



Assessment of Strategic Disinvestment  
strategies of CPSEs in India - Case Analysis of  
selected PSEs

---

Vijay Kumar Choudhary, Kanhaiya Singh and Vandana Gupta

EasyChair preprints are intended for rapid  
dissemination of research results and are  
integrated with the rest of EasyChair.

December 25, 2019

# **Assessment of Strategic Disinvestment strategies of CPSEs in India - Case Analysis of selected PSEs.**

*Vijay K Choudhary  
Kanhaiya singh  
Vandana Gupta*

## ***Abstract***

In the post independence era, the Industrial Policy Resolutions of 1948 and 1956 demarcated the areas of operations of public sector and private sector. The public sector was promoted mainly to contribute to the core sectors of the economy and there were many other objectives for building up the public sector. This included building infrastructure for economic development to generate investable resources for development. Over the period of time, public sector enterprises (PSEs) spread over from coal, steel and oil at one end to hotel and other domains. However over a period of time many of the PSEs faced several problems and turned into losses and their financial performance started deteriorating. The government thought it appropriate to make them viable through disinvestment process. Though the initiatives of disinvestment were taken by the government long back but it was only after 2000, the disinvestment process was speeded up and systematized. It was expected that PSEs after disinvestment will be in a position to perform well and contribute to the economy and the growth process. However, their performance in the post disinvestment era posed many issues and challenges. This paper is an attempt to analyze the performance of selected PSEs in the disinvestment ear to understand the factors affecting their performance.

---

Key words: Disinvestment, financial performance, productivity, profitability, valuation

- Vijay k Choudhary, Research scholar, GLA University
- Kanhaiya Singh, Professor, IBM, GLA University
- Vandana Gupta, Professor, IMT, Ghaziabad

## **Introduction**

The motivation for expanding the public sector extends from the theory of “commanding heights” to the provision of consumption goods at subsidized rates. Eventually public sector enterprises are now spread over from coal, steel and oil at one end to hotel and bread making at the other. It was earlier thought that by the progressive expansion of the public sector, the country would be able to move towards the socialistic pattern of society which was sought to be achieved as a goal. There were only five Central Public Sector Units under the complete ownership of Central Government with a total investment outlay of Rs.29 crore in the beginning of first five year plan. At the end of the Seventh Plan, there were 244 Central Public Sector Units which had been increased to 244 from 5 with a total investment outlay of Rs.99,329 crores. In 2005-06 the capital invested in public sector units increased to Rs.3,93,057 crores, the number of Central Public Sector Units declined to 239 from 244.

Public Units were established for gaining control over the commanding heights of the nation and for promoting critical developments in terms of social benefits and strategic value and to generate commercial resources for capital formation. For socio economic transformation in the country, PSE's are considered as powerful instruments. Contrary to the expectations, the performance of most Public Sector Units has been far below than place targeted. Many units have accumulated deficits over a period of time causing considerable drain on the exchequer. This declining trend of performance has attracted the attention of policy makers, politicians, bureaucrats, academicians, researchers and the public to check out the explanations for such a short fall in performance not only against the mentioned objectives as well as their stand on adopting a sound commercial policy of viability.

The following factors have been responsible for the slow growth of PSEs in India.

1. Lack of Importance to Profit Motive as in the present policy structure, in the working of public enterprises profitability criteria was not given proper place rather they are thought as social driven enterprises. It is only recently that profit aspect of public enterprises has been given due recognition.

2. Inappropriate Location- one of the important reasons for the low profitability of public enterprises is their uneconomic location. Usually, public enterprises are set up on the basis of political considerations rather than economic criteria.

3. Underutilization of Installed Capacity is another factor contributing to low profitability of the PSEs. Though, enormous installed capacities have been created with the help of foreign credits and government support but fuller utilization of the acquired capacity lacks.

4. Inadequate and inappropriate Technical Feasibility assessment while determining technical factors and scale of operations.

There may be host of other factors like delay in completion of projects, non availability of professional management, over staffing and defective recruitment and promotion policies, lack of rational pricing policy, political interference etc.

There are evidences that despite all the above reasons for non-performance or inefficient performance of PSEs, some of the PSEs have been performing well. Even in the past, it is observed that certain PSEs that were not doing well were taken o the growth process once the leadership changed. Therefore, the kind of leadership has significant role in turn around strategies of PSEs.

### **Process of Disinvestment**

In India, Public Sector Units disinvestment program developed as a noticeable feature of industrial restructuring in the late 1980s. Disinvestment is the process of transferring of partial ownership of the business from the Public Sector (Government) to the private sector (general public). Different countries have different nomenclature in such as transformation and restructuring, disinvestment, popular capitalism, denationalization, prioritization, industrial transition, economic democratization' partners in development, dis-incorporation. The words privatization and disinvestment are often used interchangeably. Disinvestment has generally come through divestiture of the government's economic activities, i.e. disinvestment of public sector enterprises mainly through the sale of equity.

The dilemma of Balance of payment hit India in 1990-91, yet it had been working a minimum of a half decade continuing that year. The underlying macroeconomic disparity that had been building up over the eighties came to a head as a result of these shocks and, along with the insufficient policy response, resulted in a BOP dilemma in 1990-91. This dilemma was due to increasing fiscal deficit and constantly increasing overvaluation of the country currency which consequences led to the rising imbalance. The negative balance of Payment position and increment in the fiscal deficit were the major causes to an adoption of a new policy towards the Public Sector of India in 1991.

From 2004-05, the disinvestment policy again underwent a major shift. The union budget for 2004-05 announced: "As long as Government retains control over the PSE, and its Public Sector character is not affected, Govt may dilute its equity and raise resources to meet the social needs of the people." The objective of disinvestment policy was to develop people's ownership in public sector enterprises and to contribute to wealth and prosperity for the country while ensuring that Government share in equity is greater or equal to 1% and retains the management and control after the disinvestment

### **Motives of Disinvestment**

Ramanadham (1988) viewed that "the best answer to the issue of privatization is to take the necessary steps to improve the efficiency of public enterprises by making suitable changes in the management structure and their relationship with the government and parliament. Steps should be taken to replace the civil services culture by commercial culture in public enterprises".

Bamekov and Raffel (1990) highlighted on productivity of services among the public and private enterprises. They claimed that the shift from public to private provision of a service is no panacea for greater productivity. The best opportunity for improving productivity using privatization occurs when the service is easily measured and monitored, but productivity effects are more ambiguous when the situation is complex, as in such fields as human services and education".

Momtazuddin (1991) in his article entitled "Privatization: Present Status and Future Potentials as Policy Options Development", presents a conceptual guideline regarding privatization. He expressed his opinion that privatization should be considered from both economic and ideological view points from economic point of view, privatization is identified as a means of increasing output, improvement of quality and minimization of cost. On the other hand from the philosophical point of view, privatization broaden the base of ownerships that an individual has a stake in the economic system.

Prasad (1991) opined that public enterprises lack autonomy. It is bureaucracy that takes major decisions for the organization on the other hand, the private sector organization model has several elements, which ensure efficient management apart from market forces.

Singh (1991) threw light on a basic issue that whether the new pattern of ownership leading to privatization of public sector undertakings results in greater efficiency or not. The resource factor and management factor are the two cardinal elements, which need to be considered in any move on privatization.

Bishop and David (1992) advocated that change of ownership brings about the change in regulatory environment, which compels the organization to perform more effectively.

Divestment or privatization typically has several motives. These include increasing the efficiency of enterprises, high-quality service, and high-quality output, and a reduction in the flow of public subsidies, which represent scarce public resources badly needed in other areas. The motives of public sector enterprises are:

- 1 .To provide Fiscal Support: One of the disinvestment motives is to provide fiscal support the demands for the disinvestment the government both at the central and state are increasing. There is compelling need to expand the activities of the state are in areas such as education, health, and medicine.

2.To improve the efficiency of PSE :Another disinvestment motive is to improve the efficiency of the working of the PSE. Disinvestment enables efficient management of public investment in PSE's for accelerating economic development and augmenting government resources for higher expenditure.

3.To list PSE's on the stock exchange: Disinvestment of shares enables the PSE's to list their securities on the various stock exchanges through various methods, listing of PSE's on the stock exchange to facilitate the development of the capital market and spread of equity culture.

4.To promote public ownership: By the way of disinvestment of PSE's government attracting private investment, both domestic and foreign disinvestment promote people's ownership of PSE's to share in their prosperity.

5.Efficient utilization of Resources: Disinvestment of PSE's leads to better use of resources and their more efficient allocation. A huge manpower which currently locked up in management, releases after the disinvestment process and their time and energy are used for redeployment in high priority social sectors that are short of such resources.

6.Development of Capital market: Through the disinvestment process public sector is permissible for stock market trade. This would beneficially affect the entire capital market by the increase in the trading of stocks which provide liquidity, marketability, accurate valuation and pricing benchmarks, a spectrum of investment alternative. It also provides a facility of raising funds to disinvested public sector enterprises for their projects.

7.Raising budgetary resources for the Government: Disinvestment of PSE's improving government's budgetary position through reduced financial support to enterprises additional resources can be generated through the sale of ownership and increased tax revenue after the improvement in the efficiency level of the firms.

8.To facilitate Competitive business environment: Disinvestment program of Public sector enterprises facilitate the country better competitive environment. By disinvestment, PSE's would

be able to respond quickly to the market forces and business needs cater in a more professional manner.

9.To provide better market discipline: Disinvestment would uncover the public sector enterprises to market discipline there by driving them to become more competitive, productive , independent and works on their own financial and economic strength. It would also release such companies from government control and introduce their own corporate governance in the disinvested companies.

10.To reduce the public debt: Disinvestment of PSE's helps to reduce the public debt of the company that has widened the gap between income and expenditure to unmanageable proportions

11.To release a lot of public resources of non-strategic PSE's: disinvestment facilitates a lot of public resources locked up in nonstrategic (non-core) PSE's and invests these resources in most priority areas, e.g health, family, welfare, education, the creation of social and physical infrastructure.

### **Process of Valuation of PSEs**

As mentioned in Step 5 above, the valuation reports prepared forms the basis of final valuation of the CPSE at the time of determining the 'Reserve Price'. In continuation to the same, DIPAM lays down certain guidelines for the determination of Reserve price. For companies listed on the stock exchanges, generally market price of the shares serves as a good benchmark for assessing the fair value of the company, however, in case of PSUs that are either not listed on the Stock Exchanges or command extremely limited traded float, deciding the worth proves to be a challenging task. It is worth noting that the valuation of an enterprise must be differentiated from the price. While the fair value of an asset is based on the assessment of intrinsic value accruing from fundamentals on a stand-alone basis, varying return expectation and underlying strategic aspects for different bidders



could influence the price. Therefore it is understood from above, Valuation is necessary to determine the 'Reserve Price' as a benchmark, which is not the market price, when a CPSE is considered for outright sale. There are three main methods of equity valuation: (i) Discounted Cash Flow (DCF) method, (ii) Relative valuation, and (iii) Asset-based Valuation. While the DCF method for valuing equity typically relies on projections of dividends and/or Free Cash Flow of a firm, Relative Valuation is based on benchmarking with equity transactions involving similar firms. Asset-based Valuation approach would involve valuation of individual assets of a firm. Since book value of assets is often different from their market value, Asset-based Valuation methods typically involve revaluing their assets based on their market value, and drawing up a balance sheet based on these values. One of the ways in which this can be done is by considering the replacement cost of assets, which involves calculating the market value of assets currently in use. There are many variations in these three methods of valuation.

Even though the methods of valuation have been prescribed, there are certain limitations that lead to different valuers arriving at different valuations. Considering that in the *DCF Method* enormous number of assumptions go into the calculations, reasonable persons can disagree on the numerical values that are used in the assumptions. It would be appropriate to say that every careful investor undertakes a thorough valuation exercise in order to choose what price he is willing to put to the shares. But every investor has a different speculative view about the future and as no formula can assess the speculative views of the diverse participants in the market, there are no water-tight formulae which can come up with an estimate on the market price. Similarly, *Asset based valuation* often involves speculation about the productive use of the assets in the future as perfectly reliable information on the value of specific assets is difficult to obtain, given the limitations of

substitutability of assets in turn leading to differences in valuation. And lastly considering Relative valuation methods, it is useful for checking the robustness of valuation obtained by other methods, but relying only on relative valuation is risky unless a perfectly comparable set of firms is available on which recent transactions have taken place.

Therefore, it can be stated that making a valuation requires an examination of several aspects of a company's activities, including analyzing its historical performance, analyzing its competitive positioning in the industry, analyzing inherent strengths/weaknesses of the business & the opportunities/threats presented by the environment, forecasting operating performance, estimating the cost of capital, estimating the continuing value, calculating and interpreting results, analyzing the impact of prevailing regulatory frame work, the global industry outlook, impact of technology and several other environmental factors.

### **Literature Review**

Galal et.al. (1994) examines the post-privatization performance of twelve companies in Chile, Malaysia, Mexico and UK to find out whether the transfer of ownership has increased efficiency. The authors considered net welfare gains in eleven of the twelve cases. According to them, it is unjust to hold privatization held responsible for all the problems of transition.

Nagaraj (2005) explain that disinvestment is not likely to affect economic performance, since the state continues to be governing the shareholder, whose behavior is unlikely to be influenced by share price movements (or return on equity). Privatization can be influenced economic outcome in a competitive environment; if not, it would be difficult to attribute changes in performance or mainly to the changes in ownership.

Krishna V Chaitanya (2007) says that India is one of the fast emerging economies striving to control its deficit by all possible measures in the form of economic reforms. His study over six years suggests that Disinvestment/privatization as one of the measures of economic reforms implemented in 1990-91 in India which resulted in privatizing about thirty Public Sector Enterprises in the country.

Eskil et al (2008) finds the differences in performance between private companies and state owned enterprises. They use a panel covering all registered companies during the 1990s in Norway, a country where state owned enterprises play an important role in regular markets. Return on assets as well as costs relative to sales revenue are used as measures of performance in markets where private companies and state owned enterprises compete with each other. Overall, private companies perform significantly better than state owned enterprises.

Arnold et. al. (2008) suggest that conventional explanations for the post 1991 growth of India's manufacturing sector have focused on goods, trade liberalization and industrial de-licensing. However the pace of policy reforms is determined by political considerations. The de-licensing policy brought a dramatic response from foreign and domestic providers, Foreign Direct Investment inflows into services following liberalizations into other sectors. According to them there is a strong and significant link between progress in services reform and productivity in manufacturing industries. They also investigate the relative contribution of reform in each of the service sectors to the productivity of manufacturing firms and find that liberalization in the banking and telecommunication sectors had the largest productivity effects on manufacturing firms over the period.

Shivendu (2008) finds that privatization problem have not been driven by ideological or efficiency reasons. It is run by the cost- benefit tradeoffs made by politicians. Through the study of 43 countries on more than 4700 Privatisation transactions the author highlight that the economics of privatization often dominates its politics. He has further point out that support for institutional quality as consistent and significant determinant of proportion of partial privatization. Surprisingly, the countries having higher corruption led to have higher proportion of privatization in competitive sector, but lower privatization in core sector.

Kumar Das (2009) in his studies associated with sustainable privatization of infrastructure projects offer a way for government to make infrastructure delivery more effective and efficient than public provision. According to him there is value for money to government from entering in to Public-Private partnerships in infrastructure. Disinvestment leads to significant improvement in profitability, efficiency and real output of firms, besides providing some fiscal boost to government.

Omrane and Jeffrey (2011) analyses a sample of 1866 privatizations from 37 countries and estimate the impact of disclosure standards and legal institutions that discipline auditors on the method chosen for the divestiture of state-owned enterprises. The disagreement between minority and controlling shareholders can slow down a government from privatizing by selling its stake to disperse investors in the public capital market with a share-issue privatization that generates important pour out to economic benefits, rather than an asset sale to a small group of 49 buyers. They find that share-issue privatization become more likely when countries command strict disclosure standards, although result is sensitive to model measurement. Investors value reforms that subject auditors to more severe private and public enforcement over several other legal determinants, including enhancing disclosure standards.

Boardman and Vining (1989, 1992) compare the performance of Private Corporations, State Owned Enterprises and Mixed Enterprises among the largest non industrial corporations. For analysis they used four profitability measures. 1) Return on Equity 2) Return on Assets 3) Return on Sales & 4) Net Income They used two procedures to examine aspects related to competence like sales per employee and Sales per Rupee of Asset. In order to reflect the competitive position of each firm, they included assets, sales, employees and a measure of market share. Assets, sales, employees' measure size, they reflect economics of scale and to some extent, the market power also.

Khatik S.K and Singh P.K (2005) have been made an attempt to evaluate the profitability and financial health of IDBI through the application of the technique of Ratio Analysis. Capital

adequacy ratio, non-performing assets, priority sector advances, statutory liquidity ratio, cash reserve ratio and credit deposit ratio have been used in the study. The study revealed that the bank emphasized on lowering the cost of deposits, improving fee based income, operational efficiency and managing cost. The challenges facing the bank were massive but it has made commendable progress during the last few years.

### **Objectives of the study**

The broad objective of the present study is to assess the performance of selected PSEs, after disinvestment process so as to understand the efficiency and effectiveness of disinvestment process and procedures. The following are the broad objectives. o

1. To assess the financial performance of divested PSEs in India.
2. To understand the valuation process of PSEs
7. To draw conclusion and suggest recommendations for productive disinvestment.

### **Methodology**

The study will involve both, the primary data as well the secondary data. The primary data will be obtained for two reasons, one to validate the results obtained through secondary data analysis and two, assess the qualitative aspects of the results and findings. The sample will be the PSEs where divestment had taken place between 2001 and 2018. The base year has been chosen as 2001 since there was a separate disinvestment department was created by the government in 2001. The source of secondary data will be government published data, annual reports of the PSEs, stock exchanges and other authenticated sources. The primary data will be collected through structured questionnaire from the middle and senior management officials.

We have selected 20 PSEs from the different segments and collected data on various financial performance parameters. The data collected has been analyzed to drive primary findings about disinvestments.

### **Expected Research outcome**

The present study is expected to contribute significantly for the policy makers, PSEs and other stake holders to provide a useful direction and bring required changes for better understanding and performance of PSEs disinvestment process. Besides, the study will also contribute to the existing literature to a larger extent.