4th International Conference on Recent Innovations in Science Engineering and Management
India International Centre, New Delhi
20th March 2016, www.conferenceworld.in
(ICRISEM-16)
ISBN: 978-81-932074-6-8

THE NEED OF AN EFFECTIVE DISINVESTMENT PROCESS IN INDIA

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ABSTRACT

Now, 'why to disinvest' is not the issue as the Government has understood the role of disinvestment in the development of Indian economy. The bigger issue is 'how to disinvest' that can be defined as disinvestment process. The present paper is an attempt to analyse the policy, process and methodologies being formulated for disinvestment and their actual implementation in disinvestment transactions. The paper is based on secondary sources of data such as various manuals, reports published by departments of GOI, journals, magazines, newspapers, websites etc.

Keywords: Disinvestment, Public Sector, Privatization, Financial Performance

I. INTRODUCTION

Before Independence there were almost no 'Public Sector' in Indian economy except the instances of Railways, Post and Telegraph, Port Trust, Ordnance, Aircraft, Salt and Quinine Factories. After independence, India opted for the dominance of public sector with a belief that if it would reduce the inequality of wealth & income and enhance the general peace and prosperity of the country. The public sector was constituted expecting that management and workers in public sector enterprises would be so filled with a sense of responsibility faith and public prosperity and they would heartily do the best in their actions for the country.

But, expectation was not fulfilled as the public sector continued to show bad performance in terms of efficiency and productivity. Whereas the private sector is immensely growing at a dazzling rate.

Then the only option left is the disinvestment and privatization of public sector as some of PSUs are now not more than just extra burden on government with huge accumulated losses. By way of disinvestment, government can restructure public sector and proceeds received from disinvestment can be channelized into various ways to strengthen Indian economy. The need is just to have a positive agenda towards disinvestment and formation of best disinvestment process which should have quick, transparent, reliable and suitable.

II. REVIEW OF LITERATURE

Disinvestment Process is the procedure of disinvestment. In this regard, Government constituted Rangarajan Committee in 1993 made important observation for this purpose. Committee suggested that initially units to be

ISBN: 978-81-932074-6-8

disinvested should be identified means thereby which companies in which sectors can be disinvested. It also held that Government should retain majority share holding in Atomic and Energy sector where ever in other sector disinvestment can be made up to any level. One of its observation also held that disinvestment process should be a transparent one. On 23rd August, 1996, Disinvestment Commission was set up for a period of three years, as an advisory body to advise the Government on the matters related to disinvestment like which companies to be disinvested, mode of disinvestment, issues concerning the interest of Stake Holders, Workers, and Consumers etc. The commission gave recommendations on 58 PSEs out of 72 PSEs referred to it on which action has been taken.

The term of Disinvestment Commission expired in the year 1999, hence a new disinvestment commission was constituted in the month of July 2001 with the same terms of reference. Dr. R.H.Patil, was appointed as Chairman of commission with four other members and one member secretary. The commission was later upgraded as ministry of disinvestment in order to speed up the process of Disinvestment. Subsequently, the commission was again converted in to a Department under Ministry of Finance in May, 2004. The department has been allotted the work of all matters relating to sale of Central Government equity through offer for sale or private placement in the erstwhile Central Public Sector understanding, Re-structuring, implementations of disinvestment decisions including appointment of advisors, pricing of shares etc. Another important task for the department is to formulate the financial policy in regard to utilization of proceeds of disinvestment channelized in National Investment Fund.

In the budget speech of 2000-01, Finance Minister said that the Government equity in all Non-Strategic PSUs will be reduced to 26% or less and the entire receipt from disinvestment and privatization will be used for meeting expenditure in Social Sector, Re-structuring of PSUs and retiring Public Debt.

III. OBJECTIVES OF THE STUDY

- To streamline the policy, process, methodologies being followed for disinvestment.
- To make on analysis of actual implementation of these policies and methodologies in actual disinvestment transactions during Financial Year 1991-92 to current financial year.

IV. NEED OF DISINVESTMENT IN STATES

- State owned enterprises functioning in competitive markets are prime candidates for Disinvestment. Their sale requires little or no regulation.
- No task on central level can be done without the support and participation of states in mixed economy like India.
- Like that of government, there are many sick companies in states which are no more than burden on State government, that burden can be released by disinvestment.
- Inefficiency of State owned enterprises in showing good performance in terms of profits and quality.
- To enhance and improve overall economic efficiency.
- To raise funds for technological up-gradation, modernization and restructuring of Public Sector units.

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V. DISINVESTMENT POLICY

In 2000-01, Government made the clear statement about disinvestment policy that it is ready to reduce its stake in Non-Strategic PSEs even below 26% if necessary and that there would be an increasing emphasis on strategic sales. The main elements of policy are-:

- Re-structuring and reviving potentially viable PSUs.
- Closing down or hand over companies which can not be revived.
- Taking Government equity in all non-strategic PSUs to 26% or lower, if necessary.
- Fully Protecting the interests of workers.
- To emphasize large on strategic sales of identified PSEs.
- To use the entire proceeds of disinvestment in NIF to be channelized for meeting expenditure in social sector, re-structuring of PSEs etc. In July 2009, Government made further announcements regarding the policy.
- Profitable CPSUs, already listed not meeting the mandatory public shareholding of 10% are to be made compliant.
- CPSUs having a positive net worth with no accumulated losses. Earning net profit from last three successful years are to be listed through public offering or issue of fresh equity or a combination of both.

5.1 Disinvestment Commission's Recommendations

- To emphasize the point that valuation of PSUs should be transparent, independent and free from bias. Disinvestment Commission has given three methods of valuation of PSUs.
  1. Discount Cash Flow (DCF).
  2. Relative Valuation Approach.
  3. Net Asset Value Approach.
- Disinvestment Commission felt that method of valuation adopted for a business should be according to health of company, nature of industry and on company's intrinsic strength.
- If a company is listed on a stock exchange its valuation should be made on market price. However a specific valuation should not be valid over, period of time. Hence, valuation should be appropriated.
- In cases of strategic sale, commission recommends that assets valuation should be done. It is of the view that "To get best value through strategic sales, it would be necessary to have a transparent and competitive procedure and encourage enough competition between viable parties. It also makes clear that valuation of business in two different way of strategic sale (as transfer of management control and retaining the control) should be different.
- Valuation of equity of a firm has significant importance when companies to be disinvested are not listed on stock exchange or in cases where capital markets may not fully shows the intrinsic worth of a company.

5.2 Strategic PSEs (Reserved Industries)

In 1998-99, Government classified PSEs into two categories (a) Strategic and (b) Non Strategic. It was decided that Government would retain majority share holding in strategic PSEs whether in non strategic PSEs, Government share holding should be brought down to 26%. Area to be decided and reserved for strategic PSEs are:

(a) Arms, ammunition and allied items of defense equipment, defense aircraft and warships.

(b) Atomic energy except in the areas related to generation of nuclear power and applications of radiation and radio-isotope to agriculture, medicine and non strategic industries.

(c) Railway Transport

All other PSEs fall under category of non strategic PSEs. In the Budget speech of 1999-2000, Government made it clear that it will continue to strengthen the strategic units and privatize the non strategic PSEs through gradual disinvestment or strategic sale.

5.3 Disinvestment Process

Disinvestment process in India as follows:

- Initial step is to place proposal for Disinvestment in PSUs (based on recommendations of Disinvestments Commissions) for consideration to the Cabinet Committee on Disinvestment (CCD).
- After CCD considers the proposal for disinvestment, an advisor is appointed through a competitive bidding process. Advisors can be merchant bankers, consulting firms, in addition to these advisors known as Global advisor or Financial Advisor, Legal Advisor or chartered accountants. Assets valuers and other valuers are also appointed for specific services.

  Advisors (Global Advisors) are allotted the responsibilities of rendering of advice and assisting GOI in disinvestment matters, giving measures to enhance sale value, marketing of offer, inviting and evaluating the bids received, drawing up sale agreements and counseling on post-sale matters.

  Ministry of Disinvestment formulates the brief terms of reference for advisors and invites expression of interest from them to submit proposals. Candidates showing best technical and financial terms are hired to implement disinvestment process.
- After appointment of advisors, bidders are invited to submit their expression of interest via advertisements in news papers/websites or in any social media platform. After receiving EOI from bidders, a list of bidders is prepared who fulfilled the prescribed qualification criteria.
- Global Advisor then with the help of legal advisors formulates the draft share purchase agreement and shareholder agreement. The final draft is prepared after consulting bidders in consultation with IMG.
- The interested potential bidder make discussions with the Advisors/GOI and representatives of concerned PSUs for any clarifications.
- The work of valuation of PSUs is done with consideration to standard national and international practices. There are various methodologies followed for the valuations of PSUs like DCF method, Balance-Sheet method,

ISBN: 978-81-932074-6-8

Market multiple method etc. The method chosen for the valuation of PSUs should depend on the health or position of company (whether sound or sick), industry, liquidity of company etc.

- Then, Inter Ministerial Group finalizes "the share purchase agreement and share holders agreement." They are approved by Government and sent to bidders for inviting their final financial bids.
- IMG and inter ministerial evaluation committee determines the 'upset price' in presence of bidders. CCD, then takes the final decision regarding selection of strategic partners and signing the agreements.
- In case the PSUs are listed on stock exchange an open offer is required to be made by bidders as per SEBI guidelines.
- All documents related to process are turned over to Comptroller and Auditor General of India who prepares an evaluation for sending to Parliament and releasing them to Public which comes as the end of Disinvestment Process.

VI. MECHANISM ADOPTED IN INDIA

In India, a three tier mechanism is adopted for implementation of disinvestment Process which is as follows;

1. Cabinet Committee on Disinvestment. (CCD)
2. Core Group of Secretaries on Disinvestment.
3. Inter-Ministerial Group(IMG)

1. Cabinet Committee on Disinvestment (CCD)

There is a wide range of ministers included in CCD which are the honorable Prime Minister as the chairperson, Deputy PM, Minister of Power, Minister of Law and Justice, Minister of Commerce and Industry, Ministers of External Affairs, Ministers of finance and company affairs, Ministers of Petroleum and Natural Gas, Minister of civil aviation, Deputy chairman of Planning commission, Minister of disinvestment and Minister concerned with PSUs under disinvestment as members of committee CCD functions on the matters like considering the advice of CGD, Deciding price band for sale of Government shares, selection of strategic partner in strategic sales and to approve the final programmes of Disinvestments every year.

2. Core Group of Secretaries on Disinvestment (CGD)

Core Group of Secretaries consists of secretaries from Ministries of Finance, Industry, Disinvestment, Planning Commission and Administrative Ministry etc. The cabinet secretary works as the need of CGD. Functions of Core Group are:

a. To supervise the implementations of decisions of all strategic sale.
b. Ensuring the progress of implementation of CCD decisions.
c. CGD gives significant recommendations on all matters relating disinvestment policy.

3. Inter-Ministerial Group (IMG)

Inter Ministerial Group is the forum where inter ministerial consultation takes place at primary level. IMG consists of officers of Ministry of Finance, Department of Public Enterprises, Department of Legal Affairs, Department of

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Company Affairs, Administrative Ministry, Director of PSEs concerned. IMG is headed by Secretary, Ministry of Disinvestment.

VII. METHODS OF DISINVESTMENT

Various modes of disinvestment are:

1. Strategic Sale

In a strategic sale, management control is transferred to strategic partner and company no longer remains a Government company. In case of PSUs, the transfer of shares involves bringing down Government share holding below 51%. In strategic sale, a sale agreement is signed and Government ensures that the agreement signed with strategic partner properly safeguards the interests of Company, of Government and of Employees.

Strategic sale is suitable for non-strategic companies or where Government want to transfer management control to buyer. The successful examples of strategic sale are MFIL, BALCO, CMC, HTL. VSNL, IBP, HZL, PPL, IPCL, etc. One of the significant advantages of strategic sale is the chances of getting maximum price because of transfer of management control. But the process is quite time consuming and has issues relating to management, land & labour to be reserved. In non-strategic companies Government has given more emphasis on strategic sale.

2. Capital Market

(a) **Offer for Sale to Public at Fixed Price:**

Under this method, an issue of equity shares is made which are held by GOI to public at a pre determined price. Interested party gets the offer of sale. This method is suitable for profit making companies. This is a quite quick and transparent method. Example is offer of 1 million share of VSNL @ Rs.750 per share.

(b) **Offer for sale to Public through Book Buildings:**

Under this method, equity shares of companies under disinvestment are issued to public at large but price is discovered through bidding by interested investors. Bidder making highest bid gets the companies. Precedents of this method are Hughes software Ltd., HCC Technologies Ltd. and Bharati Televentures in private sector. Other methodologies under capital market are secondary market operation, international offering, private placement of equity and auction etc.

3. Warehousing

The target investor set is institutions under this method. This method is regulated by RBI restrictions on Bank Investments. Under this method, GOI sells shares at a discount to market price. As such no warehouser is interested to invested. There are no examples of this method being implemented in PSUs till now.

4. Reduction in Equity

i. This method is regulated by Companies Act, SEBI Buyback regulations. Under this method, company buy its shares back from other shareholders and cancel them. There are two ways further in this method:

- Buy-back can be made through tender route with a fixed price.
- It can be made through book building where price is determined through bidding by interested investors.

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ii. Secondary method of reducing equity is conversion of equity into other instruments like deep discount bonds, partial/fully convertible bonds, bonds with warrants attached, and preference shares with or without warrants. This method is regulated by companies Act. Example:- NALCO.

5. Trade Sale

Trade sale is sale of a business or a division of non core activity. Price is determined by auction where the seller concerns for two things as obtaining the maximum amount of sale proceeds and ensuring that the expenses to consumer remains at affordable price. In UK, sale is generally used with smaller industries and enterprises.

6. Asset Sale or Winding Up

This method is applied in companies that are either sick or facing closure. Open auction or tender method is normally adopted in tender method. But the sick companies under SICA are wound up and hander over of official liquidator for realization of dues.

7. Management/Employee Buyout

London's bus service was recognized in to companies which are purchased by their managers and employees. This method is suitable for small enterprises with a small and highly motivated manpower.

8. Sale Through Demerger

This method is governed by Companies Act 1956. In this method, there is transfer of an undertaking from one existing company to other existing company which are called Transfer company and Transferee company respectively. This method has experienced the successful sale of a few hotels of ITDC and HCI (a subsidiary of Indian Airlines.)

VII. METHODOLOGIES BEING USED FOR VALUATION OF PSUS

Based on the recommendations of the Disinvestment Commission there are four methodologies being used for valuation of PSUs which are:

(a) Discounted Cash Flow Method.
(b) Balance Sheet Method.
(c) Transaction/Market Multiple Method.
(d) Asset Valuation Method.

(a) Discounted Cash Flow Method (DCF)

This methodology is used for valuation of business on a going concern concept. This method shows the present value of a business in terms of its future cash earnings capacity. The objective while valuing a business under DCF method is to determine net present value of free cash flows arising from a business over a future period of value which period is called explicit forecast period.

This approach is suitable for companies where future cash flow can be projected with a reasonable degree of reliability. In a fast changing market like telecom or automobile, the explicit period should not be more than 5 years; beyond that period any projections made would be simply speculation.

ISBN: 978-81-932074-6-8

Free cash flows for a year is derived by deducting total of annual tax outflow, capital expenditure (assumed) and assumed incremental working capital from the respective year's profit before depreciation, interest and tax for explicit period. The future cash flow thus derived is then discounted at a discount rate which represents Weighted Average Cost of Capital. Based on WACC, a discounting factor is arrived.

Discount factor = 1/(1+WACC) (of previous year)

Then a terminal value is calculated which reflects the average business conditions of company that are expected to prevail over the explicit period. This is further discount to reach at Enterprise value which is the sum of value of debt as well as equity. And to arrive equity value, the outstanding net debt as on valuation of date is deducted from this enterprises value and thus we obtain the net Equity Value of a company for disinvestment. This methodology is most appropriate where the business possesses substantial intangible like brand, goodwill, distribution of net worth etc. The DCF methodology is considered the best methodology for valuation all over the world because it takes into account all the factors relevant for valuation.

(b) Balance Sheet Method

The Balance Sheet method or Net Asset Value methodology expresses the value of a business on the basis of value of its underlying assets. This methodology is normally used to determine the minimum price seller will be willing to accept and thus establish the floor for the value of a business. This methodology is used in enterprises where the value of intangibles is not significant and the business is recently set up. However, the main drawback of this method is that under this method a business is valued by the net value of assets represented in financial statement and hence this method does not consider the earning capacity of a business. This method is used for valuation of a business on a going concern.

(c) Market Multiple Method

This method evaluates a company taking into consideration the transaction value of a comparable companies in the industry and benchmarks it against certain parameters like earning, sale etc. There are two most common used ways.

i. EBIIDA Multiple:-

EBIIDA works on the promise that value of a business is directly related to quantum of Gross Profit. The net profits are adjusted to arrive at EBITDA that is Earnings before Interest, Taxation, Depreciation and amortization. In this method:-

Enterprise Value (EV) = Market Value of Equity + Market Value of Debt

and

EBITDA multiple = EV/EBITDA

ii. Sales Multiple:

Sales multiple is calculated as:

Sales multiple = Enterprises Value / Net Sales of Current Year

The main drawback of market multiple methodology is not considering time value of money and actual value required to earn maintainable profits. However this methodology is widely used by investors to obtain benchmark values for an enterprise.

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(d) Asset Valuation Method

The asset valuation method is appropriate in case of liquidation / closure of the business. This method estimates the cost of replacing the tangible assets of business. The replacement cost takes into consideration the market value of various assets or the expenditure required to create the similar infrastructure of a company being valued. This method is not suitable for valuing business on a going concern basis. This method may be useful where it is felt that other methodologies are not able to capture the fair present value of such assets.

Receipts (In Cr.) From Disinvestment (1991-92 to Till Date)

Year	Target Fixed	Actual Receipt	Method of Disinvestment
1991-92	2500	3037.74	Minority shares sold by Auction Method
1992-93	2500	1912.51	Shares sold by Auction Method
1993-94	3500	-	Auction Method
1994-95	4000	4843.10	Shares sold by Auction Method.
1995-96	7000	168.48	Auction method
1996-97	5000	379.67	GDR-VSNL
1997-98	4800	910	GDR-MTNL
1998-99	5000	5371.11	Cross purchase, Domestic offering, VSNL
1999-00	10000	1860.14	GDR-GAIL, Domestic offering of VSNL, Capital reduction, Strategic sale of MFIL
2000-01	10000	1871.26	Sale of KRL, CPCL, BRPL, TO CPSE, Strategic sale of BALCO, LJMC
2001-02	12000	5657.69	Strategic Sale
2002-03	12000	3347.98	Strategic Sale, Employee Buyout
2003-04	14500	15547.41	Strategic Sale, Offer for Sale
2004-05	4000	2764.87	Offer of sale, Sale to Employees
2005-06	No Target Fixed	1569.68	Sale of shares to PSEs and Employees
2006-07	No Target Fixed	-	-
2007-08	No Target Fixed	4181.39	Sale to PSEs and Employee, Offer for Sale
2008-09	No Target Fixed	-	-
2009-10	No Target Fixed	23552.93	Sale of NHPC, OIL, REC, NTPC and NMDC
2010-11	40000	22144.20	Sale of SJVN, EIL, CIL, MOIL, PGCIL
2011-12	40000	1144.55	Sale of PFC

Source : Department of Disinvestment, GOI

IX. CONCLUSION

The present disinvestment policy in India has gone under many phases and now the Government has decided the path of strategic sale to be adopted for disinvestment in Public Sector Units (Non Strategic). The Disinvestment process works on three-tier mechanism consisting of CCD, CGD and IMG. Disinvestment Commission to make the process transparent, free from bias gave valuable recommendations regarding valuation of PSUs under disinvestment. Recommendation to standardize the methodologies has also given to facilitate the accurate valuation of a PSU. The financer observed that the Disinvestment and Privatization are useful economic tools. He said 'We will selectively employ these tools, consistent with the declared policy'. The Government has now decided not to privatize profit making PSEs and focus is now on to disinvest non-strategic (not financially sound) companies through strategic sale.

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