchange mechanism if there is lack of sufficient demand on the first trading day and thereafter plan the OFS at a more suitable time in future.

*Exchange Traded Funds*: The idea of a ETF covering the index of listed CPSEs was first proposed by the Kelkar Fiscal Committee in 2012. They identified two concerns with disinvestment: (i) how to get the sale price right and (ii) how to reduce risks for retail investors. The committee proposed a market-based ETF which can reduce risks for retail investors and also help them diversify their portfolio (Kelkar et al., 2012). The MoF accepted the recommendation and Cabinet gave its approval to the CPSE ETF scheme.

ETF is a pool of stocks that reflects the composition of an index, like S&P BSE SENSEX. In this method, the government sells shareholding in select CPSEs to a fund house which owns the ETF. The ETF fund manager first formulates the scheme and offers to the public for subscription by way of a New Fund Offer (NFO). The subscription proceeds are used to purchase the shares of constituent companies in similar composition and weights

[97]The timeline to meet the minimum public shareholding of 10% in listed companies was due to expire in 2013.

[98]Announcement of floor price of the stock can be made one day prior to the trading day. While there is no obligation on the seller to disclose the floor price, the knowledge of floor price is essential as it forms the basis for bidding. This in turn may help to discover the cut off price for bidding. The first day of trading (T day) is reserved for non-retail participants, while the second day (T+1) for retail investors. Allotment of shares is made on T+1 basis i.e., the very next day of trading.

based on the underlying index. Shares are usually sold at a discount to the scheme and the fund manager in turn creates and allots units of the scheme, to the investors. Once the NFO closes, the units are listed on the exchanges.

*Buybacks*: Buyback is a process under the Companies Act where a company purchases its shares from its existing shareholders to restructure capital and increase the underlying value of shares. In March 2012, the DPE issued guidelines which provided that if a CPSEs decides to buyback its shares, then the DOD can tender equity on behalf of the major shareholder i.e., government of India. It also instructed the firms to amend their articles of association to provide for buyback of shares (Department of Public Enterprises, 2012). Speculation surfaced that the government was considering disinvestment in several profitable firms through buyback (Online, 2012). Later the *Standing Committee on Finance* (2012-13) raised a query whether buyback was beneficial for the investors of the public sector firms. In response, the government clarified that allowing DOD to events like buyback was only an enabling provision and the final decision vested with the CPSEs (Standing Committee on Finance, Lok Sabha, 2012).[99]

In the first term of the UPA, there was a reluctance to undertake large disinvestments. Only four major disinvestment transactions took place. But two factors lead to the increase in disinvestments in the second term of UPA. Firstly, the Communist parties withdrew support to UPA in 2008 over the issue of the nuclear deal with the United States. Despite this loss of support in parliamentary voting, the UPA returned to power with an increased majority and the mandate to vote in parliament without needing to rely on the support of parties outside the alliance. Secondly, in September 2008, the bankruptcy of the US investment bank Lehman Brothers signalled the start of the Great Recession. While the Indian economy was not as badly affected as some of the other leading economies of the world, it did have a significant impact on public finance. Fiscal deficit had started to increase compared to previous years. The government needed to raise more funds than before (See, Figure 3). Hence these proved to be major factors in why most disinvestments of Phase 3 were carried out between the years 2009-2014.

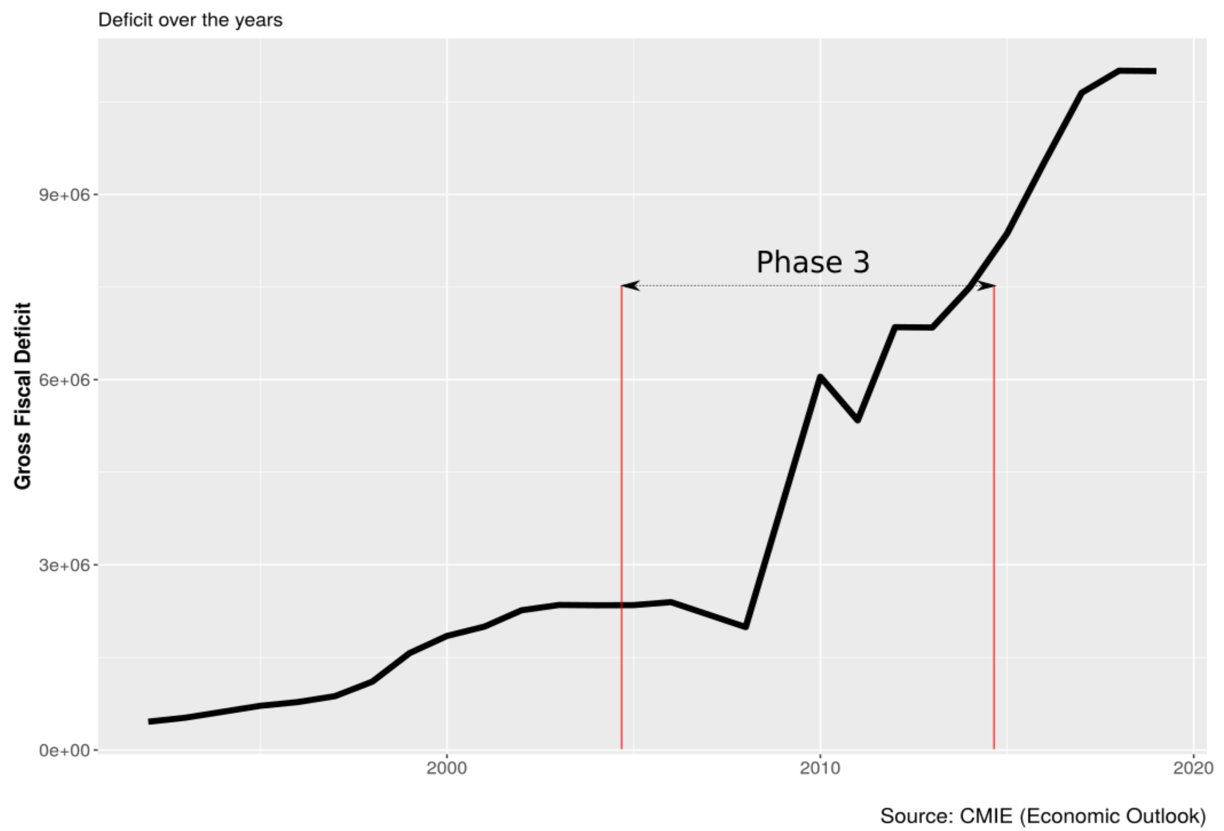
## 3.3 Details of minority stake sales

This part provides detail on facts, figures and sale-related controversies among some of the major disinvestment transactions that took place during Phase 3.

Table 16 provides an overview of disinvestment by various methods from FY05 to FY14. It shows the number of transactions, number of CPSEs, disinvestment proceeds, % of total shares sold and the change in government equity post the transaction. On an average, the government sold 5.63% of total shares and the average reduction in government

[99]During Phase 4, buyback was made compulsory for a certain class of CPSEs.

**Figure 3** Fiscal deficit in phase 3




**Source: CMIE**

equity has been around 5.47%.

**Table 15** Target versus realisation: Phase 3

| Year | Budget target (INR crore) | Amount realised (INR crore) |
|---|---|---|
| 2004-2005 | 4000 | 2765 |
| 2005-2006 | 0 | 1570 |
| 2006-2007 | 0 | 0 |
| 2007-2008 | 0 | 4181 |
| 2008-2009 | 0 | 0 |
| 2009-2010 | 25000 | 23553 |
| 2010-2011 | 40000 | 22763 |
| 2011-2012 | 40000 | 14035 |
| 2012-2013 | 30000 | 23857 |
| 2013-2014 | 54000 | 21321 |
| Total | 1,93,000 | 1,14,045 |

Source: Dataset on disinvestments created by the authors. Targets taken from the Union Budget Speeches.

**Table 16** Disinvestment from FY05 to FY14

| **Methods of disinvestment** | **Number of transactions** | **Number of CPSEs** | **Disinvestment proceeds (INR crore)** | **Average % of shares sold** | **Average change in % of govt equity post disinvestment** |
|---|---|---|---|---|---|
| PUBLIC OFFER | 32 | 22 | 91,206.59 | 7.32 | 7.32 |
| CPSE TO CPSE SALE | 1 | 1 | 5,340.00 | 10.00 | 10.00 |
| AUCTION TO FINANCIAL INVESTORS | 2 | 1 | 3,934.53 | 9.13 | 9.13 |
| EXCHANGE TRADED FUND | 1 | 10 | 3,000.00 | 0.83 | 0.83 |
| BUYBACK | 1 | 1 | 2,131.28 | 9.00 | 0.40 |
| BLOCK DEAL/MARKET SALES | 1 | 1 | 1,888.93 | 4.66 | 4.66 |
| INSTITUTIONAL PLACEMENT PROGRAMME | 1 | 1 | 358.21 | 3.56 | 3.56 |
| SALE TO EMPLOYEES | 4 | 4 | 67.36 | 1.27 | 1.27 |

Source: BSEPSU database and authors' calculation based on annual reports

Public offer was the most widely used method in this phase. Out of total 43 transactions, 32 transactions were public offer. This figure includes 13 offer for sale through stock exchange transactions. Public offer contributes 84% to the overall disinvestment proceeds in this period. We note that the BSE PSU database covers 'public offer' to mean OFSs and ETF transactions also. Figure 4 and 5 below shows the yearly distribution of amount raised and percentage reduction in equity respectively across various methods from FY05 to FY14.

**Figure 4** Trends in disinvestment proceeds from FYO5 to FY14

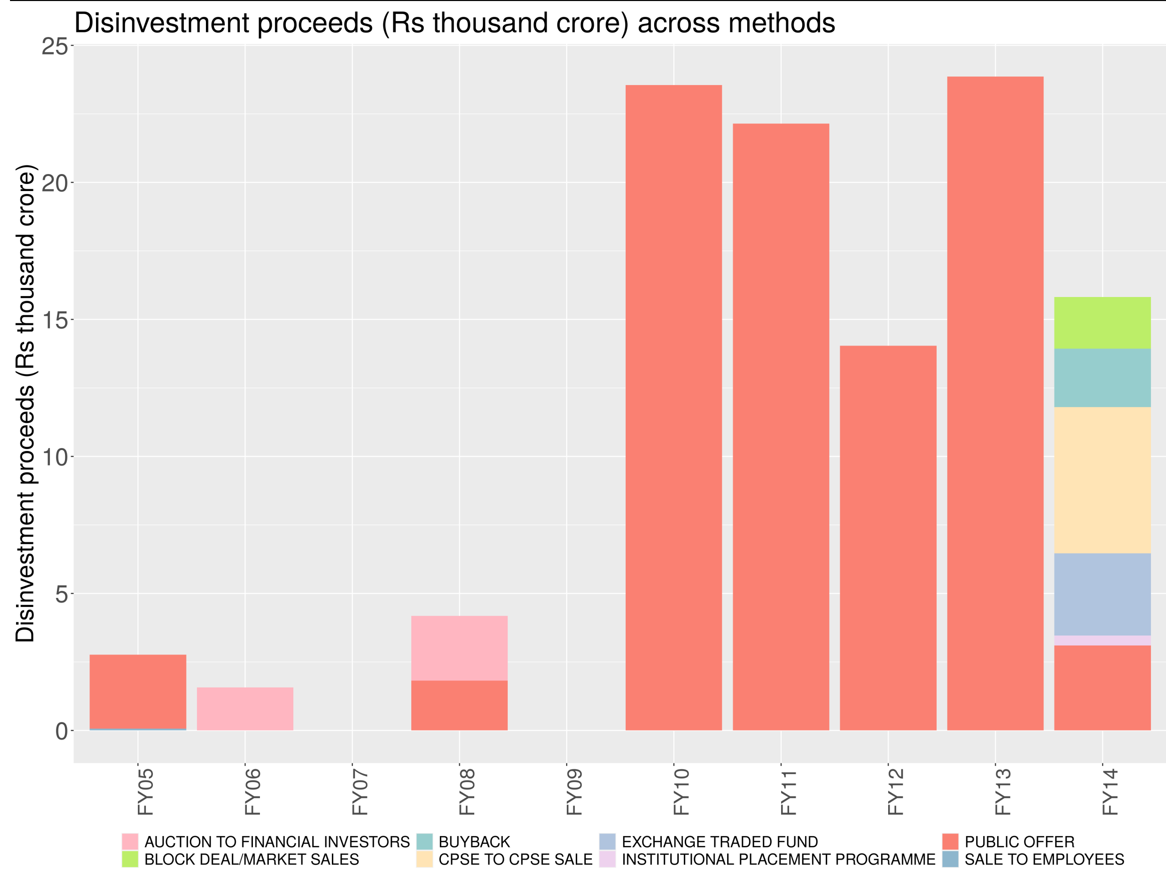
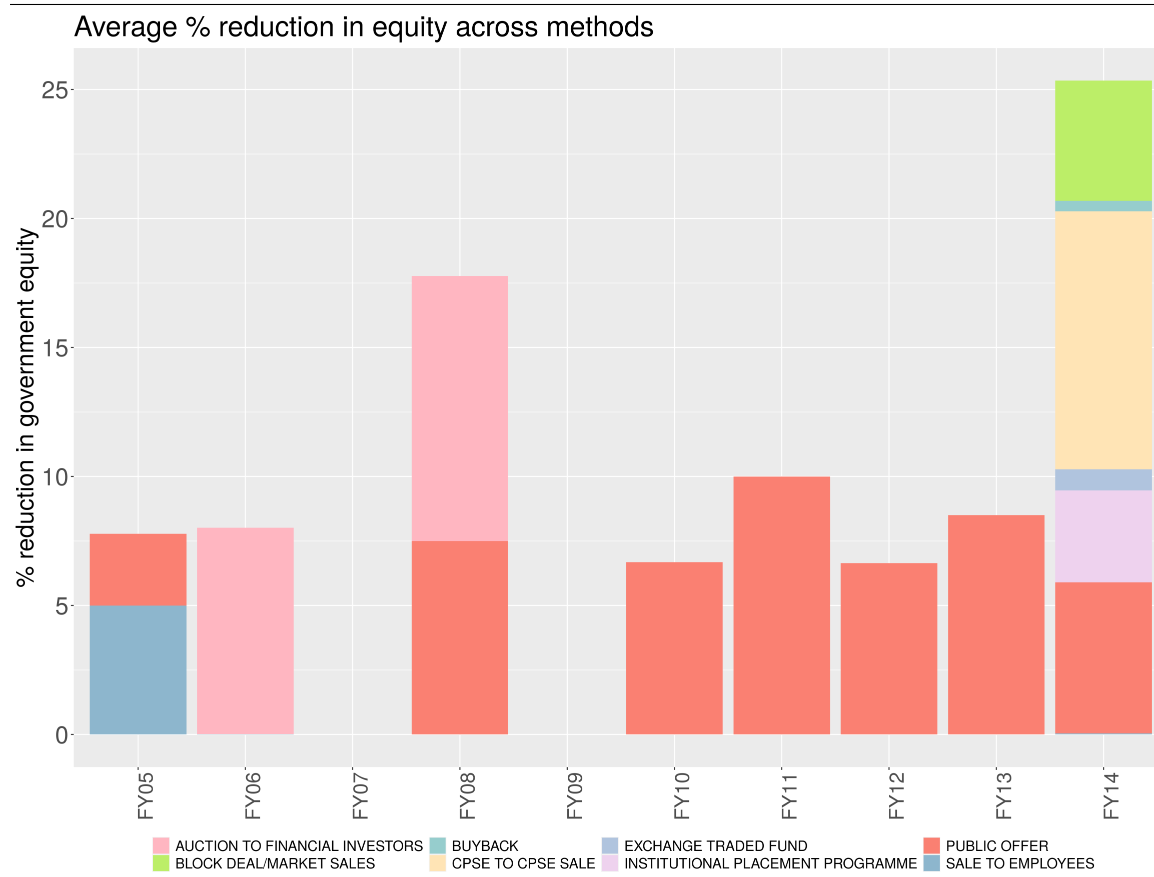


**Figure 5** Trends in reduction in equity from FY05 to FY14




Except FY08 and FY14, the stake disinvested remained constant at 8%. In FY14, we see a rise in disinvestment proceeds and stake disinvested. This is driven by use of buyback and exchange traded fund as methods of disinvestment. We now discuss each method in detail and some specific transactions within each method.

### 3.3.1 Public offers

In the first term of UPA, Initial Public Offers (IPOs) of National Thermal Power Corp. Ltd., Rural Electrification Corp. Ltd. and Power Grid Corp. Ltd. and auction of shares of Maruti Suzuki India Ltd. were conducted. In total, this raised INR 8500 crores for the government between 2004 and 2009.

After 2009, the government focused its attention on public offers and the next two years saw many large public offers take place. Five large and profitable CPSEs underwent initial public offer during this period and nine companies which were already listed performed subsequent public offers. The five companies chosen for initial public offer were Coal

India Ltd., National Hydroelectric Power Corporation Limited (NHPC), Manganese Ore (India) Limited (MOIL), Sutlej Jal Vikas Nigam Limited (SJVN) and National Buildings Construction Corporation Limited (NBCC). We look at two examples of such IPOs i.e. Coal India Ltd. and NHPC in some detail.

At the time of its IPO, Coal India Ltd. was a Navratna (later Maharatna) company and held a monopoly over the coal mining sector in India. It was the world's largest producer of coal by volume. The government sought to obtain funds to finance Coal India's capital expenditures such as washery units and also finance the company's overseas operations. Coal India had opened a subsidiary in Mozambique and purchased mining rights in two coal blocks there. The company also planned to invest in coal fields in Indonesia, Australia and the United States (Coal India Ltd., 2010). Hence a composite IPO was proposed whereby the government would disinvest 10% of its stake in the company. The price band for the shares was set at INR 225-245. Upon listing the share price was INR 243 on the trading day. The offer was oversubscribed 14 times. It was the largest ever IPO to have ever been conducted in India and it raised INR 15,200 crores for the government.

NHPC was also a energy sector company which needed funds for new power projects in remote areas like Jammu and Kashmir. It also had a composite public offer whereby the government disinvested 5% of its equity and the transaction generated INR 4025 crores. The price band was between INR 30 and 36 and the IPO was oversubscribed 23 times.

### 3.3.2 Sale to employees

Employees of CPSEs were encouraged to buy shares in their company. CPSEs such as NMDC Ltd. and Indian Tourism Development Corp. Ltd. conducted sales of company shares to their own employees. However, the fraction of equity divested in this method was limited (0.04% and 0.08% respectively).

### 3.3.3 Offer for sale through stock exchange

In March 2012, ONGC became the first listed company to divest shares using this mechanism (BSEPSU, 2020a). The government diluted 5% shareholding and realised INR 12749.52 crore. However, the deal got mired in controversy due to Life Insurance Corporation of India (LIC)'s participation in the transaction. The allegation was that since the deal received poor response from buyers, LIC was forced in the last minute to buy shares of ONGC (Sinha, 2012). The *Standing Committee on Finance* (2012-13) questioned the government whether LIC was forced to acquire shares of ONGC (Standing Committee on Finance, Lok Sabha, 2012). In response, the government clarified that LIC's investment decision was independent based on internal procedure. However, the *Standing Committee*

recommended the Insurance Regulatory and Development Authority (IRDA) to enquire whether LIC breached any prudent investment norms due to its acquisition of shares of ONGC. Further, it observed that (Standing Committee on Finance, Lok Sabha, 2012):

> *"the objective of disinvestment has been reduced to merely deficit-bridging exercise and treating the Central Public Sector Enterprises (CPSEs) as "milching cow", without using it as a long-term instrument to improve the functioning of PSUs."*

Post the ONGC transaction, there were several other OFS transactions through stock exchanges in firms like, Oil India Ltd, Rashtriya Chemicals & Fertilizers Ltd, NTPC Ltd, Hindustan Copper Ltd, MMTC, NALCO, National Fertilizers Ltd, ITDC Ltd and NMDC Ltd. In total, 13 CPSEs conducted OFSs and raised a total of INR 37,590 crore.

### 3.3.4 Buyback

In 2013, NHPC announced a buyback offer and became the first CPSE where buyback was used for disinvestment (NHPC, 2014). Post transaction, the government diluted only 0.4 % equity which added INR 2131.28 crore to the disinvestment proceeds (DIPAM, Ministry of Finance, 2013). After this deal, there were no more buybacks in CPSEs during this phase. Although there was a proposal to disinvest shares in Coal India Limited (CIL) through the buyback route, it triggered stiff opposition from the labour unions and the decision was not implemented (Ray, 2013).

### 3.3.5 Exchange traded funds

In March 2014, CPSE ETF was launched with its first fund offer. It consisted of stock of 12 CPSEs. The scheme was operated by Goldman Sachs Asset Management India Ltd. Each unit was sold at a market price of Rs. 20 and the value of each unit increased up to Rs. 25 by May 2014. Further ETF offers have been carried out which are discussed in Phase 4.

### 3.3.6 Block deal and Institutional placement

Two one-of-a-kind transactions were also seen in this phase — one block deal of shares and one institutional placement.

In March 2014, Bharat Heavy Electricals Limited (BHEL) disinvested 4.7% of government held equity through a block deal. A block deal is a special trade mechanism available at stock exchanges where large traders can make purchases of a large 'block' of shares. The details of the buyer were not released at the time of the sale. By comparing the shareholding patterns in the annual reports of the years before and after the sale, we note that the shares could have been purchased by banks and financial institutions.

On the other hand, Neyveli Lignite Corp. Ltd. underwent an institutional placement program in August 2013. Institutional placement program is defined under Chapter VII-A of the SEBI (Issue of Capital and Disclosure Requirements) Regulations. It covers specific sale of shares under stock market mechanism to specified buyers which are mainly specified corporate entities and financial institutions. In this case, the central government conducted a sale of 3.56% of its shareholding in Neyveli Lignite Co. Ltd. mostly to entities owned by the state government of Tamil Nadu. The government obtained INR 358 crores from the sale. This institutional placement could be seen as a consequence of its inability to disinvest using other means as discussed in the next section.

## 3.4 Missed opportunities

During its second term, the UPA government tried to sell off majority stake in a few companies. For this, the government used the route of strategic sale and closure laws.

*Strategic sale*: In May 2002, the CCEA had approved the sale of 49% shares of Neyveli Lignite Corporation Limited (NLC) which met with opposition from the workers who organised a strike. The arrival of the UPA government, which promised in the NCMP to not privatise profitable CPSEs like NLC, eased tensions. But in 2009, the UPA government announced its intention to disinvest a 5% stake from the company. The news was met with furore not only by the workers' unions but also by the DMK and AIADMK parties. This could possibly be one reason for why the central government chose to sell its shares of NLC to entities owned by the Tamil Nadu state government by means of institutional placement.

*Laws on closure of* CPSEs: In 2007, Tyre Corporation of India Limited (TYCIL) was a sick CPSE and multiple attempts had been made to close the company. Following the Supreme Court's decision in 2003 that mandated parliamentary approval prior to sale or closure of a CPSE, the government in 2007 enacted the Tyre Corporation of India Limited (Disinvestment of Ownership) Act, 2007. The law was intended to provide for the winding up, closure and sale of the factories and lands owned by the Tyre Corporation of India. However in 2013, the state of West Bengal that had contributed the land for the CPSE opposed the disinvestment and did not provide clearance for the sale of the land (Basu, 2013). The company's legal form continues to exist and the liquidation process for the company is currently ongoing before the Calcutta High Court.

*Merger of Air India and Indian Airlines*: In February 2007, an Empowered Group of Ministers (EGOM) recommended the merger of Air India and Indian Airlines. The Cabinet subsequently prepared the scheme of arrangement and the two airlines were merged with effect from August 2007. The merger was intended to boost synergies between international services offered by Air India and domestic services offered by Indian Airlines. But the CAG in their report from 2011 questioned the entire basis of the merger. They noted that the merger was 'ill-timed, without proper justification and synergised operation, without HR integration, delayed and having serious uncertainties.' (Comptroller and Auditor General of India, 2011). A separate committee headed by Justice Dharmadhikari had to be set up to resolve the HR integration and operation issues.

## 3.5 Summarising Phase 3

Soon after coming to power the UPA-1 adopted a policy which avoided large disinvestments. But by 2009-10, the change in both the political climate (UPA forming parliamentary majority on its own strength) and economic climate (arrival of the recession in 2008), the government's earlier caution against disinvestment was done away with. The rapid need to further relax the fiscal deficit burden also saw innovation in the way that the capital markets were utilised. Hence, new methods of disinvestment which lowered stake but did not disturb ownership such as offers for sale and ETFs were used for disinvestment. The government also wished to increase the public shareholding in CPSEs and tried to make these companies attractive for investments.

The policies adopted by UPA especially in its second term led to long-term changes in the direction of the State and the markets as the facilitators of disinvestment. These changes are reflected in the practices incorporated in the next few years of disinvestments in India.

# 4 Phase IV

**Table 17** Timeline of events in Phase IV

| Date | Event |
| --- | --- |
| May 2014 | NDA government got elected. |
| Aug 2014 | Government raises minimum public shareholding from 10% to 25% for listed CPSEs. |
| Oct 2015 | New guidelines for revival/restructuring of sick/incipient sick and weak CPSEs. |
| Nov 2015 | Closure of BRPSE. |
| Feb 2016 | CCEA approves policy on disinvestment including strategic sales; approval on constitution of Core Group of Secretaries (CGD); Role of NITI Aayog specified. |
| May 2016 | Capex measures were introduced, buyback made compulsory for certain CPSEs. |
| Apr 2016 | DOD's name changed to Department of Investment and Public Asset Management (DIPAM). |
| Dec 2016 | Insolvency and Bankruptcy Code was notified. |

**Table 18** Timeline of events in Phase IV

| Date | Event |
|---|---|
| **Aug 2017** | A new body called Alternative Machinery (AM) was created to expedite strategic disinvestment. |
| **Jan 2018** | HPCL sold to ONGC followed by several CPSE to CPSE sales between 2018-20. |
| **Jun 2018** | DPE issues new guidelines for closure of sick/loss making CPSEs. |
| **Mar 2018** | Bids invited for sale of Air India - no bids were received. |
| **Nov 2018** | Launch of Bharat 22 ETF New Fund Offer and cabinet approved mechanism for sale of enemy shares. |
| **Feb 2019** | CCEA approved DIPAM's procedure and mechanism for asset monetisation of CPSEs. |
| **Mar 2019** | DIPAM issues asset monetisation policy. |
| **May 2019** | NDA government was re-elected. |
| **Dec 2019** | CCEA gives in-principle approval for strategic sale of 33 firms. |
| **May 2020** | Government to announce new policy on strategic sectors. |

## 4.1 Economic situation and new government

Towards the end of FY14, India had witnessed several economic challenges. The fiscal deficit stood at 4.6% of gross domestic product (Ministry of Finance, Government of India, 2014). Growth rate stood at 6.4% in 2013-14. Also the disinvestment target could not be realised in FY14. As a result, the government had to cut INR 79,790 crore from the budgeted plan expenditure of INR 5,55,532 crore for the said FY. Public sector also underperformed during this period. Out of total 234 firms, 71 firms incurred a loss of INR 20,055 crore whereas the 163 firms booked a profit of INR 149,164 crore. Table 19 shows the declining financial ratios of CPSEs in the past six years to substantiate their poor performance.

**Table 19** Financial ratio of CPSEs since FY08

| **Ratio** | **FY08** | **FY09** | **FY10** | **FY11** | **FY12** | **FY13** | **FY14** |
|---|---|---|---|---|---|---|---|
| Return on capital employed | 21.05 | 17.95 | 17.62 | 13.81 | 13.97 | 12.56 | 12.93 |
| PBDIEET to capital employed | 26.94 | 23.88 | 23.64 | 18.77 | 18.74 | 16.97 | 16.92 |
| Net profit to capital employed | 11.21 | 10.57 | 10.15 | 7.08 | 7.34 | 7.62 | 7.53 |
| Net profit to turnover | 7.41 | 6.59 | 7.41 | 6.15 | 5.39 | 5.91 | 6.26 |

Source: PSE Survey (2013-14)

After the corruption scandals that arose out of irregularities in allocation of 2G spectrum, coal blocks etc, and coupled with a slower growth rate, the UPA's public image was dented. Between April-May, 2014 the XVIth Lok Sabha elections were held and the NDA coalition led by BJP emerged victorious with a clear majority (Singh, 2014). Although BJP's election manifesto was silent on disinvestment, speculations followed, given the past experience of privatisation in the NDA government led by Atal Bihari Vajpayee (Bharatiya Janta Party, 2014). Several leading business dailies reported that victory of BJP would unleash strategic sale resulting in privatisation (Vaishnav, 2017). Further, there were speculations about increasing the minimum public shareholding in public sector firms from 10% to 25% which was linked to a possible spike in disinvestment transactions (Nayak, 2014).[100]

## 4.2 Disinvestment policy

Contrary to expectations of strategic sale, in the first FY the government decided to retain state control over CPSEs. The Public Enterprise Survey of 2014-2015 stated that

[100]Eventually in August 2015, the minimum public float was raised to 25%, although the CPSEs have been given multiple extensions over the years to comply with the requirement, which is due for expiry in August 2021. Also, see section 4.3.3 of Phase 4.

policy of disinvestment "*envisages developing people's ownership of Central Public Sector Enterprises to share in their wealth and prosperity while ensuring that the Government equity does not fall below 51% and Government retains management control*" (Ministry of Heavy Industries and Public Enterprises, 2016). The government did not spell out any disinvestment strategy in the budget of FY15, and it only increased the interim budget disinvestment target of INR 51,925 crore to INR 58,425 crore. Given this position, FY15 witnessed offer for sale of 10% stake in CIL and 5% stake in Steel Authority of Limited (SAIL). Further five CPSE sold shares to employees. On an average, they sold 0.1% of total shares to the employees.

In 2016 the government announced a new policy on disinvestment with four fold objectives (Ministry of Heavy Industries and Public Enterprises, 2017):

1. promote public ownership of CPSEs;
2. efficient management of investment in CPSEs;
3. listing of CPSEs to deepen the capital market; and
4. raise budgetary resources.

In this section, we cover the measures taken to fulfill the policy objectives. Broadly, it is spread at three levels. *First*, we discuss the return of strategic disinvestment and some of the procedural changes. In this context, we also discuss the expanded role of DOD renamed as Department of Investment and Public Asset Management (DIPAM), and the role of a new body called NITI Aayog set up in January 2015 to succeed the Planning Commission.[101] *Second*, disinvestment through sale of minority stake for which the government continued some of the methods adopted by the UPA government, namely public offers, OFS through stock exchange, buyback and ETF. *Third*, we look at the new options the government is exploring to augment the disinvestment proceeds, like monetising surplus assets of the CPSEs, sale of enemy shares and sale of holdings in Specified Undertaking of the Unit Trust of India (SUUTI). While some of these approaches may not reduce government's shareholding in the public sector firms, the proceeds raised from these options are being considered as part of the disinvestment proceeds. Possibly these measures are taken to address the problem of rising fiscal deficit.

Additionally, we look at the new procedure on closure of firms since an efficient closure process is necessary, if a firm can neither be revived nor divested. For instance, during this phase some firms initially offered for strategic sale are now being considered for closure because the deals did not materialise. The government has adopted a new administrative route for closure of firms which exists parallel to the new statutory framework of the

[101]NITI Aayog was formed in 2015 via a union cabinet resolution. NITI stands for National Institution for Transforming India.

Insolvency and Bankruptcy Code (IBC). It may be noted that NDA was re-elected to power in 2019, and the disinvestment policy adopted in the previous term is being followed in the second term.

### 4.2.1 Strategic sale

In the budget speech of FY15, the government announced that disinvestment proceeds will include disinvestment in loss making units, and 'some strategic disinvestment'. But it was one year later in the budget speech of FY17, the government announced its policy on strategic sale and steps to carry them out (Ministry of Heavy Industries and Public Enterprises, 2017).[102] To initiate the process, NITI Aayog was vested with the authority to advise on strategic disinvestment through a consultation process among different ministries and departments. Once the firms are identified, the recommendations are submitted to the DIPAM to execute the process (DOD's name was changed to DIPAM, See Box 11). Under this mandate, NITI Aayog has to identify the firms and advise on mode of sale, percentage of shares to be sold, and methods for valuation (Department of Disinvestment, Ministry of Finance, 2016). Further, the CGD was instructed to consider the recommendations of NITI Aayog to facilitate a decision by the CCEA on strategic disinvestment and to supervise/monitor the process of implementation.

[102]Budget Speech of FY 2106-17.

**Box 11 DoD becomes DIPAM**

In 2016, the word 'disinvestment' was dropped and DOD's name was changed to DIPAM. The reason for this change could be inferred from the Budget Speech of FY 2016-17, it was announced that *"We will adopt a comprehensive approach for efficient management of investment in* CPSEs *by addressing issues such as capital restructuring, divided, bonus shares, etc. The Department of Disinvestment is being re-named as the Department of Investment and Public Assets Management* (Government of India, 2016a). As a result, DOD was re-christened as DIPAM, whose revised mandate in addition to sale of shares of CPSEs, is to advise the government in the matters of financial restructuring and to attract investment through capital markets. In other words, the new mandate of DIPAM is not just disinvestment, but also manage government investments in the CPSEs and to obtain higher returns.[a]

[a]PIB Release dated January 03, 2017.

For identifying the firms for strategic sale, NITI Aayog used the criteria of – national security; sovereign function at arm's length; and market imperfections and public purpose (Lok Sabha, 2020). By the end of 2016, NITI Aayog submitted its first and second tranche recommendations on strategic disinvestment which was approved by the CCEA (Press Information Bureau, 2017b).[103] So far NITI Aayog has identified 33 firms from non-strategic sectors for strategic sale including subsidiaries, units and joint ventures.

In the past there have been some debates/indecisiveness regarding the interpretation of the term 'strategic'. During the proceedings before the *Committee on Public Undertakings on review of loss making CPSUs* (2018-19), NITI Aayog submitted that firms serving national security purposes, sovereign or quasi- sovereign functions and performing developmental functions that the government may consider important could be categorised as 'strategic' CPSE. On the other hand, the Department of Heavy Industries opined that firms providing essential goods and services and holding dominant market positions in petroleum, power, steel, mining and transportation sectors are 'strategic' (Committee on Public Undertakings, Lok Sabha, 2018). Due to the divergent opinions, the Committee recommended the government to frame uniform parameters for categorising public sector firms as strategic. Further, it recommended to revisit the definition of strategic sector set back in 1999.[104]

[103]NITI Aayog's recommendations on strategic sale are not available in the public domain unlike the Disinvestment Commission reports.

[104]As per the 1999 union cabinet resolution, strategic sector includes arms and ammunition, and the allied items of defence equipment, defence aircraft and warships, atomic energy, minerals specified in the schedule to Atomic Energy, (Control of Production and Use) Order 1953 and railway transport.

Recently in 2020, the government announced that it would notify a new policy on list of strategic sectors where at least one and maximum four public sector firms would be present along with private sector firms. In other sectors, CPSEs will be privatised, however, the timing would depend on feasibility (Press Information Bureau, 2020).

Based on the NITI Aayog's recommendations in 2016 and 2017, the government announced strategic sale of pharmaceutical companies, namely, Hindustan Antibiotics Limited (HAL), Bengal Chemicals & Pharmaceuticals Limited (BCPL) and Karnataka Antibiotics & Pharmaceuticals Limited (KAPL) (Press Information Bureau, 2019a).[105] Also in 2016, the government repealed the acquisition legislations for HPCL and BPCL, to reopen the way for strategic disinvestment in the oil sector. Previously in 2003, the attempt to disinvest these firms was stalled when the Supreme Court held that due to the respective acquisition legislations disinvestment was not possible without prior parliamentary approval.[106]

During the union budget speech of FY18, the government announced that CPSEs may be consolidated, merged or acquired to create an integrated market. The government's rationale behind this decision is *"to strengthen the firms so they can bear higher risks, avail economies of scale, take higher investment decisions and create more value for the stakeholders"* (Government of India, 2017). Oil and gas sector were identified as possible options for creating the integration. Pursuant to this, the government proposed to create an integrated oil major. However, this was not a new decision and as discussed in Phase 1, the Sengupta Committee constituted in 1998 had recommended consolidation in the oil sector. Consequently Phase 4 witnessed strategic sales of some big firms like HPCL and REC Ltd, but they were sold to another CPSE to create *vertical integration* in the market (See, section 4.3.2 and Box 12).[107]

On November 19, 2019 the government announced a list of 28 CPSEs which were approved for strategic sale. The list included Navratna firms like BPCL, Container Corporation of India (CONCOR) and Shipping Corporation of India (SCI) (Press Information Bureau, 2019g). As the government decided to transfer majority of shares and management control to a 'strategic buyer', it triggered expectations in the market for the long awaited privatisation (Roychoudhury, 2019).[108] Also, this was a policy departure from the previous government which had put a restriction on sale of profit making firms.

[105]KAPL is a profit making firm.

[106]See, Phase 2 for the detailed discussion.

[107]In January 2018, the government sold 51.11% equity of HPCL to ONGC. In March 2019, government sold its shares in REC Ltd to Power Finance Corporation.

[108]The same announcement included the name of NTPC Ltd as the identified buyer of THDCIL and NEEPCO (Press Information Bureau, 2019e). This shows the policy of CPSE to CPSE sale continued simultaneously.

**Box 12 Prohibition on CPSEs to participate in disinvestment**

In 2002, the government had imposed a restriction on CPSEs to participate in disinvestment of other PSUs as bidders, except in special cases with the prior cabinet approval (Standing Committee on Petroleum and Chemicals, Lok Sabha, 2003).[a] Given the number of CPSE to CPSE transactions in Phase 4, it seems exemptions were given. For instance, the CCEA allowed CPSEs to participate in the disinvestment of EPIL (Press Information Bureau, 2019b). Also whenever a CPSE was sold to another CPSE, the CCEA recommended the strategic buyer as part of the sale approval. Unlike other strategic sales, neither Preliminary Information Memorandum (PIM) was issued nor bidding process was conducted. For instance, in November 2019, when CCEA approved strategic sale of NEEPCO and THDCIL along with other CPSEs, it also declared the name of the buyer i.e., NTPC (Press Information Bureau, 2019e).

[a]OM No. 4 (32)/2002 dated 18th September, 2002.

However on November 20, 2019, the government announced that while it is considering to reduce its equity below 51% on a case to case basis, it would retain 'management control' (Press Information Bureau, 2019c). Looking at these policy decisions, it signals a mixed approach of strategic sale i.e., privatisation with transfer of management control, privatisation without transfer of management control and CPSE to CPSE sale. By the end of 2019, the CCEA granted 'in-principle' approval for sale of majority stake and transfer of management control in 33 firms (Press Information Bureau, 2019f).[109]

*Sale procedure*

Although the government broadly adopted the procedure made by the previous NDA government during the second phase, a need was felt to revisit the process and make changes based on the learnings from past experiences, like CAG audit observations.[110] For instance, 'post-closing adjustment' clause in the past deals caused several disputes. As a result, the new procedure aims to structure the agreements in a manner to avoid adjustment clauses (DIPAM, Ministry of Finance, 2018b). We discuss here some of the important changes. Detailed steps of strategic disinvestment has been discussed in the Annexure.

*First*, the valuation of non-core assets remained a contention in the previous privatisa-

[109]See, section 4.3.2 for the discussion on CPSE to CPSE sale.

[110]In 2006, the CAG submitted audit observations in respect of the strategic deals carried out between 1999-2003. The observations have been discussed in Phase 2 of the paper.

tion deals, and is therefore, explicitly included in the process of determination of the final price. In addition to the existing valuation methods i.e., DCF and assets valuation, 'relative valuation' method has been introduced which is based on benchmarking with equity transactions involving similar firms. However, given the nature of public sector firms and public ownership, it may be difficult to find comparables to determine reliable valuation using this method.

*Second*, the revised procedure states that the right of the company including encumbrances must be clearly disclosed in the EOIs and surplus land to be hived off before inviting the EOIs (DIPAM, Ministry of Finance, 2018a). 'Land' was a bone of contention in the past. For instance, the demerger of surplus land in the case of privatisation of VSNL remained a dispute for over a decade.

*Third*, for the first time, a monitoring body called as the Independent External Monitor (IEM) comprising ex-Chief Justice of India, ex-CAG and ex-CVC was created to oversee the whole process through an advisory role (DIPAM, Ministry of Finance, 2018b). Possibly this has been done to bring more credibility to the process to avoid or minimise future controversies and incentivise prospective buyers.

*Fourth*, the government decided to streamline the process of strategic sale. Since involvement of CCEA in decision making process consumed time, in 2017 the CCEA delegated certain powers to expedite the process of strategic sale. As a result, a new decision making body called Alternative Mechanism (AM) was created consisting of the Finance Minister, Minister for Road Transport and Highways and Minister of Administrative Department. So once the CCEA has granted in-principle approval, AM will decide on the terms and conditions of the sale from the stage of inviting of EOIs till inviting of financial bid (Press Information Bureau, 2017a). Only after the buyer has been identified, the final CCEA approval is sought. Further, the CGD was not only authorised to take policy decisions on procedural issues, but it can also deviate, if necessary, for implementation of decisions of CCEA.

Later in 2019, AM was given the authority, after the CCEA has given in-principle approval for strategic disinvestment, to decide on the quantum of shares to be transacted, mode of sale and final pricing of the transaction or lay down the principles/ guidelines for such pricing; selection of strategic partner/ buyer and terms and conditions of sale. Further, it could decide on the proposals of CGD on timing, price, terms & conditions of sale, and any other issue related to the transaction.

*Fifth*, in October 2019, changes were made to the disinvestment procedure. As an effect, the role and responsibility of DIPAM in driving strategic sales was expanded. *First*, a consultative group was created which included the secretary of DIPAM and the representative of NITI Aayog. The main role of this group is to make recommendations to IMG for selection of CPSEs for strategic disinvestment after refining the recommendations of

NITI Aayog (DIPAM, Ministry of Finance, 2019a).[111] Earlier NITI Aayog carried out the exercise of selection of firms. *Second*, the composition of IMG was revised which is now to be co-chaired by the secretary of DIPAM along with the secretary of concerned administrative ministries. Pursuant to this change, the IMG has been given host of functions which includes the duty to recommend to the CGD, the quantum of shares to be sold, timing, mode of sale, final price, selection of the strategic buyer and terms and conditions of sale (DIPAM, Ministry of Finance, 2019b).

### 4.2.2 Minority sale

Phase 4 witnessed a push for minority stake sale which contributed to around 78% of the disinvestment proceeds between FY 15 to 20 (See, section 4.3.3.) One of the reasons for this could be because in 2014, before the introduction of the disinvestment policy, the government extended the requirement of 25% Minimum Public Shareholding (MPS) to listed CPSEs which was applicable to non-government listed firms since 2010. Although the government firms were brought at par with the privately owned firms, the norms are yet to come into operation.[112]

In 2016, the government announced the new disinvestment policy, but similar to the previous phase, the action plan for disinvestment of minority stake in profitable CPSEs remained the same (Ministry of Heavy Industries and Public Enterprises, 2017). These are:

- meeting the MPS through 'offer for sale' of shares either by the government or by the CPSE through issue of shares or a combination of both;
- listing the firms with no accumulated losses and having earned net profit in three preceding consecutive years; and
- issuing follow on public offers.

Pursuant to this policy, DIPAM was mandated to identify firms in consultation with respective administrative ministries and submit proposal to the government in cases requiring offer for sale of government equity. To sell the minority stake the government adopted

[111] The consultative group will consider the CPSEs identified by DIPAM for strategic disinvestment.

[112] In 2014 a time period of 3 years was given to meet the threshold. In 2017, the deadline was extended by a year to 2018 and again by two years to 2020 (Department of Economic Affairs, Government of India, 2017) and (Department of Economic Affairs, Government of India, 2018). Recently, the listed CPSEs got another extension of one year till August 2021 (Department of Economic Affairs, Government of India, 2020). In July 2021, the Securities Contracts (Regulation) Rules, 1957 was amended to allow the government to exempt any listed government company from the minimum public shareholding requirement.

the same methods used during the Phase 3 i.e., offer for sale of shares, buyback and ETF, but some changes have been introduced. We discuss here some of the important changes.

**OFS through stock exchange to meet MPS**

Since the minimum level of public float was increased, the government frequently used the route of OFS through stock exchange to meet the requirement. However, from time to time SEBI made several changes to this method based on the feedback from the stakeholders including DIPAM. These changes are:

1. *Eligibility*: Initially the OFS route was available to only top 100 listed companies based on average market capitalisation and only promoters could exercise this option. In 2014 this option was extended to top 200 companies and also to non-promoters who held minimum 10% shares in the company (SEBI, 2014).[113] In 2018, the OFS was further expanded and applied to companies with market capitalisation of Rs 1,000 crore or more.

2. *Retail buyers*: The examination of participation by investors in the CPSE stake sale showed low retail participation (SEBI, 2014). Several measures were taken to address this problem. In 2014, reservation of minimum 10% of the offer size for retail buyers was made compulsory. The seller was given the discretion to give *discount* to retail investors either on the bid price or cut off price.[114] In 2016, separate trading day for non-retail (T) and retail (T+1) investors was introduced (SEBI, 2016).

3. *Notice to the exchange*: The original requirement for sending notice to the stock exchange was T-2 days. This went through several changes and finally stands revised to T-1 day (SEBI, 2016). At present, the seller can send the notice of OFS on the day (T-1) immediately before the trading day latest by 5 pm. Even the floor price can be mentioned but only after the closure of trading hours. This leaves less room for speculation in stock prices due to minimal time gap between the disclosure of news and the trading day. For instance, the notice of OFS in Coal India Ltd was sent to BSE on October 30, 2018 and the OFS was to open on October 31 at 9:15 am onwards (Ministry of Coal, Goverment of India, 2018).

**Compulsory buyback**

In 2016, CPSEs were instructed to follow certain capital restructuring norms, like compulsory declaration of dividend, 'buy-back of shares', issue of bonus shares and splitting of shares (See, Box 13). While there were speculations behind the rationale of the new norms, the Secretary DIPAM on May 3, 2017 'tweeted' to clarify that these measures

[113]SEBI received feedback from the market participants and the Department of Disinvestment to expand the scope of OFS.

[114]The final allotment price could be below the floor price.

were brought in to obtain higher returns from government investments in the government companies (See figure 1 in Annexure). Since the introduction of compulsory buyback, the government has frequently used this route in several firms to liquidate its minority stake (Comptroller and Auditor General of India, 2018).

**Box 13 Capital structuring norms**

Under the new norms, the following actions have to be taken:[a]

- Every CPSE should pay a minimum dividend of 30% of profit after tax or 5% of the net-worth, whichever is higher. However, payment of lower dividend can be exempted on a case to case basis depending on factors, like business expansion needs, long term borrowings, net-worth, cash balance, etc.
- Every CPSE should exercise the option of buy-back, when its net-worth is of at least INR 2,000 crore and bank balance of over INR 1,000 crore
- Every CPSE should issue bonus shares if their reserves and surplus is equal to or more than 10 times of its paid up equity capital. In case the free reserves are more than 5 times but less than 10 times then justification to be provided for not issuing bonus shares.
- Every CPSE should split its shares when its market value exceeds 50 times of its face value.

[a]If a CPSE fails to meet any of the norms, it can file a report for exemption through the administrative ministry to the Secretary, DEA and Secretary, DIPAM.

Although it was during the UPA regime in 2012, that buyback of shares was approved as a method to meet disinvestment target, it was not made compulsory.[115] Also, since buyback involves extinguishing shares as they are sold back to the company and not transferred to the public, it is unclear whether this aligns with the disinvestment policy which aims to promote people's ownership of firms. Presently, proceeds from the buyback is considered as disinvestment proceeds.

**Exchange Traded Funds**

As part of the disinvestment policy, the government adopted the route of ETFs since *"it allowed simultaneous sale of stake in various* CPSEs *across diverse sectors through a single offering and avoids the necessity to go to the market repeatedly for divesting different stocks."* (Ministry of Heavy Industries and Public Enterprises, 2017). Further, the government's rationale for ETF is that it helps to liquidate shareholding causing minimum market disruption seen in public offerings of listed entities. Already during the Phase 3 in March 2014, CPSE ETF was launched.

[115]Under the Companies Act, 2013 decisions like buyback or declaration of dividend are left to the discretion of the board of directors. Incase of CPSEs, their articles of association carry out the effect of government instructions and directives (like the capital restructuring norms) from time to time.

During the budget speech of FY18, the government stated that considering the good response to the further fund offer of CPSE ETF, it has decided to launch one more ETF.[116] As a result, in November 2017, Bharat-22 ETF was launched which comprises of 16 CPSEs, 3 public sector banks and 3 private company stocks held by the SUUTI. The underlying index is the S&P Bharat 22 index. In 2017, the government authorised the AM to take all disinvestment decisions related to ETF, including the constitution of its portfolio (Comptroller and Auditor General of India, 2018).

**Listing of CPSEs**

Pursuant to the disinvestment policy, in the budget speech of 2017-18, the government announced putting a revised mechanism to ensure time bound listing of CPSEs (Government of India, 2017). In February 2017, DIPAM issued a revised mechanism and procedure which stated that the aim of listing CPSEs is to unlock their true value, promote public ownership, increase the disclosure norms and accountability (DIPAM, Ministry of Finance, 2017). The procedure mandated the administrative ministry, department and DIPAM to identify the eligible firms based on the criteria of positive net-worth, no accumulated losses and track of net profit in the past three immediate FYs. Further, it laid down the constitution of the IMG for appointment of advisors/intermediaries to guide the process of disinvestment through public offer. To ensure timely listing of CPSEs, a tentative timeline of 165 days has been set from the date of identification of firms by the administrative ministry/department to opening of the public offer.

During this phase the government granted approval for listing of CPSEs from time to time. However, the CAG in their compliance audit of CPSEs questioned the slow pace of listing of unlisted CPSEs and observed that as on August 31, 2018, 59 firms were listed, although there were total 90 CPSEs who met the profitability criteria. In response to the query raised by the CAG, DIPAM submitted that by end of June 2019, CSL, HAL, BDL, MIDHANI, GRSE, RITES, IRCON, RVNL, MSTC had been listed and additionally, listing of CPSEs viz. KIOCL, MDL, IRCTC, NEEPCO, THDCIL, RAILTE and IRFC was in pipeline (Comptroller and Auditor General of India, 2018). Further, it was clarified that a reasonable time gap was maintained between the listing of CPSEs to avoid lower valuations and tepid investor response. In December 2018, the CCEA approved listing of 7 CPSEs (Press Information Bureau, 2018b).

### 4.2.3 New avenues of disinvestment

Over the years, the government has expanded the scope of disinvestment and adopted new options to augment disinvestment proceeds. For this purpose, DIPAM has been authorised to supervise and implement the process.

[116] In January 2017, the first further fund offer was CPSE ETF was held.

### Sale of enemy shares

In 2018, the cabinet laid down a procedure and mechanism for sale of enemy shares which are in the custody of the Ministry of Home Affairs (MHA)/Custodian of Enemy Property of India (CEPI) (Press Information Bureau, 2018a).[117] Government's rationale for this measure is to monetise enemy shares that had been lying dormant in the past since the Enemy Property Act, 1968 came into operation.[118]

In 2017, prior to the announcement of the procedure, the Enemy Property Act, 1968 was amended which expanded the scope of 'enemy' and it includes the legal heir or successor of an enemy whether a citizen or not a citizen of India, or who has changed its nationality. Earlier, citizens were excluded. Under the approved procedure, the AM along with a High Level Committee would decide upon the quantum, price/price-band, principles/ mechanisms for sale of shares, etc. Whereas DIPAM would be responsible for executing the sale. Further, it has been decided to include the sale proceeds as part of the disinvestment proceeds in the government account.

### Asset monetisation

In the budget speech of FY17, the government took cognisance of under-utilisation of the public sector assets and expressed its intention to leverage the assets for generation of resources for deployment in new project (Government of India, 2016a).[119] For this purpose, NITI Aayog was mandated to identify the CPSEs. Pursuant to this, in 2019 the government adopted the 'asset monetisation' policy to raise funds to invest in new projects and unlock the value of unproductive assets of firms (DIPAM, Government of India, 2019).[120] The policy aims to monetise the following class of assets:

- identified non core assets of CPSEs under strategic disinvestment;[121]
- immovable enemy property under the custody of custodian of enemy property CEPI, MHA;

[117] Under the Enemy Property Act, 1968 'enemy', 'enemy subject' or 'enemy firm' means a person or country who or which was an enemy under the Defense of India Act, 1971 and Defense of India Rules, 1972. Further, 'enemy property' means any property for the time being belonging to or held or managed on behalf of an enemy, an enemy subject or an enemy firm.

[118] Around 6.5 crore shares in 996 companies are under the custody of the government. Out of these, 588 are functional companies, 139 of these are listed and the remaining are unlisted.

[119] According to the Public Sector Enterprises Survey 2016-17, the cumulative fixed assets turnover ratio (which reflects the number of times revenue is generated using the fixed assets) of operating CPSE dropped from 3.28 in FY12 to 1.95 in FY17, a decrease of 40.55% (Ministry of Heavy Industries and Public Enterprises, 2018).

[120] DIPAM formulated the process and mechanism of asset monetisation which received the CCEA approval on February 28, 2019.

[121] Seperation of non-core assets before strategic sale may help to avoid future contentions. In the case of sale of VSNL, demerger of surplus land remained a contentious issue for over a decade.

- assets of other CPSE, PSUs, other government organisation; and
- assets of sick/loss making firms under closure with prior approval of the competent authority.

Further, the government has decided to include the amount realised from the sale of non-core assets of firms considered for strategic disinvestment and sale of enemy properties as part of 'disinvestment proceeds'(DIPAM, Government of India, 2019).[122]

Under the policy, an inter-ministerial group headed by the DIPAM Secretary will identify the non-core assets on its own and also based on inputs received from the NITI Aayog. Final decision is to be taken by AM headed by the Finance Minister. AM is the highest decision making body. Once this body approves the asset, the transaction has to be completed with 12 months from the date of approval.

Given the disinvestment budget target of INR 1,50,000 crore for FY20, which is the highest ever disinvestment budgeted estimate, there is a greater push for asset monetisation. In 2019, NITI Aayog submitted a list of 50 assets but DIPAM raised certain objections and the list was expected to be redrafted (Press Trust of India, 2019a). Firms like MTNL and BSNL were identified in the beginning of the year 2020, however, no sale transaction has happened since the inception of the policy. Recently, the government has instructed NITI Aayog to prepare a list of assets which could be monetised for the next five years with an intention to intimate prospective buyers about the nature of assets available for sale (Press Trust of India, 2020a).[123]

**Sale of holdings in SUUTI**

SUUTI was set up as a statutory special administration for the management of the restructured Unit Trust of India in 2002.[124] It manages the investments of the various erstwhile UTI mutual schemes and generates revenues for the scheme and for the government. In course of its duties it regularly conducts sale of the undertaking's shares in various profitable private sector companies such as ITC Ltd., L&T Ltd. etc.

Earlier the government did not report the income obtained from the sale of its shares in different companies held as part of the scheme of undertaking as 'disinvestments'. But in March 2014, the shares of Axis Bank Ltd. held by the government as part of SUUTI's scheme were sold and the sale was reported as disinvestment. Subsequently, sale of L&T

[122]See, Para 4.4.3.

[123]In 2018, the *Committee on Public undertakings* observed that attempts to monetise assets of loss making firms have not made much progress since it failed to generate interest among buyers. The committee referred to monetisation of assets of several CPSEs, including Air India's land which failed because of lack of title deeds and limiting provisions in the lease agreements of the assets (Committee on Public Undertakings, Lok Sabha, 2018).

[124]It was set up under the Unit Trust of India Transfer of Undertaking and Repeal Act, 2002.

Ltd.'s shares in 2016 and 2017, another round of sale of Axis Bank's shares in 2017 and one round of sale of ITC Ltd. shares were conducted. The government reported a total of INR 23,801 crore as proceeds from disinvestment of shares held as part of SUUTI's scheme. Of this, INR 5500 crore were reported from the sale of Axis Bank's shares in March 2014.

The CAG in their report in 2018 questioned the practice of the government reporting the receipts from sale of shares in SUUTI scheme as proceeds from disinvestment. They noted that the account heading for these receipts should have been 'other receipts of government account' and not under 'disinvestment' (Comptroller and Auditor General of India, 2018). The excess income earned from SUUTI receipts should also not be classified as 'disinvestment'.

### 4.2.4 Revival and closure of firms

In October 2015, the DPE issued guidelines for the administrative ministry/department in preparation of proposals for revival/restructuring of CPSE under their administrative control. Aim was to streamline the existing mechanism and expedite the process of revival. As a follow up step, in the next month, the BRPSE was wound up which was set up in 2004 by the UPA government. Similarly to address the problem of sick CPSEs and inordinate delays in their closure, in September 2016, the DPE adopted the *Guidelines for time-bound closure of sick/ loss making CPSEs and disposal of movable and immovable assets*. The guidelines lay down the process for closure of CPSEs, not already under liquidation. The process is to be overseen by the administrative ministry and does not involve court or a judicial process (Department of Public Enterprises, Government of India, 2016).[125]

Although in December 2016, India adopted a new insolvency framework, the revised DPE guidelines of 2018 neither makes any reference to the IBC nor contemplates the engagement of Insolvency Professionals (IPs) or similar professionals.[126] In effect, with the DPE guidelines in place, there exists a 'parallel' framework to wind up the public firms. In 2012 i.e. before the IBC came into force, the CAG had already highlighted the need of involving professionals like Chartered Accountants (CAs) and Company Secretary (CS) in the role of official liquidator to address the agency problem and delays in closure process (Comptroller and Auditor General of India, 2012). It also noted that public and private sector companies should have a unified system of redressing insolvency.

Further on the applicability of the Code to the public sector firms, a legal dispute has

[125]Under the DPE guidelines, the closure process has four key players that make decisions: the CPSE, administrative ministry, the Cabinet and the NITI Aayog. The DPE has the role of coordination and oversight. However, once NITI Aayog gives the recommendation and Cabinet gives approval, the implementation is done by the CPSE itself and/or the administrative ministry.

[126]Since the Insolvency Code aimed to streamline the restructuring and closure process, the *Sick Industrial Companies (Special Provisions) Act*, 1985 was repealed.

arisen in the case of *Hindustan Antibiotics Ltd.* (National Company Law Tribunal, 2019). This legal challenge has come up despite there are few CPSEs undergoing resolution or liquidation under the Code. While the matter is yet to be decided by the Bombay High Court, the literal interpretation of the provisions does not indicate exemption of public sector firms from the IBC.[127] Further, using the IBC route to resolve the financially insolvent and bankrupt PSUs in a time-bound manner can expedite the process of disinvestment and can also have implications for the policy concerning their restructuring and closure (Banerjee et al., 2020).

## 4.3 Outcome of disinvestment

The government of India disinvested its stake in 50 CPSEs across 112 transactions and raised a total of INR 3,05,357 crore between FY15-20 through strategic disinvestment (CPSE to CPSE sales) and minority stake sales (using methods like public offer, buy back, exchange traded funds and sale to employees). Further, no disinvestment proceeds has been raised under asset monetisation. Also during Phase 4, the government continued the legacy of setting disinvestment targets. The targets reflected the fact that disinvestment was an important plank of the government policy. There was a substantial increase in disinvestment targets and realisations in Phase 4. Table 20 shows that the government was able to achieve its targets consecutively in FY18 and FY19. With all years combined, the government was able to achieve 77% of total disinvestment targets.

In this section, we discuss the outcome under the methods of disinvestment i.e., strategic sale and the minority stake sale.

[127] There are specific provisions in the Companies Act, 2013 which exempt government companies from certain requirements and it is a settled principle of statutory interpretation that unless there is a specific exemption, law has to be read in its literal sense.

**Table 20** Target versus realisation: Phase 4

| Year | Budget target (INR crore) | Amount realised (INR crore) |
|---|---|---|
| 2014-2015 | 58,425 | 24,348 |
| 2015-2016 | 69,500 | 24,057 |
| 2016-2017 | 56,500 | 35,592 |
| 2017-2018 | 72,500 | 95,088 |
| 2018-2019 | 80,000 | 78,369 |
| 2019-2020 | 90,000 | 47,903 |
| **Total** | **4,26,925** | **3,05,357** |

Source: Dataset on disinvestments created by the authors. Targets taken from the Union Budget Speeches.

### 4.3.1 Methods of disinvestment

For the discussion on methods of disinvestment, we have substantially used our previous work (Banerjee et al., 2020).

Table 21 provides an overview of disinvestment by various methods in the last 6 years. It shows the number of transactions, number of CPSEs, disinvestment proceeds, % of total shares sold and the change in government equity post the transaction. On an average, the government sold 7.28% of total shares and the average reduction in government equity has been around 5.84%.

**Table 21** Disinvestment from FY15 to FY20

| Methods of disinvestment | Number of transactions | Number of CPSEs | Disinvestment proceeds (INR Crore) | Average % of shares sold | Average change in % of govt equity post disinvestment |
|---|---|---|---|---|---|
| Public Offer | 37 | 32 | 98,405.4 | 10 | 10 |
| Buyback | 36 | 23 | 40,354.9 | 8.34 | 0.64 |
| Sale to Employees | 21 | 15 | 937.9 | 0.138 | 0.138 |
| Exchange traded funds | 10 | 18 | 98,949 | 1.09 | 1.09 |
| CPSE to CPSE sale | 8 | 8 | 66,711.9 | 77.15 | 77.15 |

Source: BSEPSU database and authors' calculation based on annual reports

Out of the total 112 transactions in this period, there were 8 strategic sales where one CPSE was bought by another CPSE. Proceeds from these sales contributed 22% to the

overall disinvestment proceeds in this period. The rest of the transactions were minority stake sales through methods such as ETF, public offers, buyback and sales to employees. ETF and public offer each contributed roughly 32% to overall disinvestment proceeds. Figure 6 and Figure 7 below shows the yearly distribution of amount raised and percentage reduction in equity respectively across various methods from FY15 to FY20.

**Figure 6** Trends in disinvestment proceeds from FY15 to FY20

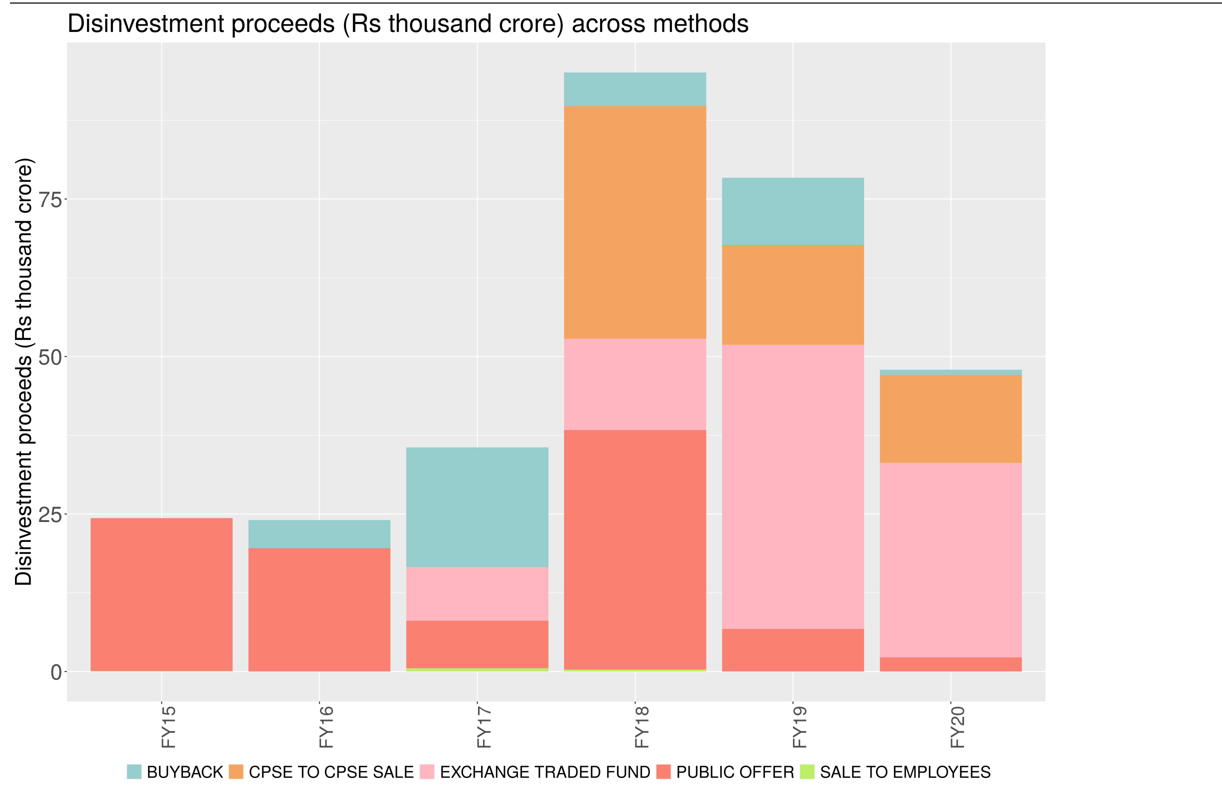
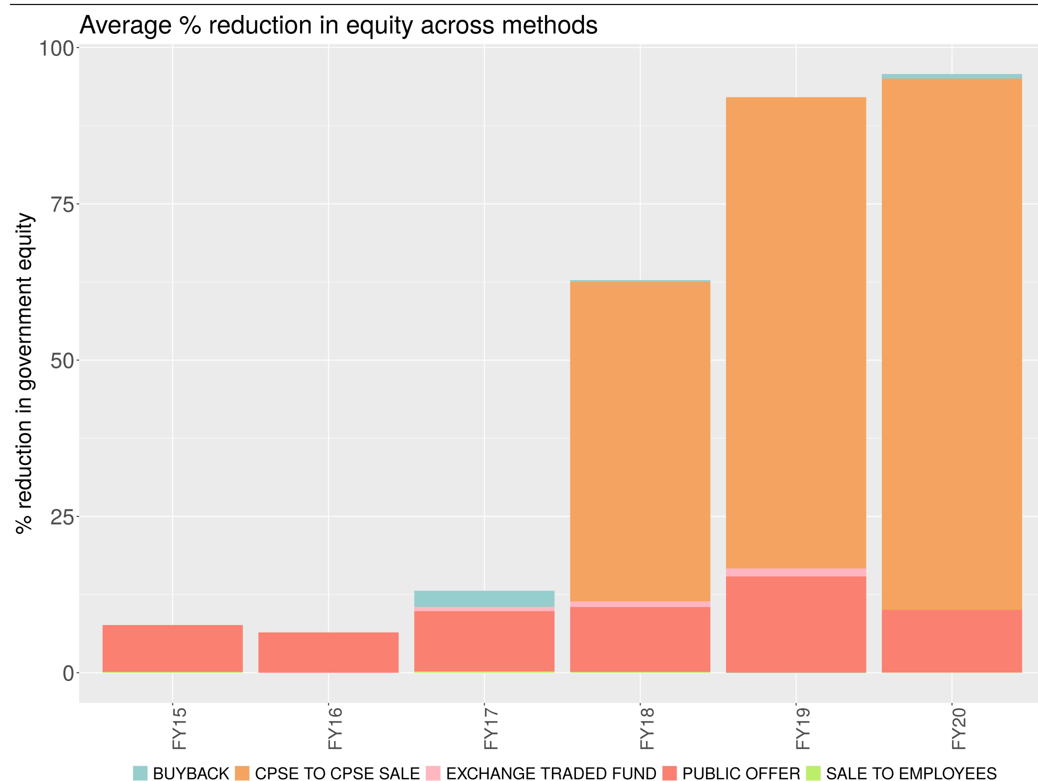


**Figure 7** Trends in reduction in equity from FY15 to FY20




The significant increase in proceeds in FY18 and FY19 is driven by ETFs and CPSE to CPSE sales. Besides CPSE to CPSE sales, the average percentage reduction in government equity remained low and constant across all years. Section 4.3.2 provides detail on strategic sales taken place in this phase. Whereas section 4.3.3 provides the outcome under the different methods adopted for minority stake sales.

### 4.3.2 Completed transactions: CPSE to CPSE sales

In the completed strategic sales, the firms were sold to another CPSE along with transfer of management control. These transactions raised a total of approximately INR 66,712 crore. The details of each of the transaction is given in Table 22. Except REC Ltd., the entire government shareholding was transferred to another CPSEs in these transactions. In case of REC Ltd., government still holds 0.25% shares.

**Table 22** CPSE to CPSE sales from FY15 to FY20

| S. No | **CPSE** | **Ministry** | **Date of transaction** | **Buyer's Name** | **% of shares sold** | **Amount realised (in INR crore)** |
|---|---|---|---|---|---|---|
| 1 | Hindustan Petroleum Corpn. Ltd. | M/o Petroleum and Natural Gas | 31/01/2018 | Oil & Natural Gas Ltd. | 51.11 | 36,915 |
| 2 | HSCC India Ltd. | M/o Health and Family Welfare | 06/11/2018 | NBCC India Ld. | 100 | 2,850 |
| 3 | Dredging Corpn. of India Ltd. | M/o Shipping | 09/03/2019 | Consortium of four ports | 73.47 | 1,049 |
| 4 | REC Ltd. | M/o Power | 28/03/2019 | Power Finance Corpn.Ltd. | 52.63 | 4,500 |
| 5 | Kamarajar Port Ltd. | M/o Shipping | 27/03/2020 | Chennai Port Trust | 66.67 | 2,383 |
| 6 | North Eastern Power Corpn. Ltd. | M/o Power | 27/03/2020 | NTPC Ltd. | 100 | 4,000 |
| 7 | THDC India Ltd. | M/o Power | 27/03/2020 | NTPC Ltd. | 74.49 | 750,00 |
| 8 | National Projects Construction Corpn. Ltd. | M/o Water Resources | 26/04/2020 | Wapcos Ltd. | 98.89 | 79.8 |

Source: BSEPSU disinvestment database. We could not find the dates of CCEA approval in the public domain.

So far strategic sale has resulted only in CPSE to CPSE sale, and there has been no transfer of ownership to a private player. As discussed earlier in section 4.2.1, the government declared its intention to create an integrated market through mergers and acquisitions so CPSEs can bear higher risks and avail benefits of economies of scale (Government of India, 2017). Possibly this could be the reason behind these transactions. For instance, in the oil sector ONGC acquired HPCL, whereas in the power sector NTPC bought REC Ltd. However, recently there was speculation that ONGC may sell shares of HPCL due to lack of synergies between the firms (Press Trust of India, 2019b). Further, HPCL had not shown ONGC as 'promoter' in its shareholding pattern filed with the stock exchanges, although the transaction was completed on January 31, 2018. It was only in August 2019, when SEBI sent a letter to HPCL to recognise ONGC as the promoter to avoid penal consequences, the shareholding pattern was corrected (HPCL, 2019). The HPCL acquisition had impacted ONGC cash reserves and debt. The buyout had converted the firm from a zero debt company into one with a debt of Rs 21,593 crore by the end of 2018-19. To payoff the debt, company's cash reserves reduced. As of September 2018, ONGC's cash and bank balances were at Rs 167 crore, down from Rs 1,013 crore in March 2018 and Rs 9,511 crore in March 2017 (NHPC, 2019).

Post these sales, the firms became subsidiaries of the buyer CPSE firms, but continue to remain government companies as defined under section 2(45) of the Companies Act, 2013. While technically the government may have divested, on an average, 77% shareholding in these CPSEs (as shown in the Table 22), it did not bring *any change* in government ownership of these firms. For instance in the ONGC and HPCL deal, the CAG observed that although the deal was as per the procedure, this disinvestment only involved transfer of government's shares in one government company to another government company

(Comptroller and Auditor General of India, 2018). Recently in 2020, the CAG again observed that disinvestment from one public sector firm to another 'did not change' stake of the government in the disinvested CPSEs (Comptroller and Auditor General of India, 2020).[128]

### 4.3.3 Minority stake sales

Between FY 15 and FY 20, 78% of the total disinvestment proceeds came from minority stake sales. Apart from public offers, there was increased adoption of other methods such as ETF, buyback and sale to employees. We evaluate each of this method based on two parameters: disinvestment proceeds raised and reduction in government equity.

**Public offer**

Public offer has been the most common method of disinvestment. In this section, for the discussion on public offer, we have included both further public offers or FPOs and OFS through stock exchange. Since FY15, there have been 37 public offer transactions including 21 OFS through stock exchange transactions.[129] The public offer route is considered as a transparent way of offloading government shares and aims to encourage public participation. However, in several public offer transactions, the LIC, whose shares are fully owned by the central government, has bought majority of the shares. In the past CAG has sought clarification from DIPAM regarding the involvement of LIC in the disinvestments for the FY18. In response, DIPAM provided information about three public offers and one OFS made by the government during the FY18. Based on the information provided to CAG, it noted that LIC bought 68.62% of government shares offered in the public offer of Hindustan Aeronautics Ltd (2017-18) and 33.56% of government shares offered during the public offer of MIDHANI (2018-19) (Comptroller and Auditor General of India, 2018).

During Phase 4, the MPS requirement was increased from 10% to 25% in listed CPSEs. As a result, there was a surge in OFS through stock exchange transactions as a method of disinvestment. However, 37 listed CPSEs out of the total 77 listed CPSEs failed to meet the MPS requirement as on December 31, 2019 (Banerjee et al., 2020). Also, the new MPS norms is yet to come into effect since the date of its operation was extended multiple times. In August 2020, CPSEs were given an extension of one more year to comply the new norms (Banerjee et al., 2020).

In July 2021, the Securities Contracts (Regulation) Rules, 1957 was amended to allow the government to exempt any listed CPSE from the minimum public shareholding requirement.

[128] See, Para 1.3.2 of the CAG report.

[129] We have covered OFS transactions between FY 15-20. In the FY 2020-21, there have been 3 more OFS transactions as on September 30, 2020 (BSEPSU, 2020b).

### Buyback

Buyback saw a surge since 2016 it was made compulsory for CPSEs who met the prescribed threshold of net worth and cash reserves. In buyback, the company is under an obligation to provide a buyback offer to all existing shareholders and extinguish the bought back shares. As a result, reduction in the total equity is higher than the reduction in government shares which may lead to an increase in % of government equity post buyback. However, if a CPSE is wholly owned by the government, total number of shares will be reduced (extinguished) by the same number of shares bought back. Hence, there will be no change in % of equity held by the government post buyback.

Table 23 presents the impact of buyback transactions on government shareholding. Since 2015, 23 CPSEs have bought back shares from the government raising INR 40,354.9 crore. It is important to note that % shares sold for three buyback transactions in FY20 is unavailable since annual report for the year is not published yet (indicated by *). Out of total 36 buyback transactions, 9 transactions led to an increase in government equity. In 11 transactions, where CPSE was wholly owned by the government, there was no change in government holding. The remaining 16 transactions recorded an average reduction of 1.19% in government equity.

In column (2) the count of individual number of CPSEs do not match with the total number of CPSEs because same 8 CPSEs recorded increase in equity in one year while decrease in another (indicated by **).

**Table 23** Summary of buyback transactions from FY15 to FY20

| **Transaction type** | **Number of transactions** | **No. of CPSEs** | **Total disinvestment proceeds(INR crore)** | **Average % of shares sold** | **Average change in % of govt equity post buyback** |
|---|---|---|---|---|---|
| Reduction in government holding | 16 | 12 | 24,494.7 | 7.63 | (1.19) |
| Increase in government holding | 9 | 9 | 8,359.07 | 2.31 | 0.16 |
| No change in government holding | 11 | 7 | 7,501.1 | 15.55* | 0 |
| Total | 36 | 23** | 40,354.9 | 8.34 | (0.64) |

Source: Authors' calculation based on annual reports

### Sale to employees

As part of its disinvestment strategy, the government has often reserved a certain quantity of its shares for offer to the CPSE employees. Usually these shares are offered

at a discount. Such transactions are expected to incentivise the employees and create dispersed shareholding. In the last six years, there have been 21 such transactions across 15 firms from which the government raised a total of INR 937.9 crore. On an average, the % of shares sold to the employees is around 0.14%. Almost half of the proceeds from this method comes from two transactions in FY17 by Indian Oil Corporation Ltd. and NTPC Ltd. In May 2016, government sold 0.29% of the total shares of Indian Oil Corporation Ltd. to its employees raising INR 262.4 crore to the 5% OFS stake in February 2016, NTPC offered to sell 2.06 crore equity shares of government to the employees at a discount rate of 5%. 85% of the shares were subscribed by around 10,800 eligible employees and government raised approximately INR 203.7 crore.

**Exchange Traded Funds**

From FY15 to FY20, there were six tranches of CPSE ETF and four tranches of Bharat-22 ETF transactions which raised INR 98,949 crore 24 lists each ETF tranche from FY15 to FY20 and provides details on allotment date, number of constituent CPSEs, amount raised by government and average reduction in % of government equity post each tranche. It is important to note that the average % reduction in government equity for three ETF transactions in FY20 is unavailable since annual report for the year is not published yet (indicated by *NA).

**Table 24** Summary of ETF tranches from FY15 to FY20

| ETF Name | ETF tranche | No. of constituent CPSEs | Allotment date of ETF units | Average % reduction in government equity | Amount realised (in INR crore) |
|---|---|---|---|---|---|
| CPSE ETF | Further fund offer 1 | 10 | 28/01/2017 | 0.98 | 5,999.99 |
| CPSE ETF | Further fund offer 2 | 10 | 25/03/2017 | 0.39 | 2,499.99 |
| CPSE ETF | Further fund offer 3 | 11 | 07/12/2018 | 2.88 | 17,000 |
| CPSE ETF | Further fund offer 4 | 11 | 29/03/2019 | 1.22 | 9,350.07 |
| CPSE ETF | Further fund offer 5 | 10 | 26/07/2019 | NA* | 10,000.39 |
| CPSE ETF | Further fund offer 6 | 10 | 07/02/2020 | NA* | 16,500 |
| BHARAT 22-ETF | New fund offer | 16 | 24/11/2017 | 0.93 | 14,500 |
| BHARAT 22-ETF | Further fund offer 1 | 16 | 29/06/2018 | 0.58 | 8,325.26 |
| BHARAT 22-ETF | Tap Offer | 16 | 22/02/2019 | 0.92 | 10,404.59 |
| BHARAT 22-ETF | Further fund offer 2 | 16 | 10/10/2019 | NA* | 4,368.8 |

Source: Author's calculation based on annual reports

While aggregate proceeds from ETF may have been high, the average reduction in government equity has been low.

## 4.4 Challenges in strategic sales

Since 2016, the CCEA has given 'in-principle' approval for strategic disinvestment of 34 CPSEs. In September 2020, the Minister of State of Finance provided the latest status of disinvestment in PSUs in response to a Lok Sabha question (Lok Sabha, 2020). Based on

this information, out of the 34 firms, transactions in 8 CPSE have been completed. Among the rest, four firms are being considered for closure while the transaction process has been stalled in two firms because of litigation. For the rest of the 20 firms, the transaction process is at different stages. In this section, we discuss the challenges that have arisen in the strategic disinvestment of some of the firms approved for sale by the CCEA. By doing this exercise, we attempt to identify the reasons which may have contributed to the delay in their strategic sale. Further for this purpose, we have referred the annual reports of the concerned firms, court decisions, replies given in the parliament and news reports.

Table 25 provides details on these firms, their administrative ministry, date of CCEA in principle approval and the status of disinvestment.

**Table 25** CPSEs given "in-principle" approval by CCEA for strategic disinvestment

| S.No. | **Name of CPSE** | **Administrative Ministry** | **Date of CCEA approval** | **Status** |
|---|---|---|---|---|
| 1 | Hindustan Fluorocarbon Ltd. | D/o Chemicals & Petrochemicals | | Consideration for closure |
| 2 | Scooters India Ltd. | D/o Heavy Industry | 27/10/2016 | Consideration for closure |
| 3 | Bharat Pumps and Compressors Ltd. | D/o Heavy Industry | | Consideration for closure |
| 4 | Hindustan Prefab Ltd. | M/o Housing and Urban Affairs | | Consideration for closure |
| 5 | Hindustan Newsprint Ltd. | D/o Heavy Industry | | Ongoing litigation |
| 6 | Karnataka Antibiotics and Pharmaceuticals Ltd. | D/o Pharmaceuticals | 01/11/17 | Ongoing litigation |
| 7 | Project & Development India Ltd. | D/o Fertilizers | | Transaction in process |
| 8 | Engineering Projects (India) Ltd. | D/o Heavy Industry | | Transaction in process |
| 9 | Bridge & Roof Co. India Ltd. | D/o Heavy Industry | 29/02/16 | Transaction in process |
| 10 | Cement Corporation of India Ltd. | D/o Heavy Industry | | Transaction in process |
| 11 | Central Electronics Ltd. | D/o Scientific and Industrial Research | 29/08/17 | Transaction in process |
| 12 | Bharat Earth Movers Ltd. | D/o Defence Production | 01/12/16 | Transaction in process |
| 13 | Ferro Scrap Nigam Ltd. | M/o Steel | 27/10/16 | Transaction in process |
| 14 | Nagarnar Steel Plant of NMDC | M/o Steel | 27/10/16 | Transaction in process |
| 15 | Alloy Steel Plant, Durgapur; Salem Steel Plant; Bhadrwati units of SAIL | M/o Steel | 27/10/16 | Transaction in process |
| 16 | Pawan Hans Ltd. | M/o Civil Aviation | | Transaction in process |
| 17 | Air India and its five subsidiaries and one JV | M/o Civil Aviation | 28/06/17 | Transaction in process[130] |
| 18 | HLL Lifecare | M/o Health | | Transaction in process |
| 19 | Indian Medicines & Pharmaceutical Corporation Ltd. | M/o Ayush | | Transaction in process |
| 20 | Indian Tourism Development Corporation | M/o Tourism | | Transaction in process |
| 21 | Hindustan Antibiotics Ltd. | D/o Pharmaceuticals | 28/12/16 | Transaction in process |
| 22 | Bengal Chemicals and Pharmaceuticals Ltd. | D/o Pharmaceuticals | 28/12/16 | Transaction in process |
| 23 | Bharat Petroleum Corporation Ltd | M/o Petroleum and Natural Gas | 20/11/19 | Transaction in process |
| 24 | Shipping Corporation of India Ltd. | M/o Shipping | 20/11/19 | Transaction in process |
| 25 | Container Corporation of India Ltd. | M/o Railways | 20/11/19 | Transaction in process |
| 26 | Neelachal Ispat Nigam Limited | M/o Steel | 08/01/20 | Transaction in process |

The first set of four firms as shown in Table 25 have been removed from the list of strategic disinvestment, and are instead being considered for closure. These firms are running in losses and it is possible that due to adverse market conditions, they received no interest from the buyers. For instance, Scooter India, a loss making company since FY10 was given in-principle approval for strategic disinvestment of entire shareholding of government's equity on October 26, 2016. In May 2018, the EOI was invited from prospective bidders but the firm received no financial proposals (PTI, 2018). In 2019, the government stalled the issue of another EOI since the automobile market was in slump (IANS, 2019a).

Due to litigation the strategic disinvestment process has been halted in two firms, KAPL and Hindustan Newsprint Limited (HNL). For instance, KAPL, a profit making pharmaceutical company was accorded the CCEA approval on November 01, 2017 for selling 100% government's equity. However, the disinvestment ran into litigation. Previously in July 2018, the Ministry of Health and Family Welfare (MoHFW) issued a notification which prohibited private sector companies to manufacture Oxytocin (Department of Health and Family Welfare, Government of India, 2018).[131] Consequently the private manufacturers challenged the notification and in December 2018, the Delhi High Court quashed the said notification (Delhi High Court, 2018).[132] Presently, the matter is sub-judice before the Supreme Court (Supreme Court of India, 2019).[133] As a result, the government has stalled KAPL's strategic disinvestment until the apex court takes a decision.[134]

Although the firms were given in principle approval for strategic disinvestment as early as in 2016, but only one strategic sale i.e. that of Air India Ltd. to Tata Sons Pvt. Ltd. has taken place. A review of the disinvestment process of 20 firms in the 'transactions in process' category shows that they are mostly at the early stages of strategic disinvestment i.e., either finalising the intermediaries or have sought EOIs from the prospective bidders. While each transaction may have its own set of challenges, we look at some of them to identify the common reasons.

*First*, transactions have failed at the stage of EOI, and in some cases multiple times. An EOI can either fail because market was not interested in buying the firm or the prospective bidders failed the eligibility criteria set by the relevant ministry. For example, in the case

[131]Oxytocin is used as first line drug for prevention and treatment of post-partum haemorrhage. However, Oxytocin has been in news because of rampant misuse of the drug on milch animals. The impugned notification allows only PSUs to manufacture and distribute Oxytocin in India. Private firms can manufacture oxytocin but only for for export.

[132]W.P.(C) 6084/2018.

[133]Civil Appeal Nos. 6588–6591 of 2019.

[134]The Department of Pharmaceuticals (DOP) has opposed the decision of strategic disinvestment of KAPL since it is a profit making firm and has been assigned the responsibility of being the sole manufacturer of Oxytocin for domestic consumption. Additionally, the Parliamentary Standing Committee on Chemicals & Fertilizers (2019-20) has recommended that the decision to disinvest should be revisited by the government in the public interest (Standing Committee on Chemicals and Fertilizers, Lok Sabha, 2020).

of Air India EOI has been issued twice, first in 2018 and again in 2020 but buyers had not expressed interest (see, Box 14). In the case of SAIL, government had accorded 'in-principle' approval for strategic disinvestment of three of its units. In February 2018, the government invited EOIs but the received EOIs did not meet the specified criteria and the process was annulled. As a result, revised EOIs had to be issued (SAIL, 2019).

**Box 14 Re-initiation of Air India privatisation**

The legacy to privatise Air India dates back to 2001 when the deal failed to take off with the exit of Tatas at the last stage of bidding. Since then no further attempt was made to disinvest Air India, and measures were taken to revive the firm. For instance in 2012 a turnaround plan and financial restructuring plan was approved. Pursuant to this plan equity infusion of INR 30,231 crore was to be made over a period of 10 years. Till the end of FY 2017, the government had already released INR 26,545 crore, however, the total loan of Air India stood at INR 48,477 crore (Lok Sabha, 2018b).

After the government gave a mandate to the NITI Aayog to identify firms for disinvestment, in May 2017 NITI Aayog proposed Air India and its five subsidiaries for strategic sale. In June 2017, the CCEA granted 'in-principle' approval to the disinvestment and the constitution of Air India Specific Alterantive Mechanism (AISAM)(Lok Sabha, 2018a).[a] This body was also expected to hive-off the surplus assets to a shell company before carrying out the privatisation. In March 2018, the PIM was issued, but no bidder participated till the last date of submission of bid. In response to the question in Lok Sabha, the government clarified that the possible reasons for non-receipt of bids were that the government retained 24% shareholding and Air India's precarious financial health (Lok Sabha, 2018b).

In February 2019, the government gave ex-post facto approval to the creation of a Special Purpose Vehicle (SPV) namely, Air India Assets Holding Ltd.[b] Pursuant to this, the debt of Air India Ltd. amounting to INR 29,464 crore, the subsidiaries which are not part of Air India and non-core/non-operational assets were transferred to the SPV(Press Information Bureau, 2019d). Towards the middle of 2019, the government signalled its intention to reinitiate privatisation of Air India. And in January 2020, the government took a second attempt. However on this occasion several changes were made to the PIM, possibly based on the past experience. Some of these were:

- Offer of 100% shares in Air India and its subsidiary Air India express
- Freezing of debt at INR 23,286.5 crore, liabilities retained at INR 8,771.5 crore
- Remaining debt and liabilities to be transferred to the SPV
- Contingent liabilities related to statutory dues and government dues to be indemnified by the government
- Government committed to pay certain employees related dues before closing of transaction
- Grant of right to use land and buildings at Delhi, Mumbai airports and corporate office for a limited period

The Covid-19 pandemic which has badly affected the global economy, especially the aviation sector, had an impact on the initial cold response. Given the cold response from the bidders and adverse market conditions, the bidding process had been further relaxed. Earlier the bidders had to absorb the pre-decided debt level of INR 23,286 crore which was a concern. Under the revised bidding parameter, a prospective buyer was allowed to value the enterprise which consisted of 15% cash and 85% towards the value of the debt (DIPAM, Ministry of Finance, 2020).[c] The deadline for submission of bids had been extended five times which includes the latest extension from October 30 to December 14, 2020.

Finally, in October 2021, Talace Pvt. Ltd., a wholly owned subsidiary of Tata Sons Pvt. Ltd. was chosen as the strategic buyer of Air India. Ownership was handed over in January 2022.

[a] Ernst & Young LLP was appointed as the transaction advisor.

[b] The SPV was incorporated in February 2018.

[c] Enterprise Value includes market capitalisation of a company, short-term and long-term debt and any cash on the company's balance sheet.

*Second*, in few firms the delays can be attributed to resistance from the workers. For instance, the disinvestment of loss making pharmaceutical firm BCPL has faced stiff resistance from the employees. BCPL suffered heavy losses post its inception. Due to such continued losses, BCPL was declared sick by the BIFR in 1993. These losses continued over the years till the year 2017 where the company managed to emerge profitable. In 2019, the CCEA decided to divest 100% of its stake. But the employees of the firm challenged this decision. In the case of *Bengal Chemical Sramik Karmachari Union v. Union of India*, a single judge Bench of the Calcutta High Court gave a judgement which said that the disinvestment of BCPL violates certain obligations of the government provided under the Constitution of India.[135] Specifically, the court said that by categorising BCPL as a non-priority sector CPSE, the central government is not ensuring the right to health provided to all persons under Article 21 read with Article 39 of the Constitution of India. The central government has filed an appeal against the decision and the matter is currently sub-judice before the Division Bench of the Calcutta High Court.

In October 2016, the government had decided to sell of HNL, but in 2017 it withdrew the proposal to sell because of political pressure in Kerala (Kerala High Court, 2018).[136] Later the government decided to sell off its entire shareholding, but the decision was challenged before the Kerala High Court in the case of *Hindustan Paper Corporation Employees Association v. Union of India*.[137] Three writ petitions were filed before the High Court where the petitioners wanted the court to direct the Kerala government to take over the firm and to declare that the firm cannot be sold to any private corporate entity. The High Court also noted that the Chief Minister of Kerala had written to the central government expressing its interest to acquire and revive the firm. Since no decision was taken on this representation, the writ petitions were filed. In October 2018, the High Court dismissed all the petitions and held that neither the state government nor the petitioners have pointed out any policy violations; nor have they asserted any specific illegality in disinvestment (Kerala High Court, 2018). In this matter, the High Court relied on the Supreme Court's decision in the case of *BALCO* where the apex court had refused to interfere in a policy decision like disinvestment unless there was an illegality involved.

However in November 2019, the Principal Bench of National Company Law Tribunal (NCLT) Delhi during the liquidation proceedings initiated against the parent company of HNL, permitted the liquidator to sell 100% shares of HNL to the government of Kerala. Presently, corporate insolvency resolution process has been initiated against HNL (Rajya Sabha, 2020). Again in the case of Bridge & Roof Company India Limited, EOI was issued on October 12, 2017. However, the EOI had to be put on hold after the company workers moved to the Supreme Court protesting divestment. Further, on January 31, 2020, the managing director of the company gave a statement to a national daily that the firm is considering writing to the centre to reconsider the disinvestment plan since they have been

[135] 2018 (3) CHN (Cal) 133

[136] Hindustan Newsprint Limited is 100% subsidiary of Hindustan Paper Corporation Limited.

[137] WP(C). No. 5550 of 2017.

profitable for four consecutive years which shows increased business (Rakshit, 2020).

*Third*, there have been modifications in disinvestment decisions taken by the government in some of the firms which may have prolonged the process of strategic sale. For instance, Ferro Scrap Nigam Limited (FSNL), a subsidiary of MSTC Limited was given 'in-principle' approval in October, 2016 but later removed from the list due to absence of tangible assets, except machinery. Further it was argued that the firm is responsible for disposal of ferrous and non ferrous scrap of steel plants of SAIL, Rashtriya Ispat Nigam Limited (RINL) and other government departments and therefore, it makes no sense for a private company to buy scrap machinery (Press Trust of India, 2017). Later the steel ministry had proposed the merger of this firm with SAIL, but in 2019 the plan was rejected possibly due to adverse market conditions and the worsening financial health of SAIL (IANS, 2019b). As a result, government decided to go for strategic disinvestment of the firm instead. Presently, the Request for proposal (RFP) for intermediaries has been floated by MSTC Limited.[138]

Incase of EPIL, in February 2016 the CCEA had decided to merger the firm with a similarly placed CPSE. As per the information available in the Annual Report of EPIIL, in September 2019, the earlier approval was modified and the government decided to allow all eligible CPSEs and private sector entities to participate in bidding process for strategic disinvestment of EPIL (EPIL, 2019).

In addition to the above reasons, the administrative machinery may be reluctant to take prompt decisions given the past experience of accusations associated with privatisation deals (Rai, 2019). For instance, there are ongoing court proceedings on the grounds of alleged corruption in the privatisation case of HZL and sale of one of the properties of ITDC in Udaipur. Both the transactions were concluded back in 2002. In case of HZL, the Supreme Court has instructed the CBI to file a closure report into the alleged undervaluation of the firm (Press Trust of India, 2020b). Similarly in the sale of ITDC hotel, the CBI found no evidence of corruption in its closure report. However in September 2020, a special CBI court in Rajasthan's Jodhpur district, rejected the report and ordered the registration of a criminal case against the then Disinvestment Minister, Arun Shourie and few retired bureaucrats, who were involved in the privatisation deal in 2002 (Mukherjee, 2020).

## 4.5 Summarising Phase 4

As the NDA government was formed in 2014, there were initial speculations about the revival of strategic disinvestment. However, the government carried out minority stake sale in the first FY and decision was taken to retain control over the CPSEs. In the budget

[138] Last date of submission of EOI was 30.01.2020 which got extended upto 28.02.2020.

speech of FY 15-16, the government announced that it may consider to raise disinvestment proceeds from strategic sale, but did not spell out any disinvestment strategy. But it brought strategic sale back into the discussion, after it was put on hold during the UPA regime. It was in 2016, the government issued the new disinvestment policy which clearly laid down its two pronged approach i.e., strategic sale and minority sale.[139] Also, the cabinet approved the new strategic disinvestment procedure. For instance, for the first time an external monitoring body was created consisting of retired constitutional heads like CAG, CVC and the Chief Justice of India, to oversee the process of strategic sale.

To initiate the process of strategic sale, the NITI Aayog, which was set up in January, 2015 to succeed the Planning Commission, was given the mandate to identify the firms and submit the list of firms to DOD. During this phase, the word 'disinvestment' was dropped from the name of DOD, and the department was rechristened as DIPAM. This was done because government expanded the traditional mandate of DOD from managing disinvestment to managing investment in the public sector firms. Government expects DIPAM to manage its investments in the CPSEs in a better manner and obtain higher returns. Initially the NITI Aayog selected the firms for strategic sale, and DIPAM executed the disinvestment process. But in 2019, the role of DIPAM was further expanded and it was authorised to give recommendations to the IMG on selection of firms for strategic disinvestment.

During the exercise of selection of firms, a debate arose on the interpretation of the term 'strategic sector'. Possibly to settle this issue, in 2020 the government announced that it would notify a new policy on strategic sectors. Under the proposed policy, at least one and maximum four public sector firms would be present in the strategic sector and private sector firms will also be allowed. In other sectors, CPSEs will be privatised.

Phase 4 saw measures to expedite the process of decision making in strategic sale. For instance, a new body called as AM, headed by the Finance Minister, was created to take crucial decisions on the firms which have already received CCEA's 'in-principle' approval. This was done to avoid CCEA's involvement at every step. Later in 2019, the AM was vested with more powers to decide on issues like, quantum of shares to be sold, final pricing, etc.

In the past six years, the CCEA approved a total of 34 firms for strategic disinvestment, including both profit and loss making entities. Clearly this was a departure from the UPA government's policy which disallowed privatisation of profit making firms. Although in the current phase transfer of control to private players is yet to take place, out of the 34 firms, 8 of them have been sold to another CPSE. For instance, HPCL was sold to ONGC and NTPC Limited (NTPCL) acquired the shares of REC Ltd. Given a prohibition was imposed in 2002 on CPSEs to participate in disinvestment of other public sector firms as

[139]The NDA government was re-elected in 2019 and followed the same disinvestment policy as adopted in the first term.

bidders, exceptions were made for these transactions. While the CAG observed that this nature of disinvestment did not change government's equity, the government justified the transactions as necessary to reap the benefits of vertical integration in the market.

For the remaining firms, 4 are being considered for closure after initial attempts to sell them did not materialise, 2 firms have run into litigation, and transactions in 20 firms are still in process. As part of the privatisation drive, the government revived the sale of Air India, since it was last attempted in 2001. First bids were invited in March 2018 but it failed. As a result EOIs were again invited in January 2020. Despite several measures to make the deal attractive like, reduction in the debt amount, offering 100% shares for sale and relaxation in the method of firm valuation, so far it has received a cold response from the bidders. As a result, since January 2020, the deadline for submission of bids has been extended five times. Finally in October 2021, Talace Pvt. Ltd., a wholly owned subsidiary of Tata Sons Pvt. Ltd. was chosen as the strategic buyer. Ownership was handed over in January 2022.

As most of the strategic sale transactions are still in process, there could be several reasons for the delay like, financial position of the firms, lack of interest from buyers, litigation, adverse market conditions, and the ongoing pandemic. Also, unlike the NDA government in Phase 2 which clearly stated privatisation as part of its disinvestment policy, the incumbent government adopted a cautious approach. This can be inferred from measures like strategic sale of CPSEs to other government owned firms and decision to reduce government equity below 51% in select CPSEs, but without transfer of management control. Another reason could be the past experience of controversies associated with the privatisation (Rai, 2019). For instance, although the privatisation of HZL and sale of properties of ITDC were concluded in 2002, there are ongoing court proceedings against the retired bureaucrats on the grounds of alleged corruption.

This phase witnessed a constant push for sale of minority stake. One of the reasons for this could be an increase in the minimum public float in listed public sector firms from 10% to 25%. To meet this, OFS through stock exchange has been a preferred method of disinvestment. Although there have been multiple OFS transactions, several listed CPSEs still fail to meet the MPS requirement. As a result, the minimum public float norms are yet to come into operation and the deadline for meeting the requirement was extended repeatedly.[140]

Other methods of minority sale included ETF and buyback. Although ETF was introduced in the previous phase, it was frequently used in Phase 4. Considering good response from the buyers, the government launched Bharat 22 ETF in 2018. Even buyback saw a surge after it was made compulsory under the new capital restructuring norms. Between FY 15-20, a total of 36 buy-back transactions took place contributing to proceeds of INR

[140] We note that in July 2021, the Securities Contracts (Regulation) Rules, 1957 was amended to allow the government to exempt any listed CPSE from the minimum public shareholding requirement.

40,3549 crore. However, the average change in government's equity is only 0.64%. Further, the capital restructuring norms made corporate actions like, declaration of dividend, issue of bonus shares and splitting of shares compulsory. This may be considered as a deviation from the past policy of promoting greater corporate autonomy envisaged under the 'Ratna' system.

During this phase, the government expanded the scope of disinvestment and added innovative avenues to augment disinvestment proceeds like, sale of enemy shares, asset monetisation policy which included sale of non-core assets of firms identified for strategic sale and sale of strategic holdings in SUUTI. Although these options may not reduce government's equity in public sector firms, the proceeds have been brought within the ambit of disinvestment, possibly to meet the fiscal deficit. In addition to carrying out strategic and minority sale, DIPAM has been authorised to carry out these transactions.

Overall Phase 4 witnessed several announcements of big ticket strategic disinvestment 'signalling' privatisation. However, there have been only strategic sales between CPSEs. The government managed to raise INR 3,05,357 crores between FY 15 to 20, on an average, the government sold 7.28% of total shares and the average reduction in government equity has been around 5.84%. Out of the total disinvestment proceeds, 78% have come from sale of minority stake using methods like public offer, ETF and buyback. Out of these methods, public offer and ETF have contributed to 32% of the disinvestment proceeds. Although some of these methods have contributed to disinvestment proceeds, there has not been commensurate reduction in the government's equity. Moreover, this is not in sync with the government's intention to exit from the non-strategic businesses for efficient utilisation of the public resources. Given the political majority the incumbent government enjoys, further privatisation could take place in the remaining term of the government which ends in 2024.

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# Appendices

## A Annexures from Phase 1

### Summary statistics

**Table 26** List of first 30 CPSE selected for disinvestment in FY 1991-92

| Sl. No | Name of the CPSE | Percentage of disinvestment in 1991-92 |
|---|---|---|
| 1. | Andrew Yule and Co. Ltd. | 9.46 |
| 2. | Bharat Earth Movers Ltd. | 20 |
| 3. | Bharat Electronics Ltd. | 20 |
| 4. | Bharat Heavy Electricals Ltd. | 20 |
| 5. | Bharat Petroleum Co. Ltd. | 20 |
| 6. | Bongaigaon Refinery and Petrochemicals Ltd. | 20 |
| 7. | CMC Ltd. | 16.5 |
| 8. | Cochin Refineries Ltd. | 6.09 |
| 9. | Dredging Corporation of India Ltd. | 1.43 |
| 10. | Fertilizers and Chemicals (Travancore) Ltd. | 1.52 |
| 11. | H.M.T Ltd | 4.9 |
| 12. | Hindustan Cables Ltd. | 3.71 |
| 13. | Hindustan Organic and Chemicals Ltd | 20 |
| 14. | Hindustan Petroleum Corporation Ltd. | 20 |
| 15. | Hindustan Photofilms Mfg. Co. Ltd | 12.53 |
| 16. | Hindustan Zinc Ltd. | 20 |
| 17. | Indian Petrochemicals Corpn Ltd. | 20 |
| 19. | Indian Telephone Industries Ltd. | 19.98 |
| 20. | Madras Refineries Ltd. | 16.91 |
| 21. | Mahanagar Telephone Nigam Ltd. | 20 |
| 22. | Minerals and Metals Trading Corpn. Ltd. | 0.67 |
| 23. | National Aluminium Co. Ltd. | 2.72 |
| 24. | National Fertilizers Ltd. | 2.28 |
| 25. | Neyveli Lignite Corpn. Ltd. | 4.59 |
| 26. | Rashtriya Chemicals and Fertilizers Ltd. | 5.64 |
| 27. | Shipping Corpn of India Ltd. | 18.49 |
| 28. | State Trading Corpn. of India Ltd. | 7.98 |
| 29. | Steel Authority of India Ltd. | 5 |
| 30. | Videsh Sanchar Nigam Ltd. | 15 |

**Source: PE Survey (1992-93)**

**Table 27** Events from FYs 1991-92, 1992-93 and 1993-94

| Objective | Policy action | Outcome |
|---|---|---|
| • Budget Speech 1991-92<br>– Raise resources (upto Rs 2500 crore)<br>– Greater public participation<br>– Greater accountability<br>• Budget Speech 1992-93 - Raise resources upto INR 2,500 crore<br>• Budget Speech 1993-94 - Raise resources upto INR 3,500 crore | • For 1991-92, disinvestment upto 20% shares was done in select CPSEs, shares sold in bundled form to institutional investors.<br>• From 1992-93 onwards, *auction* method was adopted and shares were sold on individual enterprise basis.<br>• Cross holdings of shares in three oil companies i.e., ONGC, IOCL and GAIL were carried out.<br>• Amendment in Sick Industrial Companies (Special Provisions) Act, 1985 to refer sick CPSEs to BIFR.<br>• Thrust on MoUs. | • FY 1991-92:<br>– Amount realised from 47 CPSEs: INR 3038 crore<br>– Method used: Auction<br>– MoUs signed: 72<br>• FY 1992-93<br>– Amount realised from 35 CPSEs: INR 1912 crore<br>– Method used: Auction<br>– MoUs signed: 98<br>– 40 firms were registered with BIFR<br>• FY 1993-94<br>– Amount realised in the next FY<br>– Method used: Auction<br>– 47 firms were registered with BIFR<br>– MoUs signed: 101 |

**Source: Budget Speech (1991-92) and PE Survey (1992-93), (1993-94)**

**Table 28** Events from FYs 1994-95, 1995-96 and 1996-97

| Objective | Policy action | Outcome |
|---|---|---|
| • Budget speech (1994-95): Raise resources (Upto Rs 4000 crore)<br>• Budget speech (1995-96) - Raise resources upto INR 7000 crore<br>• Budget speech (1996-97)<br>– Raise resources upto INR 5000 crore<br>– Resources to be used for education and health<br>– Announcement of setting up of DC in line with the CMP of newly formed United Front government to strengthen for better transparency | • Several reforms were made in the FY 1994-95:<br>– Public bidding lowered from Rs 1 lakh to Rs 25,000 or value of 100 shares, whichever is higher.<br>– FII registered with SEBI, NRI and OCB were allowed to participate in auction.<br>• In 1996-97, DC was set up the chairmanship of G.V.Ramakrishna. 40 CPSEs were referred for disinvestment<br>• Government planned GDR issues in petroleum and telecom sectors. | • FY 1994-95<br>– Amount realised from 13 CPSEs: INR 4843.07 crore<br>– Method used: Auction<br>– 53 firms were registered with BIFR<br>– MoUs: 100<br>• FY 1995-96<br>– Amount realised from 5 CPSEs: INR 362 crore<br>– Method used: auction and<br>– 56 firms were registered with BIFR<br>– MoUs signed: 104<br>• FY 1996-97<br>– Amount realised from only 1 CPSE i.e., VSNL: INR 380 crore<br>– Method used: GDR<br>– 60 firms were registered with BIFR<br>– MoUs signed: 110 |

**Sources: Budget Speech (1994-95), (1995-96), (1996-97) and PE Surveys (1995-96) and (1996-97)**

**Table 29** Events from FYs 1997-98 and 1998-99

| Objective | Policy action | Outcome |
|---|---|---|
| • Budget speech (1997-98): Raise resources upto INR 4800 crore<br>• Budget speech (1998-99)<br>– Raise resources upto INR 5000 crore<br>– Reduce shareholding to *26%* in all CPSEs, except for strategic considerations | • In July 1997, 'Ratna' category was introduced for promoting autonomy in decision making by CPSEs and to support them to become 'global giants'. | • FY 1997-98<br>– Amount realised from 1 CPSE i.e., MTNL: INR 902 crore<br>– Method used: GDR<br>– 62 firms were registered with BIFR<br>– MoUs signed: 108<br>• FY 1998-99<br>– Amount realised from 5 CPSEs: INR 5371 crore<br>– Out of the total proceeds, INR 4,184 crore was realised from ONGC, GAIL and IOC<br>– Method used: GDR in VSNL, domestic offerings in (CONCOR and GAIL) to FII, cross purchase of shares in GAIL, ONGC and IOC<br>– 67 firms were registered with BIFR<br>– MoUs signed: 108 |

**Sources: Budget Speeches (1997-98), (1998-99) and PE Surveys (1997-98), (1998-99)**

# B Annexures from Phase 2

## B.1 Details of individual strategic sales

### Modern Foods Industries (India) Limited

#### Background

MFIL was the first CPSE to be privatised. In 1965, MFIL was incorporated as Modern Bakeries India Ltd. to popularise wheat consumption and to set up model bread production facilities based on hygiene and nutrition (Disinvestment Commission, 1997a). The firm started its commercial production in 1968 across four plants and by 1979, it had diversified into non-bakery products.

#### Recommendations of DC

Although MFIL was a profit making firm, in February 1997, DC recommended for transfer of 100% shares to a strategic buyer. The commission observed that MFIL suffered from under utilisation of facilities and over-staffing. For e.g., MFIL had 14 workers per line compared to 8 workers in other firms with the same capacity. Further, bakery was a low margin business so cost control was required, which was not possible with the removal of wheat subsidies. Moreover, bread making was a competitive industry with the presence of several private players, hence, the commission found a government firm unfit to operate in a non-core area (Disinvestment Commission, 1997a).

#### Implementation

Initially, the United Front government had agreed for sale of only 50% shares but later in January, 1999 during the NDA government, it was raised to 74%. Since FY 1998-99, MFIL had started incurring losses. Pursuant to advertisement issued by the government 10 EOIs were received, but most of them withdrew and only 2 bidders were left at the final stage. However, only HLL submitted the final bid which meant there was only one bidder in the race. As soon as the MFIL was acquired, HLL changed the accounting procedure which lead to erosion of MFIL's net-worth and it was referred to BIFR (Lok Sabha, 2001d).[141] This created apprehensions in the market like possible retrenchment of workforce (Ray, 2001). However, government clarified that this was merely a technical requirement to meet compliance under the Sick Industrial Companies (Special Provisions) Act. Several measures were taken like extending corporate loan and corporate guarantee to strengthen financial position of MFIL. In March, 2002 BIFR accepted the revival plan of MFIL submitted by HLL (Lok Sabha, 2003c).

[141] MFIL did not make provisions for outstanding receivables more than five years old. This approach was immediately changed after privatisation to align with the accounting procedures of HLL.

However, the first privatisation deal of India could not escape controversy. In July 2001, the CAG in its preliminary report raised several issues with the transaction like appointment of global advisor, valuation of plant and machinery, land and buildings, non-valuation of intangible assets and selection of strategic partner (Lok Sabha, 2002b).[142] Although it was a preliminary report, it grabbed public attention. For instance, Outlook published a story '*Suspicion mould on this bread*' which speculated the possibility of review of disinvestment process followed by the government (Kang, 2001).

Although MFIL was valued at INR 78 crore, government fortuitously received INR 105.45 crore from HLL (Kang, 2001). But few years later in 2006, the CAG audit report strongly criticised the deal and questioned the valuation on various grounds. For instance, while MFIL had 24 franchisees yet they were valued at 'nil'. Although this was the first privatisation transaction, reserve price was not fixed for which no explanation was provided.[143] Further, valuation of core assets like plants and leasehold lands were not appropriately considered which resulted in under valuation and loss to the government (Comptroller and Auditor General of India, 2006).[144] Similarly CAG wanted valuation of intangible assets like goodwill, whereas government defended that it did not sell goodwill separately and was already counted in the DCF method (Comptroller and Auditor General of India, 2006).[145] Further, irregularities were found in the appointment of the GA, like time gap between its appointment and execution of contract.

Since this was the first case of privatisation, job loss was a big concern. However, the fears did not come true and no jobs were lost. Government had imposed a restriction on retrenchment in the shareholders agreement for the first year post sale to HLL, unless certain conditions were met.[146] However, noise was created after a newspaper article published that employees in the Delhi factory were forced to accept VRS. However, it was clarified that MFIL introduced a VRS package in June 2000 after signing a memorandum of understanding with employees union, which was more generous than VRS offered by government. Also, employees were given an option to rejoin duties if they felt pressurised to opt for VRS. Only 9 workmen accepted the offer but it could not materialise because they wanted an assurance of no transfer to other units which was one of the service conditions in MFIL. As far as compensation was concerned, wages were increased which was not possible without privatisation (Lok Sabha, 2001e).

Despite controversies, government went ahead and sold the remaining 26% shares to HLL in November, 2002. Also, the immediate performance of MFIL recorded substantial improvement on factors like capacity utilisation, production and sales revenue. For

[142] In August 2001, government sent a detailed reply to the audit observations.

[143] The government used a range of values upto INR 78.55 crore.

[144] For instance, as per the CAG plant and machinery had a valuation of around INR 8.64 crore. However, government was of the view that they were outdated and fit to be sold as scrap

[145] See, page 35.

[146] Severance benefits had to be higher of either the VRS scheme of government or benefits applicable under the law.

instance, in 2001, capacity utilisation had increased by 53% and production by 94% compared to the previous year (Lok Sabha, 2002c).

**Table 30** Milestones in MFIL's disinvestment

| Year | Developments |
|---|---|
| February, 1997 | Disinvestment Commission recommended disinvestment upto 100% |
| September, 1997 | CCD approved 50% disinvestment through strategic route |
| October, 1998 | ANZ Grindlays bank appointed as global advisor |
| January, 1999 | CCD raised the disinvestment level to 74% |
| April, 1999 | EOI was invited |
| January, 2000 | Selection of Hindustan Level as strategic partner<br>First round of disinvestment - 74% shares sold for INR 105.45 crore |
| November, 2002 | Second round of disinvestment – Government exercised put option to sell remaining 26% shares for INR 44.07 crore |

### Bharat Aluminium Company Ltd.

### Background

BALCO was set up in 1965 to manufacture and sell aluminium metal and semi-fabricated products. In 1984, like many other government firms, BALCO was asked to take over a private sick unit in West Bengal which expanded its downstream operations. Previously there had been no disinvestment in BALCO and the government held all the shares (Disinvestment Commission, 1997b). The aluminium industry was classified into two segments — primary aluminium manufacturers and secondary fabrication units with three public firms and one private firm in the primary market.[147] Although India had 12% bauxite reserves, it produced only 3% of the aluminium in the world which reflected its poor manufacturing capacity (Baijal, 2008). While BALCO had a favourable product mix, its products did not fare well in the secondary segment due to poor quality and pricing.

#### Recommendations of DC

In April 1997, the commission submitted recommendations on BALCO wherein it observed that while several players existed in the secondary segment, primary segment was oligopolistic with huge entry barriers. Post liberalisation, import duties were reduced and prices got linked to the international prices, like London Metal Exchange. In the opinion of the commission, even with less number of players, primary market was competitive (Disinvestment Commission, 1997b).

[147] The three firms were NALCO, HINDALCO and INDAL. HINDALCO is a private player owned by the Aditya Birla group.

The commission observed that due to increase in international prices and improved levels of operations, BALCO recorded improvement in financial performance from FY 1992-96 on parameters like operating income and operating profit (Disinvestment Commission, 1997b).[148] However, despite the improvement in financial performance, BALCO suffered from several problems like inadequate supply of ore, high cost of extraction, high transportation cost, outdated Solderberg smelting technology, over staffing and lack of autonomy (Disinvestment Commission, 1997b).

Since HINDALCO was about to commission its new smelter project, market share of BALCO was expected to go down from 17% to 12%. Further, in view of the commission, the market was contestable with the liberalisation of import duty. Given this situation, although the commission had earlier identified BALCO as a core group, it reviewed the position and categorised BALCO as non-core for the purpose of disinvestment. The commission recommended immediate disinvestment of 40% shares through strategic route (domestic or foreign buyer) followed by public offer within 2 years to reduce the shareholding to 26% and eventually complete exit (Disinvestment Commission, 1997b).

**Implementation**

Towards the end of 1997, government accepted DC's recommendation and the work was initiated. In 1999, Jardine Fleming was appointed as the global advisor, although a formal agreement was executed only in 2001. Prior to disinvestment, BALCO went through restructuring. Since it had a bloated capital structure, its unutilised free reserves was used to reduce the capital which raised INR 244 crore for the government. As government held the entire shares, there was no change in its shareholding post restructuring (Department of Disinvestment, Ministry of Finance, 2007).[149] In June 2000, EOIs were invited. Although it was a global advertisement, only eight bidders responded. IMG rejected two of them and finally three of them conducted due diligence of BALCO.[150] Since ALCOA withdrew at the final round of bidding only two domestic bidders were left (Lok Sabha, 2001b).[151]

Four methodologies were used to determine range of valuation for 100% equity including asset valuation methodology. Once range of value was fixed, it was applied to value 51% equity.[152] Since BALCO was a going concern, EC adopted DCF method as the appropriate methodology.[153] A reserve price of INR 514 crore which included a premium

[148]Operating income had increased from INR 394.3 crore in FY 92 to INR 601.44 crore in FY 96. Between the same period, operating profit had increased from INR 46.5 crore to 197.6 crore.

[149]BALCO's paid up capital of INR 488.85 crore was reduced to INR 244.42 crore.

[150]Three bidders were ALCOA (U.S.), HINDALCO and Sterlite Industries.

[151]On March 1, 2001, the Minister of Disinvestment, Arun Shourie, during the debate on motion to disapprove BALCO's disinvestment, clarified that ALCOA did not participate in the final round because it found BALCO's plant obsolete and needed certain assurances from the government which was denied.

[152]Four methods were DCF method, comparables method, balance sheet method and asset valuation method.

[153]DCF is used to assess how much a going concern business is likely to earn in the future.

fee for transfer of management control was fixed.[154]

Sterlite's bid was INR 551.50 crore whereas HINDALCO's quoted an amount of INR 275 crore. On February 21, 2001 CCD accepted the bid of Sterlite and the news was made public. Since privation remained a political issue and perceived as an immediate cause of job loss, the agreement provided the following clause:

> *Clause 7(e) says that the strategic buyer shall not retrench any part of the labour force of the company for a period of one year from the closing date of the transaction.*

Further, there was a prohibition on asset stripping for a period of 3 years and after three years selling any asset beyond 20% of total assets required affirmative vote of the government. These protections were incorporated to protect interest of all stakeholders for a peaceful transition (Lok Sabha, 2001b).

However, decision to accept Sterlite's bid triggered a furore in India. Between February 23 and 24, 2001, slew of writ petitions were filed — two in Delhi High Court and one in the High Court of Chattisgarh. The principle argument was that prior to disinvestment, BALCO was a 'state' and its workers enjoyed protection under Article 14 and 16 of the Constitution which was lost due to privatisation. One of the mines of BALCO was located in Korba district of Chattisgarh on a land acquired and provided by the state government to the firm. Hence, it was challenged that transaction violated the MP Land Revenue Code and was against the basis on which the land was acquired and allotted to BALCO (Lok Sabha, 2001b).

While the petitions were pending, on March 03, 2001 opposition moved a motion in the Lok Sabha to disapprove the disinvestment of BALCO. Since the allegation was that government sold a profit making CPSE to a private entity at a throwaway price, opposition demanded a JPC probe (see, Box 15). Government defended the decision to privatise and clarified that it only implemented the recommendations of the DC which was set up by the United Front government. Further, it was argued that the earlier governments from 1991-1997 adopted an *erroneous policy* of selling minority shares of the blue chip companies to cover up the fiscal deficit which neither changed the performance of the firms nor served the objective of disinvestment (Lok Sabha, 2001b).

Regarding valuation of BALCO which was the central point of criticism, opposition argued that government made a grave error by not valuing each asset which caused huge loss to the ex-chequer. However, government responded that four methods were used to value the deal which included the asset valuation methodology. However, since BALCO was

[154] Although the advisor viewed premium to be between 10-15%, Evaluation Committee recommended a premium fee of 25%. on the base value of equity.

being sold as a going concern and not liquidated, EC considered DCF as the appropriate method in line with accounting practices and global norms. The then, Minister of Law and Justice, Company Affairs and Shipping, Arun Jaitley who defended the government during the Lok Sabha debate on March 03, 2001 made the following remarks on the allegation of under valuation (Lok Sabha, 2001b):

> *Proof of valuation is in producing a better valuer. Proof of valuation is not ill-informed suggestions. Please bring a better valuer if one exists. And the answer is, 'No, I cannot produce a better valuer but I will go ahead and only discredit...*

Another bone of contention was DC had recommended dilution of 40% stake, but government sold 51% shares. On this issue, government argued that the chairman of the DC, G.V.Ramakrishna in a letter dated June 12, 1998, advised to transfer management control because aluminium prices were tumbling and 40% may not have attracted buyer.[155] Fierce Parliamentary debate continued for seven hours and at the end the motion was put to vote and negatived.[156] On March 2, 2001 government executed the shareholders and share purchase agreement with Sterlite Industries.

**Box 15 Some extracts from Parliamentary debate on motion to disapprove BALCO's disinvestment**

Opposition's view:

> *Disinvestment and privatisation are two things. If the equity participation of a management is 51 per cent, it is not disinvestment, it is total privatisation. If it is below 51 per cent, as the Congress did, it is disinvestment...*
>
> *Strategic sale is not a strategic hand-over of the management. The Congress said that strategic sale means to give part of it to get fresh capital and technology. What did you do? You have chosen a strategic owner and not a partner. How can there be a partner having 51 per cent equity? He will be the owner. How can the shareholder with 49 per cent equity dominate over one with 51 per cent equity?...*

Government's view:

> *The object is, you improve performances. This is the world experience. You turn around sick units, units which are on the verge of closing down, units which are even profitable but are now*

[155] Arun Shourie, Minister of Disinvestment, referred to the letter dated June 12, 1998 during the debate on the motion to disapprove disinvestment of BALCO. The said letter has also been referred in the Supreme Court's judgment in the matter of *Balco Employees Union V. Union of India.*

[156] Debate on the motion started at 13.53 hrs and ended late evening at 20.42 hrs. 119 votes were cast for the motion and 239 votes against the motion.

> *getting out. The downturn is moving. The profits must increase. The wealth of the units must increase. That is how, jobs are being saved. Jobs are not saved by just saying it is a sick unit, let me put in taxpayers' money back into this unit, try and give it artificial restoration for some time...*
>
> *The total disinvestment money accrued in the first 10 years is about Rs.18,000 crore and the charge is that the bulk of this amount of Rs.18,000 crore worth disinvestment took place during the Congress regime and the United Front regime. Were you using it for bridging the budgetary deficit? So, you got about Rs.17,900 crore as dividend and Rs.18,000 crore from disinvestment, a total return of Rs.36,000 crore. To get the PSUs going during this period, you ploughed back an amount of Rs.77,006 crore. Therefore, the amount that you ploughed back to keep them going was almost double the figure of dividend and disinvestment money put together....*

However, on the next day, 7000 workers at the Korba plant in Chattisgarh went on a strike. Protest was spearheaded by the BALCO workers union under the banner of BALCO *Bachao Andolan* with representatives from several labour unions including All India Trade Union Congress (Mishra, 2001). Political battle grew intense as Chattisgarh was a Congress ruled state and the then Chief Minister Ajit Jogi threatened to cancel the mining and land lease granted to BALCO (Gangopadhya, 2001). Strike lasted for 67 days and ended on May 9, 2001, when the new management promised a back pay of two months and assurance of no lay offs (BBC, 2001). As a result of the strike, BALCO had to incur a loss estimated around INR 200 crore and later during an interview with India Today, the chairman of Sterlite Industries, Anil Agarwal, admitted (Mishra, 2001):

> *It was the biggest challenge of my life. It's like buying a second-hand car. Sometimes you have to spend money on unexpected repair of such cars.*

Public outcry continued during the major portion of the year 2001. Rather situation became worse in April, 2001 when the SEBI prohibited Sterlite Industries from accessing the capital market due to violation of 'unfair trade practices' regulations (Supreme Court of India, 2001). Government had to face criticism for selling a profit making firm to a blacklisted entity. To put an end to the increasing controversy, government suo-moto referred the deal to CAG. Finally, relief came on December 10, 2001, when the Supreme Court gave a thumping approval to the transaction and rejected all grounds raised in the petitions (Supreme Court of India, 2001).

On the issue of workmen protection, the court held that earlier rights of protection under Article 14 and 16 of the Constitution neither prohibited government to disinvest a firm nor there was any principle of natural justice which entitled workers a right of continuous consultation at every stage of the disinvestment. Regarding the allegation of violation of land use, the court found that change of management or in the shareholding did not mean transfer of land from one company to another. While 'reserve price' was the

bone of contention, the court limited itself to the procedure and held that since valuation was done using a recognised methodology, followed by competitive bidding and the highest bidder was granted the deal, there was no need to venture into the question of facts. This was a big relief to the incumbent government. Finally the court held that:

> *The decision to disinvest and the implementation thereof is purely an administrative decision relating to the economic policy of the State and challenge to the same at the instance of a busy-body cannot fall within the parameters of Public Interest Litigation.*

Since the *trinity* of valuation, workers protection and land remained volatile issues in privatisation and amenable to judicial challenge, the ruling of the apex court was expected to pave way for the future strategic deals. However within a year the controversy was re-ignited, when in September 2002, the CAG issued the preliminary report and revealed shortcomings in the deal. This gave further ammunition in the hands of those who opposed the deal and privatisation of BALCO was back in news with headlines like '*Bad penny*' and '*CAG questions BALCO sell off*' (Kang, 2002) and (Press Trust of India, 2002). The preliminary report found several irregularities like deal was undervalued, insufficient time was given to valuer to determine the price of assets, value of enhanced capacity installed after disinvestment negotiation was ignored.[157] Also, the report pointed out a time gap between selection of GA and the execution of formal agreement.[158]

BALCO turned out to be a test case to measure response of CPSE employees towards future privatisation deals. While the apprehension of job loss followed by unrest and wide protests almost hijacked the deal, no retrenchment took place. One could argue it was the outcome of the protest, however, new management introduced a VRS scheme between July-August, 2001. Total 981 applications were received and 956 of them were accepted (DIPAM, Ministry of Finance, 2016). Despite losses due to strike, an ex-gratia payment of INR 5000 was made to each employee. In October 2001, a long term wage agreement for five years was entered with the employees (DIPAM, Ministry of Finance, 2016). By 2003, situation again became tense and questions were raised in the Parliament on pending VRS dues (Lok Sabha, 2003b).[159] Some employees levelled allegation against the company for coercing them to opt for VRS. Also, a committee was constituted to look into the complaints of employees of privatised firms (Ramachandran, 2003). In sum, the rift between management and the employees kept simmering.

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[157] As per CAG's observation, deal was undervalued by INR 302 crore using DCF method and by INR 262 crore applying asset valuation method. Further, asset valuer was given only 19 days, whereas at least 45 days were required.

[158] CAG had highlighted a similar irregularity in the MFIL deal.

[159] Total 1099 VRS applications were accepted and security deposit of some employees were withheld since they refused to vacate the company's accommodation.

BALCO was one of nine deals audited by the CAG in 2006. Several adverse findings were noted like, insufficient time given to the valuer, asset replacement cost obtained based on verbal inquiry instead of obtaining price by sending written enquiries, non-consideration of new commissioned capacity, skipping valuation of land and non-core assets in fixing the reserve price. Further, Sterlite claimed INR 16.72 crore as post closing adjustment which was not settled.[160]

**Table 31** Milestones in BALCO's disinvestment

| Year | Developments |
|---|---|
| April 1997 | Disinvestment Commission recommended sale of 40% shares |
| June 1998 | Revised recommendation from DC to sell 51% stake |
| To be checked | CCD approval for disinvestment of 51% shares |
| July 1999 | Date of issue of appointment letter to global advisor |
| February 2001 | Constitution of EC, headed by Additional Secretary, Mines |
| June 2000 | Formal agreement executed with Jardine Fleming as global advisor |
| June 2000 | GA invited EOI |
| February 2001 | CCD accepted Sterlite's bid of INR 550 crore |
| February 23-24, 2001 | Petitions filed in High Court of Delhi and Chattisgarh |
| March 2001 | Lok Sabha motion to disapprove proposed disinvestment of BALCO was defeated |
| March 2001 | Shareholders agreement executed with Sterlite |
| March 2001 | Workers announced strike |
| April 2001 | Writ petitions were transferred to Supreme Court |
| May 2001 | Strike was called off |
| December 2001 | Supreme Court quashed writ petitions and approved the disinvestment decision |
| September, 2002 | Preliminary CAG audit report released with adverse findings |

### Hindustan Zinc Ltd.

### Background

Pursuant to nationalisation of zinc mines in 1966, HZL was created after acquiring Metal Corporation of India Ltd.[161] HZL was engaged in the business of mining and smelting zinc and lead. In FY 91 and 92 minority shares of HZL were auctioned to the

[160] Post closing adjustments entitled the buyer to claim settlement of dues from the government which might have arisen between the date of due diligence and final closure of the deal.

[161] Nationalisation was done under the Metal Corporation (Nationalisation and Miscellaneous Provisions) Act, 1976.

financial institutions. It was disinvested again in 1997, when its shares were listed on the Bombay Stock Exchange.

### Recommendations of DC

In August 1996, when HZL was referred to the commission, it was already listed after minority stakes were divested twice in the past with government shareholding stood at 75.92%. In December 1997, the commission submitted its recommendation where it observed that HZL was the only integrated producer of both zinc and lead with a market share of 55-60%. HZL enjoyed a dominant position in both mining and smelting segment which enabled it to influence prices in Indian market. In the private sector, Binani Zinc was the only smelting company with several other secondary zinc producers. However, as the domestic demand for zinc and lead increased, both the public and private sector combined could not produce sufficient output to meet the demand, as a result India had to rely on imports. This exposed HZL to competition with the international markets.

HZL recorded a steady decline in both operation profit and profit after tax from FY 92 to FY 96.[162] In view of the commission, several reasons contributed to the declining margins, like low realisation due to rationalisation of sales prices with international norms, low operational efficiency of smelter plants and increase in interest outflows. While the commission forecasted growth prospect in the medium term due to increasing demand of zinc and lead, it listed the areas of concern in future, like high cost of production compared to international prices, possibility of reduction in import duty having adverse impact on profit margins, high cost of power used in production, low smelter capacity and utilisation and water shortage.

Despite classifying HZL as a 'non-core', the commission did not recommend disinvestment beyond 49% due to its dominant market share and ownership of considerable ore reserves, as this might have converted a public monopoly into a private monopoly. However, the commission recommended more managerial autonomy along with disinvestment upto 25% shares to a strategic partner.

### Implementation

In July 1999, the CCD approved 25% disinvestment in HZL. However, past experience of minority disinvesment in HZL lead to poor valuation, and hence, in February 2000, matter was placed before the CGD to discuss the option of privatisation (Baijal, 2008). Although the DC had recommended against transfer of ownership, situations had changed since 1997. Events like finalisation of the Competition Bill which aimed to prevent abuse of monopoly and government's announcement of strategic disinvestment in the budget of FY 2000-01 indicated a shift in policy (Baijal, 2008). Opinion was sought from the Department

[162]Operating profit decreased from INR 199 crore to 175 crore, whereas profit after tax reduced from INR 93.4 crore to 42.4 crore. Earning per share also fell from INR 2.30 in FY 92 to INR 2.0 in FY 96.

of Mines who recommended DOD a strategic disinvestment of 26% in HZL and in August, 2000 the CCD approved the proposal to privatise HZL. Prior to disinvestment, HZL was consistently booking profits which showed that the incumbent government was open to privatise profit making firms (Comptroller and Auditor General of India, 2006).[163]

In October 2000, BNP Paribas was appointed as the global advisor and advertisement for EOI was issued in December, 2000. Reserve price for 26% shares was fixed at INR 353.17 crore. Since there was only private player — Binani Zinc, the monopoly concern was raised before the CCD. However, with the new Competition Bill in place which prohibited abuse of dominance and not dominance per-se and free imports, Binani was allowed to bid (Baijal, 2008). In November 2001, financial bids were invited but government received only one bid which was lower than the reserve price and hence it was cancelled. To secure better response, modifications were carried out to the conditions of the deal like buyer to have the right to nominate chairman, unlimited environmental immunity for three years and a clear road map for government exit. Revised bids were called in March, 2002 and total five players participated. Final price bids were received from two parties which exceeded the reserve price. However in April 2002, M/s Sterlite Opportunities and Ventures Ltd with its higher bid of INR 445 crore acquired HZL. The agreement included call and put options which was exercised by HZL in August 2003, and government sold 18.92% shares in November 2003.

Both in run up to the HZL deal and immediately post closure, there were no labour strikes or petitions filed before the courts unlike the case of BALCO. Even though the Indian National Trade Union Congress which controlled HZL's labour union had called the government to reconsider its decision, it did not translate into a strike. Experience from the BALCO showed that despite widespread agitation government did not change its stand, labour strikes ended in negotiation and the Supreme Court upheld the constitutionality of disinvestment program and refused to interfere in policy matters. Combination of these factors did contribute towards a smooth transition in the HZL transaction. In fact, labour union leaders garlanded the members of the Sterlite group on their arrival at HZL's plant (Baijal, 2008).

As far as the impact of this deal on workforce was concerned, government had incorporated the same protection against retrenchment as done in the previous deals. This meant the strategic buyer could not terminate any employee from the job for a period of one year unless it offered a VRS package similar to the one existed in the company prior to disinvestment or as offered by the DPE or as per the benefits available under the labour laws, whichever was higher (Lok Sabha, 2003a). HZL had a total strength of 8322 employees at the time of disinvestment. Once the new management announced VRS package, 2287 employees availed VRS, 16 retired and 74 employees resigned. With the recruitment of 133 new workers, the net work force strength stood at 2244 employees, almost half of what

[163]HZL had earned a net profit of INR 73.77 crore, INR 90.42 crore and INR 169.22 crore from 1999 to 2001.

it was prior to the disinvestment (Lok Sabha, 2003a). In effect, no jobs were lost due to privatisation.

However, as part of CAG's audit in 2006, several irregularities came into picture. For instance, the CAG noted that HZL did not provide any business plans which is a fundamental document for any valuation exercise based on future projections. In the absence of this document, the valuation done by the GA was questionable.[164] Audit examination revealed that both the Finance Ministry and the GA had not maintained past records of assumptions and rationale behind deviations from set accounting norms related to the valuation exercise. Further, in the opinion of CAG higher discounting rate was applied which depressed the enterprise value of HZL.[165]

In 2013, HZL was back in news when Sterlite exercised its put option to buy the remaining shares from the government. Strangely, difference of opinion arose within the government over the need of prior Parliamentary approval before selling the residual stake. While the Finance Ministry opined that HZL being a private firm needed no Parliamentary permission, the Ministry of Mines submitted otherwise because HZL was acquired under a special legislation (Press Trust of India, 2013). More confusion and uncertainty got added when a petition was filed before the Supreme Court to restrain the government from selling the residual shares and CBI probe was demanded on the ground of alleged corruption in the 2002 strategic deal. Reliance was placed on the BPCL judgment where government's decision to disinvest oil majors was nullified in the absence of prior Parliamentary approval.

In 2015, the Supreme Court allowed CBI investigation followed by court's stay order in 2016 on the sale of remaining stake. Presently in 2020, the dispute is pending before the Supreme Court while it allowed the parties to pursue arbitration as stipulated under the shareholders agreement. Irrespective of the outcome of the legal dispute, this crisis situation may not set a healthy precedent for future disinvestment decisions.

[164] GA disclosed that HZL did not validate its valuation assumptions which was the basis for determination of the reserve price.

[165] Weighted Average Cost of Capital (WACC) is the discounting rate used to calculate the present value of future cash flows for the forecast period. WACC consists of cost of equity, the post-tax cost of debt and the target capital structure of the company (a function of debt to equity ratio). Since WACC was determined without considering the cost of debt, the discounting rate was inflated.

**Table 32** Milestones in HZL's disinvestment

| Year | Developments |
|---|---|
| December 1997 | Disinvestment Commission recommended for sale of 25% shares |
| July 1999 | CCD approved 25% disinvestment |
| August 2000 | Fresh consideration and CCD approved privatisation by sale of 26% shares |
| November 2000 | BNP Paribas appointed as the global advisor (letter of appointment issued) |
| December 2000 | Advertisement issued for inviting EOI with reserve price fixed at INR 353 crore |
| November 2001 | Financial bids were invited but only one bidder submitted bid below the reserved price – bid cancelled |
| January 2002 | Formal agreement executed with the global advisor |
| March 2002 | Revised bids were called – total 5 players participated |
| April 2002 | 26% shares transferred to M/s Sterlite Opportunities and Ventures Ltd. for INR 445 crore |
| August 2003 | Sterlite exercised call option |
| November 2003 | Government sold additional 18.92% shares for INR 323.88 crore |

### Indian Petrochemicals Corporation Limited

### Background

IPCL was the second largest petrochemical company primarily engaged in the business of basic petrochemicals, polymers and downstream petrochemicals. It was set up in 1969 since private sector did not make investments due to the capital intensive nature of the market. In the public sector there were two more firms — GAIL and Bongaigaon Refinery and Petrochemicals with relatively small market share. When IPCL was referred to the commission, it was a listed company and had gone through disinvestment several times and government's shareholding stood at 51.2% (See, Table 33). Demand for polymers increased post liberalisation and due to high industrial application as a substitute of traditional petrochemical products. IPCL and Reliance Industries Limited (RIL) were the dominant players in the polymers market. [166] IPCL was the largest acrylic producer in the country with a market share of 28%.

However, with lowering of import tariffs, domestic market was facing competition. IPCL sourced its feed stock like, naptha and C2/C3 from BPCL and ONGC. Naptha's prices were administered till October 1997 and thereafter it was linked to international prices.[167] IPCL had two operational plants (Vadodara and Nagothane) and the third was

[166] Ethylene and propylene are the main raw materials for polymers.

[167] Since 20% sales tax was payable in Gujarat, which was not applicable to imports, IPCL started importing naptha.

to be commissioned in Gandhar. Since the operational plants were away from the ports, IPCL faced logistic problems.[168]

Although IPCL faced challenges like pricing and availability of raw materials, competition from imports and zero import duty, its operating income and profit showed steady rise from FY 93 to FY 97 due to improved sales volume and realisation.[169]

**Recommendations of DC**

The commission noted that IPCL was created in the 60's but since the Indian market had matured with leading players in the private sector. Since the price of domestic petrochemical products depended on the landed cost of imports, the market was contestable and commission classified IPCL as 'non-core'. Moreover, due to emerging competition from the Asian region and domestic private sector, uncertainty in raw materials, deregulation of price of raw materials resulting in price rise, locational disadvantages due to distance from the ports, IPCL's competitiveness was under serious threat and it needed better access to feedstock, new markets and technology.[170]

Since IPCL and RIL dominated the polymers market, monopoly was a concern. However, the debate of monopoly had come earlier, for instance at the time of disinvestment of HZL when Binani Zinc was the only big player in the private sector (Baijal, 2008). Given this position, the commission recommended transfer of 25% equity along with management control after taking necessary precautions at the pre-qualification stage to ensure disinvestment did not lead to market dominance by a single player. As a matter of precaution, commission also suggested the requirement of prior government consent in case the strategic buyer exited from the company in the future.

**Implementation**

In December 1998, CCD gave in-principal approval to disinvest IPCL through strategic sale. Decision was also made to further divest atleast 25% stake in a time bound manner, probably to make the deal more appealing to the prospective buyers. In April 1999, M/s UBS Warburg was appointed as the GA. However in November 2000, IOCL government contemplated to sell Vadodara plant of IPCL to IOCL. As a result, the disinvestment plan was redesigned in two phases — first sell off the Vadodara plant and then sell 25% equity through strategic sale. Fierce negotiation took place between IOCL and IPCL, but the deal collapsed due to difference over the valuation (Chowdhary, 2001).[171] Finally in November 2001, the government decided not to pursue the option and decided to sell

[168]IPCL had around 13,000 employees of which 75% was located at the Vadodara plant.

[169]Operating income increased from INR 1697 crore to INR 2773.5 crore, whereas operating profit increased from INR 36.9 crore to INR 516.6 crore.

[170]IPCL faced risk of disruption since its cracker plants used single feedstock whereas competitors used multi feedstock.

[171]As per IPCL, the valuation of the plant was INR 1200 crore, but IOCL valued it at INR 300 crore.

IPCL as one entity by offloading 26% stake through strategic disinvestment (Comptroller and Auditor General of India, 2006). While government understood that selling IPCL along with the Vadodara plant was a better strategy, CAG criticised the government for its indecisiveness and causing uncertainty among the prospective buyers.

Four methods were used to determine the valuation — DCF, balance sheet, comparable companies and asset valuation which was placed before the EC who selected the valuation done as per the DCF method. Reserve price was fixed at INR 845 crore which translated to per share valuation of INR 131. In December 2001, advertisement was issued to invite EOI. Interested parties conducted due-diligence and financial bids were received in April 2002. Three bidders participated — IOCL, Reliance Petroinvestments Limited and Nirmal Chemicals Works Limited (DIPAM, Ministry of Finance, 2002a).

Government's decision to disinvest a profit making company coupled with the apprehension of private monopoly in the market invited opposition. In May 2002, the Standing Committee on '*Disinvestment in Petroleum and Petrochemicals Sector*' recommended government not to sell IPCL since it was a profit making Navratna company and the deal would have severely affected competition in the petrochemicals sector (Standing Committee on Petroleum and Chemicals, Lok Sabha, 2002). However, in the same month government accepted Reliance's bid of INR 1491 crore, way above the reserve price of INR 845 crore. On May 21, 2002 government executed shareholders agreement with Reliance Petroinvestments Ltd.[172] There was a massive difference of INR 665 crore in the bid amount between the highest and second highest bidder (IOCL). Some speculated that Reliance submitted a disproportionately high bid since it had earlier lost out in the disinvestment transactions of VSNL and IBP (Financial Express, 2002).

Similar to the past deals, the agreement had restriction on retrenchment of employees for a year from the date of the agreement and gave government the right to sell shares in future to the buyer at a fair value. In February 2004, government instead of exercising the 'put option' sold 28.95% stake through offer for sale and remaining 4.58% were allotted to the employees between 2004 and 2005 (Department of Disinvestment, Ministry of Finance, 2007).

Later in 2006, CAG's audit report highlighted several irregularities in the deal like, under valuation of non-core assets, wrong determination of capital gain tax and contingent liability, non-consideration of intangible assets (IPCL had 12 granted patents), discrepancies in the valuation of Gandhar plant and application of higher discounting rate which depressed the value of the firm (Comptroller and Auditor General of India, 2006). Further, it was noted that IPCL had an unsettled contingent and deferred taxation liability at the time of disinvestment which adversely affected the competitive bidding. Also, Reliance had raised a claim of INR 927.41 crore on account of non-disclosure of financial information

[172]The bid price offered by Reliance translated into a price earning ratio of 23 much higher than the peer companies like RIL and GAIL.

during the due-diligence process which reflected a serious flaw in the disinvestment process (Comptroller and Auditor General of India, 2006).

**Table 33** Milestones in IPCL's disinvestment

| Year | Developments |
|---|---|
| January 1992 | Auction of 20% equity to financial investors |
| November 1992 | Initial public offering |
| July 1994 | Conversion of rights partly convertible debentures |
| December 1994 | Issue of GDRs |
| March 1998 | Disinvestment Commission recommended sale of 25% shares |
| December 1998 | CCD approved 25% disinvestment |
| April 1999 | Appointment of GA |
| November 2000 | Government decided to sell Vadodara plant to IOCL |
| November 2001 | Deal collapsed over valuation difference |
| December 2001 | Advertisement issued to invite EOI with a reserve price of INR 345 crore |
| April 2002 | Financial bids were received |
| May 2002 | GA entered into agreement with the government after a gap of over 3 years since appointment in 1999 |
| May 2002 | 26% shares sold to Reliance Petroinvestments Ltd for INR 1491 crore |
| February 2004 | Government sold 28.95% shares through offer for sale |
| 2004-2005 | 4.58% shares allotted to employees |

Finally DC observed that IPCL had issued foreign currency convertible bonds with a conversion option to holders till 2002 which if converted would bring down the government stake from 59% to 51%.

The then Ministry of Disinvestment issued guidelines regarding Management-Employee Bids in Strategic Sale on 25th April, 2003 to encourage and facilitate the participation of employees in strategic sales (White paper).

### Hindustan Teleprinters Ltd.

### Background

In 1960, HTL was incorporated to manufacture electromagnetic teleprinters for the telegraph wing of P&T department. Later in 1990-91, HTL manufactured switches for telephone exchanges based on the technology of C-DoT. DOT was the largest buyer of telephone equipments in the country, but with the entry of private players including multi-nationals in the switching segment, the market had turned competitive (Disinvestment

Commission, 1997b).[173]

**Recommendations of DC**

Based on the competitive market structure, the commission classified HTL in the non-core category. Since HTL had an assured quota of 15% of all DOT purchases, it sustained the operating income. However, due to exposure to intense competition, the profit of the firm had steadily declined (Disinvestment Commission, 1997b).[174] In addition to this, the commission flagged several other concerns like, possible loss of assured demand, inadequate financial strength and large work force with unsuitable skills. As a result, in 1997 the commission recommended sale of 100% or 50% shares of HTL through strategic sale.[175]

**Implementation**

In December 1998, the cabinet decided to disinvest 50% of the equity in HTL to a strategic partner and in September 1999, KPMG was selected as the GA for the disinvestment process. However in May 2000, the *Standing Committee on Communications* expressed concern over the government's decision to disinvest HTL a profit making firm and recommended to continue the public nature of the firm (Lok Sabha, 2000). Since bidders showed lack of interest for the earlier proposal, in May 2000 the government decided to disinvest 74% of the equity. Although 6 EOIs were received, only two financial bids were submitted. Using DCF methodology, a reserve price was fixed at INR 38.80 crore. Finally in October 2001, the firm was sold to Himachal Futuristics Limited for an amount of INR 55 crore (Comptroller and Auditor General of India, 2006).

In September 2002, the buyer submitted a post closing adjustment claim of INR 56.49 crore which was not accepted by the government and the matter eventually went to the arbitral tribunal (Comptroller and Auditor General of India, 2006).[176] In 2006, when CAG audited the deal, the dispute was pending. As a result, the CAG observed that the claim had the potential of wiping off almost the entire realization from disinvestment (INR 55 crore) of HTL.[177] In 2007, the arbitral tribunal ruled in favour of HTL which was challenged by the government before the Delhi High Court. However in 2012, the High Court upheld the arbitral award (Delhi High Court, 2012).

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[173] Mutlinational firms like Siemens, Ericsson, Alcatel operated in India in joint venture with local partners like Tata, Modi group, KK Birla group.

[174] In FY 92, profit was INR 6.7 crore, which had come down to INR 0.5 crore in FY 96.

[175] The commission recommended a third option of straight sale of the assets of the company through competitive bidding, if the option of strategic sale was not feasible.

[176] The claim showed the difference between the last audited balance sheet and the financial position of the firm (changes in current assets/current liabilities) as on the date of purchase of shares by the buyer.

[177] Audit examination also revealed that the asset valuer had reduced the value of the land by 50% without assigning any reason in the valuation report.

| Year | Developments |
|---|---|
| April 1997 | Disinvestment Commission recommended sale of 100% or 50% equity shares |
| December 1998 | Cabinet decided to divest 51% equity |
| May 2000 | Government revised the earlier proposal and decided to sell 74% shares |
| October 2001 | Strategic sale was completed for an amount of INR 55 crore |
| September 2002 | Buyer raised a post closure adjustment claim of INR 56.49 crore |
| October 2007 | Arbitral Tribunal awarded the claim in favour of HTL |
| December 2012 | Delhi High Court dismissed government's appeal and upheld the award |

### CMC Ltd.

#### Background

CMC was established in 1975. When International Business Machines wound up its operation in India, CMC overtook maintenance of all IBM installations and offered services like hardware maintenance, systems engineering, system design, development, consultancy, etc. The first round of disinvestment took place in 1992, when government sold 16.69% equity to General Insurance Corporation (GIC) and its subsidiaries (Comptroller and Auditor General of India, 2006).

#### Recommendations of DC

In April 1999, CMC was referred to the DC, but it was withdrawn as the government decided to raise additional equity via private placement or by public issue. However, no additional capital was raised (Baijal, 2008).

#### Implementation

In 2001, pursuant to the government's policy to bring down its shareholding to 26% in non-strategic sector, CMC being non-strategic, was considered for strategic disinvestment. KPMG was appointed as the transaction advisor and bids were invited. Although 14 EOIs were received, finally only 2 financial bids were received. Out of these one bid was found to be non-compliant due to non-submission of the required bank guarantee. Finally, Tata Sons Limited, which was the second bidder acquired 51% equity of CMC, a profit making firm, for INR 152 crore in October 2001.[178] The reserve price was fixed at INR 108.88 per share, whereas Tata quoted INR 152 per share. In 2004, the government sold its residuary

[178]Post privatisation, Computer Maintenance Corporation was rechristened as CMC.

share of 26.25% equity through offer for sale in public offer which made it a fully privatised company (Baijal, 2008). In 2006, the CAG in their report flagged irregularities in the deal, like gap between the letter of appointment of the transaction advisor and execution of a formal agreement, absence of reason for lower projection of future revenues than the firm's business plan, etc.[179]

**Table 34** Milestones in CMC's disinvestment

| Year | Developments |
|---|---|
| 1992 | Government disinvested 16.69% equity to GIC and subsidiaries |
| April 1999 | CMC was referred to the Disinvestment Commission, but later withdrawn |
| 2001 | Government approved strategic disinvestment to bring down its equity to 26% |
| October 2001 | Management control of CMC Ltd. was transferred to the strategic partner (Tata Sons) |
| April 2003 | Sale of 6.06% equity shares to employees |
| February 2004 | Sale of government's residuary shares of 26.5% through public offer |

### Paradeep Phosphates Ltd.

### Background

PPL was incorporated in 1981 with an objective to develop additional capacity of phosphatic fertilizers in the country to meet the rising demand of such fertilizers. It was given the mandate to set up the Asia's largest Di-Ammonium Phosphate (DAP) fertiliser plant along with the Sulphuric Acid Plant (SAP), Phosphatic Acid Plant (PAP) and captive power plant (Disinvestment Commission, 1999b). Initially, it was a joint venture between the government of India and Nauru, but the collaboration was ended in 1993. The company was involved in production and marketing of complex fertilizers such as DAP, NPK and NP. The project of installing production facilities was divided in two phases. In phase 1, DAP plant with annual capacity of 72,000 metric tonnes along with offsite facilities was commissioned in 1986. In phase 2, a SAP having an annual capacity of 6,60,000 metric tonnes and a phosphoric acid plant having an annual capacity of 2,25,000 metric tonnes were installed in 1992 (Disinvestment Commission, 1999b).

#### Recommendations of DC

PPL was referred to the DC in Jul, 1998. The commission in its Xth report observed

[179]In 2015, CMC was merged into Tata Consultancy Services.

that fertilisers had substantially contributed to the growth story of Indian agriculture, but as the demand exceeded supply fertilisers had to be imported.[180]

The commission observed that the company suffered from poor financial health right from its incorporation in 1981 due to project implementation delays, low capacity utilisation and excess work force. By 1992-93, the company was on the verge of being declared as its net-worth was almost wiped out. Several restructuring attempts were made but the financial health of the firm continued to deteriorate. The commission flagged several challenges like, high costs, excess work force, single product strategy (DAP) whereas the competitions had multiple products and plant locations far from the high demand market. The commission found the fertilisers market to be sufficiently competitive and it noted that a firm could survive in the long run only with competitive costs. Also, PPL was at a disadvantageous position compared to its competitors because the prices of DAP output was controlled by the government which led to higher cost of production and poor margins.

As the commission found the market to be sufficiently competitive with the presence of several private players, it classified PPL in the non-core category. Besides, PPL faced various challenges which affected its financial viability, and hence, the commission recommended disinvestment of atleast 51% shares through a strategic sale.[181]

**Implementation**

The government in November 2000 decided to disinvest 74% stake in the company through strategic sale. In March 2001, EOIs were invited but after 10 months a restructuring package was declared only 23 few days before inviting the financial bids. While this was done to curb the declining financial health of the firm, the CAG in their report found the restructuring timing as 'improper' for it might have caused uncertainty in the minds of prospective buyers (Comptroller and Auditor General of India, 2006). By February 2002, the process of disinvestment was completed when the government sold its stake to Zuari Maroc Phosphates Limited, the 'sole bidder' at a price of INR 151.70 crore at a rate of INR 473 per share.[182]

Under the shareholders agreement, the buyer had agreed to implement the pending wage revision within a month of closure of the deal (Lok Sabha, 2002a). As a result in March 2002, the new management implemented the wage revision which was pending since

[180] Major raw materials like phosphoric acid, ammonia, rock phosphates, sulphur and MOP were imported from Morocco, Tunisia, Indonesia, Gulf countries, Jordan and Saudi Arabia. Earlier, the import was regulated by the Department of Fertilisers. The coordinating agencies were IFFCO (for sulphuric acid) and RCF (for ammonia). In 1992, in order to reduce the mounting burden of fertilisers subsidy, the government decanalised DAP imports, but introduced an ad-hoc subsidy measure which was increased from time to time to meet the increasing demand.

[181] The commission also recommended immediate fresh infusion of capital to avoid the firm from being referred to BIFR.

[182] The buyer was a joint venture of Zuari Industries Limited of the K.K.Birla group and Marcos Phosphore SA, a wholly owned subsidiary of the fertiliser giant OPC of Morocco.

1997 and it was revised with effect from January, 1997. Also, privatisation of PPL did not result in retrenchment of employees. Post disinvestment, PPL was referred to BIFR and in July 2005, it was formally declared as sick company. However by FY 2005-06, the capacity utilisation of PPL was substantially enhanced from 32% to 175% and it booked a profit of INR 12 crore (Baijal, 2008).[183]

Sale of PPL was the first deal, where the accepted bid price (INR 151.70 crore) was below the reserve price (INR 176.09 crore) which lead to controversies. In March 2002, the Disinvestment Minister, Arun Shourie clarified before the Lok Sabha, that as on the date of sale of the firm, PPL was incurring a loss of INR 10-12 crore every month. Besides, it had outstanding liabilities of INR 856.34 crore as on March 31, 2001 and an outstanding government of India loan of approximately INR 200 crore. Considering the poor financial health of PPL, the CCD accepted the bid price below the reserve price (Lok Sabha, 2002a).

More controversy arose when in December 2002, the buyer raised a post closure adjustment claim of INR 151.55 crore which was more than the disinvestment proceeds. As the government refused to settle the claim, the dispute dragged. Later in 2006, when the buyer approached the court, it sparked speculation around reversal of the deal (TNN, 2006). Also in 2006, the CAG audit highlighted several discrepancies in the deal like, lack of clear title to properties which affected the value of reserve price, huge variations between the valuation determined under the various methods and no formal contract executed with the GA (Comptroller and Auditor General of India, 2006).[184]

**Table 35** Milestones in PPL's disinvestment

| Year | Developments |
|---|---|
| July 1998 | PPL was referred to the Disinvestment Commission |
| June 1999 | Disinvestment Commission recommended strategic disinvestment of atleast 51% equity shares |
| November 2001 | Government approved strategic disinvestment of 74% shares |
| February 2002 | Management control of PPL was transferred to the strategic partner (Zuari Phosphates Ltd.) |
| March 2002 | New management implemented long pending wage revision w.e.f from 1997 |
| December 2002 | Buyer raised a post closure adjustment claim of INR 151.55 |
| July 2005 | BIFR declared PPL a sick company |

[183]In 2001-02, PPL produced 2.3 lakh MT of DAP, whereas it touched 12 lakh MT in 2005-06.

[184]An amount of INR 47.89 crore was deducted towards contingent liability under the balance sheet method and asset replacement method, but it was not deducted under the DCF method.

### VSNL

VSNL was set up in 1986 with paid up equity capital of INR 60 crores. It was intended to handle services relating to overseas communication e.g., telephony and telegraphy. In 1991 it introduced email services. In 1995 it started providing dial-up and leased line internet connections. The company held a monopoly on international long distance telephony and internet service provider (ISP) services. VSNL was one of the few service-sector CPSEs that was not only profitable but was also at the front end of technological capabilities. Also, it was never referred for disinvestment either by the government or by the DC.

The disinvestment process of VSNL can be divided into three phases:

1. Offloading of shares to domestic investors
2. Offloading of shares in the international market
3. Strategic sale

#### Domestic investors

In 1991-92 VSNL disinvested 20% of equity amounting to INR 12 crores in favour of various financial institutions, banks and mutual funds. A bonus issue of shares was also carried out, bringing total paid up capital to INR 80 crores. This was carried out as part of the first phase of disinvestment where shares were sold to public financial institutions.

#### International investors

Since 1993-94, VSNL had sought to launch a GDR issue. At the time, GDRs were in vogue to allow telecom companies to access foreign capital and improve the global profile and standing of the company. The telecom companies in many of the developing countries such as Indonesia, Pakistan, Venezuela, Mexico etc. issued GDRs during this time (Mustafa and Fink, 1998). Initially the annual reports for each year mentioned that the market conditions were poor and not conducive for a successful offer. Finally the wait ended in February 1997 when the first composite GDR issue listed on the London Stock Exchange. The offer fetched US$526.6 million and was oversubscribed by ten times, drawing 662 investors from 28 countries. The company issued 1.2 crore fresh shares and the government offered 39 lakh of its shares. Government divested 4.23% of its total stake in VSNL through this offer.

Following the success of the first GDR offer, a subsequent offer took place in February 1999. This was also a composite offer where the company issued 28 lakh new shares and the government sold 10 million of its shares to international investors. Priced at US$9.25 per share, the issue was oversubscribed and the government realized US$ 185 million from

the sale of 20 million GDRs (each GDR being equivalent to half a share). 10.53% equity of the total stake was disinvested through this offer.

Both GDR issues have been considered a success — the World Bank (WB) in particular appreciated the better demand forecasting practiced by VSNL while waiting to launch its GDR issue (Mustafa and Fink, 1998).

**Strategic sale**

VSNL was conferred Navratna status in 1997. This signified greater autonomy at the hands of the company's management and board. The company remained highly profitable when compared to peer firms like MTNL. Hence it was never chosen by the DC for disinvestment, likely because the company was seen as an example of a CPSE which was in strategic sector, profitable and autonomous. The company also held a monopoly on international calling and internet services and it had signed a Revenue Sharing Agreement with the Government of India. This Revenue Sharing Agreement revised the net revenues per minute from international basic telephony and licence fees. In August 2000, the company also went in for a successful issue of American Depository Receipts (ADRs) at the New York Stock Exchange.

Concern arose at the level of World Trade Organization (WTO) which, under the General Agreement on Trade of Services (GATS), stipulated that internet providers and long distance telephony should not be under the control of state-run monopolies. The National Telecom Policy, 1994 also provided for role of market in the telecom sector. Hence the Cabinet Committee on Economic Affairs in September 2000 decided that the monopoly status of VSNL shall be revoked by 2004.

However, on February 20, 2001 the government issued an advertisement inviting bids for 25% stake in VSNL from companies with a minimum net worth of INR 2500 crores ($537.4 million). SBI Capital Markets Ltd. and Credit Suisse First, Boston were appointed as the advisors at a fee of 0.19% of the transaction value. Crawford Bayley & Co. was chosen as the legal advisor and the asset valuer was Pricewaterhouse Coopers Ltd. Two complete bids were received from the Reliance Group offering INR 1347 crores and the Tata Group offering INR 1439 crores (INR 202 per share). The reserve price was fixed at INR 1218 crore. Being the highest bidder, a Tata Group subsidiary i.e. Panatone Finvest Ltd acquired VSNL in February 2002.

Post acquisition of equity by the Tatas, the government share dropped to 26%, whereas Tata group held 45% and an extra 1.97% had been disbursed to employees.

VSNL board (under Tata management) decided to invest INR 1,200 crore in TTL. The Tatas justified the decision being part of the effort to extend VSNL's activities to the basic services customer. The investment was to be made over 3-4 years for a 20-26% stake in the company. TTL was planning projects worth INR 8,247 crore over the next four years

with equity amounting to INR 4,325 crore. Out of this, the Tata group was to put in INR 2,552 crore, VSNL was to put in INR 1200 crore and INR 573 crore were to come in from non-Tata sources.

**Audit observations on strategic sale**

In 2006, the CAG audit examination revealed several issues with the privatisation of VSNL. For instance, some crucial decisions were taken at the fag end of the time limit for receipt of financial bids, like intimation of withdrawal of contingent taxation liability on January 31, 2002 when the bids were to open the next day. Similarly, to enhance the attractiveness of the offer, a decision was taken to award most favoured customer status to the strategic buyer by MTNL and BSNL for routing the international long distance calls by the latter firms through VSNL at market rates for a period of two years after transfer of management control. However, the decision was communicated by the DOT to VSNL on January 29, 2002 only two days before receipt of financial bids.

Another issue was with the appointment of the advisors to the deal. The CAG pointed out that there was a time gap of 1 year between the date of issue of letter of appointment and the date of execution of the contract. In other words, for one year, the transaction advisors provided services without a formal contract of appointment.

Further, the CAG found problems with the valuation report due to non-consideration of vital information which were not received from the DOD. Also in case of properties like land and buildings, agreement/conveyance deeds had not been registered, title had not been transferred in the name of VSNL and the title/lease deed in respect of certain land and buildings were not made available to the valuer.

**Post sale disputes**

While VSNL's privatisation was concluded in 2002, disputes arose after the sale which lingered on for several years.

**Demerger of land**

First dispute arose out of delay in demerger of surplus land. VSNL had 773.13 acres of surplus land which was not seperated/demerged before carrying out disinvestment which lead to several complications. Back in 2002 when the deal was being executed, only 10 days prior to the receipt of financial bids, DOT informed MoF that VSNL had surplus land measuring 773 acres. Since the ministry instructed not to value the surplus land, it was not included in the valuation of the firm.

However, a clause was incorporated in the SHA that post disinvestment the surplus land would be demerged to a separate company which would have shareholding identical to VSNL's capital structure prior to disinvestment. In other words, the (Tata Communi-

cations, name changed from VSNL) was prohibited from selling the surplus land except in the manner as stipulated in the agreement. Further, Tata Communication was not entitled to benefit from the sale proceeds of the land other than in the ratio of shareholding as it stood prior to the disinvestment.

Although a special purpose vehicle named HPIL was incorporated to carry out the land demerger, the event of demerger never took place because Tata Communication was not ready to bear the capital gain tax and stamp duty liability. Finally in 2016, the Income Tax Act was amended which exempted erstwhile public sector companies, like VSNL from capital gain tax arising from a demerger transaction (Government of India, 2016c). Although the demerger plan exempted Tata Communication from stamp duty liability, but the MCA approved the demerger plan only in 2019 (Business Line News Bureau, 2019). Given the recent developments, the VSNL land dispute seems to be finally resolved after a gap of 17 years.

**Revocation of monopoly status**

Another dispute was related to VSNL's monopoly status in the telecom market which had been guaranteed by a decision of Cabinet until 2004. However, in July 2000, the DOT informed the new owners i.e., The Tata Group that VSNL would be de-monopolised by March 2002. The Tatas contended that the monopoly status was a promise made to them as part of the strategic sale and therefore, took the matter to the Bombay High Court. While the government offered compensation in lieu of the potential losses caused to the Tata Group, the Tata Group sought additional compensation. However, the High Court rejected the claim on the ground that it did not have jurisdiction under the TRAI Act, 1997 and advised the parties to go for mediation.[185] The Tata Group filed a petition against this order which is currently pending.

**Table 36** Milestones in VSNL's disinvestment

| Year | Developments |
|---|---|
| 1992 | Auction of bundled shares to public institutional investors. 20% stake sold. |
| February 1997 | First GDR issue. 4.2% stake sold. |
| February 1999 | Second GDR issue. 10.3% stake sold. |
| 2000 | ADR issue at NYSE |
| February 2002 | Strategic sale to Panatone Finvest Ltd., a Tata Group company. 25% stake divested. |
| 2002 | Tata-led board starts to restructure the company and integrate with Tata Teleservices Ltd. |
| 2004 | Questions raised on sale of surplus land, allegations of asset stripping and call option by government of India |
| 2019 | Settlement of land demerger issue |
| 2020 | Dispute on the revocation of monopoly status remains pending |

[185] See *Tata Communications Ltd. v. Union of India*, 2010 (6) Bom CR 208.

**Maruti Udyog Ltd.**

Disinvestment of MUL was unique and unlike any other CPSE, it was not privatised by strategic sale or competitive bidding, but through issue of right shares and use of public offer route (DIPAM, Ministry of Finance, 2002b). Between between 1992 and 2003, MUL operated as a 'hybrid' company with 50% stake held by government and Suzuki Motor Co. Ltd. ("Suzuki") of Japan each, but government gradually exited from the firm at different stages of its growth.

MUL traces it origin to Maruti Ltd. and Maruti Technical Services Ltd., promoted by Mr. Sanjay Gandhi who wanted to develop an indigenous mass-produced 'people's car' and was granted a license to produce 50,000 cars per year in 1973 (Hamaguchi, 1985). The companies had units in Gurgaon, Haryana. By 1977, the company had manufactured only 100 cars and faced mounting losses. In 1980, the government enacted a law and acquired it.[186] Given the need for technical collaboration with foreign car manufacturers, the government signed a joint venture agreement with Suzuki in 1982. In terms of the agreement, Suzuki held 26% shares with an option to acquire another 40% (Mukherjee, 2014).[187]

*Dispute over joint control*

Pursuant to the JVA, in 1987 Suzuki acquired 40% stake in MUL and another 10% in 1992 which permitted Suzuki to gain 50% ownership. As a result, MUL was no longer subject to CAG audit and supervision of the DPE. Since both the transactions involved issue of fresh stock on rights basis, it did not realise any revenue for the government (DIPAM, Ministry of Finance, 2002b). Further, while Suzuki paid a premium of INR 269 per share, it did not pay any control premium. Both the transactions became contentious, as the government expected payment for dilution of its stake and parting control over a public firm with a foreign entity. Several other differences arose in the manner of business expansion culminating in a legal dispute over the appointment of managing director by the government, alleged not in consultation with Suzuki. While the Delhi High Court approved the appointment, it instructed the government officials not to make any provocative statement against Suzuki.[188] Eventually Suzuki invoked the arbitration clause under the JVA agreement.

In 1998, when the NDA government announced its intention to exit MUL, it triggered labour unrest and minor strikes (Becker-Ritterspach, 2009). Further, the government took several measures to negotiate a settlement to the arbitration, like appointing a Japanese

[186]For acquiring the entities, Maruti Limited (Acquisition and Transfer of Undertakings) Act, 1980 was enacted and the acquired entity was renamed as MUL.

[187]As per the collaboration, 30% of the value of each finished car were to originate from components whose technological input to be given by Suzuki.

[188]1998 (93) CompCas 771

nominee of Suzuki, as the chairman and creation of the post of joint MDs (Mitra, 1998). Since the details of the negotiation proceedings were not made public, it invited criticism. Also, the process of negotiation lead to the realisation that present model of joint control was not sustainable in the long run.

However in October 2000, workers went on a strike for 89 days which drew national attention (Annavajhula and Pratap, 2002). Only after the new incentive scheme was in place, the strike ended in January 2001, but 92 workers were dismissed. Further, workmen had to agree not to go on strike in future and signed 'good conduct undertaking' which was later rescinded post heated debate in the Lok Sabha (Becker-Ritterspach, 2009).

In May 2002, the parties reached a revised JVA whereby the government decided to disinvest its stake in MUL. Preparations were made to list MUL in India. In terms of the settlement agreement, Suzuki had to pay government Rs. 1000 crores as share premium for the shares allotted in 1987 and 1992 and agreed to underwrite the public issue of MUL at Rs. 2300 per share. In response, the government agreed to conduct a rights issue of INR 400 crore thereby raising Suzuki's stake to 54% and transfer the control. By 2003, the government expected to further reduce its stake to 25% through a public offer along with the right of put option until April 30, 2004 to exit from MUL. With the completion of rights issue in 2002, MUL became a subsidiary company of Suzuki Motors Co. Ltd. of Japan.

*Initial Public Offer and final exit*

The IPO was successful and was oversubscribed by more than ten times which was rare for a public sector stock.[189] Possible reason for the overwhelming response was government's decision to exit by offloading 60% shares to non institutional retail investors (as opposed to the then market practice of 40%). For the first time, government exited a public sector firm in a public offer. In September 2005, the UPA government decided government's complete exit from MUL and sold 8% stake to public sector banks. Finally in May 2007, government sold off its remaining stake through a differential auction with 32 financial institutions.

In May 2007, the government conducted the sale of all its remaining stake in the company. It conducted a differential auction with 32 financial institutions, selling the shares at weighted average price of Rs. 794.49 per share. Government realized Rs. 2,366.94 crores from this transaction.

[189] KPMG, Ernst & Young and S.B. Billimoria & Co. were appointed as valuers. Share was valued at INR 3,280 for the public offer. Kotak Mahindra was appointed as the financial advisor and Dua & Associates as the legal advisor.

**Table 37** Milestones in MUL's disinvestment

| Year | Developments |
|---|---|
| 1987 | Right issue of shares to Suzuki increasing its stake to 40%. |
| 1992 | Right issue of shares to Suzuki increasing its stake to 50% and gaining joint control. |
| 1997-1998 | Corporate governance issues leading to legal dispute. |
| October, 2000 | Employees went on strike to oppose disinvestment which lasted for 89 days. |
| May 2002 | CCD approved disinvestment of MUL.<br>Government entered into revised JVA which contained terms of negotiation. |
| June 2002 | Rights issue of shares increasing Suzuki's stake to 54% and transfer of control. |
| June 2003 | MUL listed on the stock exchanges; government offloaded 27.2% stake and raised INR 933 crores as sale proceeds. |
| September 2005 | Government sold 8% stake to banks and financial institutions and raised INR 1,567.60 crores. |
| May 2007 | Government sold its remaining stake through public auction and raised INR 2,366.94 crores. |

## B.2 Sale of hotels of ITDC and HCIL

### Background

During Phase 2 several government-run hotels were sold to private entities. The hotels properties belonged to two CPSEs i.e., ITDC and HCIL. ITDC was set up in 1966 to build and promote tourism infrastructure in the country (Standing Committee on Transport, Tourism and Culture, 2006). HCIL is a wholly owned subsidiary of Air India Ltd., set up in 1971 to build and operate hotels especially near airport areas. This was a common practice among airlines at the time.[190]

### Recommendations of DC

Both ITDC and HCIL were referred to the DC. The DC noted that ITDC ran hotels in premier segments of the market but it was not able to compete with the private players due to lower quality of service. ITDC also had higher employment costs compared to private sector competitors. Hence, the DC sought to restructure the company by selling off the hotels owned by ITDC in metro cities and demerging the corporate entity of ITDC in favour of creating the hotel's own entity (Disinvestment Commission, 1997a). For the same reasons the DC also recommended of sale for two joint venture entities i.e. Ranchi

[190]See Ministry of Civil Aviation Annual Report 2002-03.

Ashok Bihar Hotel Corporation and Utkal Ashok Hotel Corporation. These hotels where joint ventures of ITDC with Bihar State Tourism Development Corporation and Orissa Tourism Development Corporation respectively (Disinvestment Commission, 1997e).

The DC also addressed the issue of disinvestment in HCIL which was a wholly owned subsidiary of Air India Ltd. It noted that while HCIL's hotels had assured business and were located in prime areas; the company had poor brand equity, low occupancy rates and poor upkeep of hotels. Hence the DC recommended that HCIL's hotels in Mumbai and Delhi be demerged and sold to private entities. It also recommended sale of HCIL's hotel in Srinagar after dialogue with the government of Jammu and Kashmir.

**Implementation**

After the constitution of DOD, the government set out to implement the recommendations of DC with respect to the hotels. The CCD in March 2002 approved the disinvestment of 17 hotels and one hotel to be given to private management on long term lease. A Global Advisor i.e. Lazard India Ltd. was appointed to advise on the bidding process. IMG was constituted to oversee and advise on the process of disinvestment of ITDC hotels. One of the 17 hotels situated in Chandigarh was not even completed at the time of sale (Standing Committee on Transport, Tourism and Culture, 2006). HCIL successfully sold three hotels. Its Global Advisor was Lazard India Ltd. and Asset Valuer was Kanti Karamsey & Co.

Hotel sales were conducted following these steps (Comptroller and Auditor General of India, 2005):

1. Valuation of the properties is carried out to arrive at the reserve price;
2. Invitation of Expression of Interest;
3. Short listing of the firms and executing confidentiality agreement;
4. Carrying out due diligence exercise;
5. Submission of the financial bids;
6. Successful bidder is selected.

All 17 hotels were demerged and separate companies were formed for the management of each hotel based on DC recommendations. Government executed share purchase agreement after identifying the strategic buyer. The terms of the agreement provided for post-closure adjustment.

Sale of 17 hotels of ITDC yielded a total of INR 404.76 crore and sale of three hotels of HCIL yielded INR 242.5 crore.

**Controversies**

Under the disinvestment program 18 out of 23 hotels originally owned by ITDC were sold. This was a large-scale sale of assets and was subject to criticism by both the parliament and media for the adverse effects it had on ITDC's finances post disinvestment. Some of the effects caused by disinvestment in the operation of ITDC were noted in 2006 in a Rajya Sabha committee proceeding (Standing Committee on Transport, Tourism and Culture, 2006):

> *"Renovation schemes were put on hold rendering ITDC properties non-competitive. The psycho-fear created by uncertainty kept the morale of the employees very low affecting the services. Business providers were hesitant to do business with ITDC due to the uncertainty. Media publicity on ITDC disinvestment had also played a major role affecting business adversely ... As a result of the impact of disinvestment, ITDC suffered losses during four consecutive years from 1999-2000 to 2002-03 ..."*

The issues surrounding disinvestment of ITDC also reached the courts. The sale of Hotel Agra Ashok, an ITDC hotel that had been sold to a private bidder, was disputed before the Supreme Court. The workers' unions argued that the disinvestment was arbitrary and illegal. They also challenged the non-implementation of VRS for the employees. In the case of *All India ITDC Workers Federation v. Union of India*[191] the court noted that the service terms for the employees had not changed after privatisation. It also observed that VRS was not applicable to the employees since the hotel property did not have a VRS scheme even before disinvestment. Hence the Supreme Court declined to interfere in the implementation of the government's policy decision.

In 2014, an FIR was filed with the CBI alleging irregularities of a criminal nature with the sale of Laxmi Vilas Palace Hotel in Udaipur, Rajasthan by ITDC in 2001. The then Disinvestment Secretary, the CEO of the asset valuation and financial advisory firms which acted on the deal and the buyer company were named in the FIR. While the CBI concluded its probe and submitted that there was no evidence of criminal wrong doing, in September 2020, a special CBI court in Rajasthan's Jodhpur district, rejected the report and ordered the registration of a criminal case against the then Disinvestment Minister, Arun Shourie and few retired bureaucrats, who were involved in the privatisation deal in 2002 (Mukherjee, 2020). Further, it also ordered the Udaipur district collector to take

[191] (2006) 10 SCC 66

possession of the hotel and appoint a receiver for the property. The collector also has to ensure that the hotel is run by a central government institution with experience in this industry (Mandhani, 2020).

The HCIL deal also attracted parliamentary criticism. A Rajya Sabha committee voiced the following concerns with the sale of Centaur Hotel Mumbai Airport (Standing Committee on Transport, Tourism and Culture, 2003):

1. It questioned the criteria used for selection of the buyer i.e. A.L. Batra. Their bid was questioned on the ground that it was submitted *"without any reference of any appropriate set up as to which (entity) will be the purchaser of Centaur Hotel ..."*
2. The government had sought to improve the bid offer by reducing the turnover levy imposed by Airports Authority of India. Despite doing so, only one bidder, who was the same bidder as the previous round, was selected.
3. One of the assets transferred to the bidder was a petrol pump. However, it was noted that the Ministry of Petroleum and Natural Gas was the owner of the pump and HCIL was only a dealer of petrol. Hence HCIL may not have had the legal title to sell the pump to the bidder.
4. Finally, the Committee recommended that the government should order an enquiry into the entire transaction relating to Centaur Hotel Mumbai Airport by the Central Vigilance Commission.

The CAG criticised various aspects of the sale of HCIL's hotels. They noted that various relaxations were made by the ministry with regards to following timelines. The method of valuation of the property was at variance with valuation methods used for other deals — the CAG noted that the DCF method was not correctly used in these cases (Comptroller and Auditor General of India, 2005).

'Post closure adjustment' proved to be a major legal issue in the sale of both of HCIL's Mumbai based hotels. In case of Centaur Juhu, a dispute arose while calculating the adjustments towards doubtful debts, leave encashment, gratuity, insurance claim and advances paid to suppliers. Although the government was a party to the dispute, the Financial Adviser, Ministry of Civil Aviation was appointed as the Arbitrator and the proceedings began in March 2006 (Department of Disinvestment, Ministry of Finance, 2007). The arbitrator ruled that the buyer was required to pay the advances. In case of Centaur Vile Parle, the buyer and the government disputed over the amount of the claim and they also went in for arbitration. A retired High Court judge was appointed as the arbitrator. He passed an award directing the buyer to pay INR 1.88 crore towards adjustment. The buyer appealed to the Bombay High Court. The High Court set aside both orders in the cases of HCIL's hotels. While the facts were specific to each case, the common reason for the

High Court's orders were that the arbitrators had failed to consider material facts placed before them.[192]

[192]Centaur Juhu case — *Siddhivinayak Realties Pvt. Ltd. v. V Hotels Limited*, Order dated 10 May 2013 in Arbitration Petition No. 667 of 2011. Centaur Airport case — *Sahara Hospitality Ltd. v.* HCIL, Order dated 8 May 2015 in Arbitration Petition no. 810 of 2011.
Separately the state government of Maharashtra also claimed premium towards the repurposing of the hotel property of Centaur Juhu. The property was on lease from the state government and it violated a rule that a specific portion of the land must have a garden which is open to the sky, (See Annual Report of HCIL, 2012-13).

# C Annexures from Phase 4

**Figure 8** Tweet, Secretary DIPAM

**Source: Twitter**

**Box 16 Steps for strategic disinvestment**

- Step 1 - Selection of CPSE for disinvestment: This involves identification of firms by Niti Aayog, recommendation by CGD and "in-principle" approval by the CCEA.[a]

- Step 2 - Selection of intermediaries: Transaction Advisor (TA) and legal advisor are appointed by the DIPAM based after following bidding process, whereas the adminstrative ministry/department appoints the asset valuer.

- Step 3 - PIM and EOI: TA conducts due-diligence of the CPSE and prepares PIM. Administrative ministry recommends the terms and conditions of the EOI. After that they are submitted before the EC and CGD for recommendations and finally placed before the AM for approval.

- Step 4 - Selection of bidders: TA screens the EOIs and submits a report to the administrative ministry without disclosing the identity of the potential bidders. After considering the report, the ministry presents it before the EC for correction and approval.

- Step 5 - Valuation: Concurrently with Step 3, valuation exercise is initiated. Asset valuer in consultation with the CPSE and administrative ministry prepares the asset valuation report. Whereas the TA prepares the business

valuation report. However, both the reports do not carry valuation numbers and placed before the EC for approval.

- Step 6 - Preparation for RFP: At this stage, all the transaction documents like share purchase agreement, shareholders agreement and confidential information memorandum are prepared and placed before the CGD for approval. After incorporating their suggestions, the documents are shared with the short listed bidders (DIPAM, Ministry of Finance, 2018b).

- Step 7 - Preparation of Data Room: CPSE prepares the data room which could be either online or on physical platform. Identity of the short-listed bidders are kept confidential to the CPSEs.

- Step 8 - Due Diligence by Qualified Institutional Buyer (QIB): Short listed bidders carry out due-diligence after signing confidentiality agreement with the TA.

- Step 9 - Firming up the clauses of RFP: Based on the feedback of the short-listed bidders some changes may be made to the agreements and the vetted documents are placed before the AM for approval.

- Step 10 - Bidding Procedure and Fixation of Reserve Price: As the reserve price is fixed, the CGD may also decide whether a security clearance is required for the bidder.

- Step 11 - Consideration and Approval of the bid by the CCEA: At this stage all the relevant details like identity of the highest bidder, price quoted are incorporated in the agreements and placed before the CCEA for approval.

- Step 12 - Completion of the Transaction: Highest bidder is invited to execute the agreements and expected to complete the closure requirements.

[a] In October 2019, the government modified the process which requires involvement of both DIPAM and NITI Aayog in selection of the firms.

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