DISINVESTMENT POLICY & PROCEDURES



DEPARTMENT OF DISINVESTMENT GOVERNMENT OF INDIA

FOREWORD

Ever since India embarked in the early 90s on rectifying its economic policies and structure, the disinvestment programme has been an important element of its reform agenda. While governments have replaced governments since then, each of them has continued to build on the disinvestment steps taken by its predecessor. Similarly, while different parties control governments in different parts of the country today, most of them are attempting – through disinvestment – to disengage government from economic and commercial enterprises.

In a word, there has in fact been a consensus on disinvestment in practice. Unfortunately, political parties have developed a practice in India of doing one thing when and where they are in power, and opposing the same thing when and where they are out of power.

In part for this reason there has been a persistent demand from various quarters that the policies and procedures that are being followed should be documented more thoroughly. Some of the State Governments which have embarked on disinvestment have also been asking us to inform them of the procedures that have been adopted at the Center: they have told us that such an account would assist them in determining how they should proceed.

This manual gives a broad overview of the issues that come up during a disinvestment transaction. It consolidates information about the way disinvestment policy and procedures have evolved. It also enumerates the different methods and approaches that are adopted in dealing with issues that are much in the public eye – such as valuation and the manner in which the interests of employees be safeguarded.

The manual is a compilation of the experience that has been gained thus far. As we learn more, the manual will be revised and updated.

All of us in the Department of Disinvestment will be grateful for suggestions to improve the manual so that it may continue to be useful.

AM (Arm Shoune)

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ABBREVIATIONS USED

ADR - American Depository Receipt

BSE - Bombay Stock Exchange

CCD - Cabinet Committee on Disinvestment

CGD - Core Group of Secretaries on Disinvestment

CAPM - Capital Asset Pricing Model

DPE - Department of Public Enterprises

DCF - Discounted Cash Flow

EOI - Expression of Interest

EBITDA - Earnings Before Interest, Taxes, Depreciation & Amortisations

FDI - Foreign Direct Investment

GAAP - Generally Accepted Accounting Principles

GDR - Global Depository Receipt

GOI - Government of India

IMG - Inter-Ministerial Group

IPO - Initial Public Offering

LSE - London Stock Exchange

NASDAQ - National Association of Securities Dealers Automated Quotations

NAV - Net Asset Value

NYSE - New York Stock Exchange

NRI - Non Resident Indian

NEP - New Economic Policy

NSE - National Stock Exchange

NCAER - National Council for Applied Economic Research

PSU - Public Sector Undertaking

PSE - Public Sector Enterprises

PE Ratio - Price Earning Ratio

PAT - Profit After Tax

PIM - Preliminary Information Memorandum

QIB - Qualified Institutional Buyer

RFP - Request for Proposal

RFQ - Request for Qualification

SLPE - State Level Public Enterprise

SEC - Securities Exchange Commission

VRS - Voluntary Retirement Scheme

WACC - Weighted Average Cost of Capital

PART — A

WHY PRIVATISATION?

CHAPTER - 1

INTRODUCTION

This manual deals basically with two issues "Why to Privatise" and "How to Privatize". Part A deals about the rationale of privatisation. Part B deals with the procedure of Privatisation.

Privatisation has different nomenclature in different countries like 'disinvestment', peoplisation', 'popular capitalism', 'denationalisation', 'prioritisation', 'industrial transition', 'economic democratisation', 'partners in development', 'dis-incorporation', 'assets sales programme', 'transformation and 'restructuring'. In this manual, the words privatisation and disinvestment have been used interchangeably.

why this Manual?

Policymakers, be it in the administrative Ministries or in the State Governments occasionally face a dilemma. They are often convinced about the merits of Privatisation, but do not know how to implement it. The enormous outpouring of literature on Privatisation, the dramatic success of privatisation in a large number of diverse countries, and the economic realities of the excessive burden of overstretched public sector in their States, have convinced them to try privatisation. Yet to most of them, the process of implementing privatisation is shrouded in mystery. This fear of the unknown often discourages them from taking the first step.

They are often confronted with a number of questions like which Public Sector Enterprises should be taken up for disinvestment, which method of disinvestment should be followed, how to disinvest to get the best realization and optimize on the objectives, how to prepare documents etc.

No standard recipe for disinvestment in Public Sector Enterprises (PSEs) is currently available either at the national level or at the state level.

Though a group of international practitioners and advisors in the art and science of privatisation have developed in the West----lawyers, bankers, accountants, business consultants, communicators and the like, with their large body of accumulated experience and expertise, which is largely related to the Western economies, not much is available to guide, in the developing economies. Thus, while we would do well to learn from the successful experiences of the west, we would have to be careful with the pitfalls, which were responsible for setback to some of the economies in the east. In the final analysis while experience of other countries is available to us by way of guidance, we would have to evolve our own techniques, best suited to our level of development. It makes all the difference whether or not there already exist fully functioning markets, which could integrate or assimilate the former PSEs. The historic, cultural and institutional context influences the way in which and the pace at which privatisation is implemented. Where market economy is not fully developed, ways would have to be found to safeguard the interests of consumers and investors, which would ensure a fuller play to the wealth

creating role of the entrepreneurs. The main purpose of this manual is to demystify this process and to share with policymakers, national and international experience on implementation of privatisation.

Who will benefit from this Manual?

This manual is primarily meant for public policymakers entrusted with the job of implementing privatisation decisions. It will be useful to them in the following ways. It will:

- Provide overall understanding of the privatisation process.
- Assist in planning the logistics to implement the privatisation decision.
- Enable to implement the privatisation transactions.
- Guide the material supervision of consultants (financial advisors) recruited to implement the privatisation transactions.
- Improve design of privatisation policies by painting a realistic picture of the implementation phase.

What kinds of Privatisation Transactions will benefit from this Manual?

This manual is intended to be useful for a wide variety of privatisation transactions, for example, the sale of the majority of shares in a public enterprise to a strategic investor, and quasi-privatisation transactions such as management contracts, leases and concessions to the private sector for operating a public utility. Much of the material in the manual is relevant to almost any kind of privatisation transaction that involves competitive bidding. For the sake of clarity the manual takes as a base case a common form of privatisation transaction: the sale of the majority interest in a state-owned enterprise to a strategic partner. Nevertheless, the manual also discusses deviations from this base case and their implications on implementation. It will be most helpful in what has come to be known as case-by-case privatisation.

For the sake of convenience, this manual has been divided in two parts. Part A deals with Evolution of Public Sector, Genesis and Rationale of Disinvestment and the Disinvestment Policy of Government of India. Major issues in Disinvestment have also been covered. Experiences of other countries and successful privatisations in India have also been described. A chapter has been devoted to Privatisations in States. Part B deals with the procedure being followed by Government of India. It describes the policy as to which sectors should be taken up for disinvestment, what should be the extent of disinvestment, what methods should be adopted and the procedure to be followed for disinvestment. Various concepts and issues involved in disinvestment have also been discussed along with the various options and methodologies for disinvestment to find out the "best-fit". A chapter has been devoted to describing the various methodologies for valuation. The labour issues have separately been discussed along with the various protections available to the employees.

The manual starts by defining the overall objectives and developing an over view of the process that will unfold. While it is not necessary and probably not possible to plan every

detail in advance, certain principles and basic modus operandi need to be agreed, conflicting objectives prioritised, the trade off identified and a commitment made to drive the programme through, despite the opposition that will develop from those in favour of maintaining status quo.

Several issues relating to disinvestment/privatisation are discussed in this manual and possible solutions thereto provided. The manual also deals with various policy matters and procedures, which may be adopted for disinvestment/privatisation. It may, however, be clarified that such issues, policies, procedures, statements are only illustrative and not exhaustive.

CHAPTER - 2

GLOBAL PERSPECTIVE

Globally, the roots of the State intervention in economic activities in the previous century can perhaps be traced back to early 30s when, in the wake of the Great Depression. Roosevelt tried to rein in the dubious behaviour of the wayward private enterprises in the US through the New Deal, which witnessed the setting up of the regulatory agencies like the Securities and Exchange Commission (SEC) and the onset of large federal deficits. public works expenditure and cheap money. The US Government's intervention involved support to markets when they failed to generate socially desirable outcomes and a check on the power of private monopolies. State intervention in commercial activities seemed to have got a further fillip with the perceived success of the Soviet industrialisation. This was followed by the large-scale state intervention / nationalisation during late 40s and 50s, all over the world, driven by the pressure / resource requirements of rebuilding the post War and postcolonial economies. There appeared to be an economic consensus around the world accepting public enterprises as inevitable part of the economy, especially to manage natural monopolies and the core industries. The lack of entrepreneurship, security of the country, concern for balanced regional development, employment generation etc., were some of the other major motivators for encouraging the public sector trend.

Thus, Britain nationalised its core industries, such as coalmines, iron and steel, electricity, gas, ports and shipbuilding. In post war France, the economy was divided into three segments – the private, the controlled and the nationalised. Public utilities, core and strategic sectors, telecommunications, airlines, automobiles were all either nationalised or brought under majority ownership and control. In the developing countries too, public sector came to acquire a major role. Here, the state intervention was fuelled by several other considerations, such as, the state of private entrepreneurship and managenal expertise, regional imbalances in industrial development, employment generation etc. It was thought that the social welfare objectives could be best achieved through comprehensive state intervention. This trend continued throughout 60s and 70s, in several countries.

Disenchantment with public sector started in 1970s. It was observed in many countries that the performance of the public enterprises was far below the expectations and worse than the private sector. The public sector seemed to perform well only when protected through Government created monopolies, entry reservations, high tariffs and quotas etc. The problems got further accentuated due to preemption of massive resources by the under performing public sector which left little money for more urgent social needs and public welfare. These problems were brought in sharp focus after the second oil shock of 1979, when it became clear that the experiments with Government ownership of commercial activities were not succeeding. This decade witnessed the start of the reversal of the trend.

A new trend of global integration began to emerge and countries all over the world, whether developed or developing, capitalist or socialist, started undergoing vast economic changes, witnessed by the decline in the role of the State in commercial activities and privatisation of state owned enterprises. By 1980s, privatisation had started in real earnest in several parts of the world. This was facilitated by the gradual integration of the world economies, which ensured that capital and goods flowed more freely to countries suffering from lack of resources. Foreign capital is now freely available to finance the large infrastructure projects, for want of which the domestic private parties were hitherto unable to come forward, and the State support was earlier necessary. Acceptance of the WTO regime by most of the countries has since led to gradual abolition of quantitative restrictions and reduction in duties and removal of restrictions on inter country trade. As a result, the relevance of the State in providing resources for various commercial activities and protecting the interests of consumers has been considerably reduced.

CHAPTER -- 3

EVOLUTION OF PUBLIC SECTOR IN INDIA

"The State will progressively assume predominance and direct responsibility for setting up new industrial undertakings and for developing transport facilities."

-Industrial Policy Resolution 1956.

Before independence, there was almost no 'Public Sector' in the Indian economy. The only instances worthy of mention were the Railways, the Posts and Telegraphs, the Port Trust, the Ordnance and the Aircraft factories and few Government managed undertakings like the Government salt factories, quinine factories etc.

After independence and with the advent of planning, India opted for the dominance of the public sector, firmly believing that political independence without economic self-reliance was not good for the country. The passage of Industrial Policy Resolution of 1956 and adoption of the socialist pattern of the society led to a deliberate enlargement of our public sector. It was believed that a dominant public sector would reduce the inequality of income and wealth, and advance the general prosperity of the nation. The planners also seemed to believe that by placing the management and workers in public enterprises in a position of responsibility and trust, they would be so imbued with a sense of the public good that their actions and aspirations would naturally reflect what was best for the country.

The main objectives for setting up the Public Sector Enterprises as stated in the Industrial Policy Resolution of 1956 were:

- To help in the rapid economic growth and industrialization of the country and create the necessary infrastructure for economic development;
- To earn return on investment and thus generate resources for development;
- To promote redistribution of income and wealth;
- To create employment opportunities;
- To promote balanced regional development;
- To assist the development of small-scale and ancillary industries; and
- To promote import substitutions, save and earn foreign exchange for the economy.

In tune with the widespread belief at that time, the 2nd Five Year Plan stated very clearly that 'the adoption of socialist pattern of society as the national objective, as well as the need for planned and rapid development, require that all industries of basic and strategic importance, or in the nature of public utility services, should be in the public sector. Other industries, which are essential and require investment on a scale, which only the state, in the present circumstances, could provide, have also to be in the public sector. The state has, therefore, to assume direct responsibility for the future development of industries over a wider area.'

The Second Plan further emphasized that 'the public sector has to expand rapidly. It has not only to initiate developments which the private sector is either unwilling or unable to undertake, it has to play the dominant role in shaping the entire pattern of investment in the economy, whether it makes the investments directly or whether these are made by the private sector. The private sector has to play its part within the framework of the comprehensive plan accepted by the community.'

Growth of Investment

The investment in public sector enterprises has grown from Rs.29 crores as on 1.4.1951 to Rs.2,52,554 crores as on 31.3.2000. The growth of investment in the central public sector enterprises, including those enterprises, which are under construction, over the years, is given below:

<u>Table – I</u>

Investment in Public Sector Enterprises

Particulars	Total Investment (Crore)	Enterprises (Numbers)
At the commencement of the 1 st 5-Year Plan (1.4.1951)	29	5
At the commencement of the 2 nd 5-Year Plan (1.4.1956)	81	21
At the commencement of the 3 rd 5-Year Plan (1.4.1961)	948	47
At the end of the 3 rd 5-Year Plan (31.3.1966)	2,410	73
At the commencement of the 4 th 5-Year Plan (1.4.1969)	3,897	84
At the commencement of the 5 th 5-Year Plan (1.4.1974)	6,237	122
At the end of 5 th 5-Year Plan (31.3.1979)	15,534	169
At the commencement of the 6 th 5-Year Plan (1.4.1980)	18,150	179
At the commencement of the 7 th 5-Year Plan (1.4.1985)	42,673	215
At the end of 7 th 5-Year Plan (31.3.1990)	99,329	244
At the commencement of the 8th 5-Year Plan (1.4.1992)	1,35,445	246
At the end of 8 th 5-Year Plan (31.3.1997)	2,13,610	242
As on 31.3.1998	2,31,024	240
As on 31.3.1999	2,39,167	240
As on 31.3.2000	2,52,554	240

Source: Public Enterprises Survey 1999-2000

CHAPTER - 4

GENESIS OF DISINVESTMENT IN INDIA

"While the case for economic reforms may take good note of the diagnosis that India has too much government interference in some fields, it ignores the fact that India also has insufficient and ineffective government activity in many other fields, including basic education, health care, social security, land reforms and the promotion of social change. This inertia, too, contributes to the persistence of widespread deprivation, economic stagnation and social inequity."

-Amartya Sen & Jean Dreze

By the mid-1980s, around the globe, the pendulum of political option was swinging decisively towards the view that the proportion of the GNP due to Government economic activity should be reduced to the extent possible. This coincided with the belief that even for natural monopolies, effective regulatory surrogates for competition could be devised that would protect the consumers from the abuse of the monopoly power of these companies.

Many eminent economists argued that Government must not venture into those areas where the private sector can undertake job efficiently. Lot of emphasis was laid on market driven economies, rather than state administered economies. The collapse of socialist economy of the Soviet block convinced the policy planners, around the world, that role of the state should be that of a regulator rather than the producer. The resources deployed by the Government for undertaking commercial activities should be unlocked and deployed for the social activities.

During the 1980s, the disillusionment witnessed in the socialist economies added to the disenchantment with the public sector in the mixed economies in the world. USSR started the economic reforms under **perestroika**, which swept the economies of Eastern Europe. China also introduced economic reforms and it was recognized that public sector did not optimize efficiency and productivity of capital. It was realized that the large number of public enterprises working under mixed economies were victims of over centralization in decision making and excessive bureaucratization.

In India for almost four decades the country was pursuing a path of development in which public sector was expected to be the engine of the growth. However, the public sector had overgrown itself and their shortcomings started manifesting in the shape of low capacity utilization and low efficiency due to over manning and low work ethics, over capitalization due to substantial time and cost over runs, inability to innovate, take quick and timely decisions, large interference in decision making process etc.

Nobel Laureate Dr. Amartya Sen and Jean Dreze opined that "While the case for economic reforms may take good note of the diagnosis that India has too much

government interference in some fields, it ignores that fact that India also has insufficient and ineffective government activity in many other fields, including basic education, health care, social security, land reforms and the promotion of social change. This inertia, too, contributes to the persistence of widespread deprivation, economic stagnation and social inequality."

The Government started to deregulate the areas of its operation and subsequently the disinvestment in Public Sector Enterprises was announced. The Industrial Policy of 1991 started the process of de-licensing and except 18 industries, industrial licensing was withdrawn. The process of deregulation was aimed at enlarging competition and allowing new firms to enter the markets. The market was opened up to domestic entrepreneurs/industrialists and foreign capital was provided free entry up to 51% equity in high technology areas.

The Industrial Policy of 1991 limited the priority areas for the public sector to:

- Essential infrastructure goods and services;
- Exploration and exploitation of oil and mineral resources;
- Technology development and building of manufacturing capabilities in areas which are crucial in the long term development of the economy and where private sector investment is inadequate; and
- Manufacture of products where strategic considerations predominate such as defence equipment.

RATIONALE FOR DISINVESTMENT

Because of the current revenue expenditure on items such as interest payments, wages and salaries of Government employee and subsidiaries, the Government is left with hardly any surplus for capital expenditure on social and physical infrastructure. Whereas the Government should be spending on basic education, primary health and family welfare, huge amounts of resources are blocked in several non-strategic sectors such as hotels, trading companies, consultancy companies, textile companies, chemical and pharmaceuticals companies, consumer goods companies etc. Not only this – the continued existence of the PSEs is forcing the Government to commit further resources for the sustenance of many non-viable PSEs. The Government continues to expose the taxpayers' money to risk, which it can readily avoid. To top it all, there is a huge amount of debt overhang, which needs to be serviced and reduced before money is available to invest in infrastructure. This makes disinvestment of the Government stake in the PSEs absolutely imperative.

The **primary objectives** for privatising the PSEs are, therefore, as follows:

- Releasing the large amount of public resources locked up in non-strategic PSEs, for redeployment in areas that are much higher on the social priority, such as, basic health, family welfare, primary education and social and essential infrastructure;
- Stemming further outflow of these scarce public resources for sustaining the unviable non-strategic PSEs;
- Reducing the public debt that is threatening to assume unmanageable proportions;
- Transferring the commercial risk, to which the taxpayers' money locked up in the public sector is exposed, to the private sector wherever the private sector is willing and able to step in the money that is deployed in the PSEs is really the public money and is exposed to an entirely avoidable and needless risk, in most cases;
- Releasing other tangible and intangible resources, such as, large manpower currently locked up in managing the PSEs, and their time and energy, for redeployment in high priority social sectors that are short of such resources;

The **other benefits** expected to be derived from privatisation are:

Disinvestment would expose the privatised companies to market discipline, thereby forcing them to become more efficient and survive or cease on their own financial and economic strength. They would be able to respond to the market forces much faster and cater to their business needs in a more professional manner. It would also facilitate in freeing the PSEs from the Government control and introduction of corporate governance in the privatised companies.

- Disinvestment would result in wider distribution of wealth through offering of shares of privatised companies to small investors and employees.
- Disinvestment would have a beneficial effect on the capital market; the increase in floating stock would give the market more depth and liquidity, give investors easier exit options, help in establishing more accurate benchmarks for valuation and pricing, and facilitate raising of funds by the privatised companies for their projects or expansion, in future.
- Opening up the public sector to appropriate private investment would increase economic activity and have an overall beneficial effect on the economy, employment and tax revenues in the medium to long term.
- In many areas, e.g., the telecom sector, the end of public sector monopoly would bring relief to consumers by way of more choices, and cheaper and better quality of products and services – as has already started happening.

CHAPTER - 6

DISINVESTMENT POLICY

(I) The Initial Phase

The policy of the Government on disinvestment has evolved over a period and it can be briefly stated in the form of following policy statements made in the chronological order:

A. Interim Budget 1991-92 (Chandrashekhar Government)

The policy, as enunciated by the Chandrashekhar Government, was to divest up to 20% of the Government equity in selected PSEs in favour of public sector institutional investors. The objective of the policy was stated to be to broad-base equity, improve management, enhance availability of resources for these PSEs and yield resources for the exchequer.

"It has been decided that Government would disinvest up to 20 per cent of its equity in selected public sector undertakings, in favour of mutual funds and financial or investment institutions in the public sector. The 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 crores to the exchequer in 1991-92. The modalities and details of implementing this decision, which are being worked out, would be announced separately."

B. Industrial Policy Statement of 24th July,1991

The Industrial Policy Statement of 24th July 1991 stated that the government would divest part of its holdings in selected PSEs, but did not place any cap on the extent of disinvestment. Nor did it restrict disinvestment in favour of any particular class of investors. The objective for disinvestment was stated to be to provide further market discipline to the performance of public enterprises.

"In the case of selected enterprises, part of Government holdings in the equity share capital of these enterprises will be disinvested in order to provide further market discipline to the performance of public enterprises".

C. Budget speech: 1991-92

In this pronouncement, the cap of 20% for disinvestment was reinstated and the eligible investors' universe was again modified to consist of mutual funds and investment institutions in the public sector, and the workers in these firms. The objectives too were modified, the modified objectives being: "to raise resources, encourage wider public participation and promote greater accountability".

"In order to raise resources, encourage wider public participation and promote greater accountability, up to 20 per cent of Government equity in selected public sector undertakings would be offered to mutual funds and investment institutions in the public sector, as also to workers in these firms".

D. Report of the Committee on the Disinvestment of Shares in PSEs (Rangarajan Committee): April 1993

The Rangarajan Committee recommendations emphasised the need for substantial disinvestment. It stated that the percentage of equity to be divested could be up to 49% for industries explicitly reserved for the public sector. It recommended that in exceptional cases, such as the enterprises which had a dominant market share or where separate identity had to be maintained for strategic reasons, the target public ownership level could be kept at 26%, that is, disinvestment could take place to the extent of 74%. In all other cases, it recommended 100% divestment of Government stake.

Holding of 51% or more equity by the Government was recommended only for 6 Schedule industries, namely:

- I. Coal and lignite
- II. Mineral oils
- III. Arms, ammunition and defence equipment
- IV. Atomic energy
- V. Radioactive minerals, &
- VI. Railway transport

E. The Common Minimum Programme of the United Front Government: 1996

The highlights of the policy formulated by the United Front Government were, as follows:

- To carefully examine the public sector non-core strategic areas;
- To set up a Disinvestment Commission for advising on the disinvestment related matters;
- To take and implement decisions to disinvest in a transparent manner;
- Job security, opportunities for retraining and redeployment to be assured.

No disinvestment objective was, however, mentioned in the policy statement.

"The question of withdrawing the public sector from non-core strategic areas will be carefully examined subject, however, to assuring the workers and employees of job security or, in the alternative, opportunities for retraining and redeployment. The United Front Government will establish a Disinvestment Commission to advise the government on these steps. Any decision to disinvest will be taken and implemented in a transparent manner".

F. Disinvestment Commission Recommendations: Feb.1997- Oct. 1999

Pursuant to the above policy of the United Front Government, a Disinvestment Commission was formed in 1996. It made recommendations on 58 PSEs. The recommendations indicated a shift from public offerings to strategic / trade sales, with transfer of management, as the following table shows:

<u>M</u>	ode of disinvestment recommended	Number of PSEs
Α.	Involving change in ownership / management 1. Strategic sale 2. Trade sale	29 8
₿.	Involving no change in ownership / management Offer of shares	5
C.	No change 1. Disinvestment deferred 2. No disinvestment	11 1
D.	Closure / sale of assets GF	24 RAND TOTAL 58

(II) The Second Phase

A. Budget Speech: 1998-99

In its first budgetary pronouncement, the Government decided to bring down Government shareholding in the PSUs to 26% in the generality of cases, (thus facilitating ownership changes, as was recommended by the Disinvestment Commission). It however, stated that the Government would retain majority holdings in PSEs involving strategic considerations and that the interests of the workers would be protected in all cases.

"Government have also decided that in the generality of cases, the Government shareholding in public sector enterprises will be brought down to 26 per cent. In cases of public sector enterprises involving strategic considerations, government will continue to retain majority holding. The interest of workers shall be protected in all cases".

The policy for 1999 – 2000, as enunciated by the Government, was to strengthen strategic PSUs, privatise non-strategic PSUs through gradual disinvestment or strategic sale and devise viable rehabilitation strategies for weak units. A highlight of the policy was that the expression 'privatisation' was used for the first time.

"Government's strategy towards public sector enterprises will continue to encompass a judicious mix of strengthening strategic units, privatising non-strategic ones through gradual disinvestment or strategic sale and devising viable rehabilitation strategies for weak units".

Strategic & Non-strategic Classification

On 16th March 1999, the Government classified the Public Sector Enterprises into strategic and non-strategic areas for the purpose of disinvestment. It was decided that the Strategic Public Sector Enterprises would be those in the areas of:

- a) Arms and ammunitions and the allied items of defence equipment, defence air-crafts and warships;
- Atomic energy (except in the areas related to the generation of nuclear power and applications of radiation and radio-isotopes to agriculture medicine and non-strategic industries);
- c) Railway transport.

All other Public Sector Enterprises were to be considered non-strategic. For the non-strategic Public Sector Enterprises, it was decided that the reduction of Government stake to 26% would not be automatic and the manner and pace of doing so would be worked out on a case-to-case basis. A decision in regard to the percentage of disinvestment i.e., Government stake going down to less than 51% or to 26%, would be taken on the following considerations:

- (a) Whether the industrial sector requires the presence of the public sector as a countervailing force to prevent concentration of power in private hands, and
- (b) Whether the industrial sector requires a proper regulatory mechanism to protect the consumer interests before Public Sector Enterprises are privatised.

C. Budget speech: 2000 - 2001

The highlights of the policy for the year 2000 – 01 were that for the first time the Government made the statement that it was prepared to reduce its stake in the non-strategic PSEs even below 26% if necessary, that there would be increasing emphasis on strategic sales and that the entire proceeds from disinvestment / privatisation would be deployed in social sector, restructuring of PSEs and retirement of public debt.

The main elements of the policy were reiterated as follows:

- To restructure and revive potentially viable PSEs;
- To close down PSEs which cannot be revived;
- To bring down Government equity in all non-strategic PSEs to 26% or lower, if necessary;

- To fully protect the interests of workers:
- To put in place mechanisms to raise resources from the market against the security of PSEs' assets for providing an adequate safety-net to workers and employees;
- To establish a systematic policy approach to disinvestment and privatisation and to give a fresh impetus to this programme, by setting up a new Department of Disinvestment;
- To emphasize increasingly on strategic sales of identified PSEs;
- To use the entire receipt from disinvestment and privatisation for meeting expenditure in social sectors, restructuring of PSEs and retiring public debt.

"Government's policy towards the public sector is clear and unambiguous. Its main elements are: -

- Restructure and revive potentially viable PSUs;
- Close down PSUs which cannot be revived;
- Bring down Government equity in all non-strategic PSUs to 26% or lower, if necessary; and
- Fully protect the interests of workers.

In line with this policy during the last two years financial restructuring of 20 PSUs has been approved by the Government. As a result, many PSUs have been able to restructure their operations, improve productivity and achieve a turn around in performance. Hon'ble members are aware that Government have recently approved a comprehensive package for restructuring of SAIL, one of our Navaratna PSUs.

There are many PSUs which are sick and not capable of being revived. The only remaining option is to close down these undertakings after providing an acceptable safety net for the employees and workers. Resources under the National Renewal Fund have not been sufficient to meet the cost of Voluntary Separation Scheme (VSS) for such PSUs. At the same time, these PSUs have assets, which if unbundled and realised, can be used for funding VSS. Government will put in place mechanisms to raise resources from the market against the security of these assets and use these funds to provide an adequate safety-net to workers and employees.

Government have recently established a new Department for Disinvestment to establish a systematic policy approach to disinvestment and privatisation and to give a fresh impetus to this programme, which will emphasize increasingly on strategic sales of identified PSUs. Government equity in all non-strategic PSUs will be reduced to 26% or less and the interests of the workers will be fully protected. The entire receipt from disinvestment and privatisation will be used for meeting expenditure in social sectors, restructuring of PSUs and retiring public debt."

D. Address by the President to Parliament in the Budget Session (February, 2001)

"The public sector has played a vital role in the development of our economy. However, the nature of this role cannot remain frozen to what it was conceived fifty years ago — a time when the technological landscape, and the national and international economic environment were so very different. The private sector in India has come of age, contributing substantially to our nation-building process. Therefore, both the public sector and private sector need to be viewed as mutually complementary parts of the national sector. The private sector must assume greater public responsibilities just as the public sector needs to focus more on achieving results in a highly competitive market. While some public enterprises are making profits, quite a few have accumulated huge losses. With public finances under intense pressure, Governments are just not able to sustain them much longer. Accordingly, the Centre as well as several State Governments are compelled to embark on a programme of disinvestment.

The Governments' approach to PSUs has a three-fold objective: revival of potentially viable enterprises; closing down of those PSUs that cannot be revived; and bringing down Government equity in non-strategic PSUs to 26 percent or lower. Interests of workers will be fully protected through attractive VRS and other measures. This programme has already

achieved some initial successes. The Government has decided to disinvest a substantial part of its equity in enterprises such as Indian Airlines, Air India, ITDC, IPCL, VSNL, CMC, BALCO, Hindustan Zinc, and Maruti Udyog. Where necessary, strategic partners would be selected through a transparent process".

E. Budget Speech: 2001 - 2002

Objectives

To use the proceeds for providing -

Restructuring assistance to PSUs
Safety net to workers
Reduction of debt burden
Additional budgetary support for the Plan,
primarily in the social and infrastructure
sectors (contingent upon realisation of the
anticipated receipt.)

"Given the advanced stage of the process of disinvestment in many of these companies, I am embotdened to take credit for a receipt of Rs 12000 crore from disinvestment during the next year. An amount of Rs 7000 crore out of this will be used for providing restructuring assistance to PSUs, safety net to workers and reduction of debt burden. A sum of Rs 5000 crore will be used to provide additional budgetary support for the Plan primarily in the social and infrastructure sectors. This additional allocation for the plan will be contingent upon realisation of the anticipated receipts. In consultation with Planning Commission I shall come up with sectoral allocation proposals during the course of the

CHAPTER - 7

DISINVESTMENT TILL NOW

Other than the Lagan Jute Machinery Company Limited and Modern Food Industries (India) Limited, only minority stakes in different PSEs were sold till 2000. As stated above (2000-01 budget speech), the Government has modified its policy to emphasise on strategic sales. During the last quarter of 2000-01, 51% shares of BALCO have been sold to a strategic investor. The disadvantages of sale of minority stakes by the Government have been found to be as follows:

- Lower realisations because the management control is not transferred. Moreover, it signals lack of commitment to efficient governance of PSEs.
- With the limited holding remaining with the Government after minority sales, only small stakes can be offered to the strategic partner, if it is decided to go for a strategic sale subsequently. This depresses the possibility of higher realizations from the strategic partner, especially since the latter has to offer the same price to other shareholders also through an open offer.
- The minority sales also give the impression that the main objective of the Government is to obtain funds for reducing its fiscal deficit.

The following table indicates the actual disinvestment from 1991-92 to 1999-2000, the methodologies adopted for such disinvestment and the extent of disinvestment in different CPSUs.

Year	No. of PSEs in which equity sold	Target receipt for the year (Rs. In Crores)	Actual receipts (Rs. In Crores)	Methodology
1991- 92	47 (31 in one tranche and 16 in other)	2500	3038	Minority shares sold by auction method in bundles of "very good", "good", and "average" companies.
1992- 93	35 (in 3 tranches)	2500	1913	Bundling of shares abandoned, Shares sold separately for each company by auction method.
1993- 94		3500	Nil	Equity of 7 companies sold by open auction but proceeds received in 94-95.
1994- 95	13	4000	4843	Sale through auction method, in which NRIs and other persons legally permitted to buy, hold or sell equity, allowed to participate.
1995- 96	5	7000	362	Equities of 4 companies auctioned and Government piggy- backed in the IDBI fixed price offering for the fifth company.
1 996 - 97	1	5000	380	GDR (VSNL) in international market.

1997- 98	1	4800	902	GDR (MTNL) in international market.
1998- 99	5	5000	5371	GDR (VSNL) / Domestic offerings with the participation of FIIs (CONCOR, GAIL). Cross purchases by 3 oil sector companies i.e. GAIL, ONGC & IOC
1999- 00	3	10000	1584	GDR (GAIL) in international market & MFIL's strategic sale. VSNL domestic issue.
2000- 01	3	10000	. 1868	BALCO, KRL(CRL) & MRL through strategic sale / acquisition
Total	42 *	54,300	20,261	

^{*}Total number of companies in which disinvestment has taken place so far.

The realisations of Rs. 20,261 cr. shown above account for an aggregate disinvestment of about 16% equity of 42 PSEs.

MAJOR ISSUES IN DISINVESTMENT

A. Government control

The shares of the PSEs listed on the stock exchanges are currently heavily under valued. This is primarily because of the indifferent performance of the PSEs as well as the market perception that the Government is not prepared to let go its control over the PSEs and introduce corporate governance therein. The Price / Earning (PE) ratios of most of the PSEs are in single digits, generally around 4 or 5 — very much below the comparable companies in the private sector in India and abroad. The Table below shows the comparison between the recent PE ratios of some companies in the public and private sectors.

Price / Earning per Share (P/E) Ratios of Indian Public & Private Sectors (Source: Business Standard - 27.2.2001)

Pt	ublic Sector		Private Sector			
PSE	P/E Ratio	<u>Price</u>	Company	P/E Ratio	Price	
Aluminium Naico	7.2	56.70	Hindalco	8.3	775.60	
Banking		-				
SBI Bank of Baroda Corporation Bank UTI Bank	6.9 3 4.6 4.8	224.75 58.65 110.90 35.70	HDFC Bank ICICI Bank IDBI Bank	30.7 20.7 27.3	250.90 155.05 24.00	
Financial IDBI	2.7	29.40	icici	7	94.65	
Gas GAIL	4.4	56.25	Gujrat Gas	15.8	668.55	
Heavy Engg. BHEL	7.5	164.95	АВВ	24.3	316.95	
Housing Finance GIC Housing Finance	3.9	9.35	HDFC	16.8	592.85	
InfoTech CMC	59.4	362.35	Infosys Wipro	64 91.7	5,695. 35 2368.65	
PetroChem IPCL	8.6	69	RIL	15.1	402.75	
Petro-Marketing IBP	15.7	316.9	Castrol	24.2	262.85	

The adverse market perception about the PSEs, which is reflective of their indifferent performance and Government control, is also obvious from the following Table which shows the comparisons between the book values and the market prices of the listed PSEs. As the Table shows, the market prices of most of these PSEs are either below or just about equal to their book value.

Book Values vs. Market Prices of some listed PSEs as on 8.2.01
Source: Business Standard

S.No.	Name of PSE	BSE / NSE	Book Value
	INCOLUMN TOP	Closing Price	DOOK VAIUE
1.	BEML	29.75	160 57
2.	BEL	80.35	160.52
3.	BHEL		65.60
4.	BPCL	172.30	147.03
5.	BRPL	187.75	232.98
6.	· · · · · · · · · · · · · · · · · · ·	11.50	30.92
	CPCL (MRL)	38.55	78.29
7.	CONCOR	180	93.52
8.	Dreg. Corp.	91	122.61
9.	EIL	177.15	112.31
10.	GAIL	58.65	55.88
11.	HOCL	9.35	36.16
12.	HPCL	193.80	170.38
13.	HZL	22.85	24.72
14.	IOC	171.15	180.63
15.	IPCL	78	121.77
16.	ITI	29.50	30.07
17.	KRL (CRL)	55.50	185.50
18.	MTNL	191.35	113.02
19.	NLC	14.30	25.33
20.	ONGC	154.60	188.02
21.	RCF	9,15	24.04
22.	SCI	39.55	67.95
23.	SAIL	8	12.75
24.	VSNL	375.10	216.64
	:		210.07

B. Performance of PSEs

If one examines the achievements of the PSEs by the yardstick of objectives they were expected to achieve, as listed in Chapter-3, one would observe that many of these objectives have, at best, met with limited success. The infrastructure for economic development is still inadequate. The return on investments in PSEs, at least for the last two decades, has been quite poor, and the PSEs have not able to generate resources for development. The PSE Survey shows that between 1986-87 & 1997-98, the Central Government owned PSEs, as a whole, never earned post tax profits that exceeded 5% of total sales or 6% of capital employed. Thus, the return earned by the public sector was significantly lower than the rate of return for a time deposit of one year in commercial banks. Also, the PSEs' highest return on Capital Employed (6% in 1995-96 and 1997-98) is at least 3% points below the interest paid by the Government on its borrowings. Thus,

adjusted for the effective interest rate, they have actually been giving negative return on capital. If the profits of the PSEs working in the monopoly environment are excluded, the picture becomes even worse.

Another study shows that, for the period 1988–89 to 1997–98, (a) the unit gross profits and post tax profits of a sample of PSEs in the manufacturing sector were significantly lower than the private sector companies (when measured as a proportion of sales revenue net of indirect taxes), and (b) excluding the profits of PSEs in the monopoly areas (petroleum, power, coal & lignite), the post tax profits turn to losses for the manufacturing PSEs for 9 out of the 10 years. The following Table demonstrate the above points.

PSE Profitability Compared to the Private Sector {Profit After Tax (PAT) / Net Sales (%)}

As on 31 March	90-91	91-92	92-93	93-94	94-95	95-96	96-97	97-98
Ali non-service PSEs	2.40	2.00	2.20	3.00	4.40	4,90	4.40	5.28
PSEs without petroleum	-0.80	0.10	-0.10	-1.20	1.60	3.40	2.70	3.08
Pure manufacturing PSEs	-4.50	-5.30	-5.40	-6,90	-2.30	-2.40	-4.30	-3.90
Manufacturing private sector	5.70	4.90	4.90	6.60	9.10	9:00	7.00	6.20

Source: NCAER Study Report.

The following Table shows a comparison between the PSEs and the private sector companies from the point of view of the cost structure. Here also, PSEs fare quite poorly as compared to private sector with regard to various cost parameters.

Comparison of Cost Structure (As Percentage of Sales)

	90-91	91-92	92-93	93-94	94-95	95-96	96-97	97-98
Raw materials / Net sales		1						1
PSEs minus petro	39.5	39.6	39,8	36.3	35.0	35.0	35.9	40.6
Private sector mfg.	44,4	44.1	41.4	42.5	43.7	42.9	42.3	40.4
Power & fuel / Net sales		i						1
PSEs minus petro	10.3	10.9	12.7	13.5	12.9	13.3	14.9	19.5
Private sector mfg.	6.8	7.0	6.9	6.6	6.2	6.5	6.6	5.0
Wages / Net sales							1	
PSEs minus petro	18.6	17.3	18.1	17.7	17.6	19.2	19.1	23.3
Private sector mfg.	8.9	8.8	8.6	8.1	7.9	7.9	8.2	6.5
Interest / Net sales							1	
PSEs minus petro	8.8	9.9	11.3	11.5	9.0	9.1	9.8	11.7
Private sector mfg.	6.0	6.7	6.0	5.2	5.2	5.8	5.9	4.7
A. Raw material differential	-4.9	-4.5	-1.6	-6.2	-8.7	-7.9	-6.4	0.2
B. Wages+interest+power					Ì			
differential	16.0	15.6	20.6	22.8	20.2	21.4	23.1	38.5
C. Total differential]	
(A + B)	11.1	11.1	19.0	16.6	11.5	13.5	16.7	38.7

Source: NCAER Study Report.

The next Table shows that despite huge investment in the public sector, the Government is required to provide more funds every year. The public sector equity base of about Rs. 40,000 cr. (up to March 1990) yielded Rs. 17,938 cr. for the Government as dividend in nine years. However, the Government had to invest a further sum of Rs. 61,211 cr. during this period in the form of equity (Rs. 24,829 cr.), plan loans (Rs. 26,185 cr.) & non-plan loans (Rs. 10,197 cr.), besides providing for the Voluntary Retirement Scheme. The average rate of return on the Government investment for these years works out from 1% to 6.5%.

Budgetary Support to Public Sector Enterprises

(Excluding provisions for Voluntary Retirement Scheme)

(Rs. In crores)

<u>Year</u>	Pla	Ω	Non-plan Loans	Total support	Dividend paid	
	Equity	Loan				
1990-91 (RE)	3531	2477	1067	7075	413	
1991-92 (RE)	2491	2735	759	5985	687	
1992-93 (RE)	2238	2403	600	5241	792	
1993-94 (RE)	2419	4072	780	7271	1028	
1994-95 (RE)	3442	3613	911	7966	1436	
1995-96 (RE)	2050	3218	1184	6452	2205	
1996-97 (RE)	2439	2956	1459	6854	2836	
1997-98 (RE)	3004	2550	1583	7137	3609	
1998-99 (RE)	3215	2161	1854	7230	4932	
Total	24829	26185	10197	61211	17938	
Paid up capital of all CPSU:	s as on 31.3.90		About	40000	-	
Paid up capital of all CPSU (as per DPE Survey 19			77	7066	_	

Source: Ministry of Finance

The next two Tables reflect the huge amounts of the hidden subsidies that go into maintaining of the unviable / weak PSEs and the extent of drain that the PSEs continue to cause on the exchequer.

The Hidden Subsidies Cost of Revival / Restructuring of PSEs

Figure in crores of Rupees

		rigate in crotes of respects				
	Since 1992-93	Proposals* approved in the last 3 ye * (23 new proposals approved)				
Fresh infusion of funds	3190	2053	5243			
Loans converted into equity	7630	2720	10350			
Loans written off	10126	8285	18411			
Total amount involved	20,946	13,058	34,104			

<u>Plus</u>: Waiver of guarantee fee, freezing of loan / interest payments, moratorium on repayment, exemption from payment of taxes etc.

Waiver of Dues of Public Sector Enterprises

Figure in crores of Rupees

Item	1996-97	1997-98	1998-99
Loan repayments waived	1068.27	300.70	572.99
Interest waived	404.66	193.16	1360.37
Penal interest waived	51,74	62.60	257.78
Loan repayments on which moratorium allowed	762.91	707.57	779.51
TOTAL	2287.58	1264.03	2970.65

The Government has not been able to achieve the original objectives for which the PSEs were established; it has also been constantly losing the value of its investment in the PSEs as a shareholder. The PSE survey 1998 – 99 shows the shareholders funds as Rs. 201171.05 cr., as against which the accumulated losses are shown as Rs. 47148.26 cr. Out of 235 operating PSEs, 106 PSEs made losses in 1998 – 99, according to the PSE Survey.

The Public Enterprises Survey 1998-99 shows that out of the equity invested in the Central Government PSEs (Rs.77066 cr.), as much as Rs. 74887 cr. was held by the Central Government, State Government, holding companies and foreign investors. Of the remaining equity (Rs. 2179 Cr.), a substantial chunk was held by financial institutions and banks. Thus, there has been little redistribution of wealth to the small investor / public at large either.

PSEs' performance on the productivity front and with regard to manpower costs has also been disappointing. A study commissioned by NCAER has pointed out that between 1984-85 and 1997-98, whereas the per capita emoluments of the PSE employees have risen at a compound annual rate of 3.95% in real terms, the real value of sales was 3.51%, which indicates "that the PSE Labour force has appropriated disproportionately large factor payments at the expense of sales". The study also shows that the "wage costs per rupee of sales in public sector manufacturing activities are significantly higher than in comparable private sector firms, despite the latter often paying a higher wage rate than PSEs". The following table illustrates the point.

Wages / Net Sales (%)

		1990-91	1991-92	1992- 93	1993- 94	1994- 95	1995- 96	1996- 97	1997- 98
Wages/Net Sales									
Non-service PSEs		10.0	10.1	10.0	10.0	10.0	10.2	9.5	10.6
PSE minus petro		18.6	17.3	18.1	17.7	17.6	19.2	19.1	23.3
Private	sector	8.9	8.8	8.6	8.1	7.9	7.9	8.2	6.5
Manufacturing		1		1	J	,	7.5	U, <u>a</u>	0.5

Source: NCAER Study Report,

As regards the objective of balanced regional development, despite five decades of attempted industrialisation through the PSEs, there are still many pockets, especially in the eastern part of the country, which woefully lack in industrial growth and infrastructure. Commendable growth has, no doubt, taken place as far as the small scale and ancillary industries are concerned. However, most of these too have not been able to keep pace

with the times and the changed scenario; and suffer from lack of economies of scale, obsolete technologies and many other ills.

The objectives of import substitution, saving and earning foreign exchange through the PSEs too, are met with very limited success.

It has been widely observed that the PSEs have no commercial motivation. Their financial needs have often to be subordinated to other macro-economic considerations and they often face shortage of funds. They survive on monopolistic profits. Apart from all this, the increasing integration of the Indian financial, capital and foreign exchange markets with global markets, starting with the economic reforms of July 91, has exposed the public sector to market forces, as a result of which it now finds itself unable to stand on its own feet without the State support.

C. Employee issues

According to NSSO statistics, the total workforce in India during 1997 was about 355 million. Out of this, the organised sector accounted for 27 million workers, of which 20 million workers were employed by the Central and State Governments and the Central and the State PSEs. The total work force in Central PSEs was less than 2 million as on 31st March 99. If the funds invested in the PSEs' shares were to be deployed in areas such as infrastructure that would have generated far more employment and ensured better redistribution of wealth. It is also worth noting that even without any privatisation till now (barring Lagan Jute, Modern Food and BALCO), the PSEs workforce has been consistently going down — at least during the last ten years — due to economic pressures; in the 3 companies privatized till now, no labour reduction has taken place.

The DPE Survey points out that large scale employment by public sector enterprises has over the years, led to a situation where some of the enterprises are saddled with over employment or excess manpower resulting in low level of per capita productivity. If the privatised companies grow rapidly, no labour restructuring may be required.

CHAPTER - 9

EXPERIENCE OF OTHER COUNTRIES AND WTO ISSUES

It has been universally recognised that the instrument of public ownership, widely used during post-colonial rule and post war reconstruction period, is no longer the most desirable instrument for development. The signing of WTO has also led to severe global competitive pressure on national industries with the realisation that they will not survive unless they are competitive in international markets. Further, due to the Government's inability to raise taxes and reduce expenditure, the use of taxpayers' money in running industries has come under serious criticism in most of the countries. These pressures have led to large-scale privatisations around the world.

Apart from Britain and France, there are several other countries where privatisation has taken place. Worth mentioning are the privatisations in the erstwhile East Germany, China and Chile. While privatisation started in Germany as far back as in 1959, over 14,500 companies were sold by Treuhandstalt (THA) post 1990, following reunification of Germany. Privatisation was carried out through public sale, sale by option, trade sale, management / employee buy-outs etc. THA was able to successfully complete its assigned job.

In the case of China, market reforms started in 1998. The reforms included corporatisation and listing of large and medium size State Owned Enterprises (SOE) on the domestic and foreign Stock Exchanges and permission to foreign investors to invest in various infrastructure and utility businesses, such as railways, toll roads, ports and power plants. In 1978, over 75% of the industrial output was produced by the state sector which is reported to have fallen to 34% by 1995. The collective sector is reported to have increased from 32% to 37%, individual sector (small capitalist businesses) from 1.8% to 13% and others (including all other capitalist enterprises - ocal and foreign) from 1.2% to 16.6%. Thus, the private sector grew at the expense of the state sector. At the 15th Party Congress held in September 1997, the Central leadership decided to engage in fundamental restructuring of some 300,000 SOEs within a 3 year framework by 2000, through mergers, acquisitions, corporatisation / privatisation and declaring bankruptcies, injection of fresh capital through the introduction of the joint stock system and systematic lay off of excess workers. According to the World Investment Report 1997, foreign direct inflows to China amounted to US \$ 42.3 billion in 1996. The level of FDI inflows in other years were also similar in comparison to annual inflows in India, of the order of US \$ 1.5 to \$ 3 billion every year.

Chile is another example of notable privatisations. Deregulations, liberalisation and privatisation have been the major elements in the Chilean economic policy since 1973, reversing a long trend of the growth of public sector. Since 1973, it has undergone 4 major privatisations: the transfer of expropriated enterprises during 1974-75; the extensive privatisation during 1975-79 of enterprises that were not expropriated but in which the state had ownership; the privatisation of bankrupt private corporations (including banks) from 1984 to 1986; and finally the privatisation of large public corporations (mainly public utilities) which started in 1986 and continued throughout 1988.

Among the specific cases of successful privatisation, the privatisation of ENI (Italy), is cited as one of the most successful privatisations. ENI was used by the Italian Government as a flagship company for privatisation. In the beginning there was a lot of opposition, but the success of the transaction ultimately changed the entire perception about privatisation in Italy. The Government stake was sold in four tranches of around 15% each, between 1995 – 1998. The sale of each tranche resulted in the improved perception about the value of ENI shares. While the first tranche of 15% shares fetched US \$ 3.95 billion in December 95, the fourth (last) tranche of 13% shares (which resulted in ENI becoming a private company) fetched the Government US \$ 7.3 billion, that is, more than double of the first offering. Post privatisation, the value of Government shareholding increased dramatically to the extent that the Government's remaining stake in ENI (38.6%) had about the same market value (US \$ 22 billion) as the market value of 85% shares after completion of the first offering in December 1995.

SUCCESSFUL PRIVATISATIONS IN INDIA

The three cases of privatisation in India till now are those of the Lagan Jute Machinery Company Limited, Modern Food Industries (India) Limited and BALCO. The highlights of these are given below.

Lagan Jute Machinery Company Limited (LJMC)

The Lagan Jute Machinery Company Limited (LJMC) was the first case of successful privatisation of a Central Public Sector Undertaking, carried out by the Government. LJMC is a Calcutta based company, and manufactures jute machinery (mainly spinning and drawing frames). It employed around 400 employees prior to privatisation. It started making losses from 1996-97 onward and the turnover was on a decline. LJMC's net worth as on March 1998 was around Rs. 5 crore and its annual turnover was also around Rs. 5 crore at that time.

LJMC had potential to increase turnover and be profitable. It was the main supplier of the type of machines that it manufactured. The Company was known for the quality of its products. There was a scope for expanding into the spares market and exports. Some (but not substantial) investment was required to modernize and renovate the plant and machinery. The manpower age profile was high but there was not much surplus manpower.

In the initial stages of disinvestment, LJMC was approved for privatisation in the year 1997, through sale of 74% stake to a strategic partner. The disinvestment process was handled by LJMC's holding company, Bharat Bhari Udyog Nigam Limited (BBUNL), under the administrative control and directions of the then Department of Heavy Industries (DHI), Ministry of Industry, Government of India.

Disinvestment process

- Objectivity & transparency were the key requirements in the whole disinvestment process. As it was the first case of disinvestment for the Indian Government, the disinvestment process evolved as the transaction progressed.
- After the issue of the advertisement for inviting bids from the potential partners, it took around 10 months to complete the disinvestment process.
- The advisors carried out a review of the company and gave advice on the extent, mode and methodology for the disinvestment. The issues requiring action by the management/ approval of the GOI were identified and steps taken to ensure that the process moved smoothly and shareholder value was maximized.
- The Cabinet gave its approval and the necessary agreement was entered into with the strategic partner in December 1999. After the full payment against the shares and

execution of share transfer agreement, the management of the company was handed over to the strategic partner in July 2000.

Present status of LJMC

- The strategic partner has retained the same senior management team and there has been no retrenchment of workers. An industry expert has been appointed as the Managing Director of LJMC. The operating and financial performance of the company has improved after the change of the management.
- The performance of LJMC, post-privatisation (July–Sep 2000), as compared to preprivatisation period (i.e. April–June 2000), as reported by the management, is given below:

Particulars	Pre-privatisation period	Post -privatisation period
	(April – June 2000)	(July - September 2000)
Gross		
turnover	Rs. 6 million	Rs. 24 million
Profit / Loss		
	Incurred loss	Showed profit
Orders		
booked	Rs. 12 million	Rs. 15 million
Export of		
spares	Rs. 0.5 million	Rs. 1.6 million

- The new management is reported to have taken initiative to introduce new products and revamp the marketing function (which was weak earlier) and other areas for improving the company's performance.
- LJMC is on the path of revival after privatisation without drastic surgery and without any
 of the common apprehensions about privatisation having taken place.

Modern Food Industries (India) Limited (MFIL)

MFIL was incorporated as Modern Bakeries (India) limited in 1965. It had 2042 employees as on 31.1.2000. It went through minor restructuring during 1991-94 when its Ujjain Plant was closed, the Silchar project was abandoned and the production of Rasika drink was curtailed. The company was referred to Disinvestment Commission in 1996. In February 1997, the Commission recommended 100% sale of the company, treating it in the non-core sector. While making this recommendation, the Disinvestment Commission cited underutilisation of the production facilities, large work force, low productivity and limited flexibility in decision-making, as some of its weaknesses.

In September 1997, the Government approved 50% disinvestment to a Strategic Partner through competitive global bidding. In October 1998, ANZ Investment bank was appointed as the Global Advisor for assisting in disinvestment. In January 1999, the Government decided to raise the disinvestment level to 74%, and an advertisement, inviting Expression of Interest from the prospective Strategic Partners, was issued in April 1999.

Pursuant to the advertisement and other marketing efforts by the Advisor, 10 parties submitted Expressions of Interest. Out of these, only 4 conducted the due diligence of the company, which included visits to Data Room, interaction with the management of the MFIL, and site visits. After due diligence, only 2 parties remained in the field, and on the last day for submission of the financial bid (15.10.99), the only bid received was that from Hindustan Lever Limited (HLL). The Government approved the selection of HLL as the strategic partner in January 2000, and the deal was closed on 31.1.2000.

As per the accounting procedure followed prior to disinvestment (31.1.2000), the Company did not make a provision for outstanding recoveries exceeding 5 years even, whereas the new management made provision for all outstanding recoveries which were more than 3 years old on the grounds that strict application of accounting principles warrant so. The accounts for the year 1999-2000, thus prepared, show an accumulated loss of Rs. 3099.97 lakhs, with the net-worth of the company as Rs. 201.45 lakhs. Since the net-worth of the company got eroded, by more than 50% of its peak net-worth (Rs. 1756.79 lakhs), during the immediately preceding four financial years, MFIL had to file a report with the BIFR in accordance with the requirements of Sick Industrial Company (Special Provisions) Act, 1985.

The following Table shows the highlights of the Strategic Sale.

Modern Food Industries (India) Ltd.

PRIOR TO SALE		AFTER SALE	
Authorised share capital Paid up capital	Rs. 15.00 cr. Rs. 13.01 cr.		
Losses 1998-99 cr.	Rs. 6.87	1. 74% of the shares sold for Rs. 105.45 cr. and further Rs. 20 cr. Invested by HLL in the company.	
Losses 1999-00 cr.* *(Inclusive of an amount of	Rs. 48.23	2. Thus, the Government gained by selling Rs. 1000 shares for Rs. 11,490, i.e., more than 11 times the	
Rs. 35.19 cr. towards provisions made for previous years.) Number of employees	2042	face value & 3.68 times the Book Value. 3. HLL's share value went up from Rs. 2138 on	
2. Net Worth (and total expected realisation) as per DPE Survey		30 th Dec. (prior to sale) to Rs. 3247 on 25 th Feb. (post sale).	
1998-99 cr.	Rs. 28.51	4. The employees of a company incurring losses became HLL employees - an efficient company. The Shareholders' Agreement envisages:	
Value of assets as per 31.3.99 accounts: Gross		" the parties envision that all employees of	
Net cr.	Rs. 18.99	the company on the date hereof will continue in the employment of the company."	
Market value of land & building as per Government valuer	D- 100 CC		
(unrestricted use) cr.	Rs.109.00		
3. Valuation of 100% equity by different methods – as to	Rs. 30 cr.		
done by global advisors	Rs. 70 cr.		

Post - Disinvestment Scenario

- The decline in sales of Modern bread, which continued till the beginning of 2000, has been arrested. Weekly sales in December 2000 were around 44 lakhs SL, which is a 100% increase over the figure of April 2000.
- As on 31.12.2000, HLL has extended secured corporate loans to MFIL to the extent of Rs. 16.5 crores for meeting the requirement of funds for working capital and capital expenditure.
- HLL has provided a corporate guarantee to MFIL's banker, viz., Punjab national Bank, which has helped the Company in getting the interest rate reduced considerably to the extent of 3-4% of its earlier borrowing cost.
- Steps have been taken towards improvement in quality of bread, its packaging and marketing with trade-promotion activities besides training the manpower in quality control systems.

Bharat Aluminium Company Ltd. (BALCO)

BALCO is a fully integrated aluminium producing company, having its own captive mines, an alumina refinery, an aluminium smelter, a captive power plant, and down-stream fabrication facilities. It was set up in 1965 and has its corporate office in New Delhi. Its main plant and facilities are situated in Korba (Chhatisgarh). It also has a fabrication unit in Bidhanbagh (West Bengal). The refining capacity of BALCO is 2 lakh tonnes per year and its smelting capacity is 1 lakh tonnes per year. Its employee strength is around 7000.

The Government of India had 100% stake in BALCO prior to disinvestment. In 1997, the Disinvestment Commission classified BALCO as non-core for the purpose of disinvestment and recommended immediate divestment of 40% of the Government stake to a strategic partner, and reduction of the Government stake to 26% within 2 years of the strategic sale, through a domestic public offering. It further recommended divestment of the entire remaining stake at an appropriate time thereafter. The Cabinet accepted the recommendation of the Disinvestment Commission for divestment of 40% stake through a strategic sale and further divestment through the capital market.

Later, in 1998, the Disinvestment Commission revised its recommendation and advised the Government to consider 51% divestment in favour of a strategic buyer along with transfer of management, which was accepted by the Cabinet. The Government thereupon appointed M/s Jardine Fleming as Advisor to assist in the sale of its 51% stake in BALCO to a strategic buyer.

Simultaneously, it was brought to the attention of the Government that BALCO had a bloated equity of Rs. 489 cr. and large unutilised free reserves of the level of Rs. 424 cr. It was suggested by the Ministry of Mines that BALCO's equity be reduced by 50% prior to disinvestment, using its substantial cash surplus. This proposal was accepted. As a result, the Government received Rs. 244 cr. from the capital restructuring of BALCO, and another Rs. 31 cr. as tax on this amount, prior to disinvestment.

The strategic sale process for BALCO started in late 1997, after the first decision of the Government, and finally came to end in 2nd March 2001. The 51% stake was sold to Sterlite Industries, the highest bidder, and fetched the Government Rs. 551.50 cr. The price received was higher than the values indicated by the various methods of valuation used.

The Government, thus recovered Rs 827.50 crores from this privatisation against approximately Rs. 10 crores as dividend it used to get against the 51% shares, it used to get in earlier years, during the peak Aluminium cycle.

Post sale, a number of doubts have been raised by various quarters on the disinvestment of BALCO, especially with regard to transparency, valuation and protection of employees interests. However, the entire sale process, including the appointment of Advisor and the approval of the price bid, has been carried out in an extremely transparent manner, in keeping with the highest standards of global practices. Of special mention are the clauses in the Shareholders Agreement with the strategic buyer, which offer adequate protection to all levels of employees with regard to their job safety and severance packages.

PRIVATISATION IN STATES

The consolidated position of the State level Public Sector Enterprises (SLPEs), as on 31st march 1997 and 31st Mach 2000 was as under:

As on 31.3.1997

(a)	Total number of SLPEs of which—	1071	
	Profit Making SLPEs*	247	
	Loss Making SLPEs*	319	
(b)	Total investment in SLPEs#	Rs.	117760 cr.
	Equity	Rs.	39218 cr.
	Loans	Rs.	78454 cr.

^{*} Besides these, there were other companies running on no profit – no loss basis, or were non-working / defunct.

There is an unreconciled difference of Rs. 88 cr. In the total of equity and loans.

(Source: Interim Report of Study Group on Disinvestment in State PSUs, October 1999, Planning Commission)

As on 31.3.2000

(a)	Total SLPEs 9		946
(b)	Of which -		
	(i)	Non-working SLPEs	241
	(ii)	SLPEs in losses	551
	(iii)	SLPEs not submitting	
		their accounts	100
(c)	Estim	ated accumulated losses	
	as %	age of cumulative	
	invest	tment in all SLPEs	9%

A number of States have also started making privatisation / disinvestment / restructuring of State PSEs as a fundamental part of their economic reforms. Many of these have also set up State level Disinvestment Commissions. The following Table, compiled on the basis of the information received from the States and other sources, illustrates the disinvestment efforts in the States.

Disinvestment in States

S. No	Name of the State	Approximate number of State Level Public Enterprises (SLPEs)	Estimated total investment in SLPEs (Rs in crores)	SLPEs identified for disinvestment / winding up /restructuring	No. of SLPEs in which process initiated
1.	Andhra Pradesh	51	4444	21	10
2.	Assam	42	3676	1	
3.	Goa	12	4869	1	
4.	Gujarat	49	23438	11	5
5.	Haryana	27	4746	8	2
6.	Himachal Pradesh	21	3143	5	
7.	Jammu & Kashmir	N/A	N/A	7	
8.	Karnataka	77	16641	17	9
9.	Madhya Pradesh	34	8561	27	2
10.	Maharashtra	65	19186	6	3
11.	Orissa	72	8544	N/A	N/A
12.	Punjab	53	12425	9	2
13.	Rajasthan	24	10838	11	
14.	Tamil Nadu	84	10158	13	3
15.	Uttar Pradesh	50	17313	25	6
16.	West Bengal	80	14081	2	2

<u>Source</u>: Based on information collected from State Governments, Institute of Public Enterprises (IPE), Hyderabad and other sources.

FUTURE DIRECTION

Globally, the beneficial effect of privatisation on the economy has come to be widely appreciated now and the investors are eagerly looking forward to further privatisation in India. The recent Government announcement to sell strategic stakes in VSNL and CMC resulted in increase in the market capitalisation / value of the Government holdings in the listed PSEs by almost Rs. 4,000 cr. within a single day, which indicates that privatisation is not only being looked at favourably by the market but also that it is a very strong motivator for bringing in substantial resources to our country. Moreover, the removal of quantitative restrictions on imports, lowering of import tariffs and removal of restrictions of other kinds on global trade, services and capital, pursuant to our acceptance of the WTO regime and various economic reforms, have made it imperative that the public sector is privatised at the earliest, failing which it will soon fall sick and find it extremely difficult to survive in the new competitive environment.

Privatisation, in future, should be driven by the primary objectives of disinvestment, as mentioned earlier. To re-emphasise, the corner stone for privatisation should be the most efficient allocation of the scarce resources, both monetary and non-monetary, that meets the uppermost social objectives of the country. The highest concerns on the social priorities are basic health, family welfare, primary education, development of infrastructure and the retirement of public debt. The resources currently blocked in non-strategic PSEs, , should therefore, be released as soon as possible through sale of Government stake in such PSEs for redeployment in the above sectors. We should also ensure that there is no further flow of resources to these PSEs and no new PSEs are formed in non-strategic sectors. Our mission would, therefore, be to —

- Obtain decision of Government on disinvestment / strategic sale in all non-strategic CPSEs in the next 3 – 4 years.
- Complete such sales within the next five years, and wind up Department of Disinvestment.
- All loss making non-strategic CPSEs to be financially restructured, if necessary, and privatised.
- d. Even with financial restructuring package, if privatisation is not possible, such CPSEs, which are, prima-facie unviable and should be closed, to prevent wastage of public funds in running / reviving such units.

It is often suggested that weak and sick PSEs should be privatised first, and the profit making PSEs need not be touched. However, the logic / rationale for privatising or not privatising a PSE is not based on whether it is making profit or loss but whether it is in a strategic sector or in a non-strategic sector, and whether the taxpayers' money can be saved from the commercial risks by transferring the risk to the private sector wherever the private sector is willing to step in and assume such risks.

The objective should be not to waste too much time over this but to privatise those PSEs first in the case of which this can be done with the least possible delay, since the opportunity cost of letting the resources remain locked up in PSEs is too high. However, broadly, the following criteria would be used for identifying the PSEs for disinvestment / privatisation:

- PSEs in the sectors where adequate regulations and / or competition exist to take care of the monopoly and consumer interest aspects;
- The unviable PSEs whose continued existence is likely to cause a drain on exchequer;
- The PSEs that are subject to intense competition or are likely to be exposed to competition because of the impending reforms.
- PSEs providing services or goods, which, with the altered perceptions of the role of the State, are not the ones, that Government need provide or manufacture.

PART-B

PROCEDURES OF PRIVATISATION

CHAPTER 13

DISINVESTMENT COMMISSION'S RECOMMENDATIONS

The Disinvestment Commission was set up on 23.8.1996 for a period of 3 years with the following terms of reference :

- 1. To draw a comprehensive overall long term disinvestment programme within 5-10 years for the PSUs referred to it by the Core Group.
- 2. To determine the extent of disinvestment (total/partial indicating percentage) in each of the PSU.
- 3. To prioritise the PSUs referred to it by the Core Group in terms of the overall disinvestment programme.
- 4. To recommend the preferred mode(s) of disinvestment (domestic capital markets/international capital markets/auction/private sale to identified investors/any other) for each of the identified PSUs. Also to suggest an appropriate mix of the various alternatives taking into account the market conditions.
- 5. To recommend a mix between primary and secondary disinvestments taking into account Government's objective, the relevant PSU's funding requirement and the market conditions.
- 6. To supervise the overall sale process and take decisions on instrument, pricing, timing etc. as appropriate.
- 7. To select the financial advisers for the specified PSUs to facilitate the disinvestment process.
- **8**. To ensure that appropriate measures are taken during the disinvestment process to protect the interests of the affected employees including encouraging employees' participation in the sale process.
- 9. To monitor the progress of disinvestment process and take necessary measures and report periodically to the Government on such progress.
- 10. To assist the Government to create public awareness of the Government's disinvestment policies and programmes with a view to developing a commitment by the people.
- 11. To give wide publicity to the disinvestment proposals so as to ensure larger public participation in the shareholding of the enterprises.

12. To advise the Government on possible capital restructuring of the enterprises by marginal investments, if required, so as to ensure enhanced realization through disinvestment.

The Disinvestment Commission will be an advisory body and the Government will take a final decision on the companies to be disinvested and mode of disinvestment on the basis of advice given by the Disinvestment Commission. The PSUs would implement the decision of the Government under the overall supervision of the Disinvestment Commission.

The Commission, while advising the Government on the above matters, will also take into consideration the interests of stakeholders, workers, consumers and others having a stake in the relevant public sector undertakings.

Modified Terms Of Reference

The terms of reference of Disinvestment Commission were modified on 12.1.1998. The modified terms of reference were as follows:

- 1. Disinvestment Commission shall be an advisory body and its role and function would be to advise the Government on disinvestment in those public sector units that are referred to it by the Government.
- 2. The Commission shall also advise the Government on any other matter relating to disinvestment as may be specifically referred to it by the Government, and also carry out any other activities relating to disinvestment as may be assigned to it by the Government.
- 3. In making its recommendations, the Commission will also take into consideration the interests of workers, employees and others stake holders, in the public sector unit(s).
- 4. The final decision on the recommendations of the Disinvestment Commission will vest with the Government.

72 Public Sector Enterprises (PSEs) were referred to Disinvestment Commission, out of which 47 were profit making. The Disinvestment Commission gave its report on 58 Public Sector Enterprises, out of which 38 were profit making. In these 58 PSEs, the following methods of sale were recommended:

S.No.	Method of Sale	N	o. of PSEs
1. 2. 3. 4. 5.	Strategic Sale Trade Sale Offer of Shares No Disinvestment Disinvestment deferred Closure/Sale of Assets		29 8 5 1 11
		Total:	 58

SYSTEMS AND PROCEDURES OF DISINVESTMENT

For decision making and implementation, there is a three tier mechanism in Government of India:

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

Cabinet Committee on Disinvestment

The Cabinet Committee on Disinvestment (CCD) is chaired by the Prime Minister and comprises of Minister of Law, Justice & Company Affairs and Minister of Shipping, Minister of Heavy Industries and Public Enterprises, Minister of Petroleum and Natural Gas, Minister of External Affairs, Minister of Finance, Minister of Civil Aviation, Deputy Chairman, Planning Commission, Minister of State (Independent Charge) of the Department of Disinvestment and the Minister concerned with the CPSU under disinvestment.

The functions of the Committee are as follows:

- To consider the advice of the Core Group of Secretaries regarding policy issues relating to the disinvestment programme.
- 2. To decide the price band for the sale of Government shares through GDR/domestic capital market route prior to the book building exercise, and to decide the final price of sale in all cases.
- 3. To decide the final pricing of the transaction and the strategic partner in case of strategic sales.
- 4. To decide on cases where there is disagreement between the recommendations of the Disinvestment Commission and the views of the Department of Disinvestment.
- 5. To approve the three-year rolling plan and the annual programme of disinvestment every year.

Core Group of Secretaries on Disinvestment

The Core Group of Secretaries is headed by the Cabinet Secretary and comprises of Secretaries from Ministries of Finance, Industry, Department of Disinvestment, Planning Commission and Administrative Ministry and any other Department as may be required.

The Core Group directly supervises the implementation of the decisions of all strategic sales.

The Core Group monitors the progress of implementation of the Cabinet decisions.

The Core Group makes recommendations to the CCD on disinvestment policy matters.

Inter-Ministerial Group

The Inter-Ministerial Group is chaired by Secretary, Department of Disinvestment and comprises of officers of Ministry of Finance, Department of Public Enterprises, Administrative Ministry and the CMD of the Public Sector Enterprise concerned.

The Inter-Ministerial Group is responsible for day-to-day implementation of the Disinvestment decision.

Department of Disinvestment

The Department of Disinvestment was set up vide Notification No.CD-551/99 dated the $10^{\rm th}$ December 1999.

Business Allocated to Department of Disinvestment:

- 1. All matters related to disinvestment of Central Government equity from Central Public Sector Undertakings.
- 2. Decisions on the recommendations of the Disinvestment Commission on the modalities of disinvestment, including, restructuring.
- 3. Implementation of disinvestment decisions, including appointment of advisors, pricing of shares, and other terms and conditions of disinvestment.
- 4. Disinvestment Commission.
- 5. Central Public Sector Undertakings for purposes of disinvestment of Government equity only.

Advisor

Normally the disinvestment process is carried out with the assistance of an advisor.

Advisory services are provided by Merchant Bankers, but in addition the legal advisors, chartered accounts and asset valuers are also required for specific services. Environmental Auditors and Public Relations firms have also been appointed for some disinvesting CPSUs.

Advisors advise governments on all aspects of privatisation transactions. In addition to implementing the basic steps mentioned earlier, advisors also counsel governments on the strategic options open to it for privatisation. The responsibilities of the advisor, would inter-

alia, cover rendering of advice and assisting government in the disinvestment of the PSU, suggesting measures to enhance sale value, preparing a detailed information memorandum, marketing of the offer, inviting and evaluating the bids, assisting during negotiations with prospective buyers, drawing up the sale/other agreements and advising on post-sale matters.

Advisors are appointed by a competitive bidding procedure. The government writes a brief Terms of Reference (TOR) for the advisors and invites expression of interest from them to submit responsive proposals. They are asked to make a presentation before the Inter Ministerial Group. The advisors offering the best technical and financial terms are hired to implement the privatisation transaction.

The fees payable to the Advisors generally consist of two components. The first components is called 'success fee' which is fixed percentage of the gross proceeds to be received by the Government from the disinvestments. Since it is directly linked with the amount of money realisible from disinvestments, it serves as an incentive to the advisor to get the best price from disinvestments.

The other component of the fee is called 'drop dead fee' which is a lump sum amount payable to the advisor only in the event of the transaction being called off by the Government.

The fees for specific transactions vary from transaction to transaction depending on various factors like mode of disinvestment, total realizable value, quantum of work required to complete the transaction, degree of difficulty and chances of success of the transaction etc. Consultants appointed for disinvestment in certain cases are also given flat/fixed/lump sum fee/asset valuation fee/out of pocket expenditure depending on different criteria.

Legal Advisor

For each privatisation, it is considered necessary to involve legal advisers who look into the legal issues and advise the government accordingly about the documentation. They help the Government in drafting and finalising various agreements.

Legal advisers examine the following documents and advise the Government on

- 1. Material contracts and agreements.
- Loan and lease agreements to ensure that there are no unduly onerous conditions.
- 3. Title deeds to ensure that there are no defects of title or onerous conditions.
- The adequacy of insurance cover and compliance with any legal or other requirement.

The legal advisors are selected through a process of limited competitive bidding and are paid a lump sum amount as fees.

Accounting Advisors

The Accounting Advisors review the financial accounting reporting and planning systems

They help the government in analyzing the balance sheet of the company, its assets and liabilities and contingent liabilities.

The Accounting Advisors are required to recast the final Accounts of the PSU as per the Accounting standards acceptable to the bidding parties.

The Accounting Advisers pay particular attention to the way the following items have been treated:

- 1. Extraordinary and exceptional items
- 2. Amortisation and depreciation
- 3. Capitalisation of expenditure
- 4. Recognition and turning of revenue and expenditure items
- 5. Basis of consolidation of subsidiaries, if any
- Deferred taxation, and
- Revaluation of assets.

The task includes:

- (a) Strategic evaluation of operating capability finances and post privatisation prospects of the state enterprise.
- (b) Evaluation of capital structure
- (c) A calculation of the impact of taxation on the privatised enterprise.

The accounting advisor is appointed through a process of limited competitive bidding and is paid a lump sum fees.

Asset Valuer

The asset valuation is conducted by government-approved valuers. Normally, the valuer is selected either through open advertisement or through short-listing from the list of government-approved valuers.

While assessing the fair value of the property, the valuer takes into consideration the following:

- 1. The status of the title of the company over land and building.
- 2. Any restrictive covenants incorporated in the title documents imposing limitations on the use or transfer of the property or any other restrictions.
- Any restrictions pertaining to the use or transferability of the property or other restrictions arising from any civic regulations or Master Plan or other reasons.
- 4. The values at which transaction have taken place in the recent past for properties of comparable nature, in terms of use, size, location and other parameters.
- 5. Valuation parameters currently in use by Authorities for determination of stamp duty and other taxes.
- Assessment of demand and supply of comparable properties at given locations.
- 7. The state of maintenance and depreciation of the property, and evaluation of expenditure, if any, required to repair and renovate the property to suit the intended use.
- 8. Terms and conditions of the proposed new lease agreements to be entered into with the lessors for the purpose of disinvestment.

The valuation of the property is done by the asset valuation methodology taking into consideration the above factors.

Valuation of Plant and Machinery Valuation of Mines, if any. Valuation of intangibles, if required. Valuation of other assets.

OVERVIEW OF THE PRIVATISATION PROCESS

The general procedure being followed for disinvestment through strategic sale process comprises mainly the following steps:

- Proposals for disinvestment in any PSU, based on the recommendations of the Disinvestment Commission or in accordance with the declared Disinvestment Policy of the Government, are placed for consideration of the Cabinet Committee on Disinvestment (CCD).
- After CCD clears the disinvestment proposal, selection of the Advisors is done through global competitive bidding process for assisting in the implementation of the disinvestment decision.
- The Advisors assist the Government in issue of advertisement in leading national and international newspapers/magazines/journals, for inviting Expression of Interest (EOI) from Prospective strategic Partners. In some cases, to expedite disinvestment, EOI advertisements have been issued before appointing Advisors.
- After receipt of the EOI, Prospective Bidders are short listed, according to the prequalification criteria in EOI advertisement.
- The Advisors, after due diligence of the PSU, prepare the Information Memorandum
 in consultation with the concerned PSU, which is given to the short listed Prospective
 Bidders, after they have entered into a Confidentiality Agreement.
- The draft Share Purchase Agreement and the Shareholder Agreement are also prepared by the Advisors, with the help of the Legal Advisors, and given to the Prospective Bidders for eliciting their reaction.
- The Prospective Bidders undertake due diligence of the PSU and hold discussions with the Advisors/the Government/the management of the PSU for any clarifications.
- Concurrently, the task of valuation of the PSU is undertaken in accordance with the standard national and international practices.
- Based on the response received from the Prospective Bidders, the Share Purchase and Shareholders Agreement is finalised and vetted by the Ministry of Law and approved by the Government and is then sent to the Prospective Bidders for inviting the final binding bids (Technical and Financial).
- After examination, analysis and evaluation, the recommendations of the Inter-Ministerial Group (IMG) are placed before the CCD for a final decision regarding

selection of the Strategic Partner, signing of the Share Purchase or Shareholders Agreements and other ancillary issues.

In case the disinvested PSU's shares are listed on SE, an open offer would be required to be hade by the bidder before closing the transaction.

In the disinvestment process mentioned above, Department of Disinvestment is assisted at each stage by an Inter Ministerial Group (IMG) comprising officers from the Ministry of Finance, Department of Public Enterprises, the Ministry concerned with the PSU apart from the Advisors.

The process flow chart on the next page shows the various stages of a typical privatisation transaction through strategic sale route.

PROCESS FLOW CHART FOR DISINVESTMENT THROUGH STRATEGIC SALE ROUTE

Disinvestment Commission's Recommendations			
Administrative Ministry's Comments			
Consideration by Core Group			
Approval of CCD			
Advertisement for Appointment of Advisors			
Receipt of Expressions of Interest from Advisors			
Presentations by Advisors			
Selection of Advisors			
Appointment of Advisors			
Process Finalisation & Due Diligence by Advisors			
Advertisement for Inviting Expressions of Interest from Bidders			
Receiving EoI			
Short-listing of Bidders & Signing of Confidentiality Undertaking			
Finalisation & Distribution of Information Package etc.			
Due Diligence etc., by Short-listed Bidders			
Financial / Capital / Business Restructuring etc. (if approved)			
Finalization of Shareholders' Agreement, Share Sale / Purchase / Other Agreements etc.			
Receipt of Final Bids & Bid Evaluation			
Cabinet, SEBI, Regulatory Approvals			
Open Offer			
Execution of Legal Documents and Inflow of Funds			
Documents Submitted to C&AG's Office for Assessment			

VARIOUS METHODOLOGIES FOR DISINVESTMENT

The various methodologies are:

1. CAPITAL MARKETS

- Offer for sale to public at a fixed price
- Offer for sale to public through book building
- c. Secondary market operations
- d. International offering
- e. Private placement
- f. Auction
- Dutch auction.
- French auction

2. STRATEGIC SALE

3. WAREHOUSING

4. REDUCTION IN EQUITY

- a) Buy-back of equity
- b) Conversion of equity into debt exchangeable into capital market instruments
- 5. TRADE SALE
- 6. ASSET SALE / WINDING UP
- 7. MANAGEMENT / EMPLOYEE BUY OUTS (M/EBOS)
- 8. CROSS SALES
- 9. SALES THROUGH DEMERGER / SPINNING OFF
- 1 CAPITAL MARKETS -
- (a) Offer For Sale To Public At Fixed Price
- Pricing: Decided before the transaction; at a discount to market to ensure success and immediate capital appreciation for investors
- Target investor set: Mix of retail and wholesale, with some reservation for small investors

- Transaction costs: High, in the range of 4-5% depending on issue size
- Time involved: 3 -4 months
- Regulation: SEBI guidelines, Stock Exchange requirements
- Suitability:
 - Companies for which small investor interest is expected to be substantial
 - Profit making companies with good future prospects
 - Companies not in need of significant technical, managerial and marketing inputs
- Precedents: Offer of 1 million shares of VSNL @ 750 per share.
- Methodology: Offer for sale
 - An issue of Equity Shares held by GoI to the public at large at a pre-determined price
 - Through an Offer Document
 - Equity Shares can be accompanied by sweeteners such as warrants
 - Issue amount is thus automatically obtained (No. of securities X price)
 - Issue underwritten by the Syndicate Members (may or may not be)
 - Offer made through an Offer Document

- Ensures widespread shareholding
- Sets valuation benchmarks for further fund raising/ offer for sale
- Relatively quick method
- Transparent method

Disadvantages

- Dependent on capital market conditions
- Price at a discount to market/ intrinsic price to ensure good response
- Process expensive -cost app. 4- 5%
- Regulatory compliances -SEBI and Stock Exchanges

(b) Offer For Sale To Public Through Book Building

- Pricing: Optimised, since price is discovered through a bidding process
- Target investor set: Essentially wholesale, with minimum 25% retail (10 applicants, per lakh of capital issued)
- Transaction costs: High, in the range of 5 -6% depending on issue size
- Time involved: 2-3 months
- Regulation: SEBI guidelines, Stock Exchange requirements

Suitability:

- Companies for which institutional interest is expected to be substantial
- Profit making companies with good intrinsic value and future prospects
- Companies not in need of significant technical, managerial, marketing inputs etc.
- Precedents: none among PSEs -Hughes Software Ltd. and HCL Technologies Ltd. in the private sector

Methodology: Offer for sale

- Issue of Equity Shares held by GoI to the public at large
- Number of securities to be pre-determined and disclosed
- Price discovery through bidding by interested investors -85% (institutional and retail) and allocations made at cut-off price (Dutch Auction) followed by a fixed price offer -cut-off price of 15% to retail investors
- Issue amount is thus automatically obtained (No. of securities X price)
- Issue underwritten by the Syndicate Members (may or may not be)
- Offer made through an Offer Document

Advantages

- Optimises price
- Ensures widespread shareholding
- Sets valuation benchmarks for further fund raising / offer for sale for IPOs
- Relatively quick method
- Transparent method

Disadvantages

- Expensive with cost of 5-6%
- Regulatory compliances SEBI & Stock Exchange

(c) Secondary Market Operations

- Pricing: at market prices.
- Target investor set: Essentially wholesale
- Transaction costs: Low, in terms of brokerage
- Time involved: spot transactions .
- Regulation: Stock Exchange requirements
- Suitability:
 - Companies which have a sizeable floating stock with good intrinsic value and good future prospects
 - Companies not in need of significant technical, managerial, marketing inputs etc.
- Precedents: none.
- Methodology: sale through market operations
 - A secondary market sale of Equity Shares held by GoI
 - Through brokers
 - To interested buyers institutional and retail
 - At trading market prices

Advantages

- Low costs only brokerage to be paid
- Disadvantages

- Unsuitable for Companies with low floating stock interest may be low
- Price dependent on day to day market conditions
- Amount of proceeds uncertain
- Possibility of price rigging
- Highly dependent on the day-to-day demand for the shares.
- Method may not be considered transparent

(d) International Offering

- Pricing: valuation by international Qualified Institutional Buyers (QIBs) (through book building) and related to domestic market prices
- Target investor set: Essentially foreign institutional investors
- Transaction costs: High, in the range of 4-5% depending on issue size
- Time involved: 3-4 months
- Regulation: Disclosure requirements by Securities Exchange Commission (SEC) and accounting in accordance with US Generally Accepted Accounting Practices (GAAP) for ADRs), NASDAQ/ NYSE/ LSE listing requirements
- Suitability .
 - Companies which have stocks listed in the international markets or companies with actively traded stock in domestic markets
 - Companies with good intrinsic value, good future prospects and of international repute
- Precedents: VSNL, MTNL, GAIL
- Methodology: offer for sale in the international markets
 - An offer to international investors through issue of Depository Receipts, which represent underlying shares (ADRs in the USA market and GDRs in markets other than the USA)
 - Recasting of accounts as per GAAP for issue of ADRs and consolidation of accounts for issue of GDRs
 - Preparation of red herring (Offer Document) and road shows
 - Price discovery through bidding and allocations made at cut-off price (Dutch Auction) or at bid price (French Auction)
 - The issue is fully underwritten
 - Offer through an offering document

Advantages

- Access to deeper international markets and capital, sometimes at better price
- Creates price tension between the overseas and home market
- Enhances visibility

Disadvantages

- Time consuming process
- Stringent regulatory requirements accounting norms and disclosures and regular reporting to SEC in case of ADRs

Cost of 4-5% for ADRs and about 3% for GDRs.

(e) Private Placement of Equity

- Pricing: valuation by merchant banker and feedback from institutional investors or price discovered through book building.
- Target investor set: Essentially institutional including multilateral agencies, private equity funds
- Transaction costs: low
- Time involved: 1-2 months.
- Regulation: Foreign investment guidelines in case of overseas investors
- Suitability:
 - Unlisted companies
 - Listed companies with low floating stock and low volumes
 - Companies with good intrinsic value and good future prospects
- Precedents: CONCOR, GAIL (Domestic issue with FIIs participation)
- Methodology: placement of equity
 - To a set of institutional investors.
 - At a negotiated price arrived at through valuation or price discovery through book building
 - With issues of management rights and exit option resolved
 - Through an information memorandum circulated among institutional investors and due-diligence
 - In case of listed companies, placement of less than 15% equity to each investor to avoid trigger of Take-over code

Advantages

- Less time consuming no regulatory compliance requirements, except in case of foreign investment
- Low transaction cost

Disadvantages

- Does not ensure widespread shareholding
- May not be considered transparent

(f) Auction

- Pricing: optimised through bidding. In case of Dutch Auction, allotments made at single price. In case of French Auction, allotments made at bid price
- Target investor set: Essentially institutional
- Transaction costs: Low
- Time involved: 1-2 months
- Regulation: SEBI Take-over code
- Suitability:

- Companies with good intrinsic value
 - Unlisted companies
 - Listed companies with low floating stock
- French Auction Low floating stock/ low trading volumes vis-à-vis number of shares on offer
- Precedents: Initial 9 rounds of disinvestment
- Methodology: Auction through the Dutch/French Auction
 - To a set of institutional investors.
 - At a price discovered through the bidding process
 - For a pre-determined number of Equity Shares
 - Allocations made
 - At a cut-off price to all investors above the cut-off price in case of Dutch Auction
 - At the bid price in case of French Auction
 - Marketing through Analysts' meet and one-on-one discussions
 - In case of listed companies, placement of less than 15% equity to each investor to avoid trigger to Take-over code

- Optimises receipts to the GoI (amount higher in case of French Auction)
- Transparent mechanism
- Less time consuming with no regulatory compliance requirements
- Low transaction cost

Disadvantages

Does not ensure widespread shareholding

(2) STRATEGIC SALE

- Pricing: Optimisation through competitive tension and control premium
- Target investor set: Investors with strategic fit techno-commercial credentials
- Transaction costs: Low
- Time involved: 6-10 months
- Regulation: Companies Act, SEBI Take-over code, Stock Exchange, RBI
- Suitability:
 - Companies in the non-core sector
 - Companies where GoI is willing to give significant management control
- Precedents: MFIL, BALCO, CCI (Yerraguntla unit), Vikrant Tyres, OPGC etc.
- Methodology:
 - Structuring the transaction in terms of
 - Extent of stake to be divested
 - Extent of management rights

- Decisions on pre qualification criteria, bid evaluation criteria and bidding process
- Preparation and circulation of information memorandum to pre-qualified buyers
- Due diligence and bidding
- Evaluation of bids and negotiations
- Signing of Sale Agreement

- Maximises price because of control premium
- Brings technical/marketing/financial/managerial expertise of the buyer to the company
- Increased value of residual GoI shareholding
- Low cost and less regulation

Disadvantages

- Time consuming
- Issues related to management, labour etc. to be resolved

3. WAREHOUSING

- Pricing: Market determined price, after building in returns to the warehouser. Profit
 on sale, net of selling expenses, by warehouser shared in pre-determined ratio
- Target investor set: Essentially institutional
- Transaction costs: Fixed return to warehouser less cost of funds for GoI
- Time involved: within 1 month
- Regulation: RBI restrictions on bank investments
- Suitability:
 - Listed companies with adequate liquidity
 - Potential for growth in market prices
- Precedents: None
 - Who will buy shares from the GoI
 - At a discount to the market price
 - To sell the shares at a later date in the market, within a specified time frame

4 REDUCTION IN EQUITY:

(a) Buy Back Of Shares

- Pricing: In accordance with SEBI Buyback regulations
- Target investor set: Shares bought back by the company
- Transaction: Companies Act, SEBI Buyback regulations
- Suitability:
 - Cash rich companies with no immediate capex plans

- Low geared companies with good intrinsic value, which is not reflected in accretion to shareholder value and market price
- Precedents: None in Public sector, Indian Rayon, Reliance Industries Limited in private sector
- Methodology: Offer by company to buy-back its shares from GoI
 - Through tender route
 - · Buy-back at fixed price
 - In case of over subscription, acceptance on proportionate basis
 - Through book building
 - Buy-back through Dutch Auction route- price discovery through bidding by interested investors- and allocations made at cut-off-price
 - Valuation to factor in future loss of dividend to GoT

- Reduces capital and thus improves EPS, Book Value & RoE of the Company post buy-back
- Low cost transaction
- Relatively quick method

Disadvantages

- Regulatory requirements
- Post buy-back debt equity ratio not to exceed 2: 1
- Maximum number of Equity Shares to be bought back should not exceed 25% of the existing paid-up capital
- The maximum amount that can be expended on a buy-back should not exceed 25% of the Company's paid-up capital and free reserves

Reduces cash surplus with the company,

(b) Conversion Of Equity Into Another Instrument

Pricing: Book value/market price based

Target investor set: Wholesale

Transaction costs: Low – Placement costs

Time involved: Up to 3 months

Regulation: Companies Act

Suitability:

- Cash rich companies with no immediate capex plans.
- Low geared companies with good intrinsic value which is not reflected in accretion to shareholder value and market price
- Precedents: NALCO
- Methodology:

- Conversion of equity into an attractive and suitable capital market instrument plain vanilla bonds, deep discount bonds, fully/partially convertible bonds, bonds with warrants attached, preference shares with/without warrants
- Preparation and circulation of an information memorandum (IM) among institutional investors
- Placement of the instrument

- Results in improvement in the capital structure of the Company combined with funds inflow for GoI
- Reduces capital & thus improves EPS, Book Value & RoE of the Company
- Low cost of transaction
- Relatively quick method
- No reduction in cash surplus with the Company

Disadvantages

- More regulatory compliance requirements for listed companies

5. TRADE SALE

Trade Sale means sale of a business or a division or a non-core activity. In addition to price, the auction to take into account factors such as capital investment to which the bidder is willing to commit and guarantees the bidder makes to employees and customers.

Though the total amount offered is an important factor in the auction, there is also a tradeoff for the Government between (1) obtaining the maximum amount of sale proceeds and (2) ensuring that charges to the customers remain at affordable prices. For this reason, the Government generally develops a number of selection criteria e.g.

- Indicative bids
- Strengths and capabilities of prospective operators.
- Financial strength and credentials of bidders
- Any special conditions/assumptions attached to the bids such as spelling out in advance the extent to which rate increase will be permitted over a transition period.

A Trade Sale is generally regarded as a quicker option to execute. Public offerings make more sense when the company to be sold has a reasonable strong skill base and capital markets are liquid. In UK, Trade Sales have generally been used with smaller industries or enterprises.

6. ASSET SALE AND WINDING UP

This is normally resorted to in companies, which are either sick or facing closure. The Asset Sale is normally done either by open auction or by tender method. Sick companies under SICA are wound up by BIFR and handed over to the official liquidator for realisation of dues through liquidation.

7. MANAGEMENT/EMPLOYEES BUYOUT (M/EBO)

For smaller companies, particularly those that are highly dependent on their personnel, management/employee buyouts have been found to be suitable privatisation techniques. Although most buyouts are led by management, active participation by the workforce is a pre-requisite for success. The workforce is to be necessarily brought along, contributing some of their own money towards the enterprise. London's Bus service was reorganized into companies, which were purchased by their managers and employees. National Freight Corporation of UK is the classic case of 100% employee buyout.

8. CROSS SALE

Strictly speaking this is not an option for privatisation. However, Governments seeking to sell enterprises via Trade Sales should decide at the outset what their policy would be with regard to bids from Government owned enterprises and spell out such policies in their initial request for qualifications from potential bidders.

9. SALE THROUGH DEMERGER/SPINNING OFF

Sections 391-394 of the Companies Act 1956 govern demerger The basic concept of demerger requires transfer of an undertaking from an existing company ("Transferor Company") to another existing company (Transferee Company"). The demerged companies have a shadow shareholding as that of the Transferor Company. The scheme of demerger has to be approved by Department of Company Affairs. To cut down the delay, new transferee companies can be incorporated as shell companies in which the properties of transferor company can be hived off i.e. demerged. Such new companies remain as "shell" companies until the properties are transferred to them as per the order of DCA. These new companies are government companies under S.617 of the Companies Act and are formed only for the limited purpose of facilitating the demerger on transfer of shares to successful bidders, these companies cease to be government companies.

STRATEGIC SALE

Government have recently established a new Department for Disinvestment to establish a systematic policy approach to disinvestment and privatisation and to give a fresh impetus to this programme, which will emphasize increasingly on strategic sales of identified PSUs. Government equity in all non-strategic PSUs will be reduced to 26% or less and the interests of the workers will be fully protected. The entire receipt from disinvestment and privatisation will be used for meeting expenditure in social sectors, restructuring of PSUs and retiring public debt.

- Extracts from Budget Speech of Finance Minister (2000-2001)

The strategic sale method being the preferred option in the Finance Minister's Budget Speech and also in the recommendations of the Disinvestment Commission and earlier the Rangarajan Committee, is described in detail in this Chapter.

A typical three-stage strategic sale process is as follows:

Stage I - Qualification of Companies/Consortia

- a) Issue of advertisement inviting EOIs
- b) Submission of EOIs and supporting documentation
- c) Despatch of RFQ, background information and PIM to interested parties
- d) Qualification of companies/consortia

Stage II - Request for Proposals and submission of Bids

- a) Notification of qualified companies/consortia and issue of "Bid pack" containing a detailed Information Memorandum (IM), Annual Reports of the company, Request for Proposals (RFP) and further information to qualified parties.
- b) Due Diligence (including interaction with management, access to data room and site visits)
- c) Negotiations and finalisation of contractual documents
- d) Submission of final bid

Stage III - Completion

Evaluation of bids
Government approvals and Regulatory approvals
Signing of contractual documentation
Completion / closure of strategic sale
Post closing adjustments

Normally it would take 6 months to 9 months for a simple privatisation operation. However the time period can vary depending on the complexity of the process.

Stage I

a) Issue of Advertisement inviting EOIs

A public announcement of a privatisation transaction assures the people of the transparency of the transaction. A typical advertisement in this category usually provides a short description of government policy on privatisation, profile of the enterprise being privatised, the bidding procedure, deadline for submission of expression of interest or bids, and the address for further information.

Advertisement is normally given in three major national newspapers and one international newspaper besides industry/trade journals. A copy of the advertisement is put on the internet on the websites of the PSU, administrative ministry, Department of Disinvestment and Ministry of External Affairs.

b) Submission of EOIs & Supporting Documents

Any company / consortium, participating in a privatisation transaction has to submit an Expression of Interest. It is normally submitted alongwith a statement of legal capacity; and a litigation impact statement. It is the responsibility of applicant to ensure that EOI is delivered at the prescribed address by the stated deadline. The covering envelope of all EOIs submitted should be clearly marked "Private and Confidential - Expression of Interest for the Strategic Sale". Responses received after the deadline or not accompanied by the required documentation are not considered. A company /consortium may be disqualified for any misrepresentation, failure to provide the required information or if any member has already submitted a separate EoI.

Contents of FOIs

All EOIs generally include the following information:

1. Executive Summary

This provides a brief description of the company and (where appropriate) of each member in the consortium, containing details like ownership structure, write up on business history and growth, business areas / activities, respective revenue details, etc. It includes a brief commentary on the capability of the company / consortium, as demonstrated, inter alia, in its past track record, to run its own business.

2. Background Information

a) The Applicant

The full name, address, telephone and facsimile numbers, e-mail address of the company or of each member of the consortium and the names and the titles of the persons who are the principal points of contact.

b) · Basic Information

This contains the details of the place of incorporation, registered office, current directors, key management personnel and principal shareholders of the company/companies in the consortium. It also contains a copy of its current Memorandum and Articles of Association and copies of audited accounts for the last three years of the company / companies in the consortium.

3. Management Organization

- An overview of the applicant's senior management and organisation structure and in the case of a consortium, that of each member; and
- Summaries of the roles and responsibilities of the directors, key management personnel of the applicant and, in case of a consortium, those of each member.

4. International Operations / Joint Ventures / Alliances

Brief write up of the company's or, in the case of a consortium, of the members, of their international operations, joint ventures / alliances (whether international or domestic), nature and size of such operations, equity ownership, if applicable, copies of the audited accounts for the last one year of such companies.

5. Professional Advisors

The names and addresses of those companies and the professional firms, if any, who are (or will be) advising the applicant/consortium, together with the names of the principal individual advisors at those companies and firms.

6. Legal Capacity of the Company/Accuracy of Information

Every company and each member of a consortium must provide with the EOI a representation, duly executed by its authorised official/ representative that it has the requisite corporate authorisation to submit the EOI and that all information provided in the EOI is complete and accurate in all material respects to the best of their knowledge. If, at a subsequent date, it is discovered that the company or any consortium member did not either possess the requisite authorisation or that any part of the information provided in the EOI was not complete or accurate in any material respect, the Government reserves the right to disqualify such company or consortium or member of the consortium from the process.

7. Outstanding Litigation

Each company, and each member of a consortium must provide with the EOI a statement litigations of pending.

c) Despatch of RFQ, background information and Preliminary Information Memorandum (PIM)

After the expression of interest is published, the investors are interested in knowing details about the company. The purpose of Preliminary Information Memorandum is to assist the investors in deciding whether they should proceed ahead with the proposed disinvestment.

Structure Of PIM

A typical Preliminary Information Memorandum includes the following information:

1. Introduction

This gives a brief of the government decision regarding disinvestment in the company, the extent of equity held by the Government, the extent of equity to be the disinvested, the contact person, the relevant telephone numbers and fax nos.

2. Information About The Company

This contains the information about the company, its history, its activities, the location, management, human resources, quality control, markets and marketing arrangements, capital structure, various assets and other details about the company. It also gives the strengths and opportunities of the company.

3. Financial Details

The Preliminary Information Memorandum gives the profit and loss account and balance sheet of the company for the last five year.

4. Formats

The preliminary information memorandum contains the formats for submitting Expression of Interest, statement of legal capacity and RFQ.

d) Qualification of Companies/Consortia

The advertisement of the transaction indicates the broad qualifications of the prospective bidders.

Based on the criteria mentioned in the advertisement, the bidders are shortlisted.

A common way to create a shortlist is to introduce another stage between announcement and short listing. This stage is referred to as Request for Qualification (RFQ). This is normally done to discourage non-serious bidders.

In the announcement for the transaction, the potential bidders can be directed to apply for prequalification by submitting detailed information in response to an RFQ document. Potential bidders send a letter asking for the RFQ package. They fill out the forms, supplying the requested information in the desired format. The government then uses this information to shortlist potential bidders.

Request For Qualification (RFQ)

A typical RFQ consists of the following three main sections:

1. Introduction & Description Of The Strategic Sale Process

This section contains: Govt's Strategic Sale Objectives, Background Information, Questions/Clarifications, Strategic Sale Timetable, Overview of the Qualification Process, and overview of the future process.

2. General Requirements & Instructions For EOIs

This section contains Eligibility Conditions, Notification of Due Date, Number of Companies and Filing Requirements, Conditions for Consortium and Disqualifications.

3. Contents of EOIs

This Section contains basic information to be provided in Expressions of Interest about the bidders, like the executive summary, background information, management, organization, international operations / joint ventures / alliances, operational ability, details about professional advisors of the bidders, legal capacity of the company and outstanding litigation as explained in Sub Para (b) above.

Based on the information submitted in EOIs, the Ministry and the advisors will carry out an evaluation of the qualifications of the companies/consortia and subsequently notify in writing those companies / consortia which qualify to participate in the next stage of the process.

<u>Stage II</u>

RFP & Bid Process

The proposed Strategic Sale process, consequent to the submission of EOI, involves a detailed due diligence exercise to be undertaken by the Bidder followed by submission of a Technical Bid and a Financial Bid.

The due diligence phase involves providing a Bid Pack containing various documents to the Bidder. Besides, visits to the Data Room, site visits to the units of the company form a part of the due diligence phase. At the end of this phase, the Bidder is expected to submit his Technical Bid and the Financial Bid. Details of form and content of the Bids and the proposed due diligence process are given in RFP.

a) Notification to qualified / short listed parties & issue of Bid Packs

A Bid Pack containing the following documents is made available to the qualified / shortlisted bidders, along with RFP after getting a confidentiality undertaking signed by them:

- Information Memorandum;
- ii) Previous 3 years' audited annual accounts of the company, and
- iii) Data Room Rules.

The following documents (which may or may not form a part of the Bid Pack) are also made available to the qualified / shortlisted bidders in due course: -

- Draft Share Purchase Agreement;
- ii) Draft Shareholders' Agreement, and
- iii) Provisional results for the Financial year

Where the EOI has been submitted by a Consortium, it is expected that there shall not be any changes in the Memoers of the Consortium consequent to the submission of EOI.

However, if a change is desired by some or all the Members prior to the submission of the Technical and Financial Bid, such change shall have to be approved by GoI. Similarly, consequent to the submission of EOI, if the Bidder desires to form a Consortium by inducting new Member(s), it shall have to seek an approval from GoI.

Where the Bidder is a Consortium, the stake in the ordinary share capital of the company can be acquired and held either through an investment vehicle ("Consortium Vehicle") or through direct holding in the company by each Member or through any Group Company (ies).

Confidentiality Undertaking

The IM being a much more detailed document, it is customary to send it only to those who have given a Confidentiality Undertaking. Typically, this undertaking requires that the potential bidders do not misuse this wealth of information. It is not uncommon for competitors to send a bogus team to discover the trade secrets of the other parties.

It is an undertaking made by the bidder in favour of President of India (acting through Joint Secretary of the administrative ministry), the company and advisors to treat all the confidential information in Confidence and not to disclose to any person, the fact that he has been provided the Confidential information or has inspected any confidential documents or the discussion/negotiation regarding the transaction.

Confidential information means all information, concerning the business, operations, prospects, finances, or other affairs of the company, It includes documents delivered in connection with a due diligence investigation, information concerning business activities, products, specifications, data know-how, compositions, designs, sketches, photographs graphs, drawings, research and development, marketing or distribution methods and processes, customer lists, customer requirements, price lists, market studies, computer software and programs, database technologies, systems structures and architectures, historical financial projects and budgets, historical and projected sales, capital spending budgets and plans, current or prospective financing sources, the names and background of personnel, personnel training techniques and materials.

It also includes information memorandum, request for proposal, draft of shareholders and share purchase agreements or other materials prepared in connection with the transaction.

Confidentiality undertaking also provides that the bidder shall not deal with any officer, Director or employee of the Govt. or Company, regarding the business, operations, prospects or financing of the company without advisor's express written consent.

The confidentiality undertaking contains an indemnity clause, whereby the bidder agrees to indemnify the advisor, the Govt. and the company any damages, loss, cost or liability arising out of any unauthorised use or disclosure by the bidder.

Request For Proposals (RFP):

A typical RFP consists of the following three main sections:

1. Background and General Information:

This section describes the goals of the privatisation transaction and provides information on the company that is being privatised.

2. Conditions of Agreement:

In this section of the RFP, a summary of contractual obligations is provided in simple, non-legalistic language.

3. Proposals and Selection Process:

This section describes the entire privatisation procedure including the process of evaluation of bids.

Information Memorandum (IM)

After obtaining the confidentiality undertaking, Advisors send out an Information Memorandum (IM) along with the RFP. An Information Memorandum is a much more indepth description of the company to be privatized than that suggested by the RFP.

This reduces the cost of preliminary due diligence for all potential bidders, thereby increasing the chances of attracting quality players who are in great demand.

A typical information memorandum usually has the following sections:

This is a brief chapter containing introduction of the company, investment considerations, business overview, objectives of Government of India and the role of the strategic partner. Business overview will include information on business activities, infrastructure, marketing and distribution, land and summary financial performance.

- General Information on Indi includes introduction about India, its institutional framework, demography, language and literacy, international relations, economic and financial indicators, foreign trade, balance of payments, economic indicators and PSU reforms.
- 3 Sector Scenariogenerally contains an overview of the industry, its segmentation, regulatory environment governing the sector in India, and policy initiatives in the sector. Industry segmentation would include various segments of the industry in India. Regulatory environment governing the sector in India would include compulsory legislation, voluntary standards, policy relating to small scale undertakings, policy related to foreign investments in the sector and laws pertaining to employer employee relations. Policy initiatives would include regulation and control, fiscal policy and taxation.
- contains introduction of the company, chronology of its growth, overview of its business, its operations. Operations include facilities, land, marketing and distribution, manufacturing plants and process, raw materials and research and development (R & D).

Structure, Responsibilities and Systems contains structure of the company, structure of the manufacturing units and financial and management information systems. Structure of the company means finance, marketing, operations, human resources development and administration. Financial and management information systems contains financial accounting, management accounting and budgeting.

contains description of the Directors, Senior Management and Employees. It contains information on the remuneration, employee entitlements, recruitment, retirement and dismissal, training and development, pension and welfare obligations and industrial relations. Employee entitlements generally means basic salary, dearness allowance (DA), residential accommodation / house rent allowance (HRA), conveyance, provident fund (PF) and gratuity, bonus, productivity linked scheme, overtime, annual increments, accident insurance, medical reimbursement scheme, health scheme, loans / advances, other benefits and perquisites, leave, holidays and leave travel concession benefits.

Financial Statements of the company include profit and loss data, balance sheet data and operational results normally for the last 5 years.

Share Purchase Agreement

The bidders put in their bid based on the last audited balance sheet information made available to them. However, the company is transferred to them at a later stage. There could be either an increase or decrease in working capital and debt during this period. Share Purchase Agreement fixes the closing date on which the company is handed over to the buyer so that the difference between the closing date and the date of last audited balance sheet can be arrived at and accounted for. It describes the purchase price, the mode of payment and the actions at closing time. It also lays down representations and warranties given by both the parties.

Share Purchase Agreement is entered into among the President of India (acting through the Joint Secretary of the Administrative Ministry), the company, the strategic partner and other principals as applicable.

It contains the following sections:

This section deals with the definitions contained in the agreement, certain rules of implementation and the summary of the entire agreement along with the schedules.

- 2. **Purchase and sale** It describes the actions at closing time, other actions and the place of closing along with other documents relevant for the above transaction.
- Purchase price It describes the purchase price and the mode of payment.

ties of the Government: It describes the right to sell, due authorization, enforceability of obligations, regulatory approvals, incorporation, due authorization, enforceability of obligations, absence of conflicting agreements, litigation, regulatory approvals, foreign participation, strategic partner review, access to information, investment intent, source of funds, technical proposals and shareholding structure.

5. Agreements on Representations and Warranties :

It describes the various representations and warranties given by both the parties.

Covenants of the parties:

It describes the actions to satisfy closing conditions, the requirements of preservations of records and of making public announcements.

Conditions precedent:

It lays down that the representations at the closing time be true and accurate. It also lays down the performance of obligations, receipt of closing documentation, consents, authorizations and registrations.

Indemnification:

It lays down the conditions for the indemnification by the strategic partner.

Termination:

It lays down the conditions for termination of the contract and effect of this termination.

10. Waiver/Survival:

The waiver/survival clause is added at the end of the agreement.

11. General:

The general section includes the various provisions regarding expenses, notices, assignment, further assurances, dispute resolution/submission to jurisdiction, amendments, governing law, appointment of agent and severability.

Shareholders' Agreement

Shareholders' Agreement is a very important agreement. It defines the rights and obligations of both the parties. Concerns of Government on protection of employees' rights, future investment/business plans and the precautions against assets stripping are generally reflected in it. It lays down the conditions for indemnification of purchaser losses after ignoring the De-Minimis figures, the survival period after which the claims become time barred and the indemnification limit to which a purchaser can be indemnified. It also lays down the terms and conditions of indemnification for any disputed tax liabilities, litigation liabilities and environmental liabilities. It lays down the procedure for management of the company after disinvestment. It also includes various representations and warranties given by both the parties. It lays down the dispute resolution mechanism for both the parties.

Shareholders' Agreement is entered into among the President of India (acting through the Joint Secretary of the Administrative Ministry), the company, the strategic partner and other principals as applicable.

It contains the following sections:

Definitions and principles of interpretation :

It contains the various definitions and

rules of interpretation given in the agreement.

Purpose and scope:

It defines the purpose and the scope of the agreement. It lays down the conditions for compliance with the agreement. It lays down the various conditions to be complied by the company.

Equity participation; financial support:

It lays down the conditions for equity participation, additional capital and dilution of Government Equity Interest.

Management of the company :

It describes the constitution of the Board of Directors, procedure for removal and replacement of nominees, procedure for calling meetings of Board, quorum, procedure for approval of matters, deemed consent, casual vacancies and filling the post of alternate Director and Managing Director.

- **5. Shareholder meetings:** It describes the procedure for general meeting of shareholders, notice of shareholder meetings, quorum and voting requirements.
- **6. Transfer of equity shares:** It lays down the conditions for general restriction on transfer, rights of first refusal, change in control, event of default, government's right to sell, Strategic Partner's right to buy, determination of fair market value, procedure for call and put options, permitted transfers and compliance with legal requirements.
- **7. Representations and Warranties:** It describes the various representations and warranties given by the company, the strategic partner and the government. It also includes a survival clause.
- **8. Indemnification and confidentiality** It lays down the various indemnifications given by all the parties in case of breach of contract. It also includes a confidentiality clause. It lays down the various equitable remedies and costs in the event of a breach of contract.
- **9. Miscellaneous:** It includes clauses on arbitration, application of this agreement, assurances, benefit of the agreement, amendments and waivers, assignment, severability, notices, governing law and expenses.

b) Due Diligence

The purpose of the due diligence programme is to provide the Bidder an overview of the Strategic Sale programme and a detailed information on the company's businesses. In order to enable the Bidder to obtain the required information, the programme provides for data room visit followed by site visit.

The following is a summarised, indicative list of types of documents and information required.

Financial Documents

- All annual reports.
- Quarterly reports.
- All accountant and auditor's reports and opinions.
- Management financial reports, capital expenditure budgets, projections and reports for last five years.
- Operating budgets, projections, and reports for last five years.
- Any financial information presented to GoI in last five years.
- Operating revenue accounts for last five years.
- Operations and maintenance accounts for last five years.

Accounts and Investments

 List of all bank accounts and investments, including account balances and value of investments.

Loan Documents

- A chart setting forth loan amortisation and interest payments (with the company both as borrower and, if applicable, lender).
- A chart showing other debt-like obligations of the company (letter of credit repayment obligations, installment sales obligations, capitalized lease obligations).
- All loan agreement in which the company is a borrower (together with related promissory notes, security documents, and ancillary agreements).
- All loan agreements in which the company is a lender (together with related promissory note, security documents and ancillary agreements).
- All documents relating to debt-like obligations of the company (letter of credit repayment obligations, installment sales obligations, capitalised lease obligations).

Equity Documents

- A chart setting forth all capital contributions of the company and share issuances by the company; share issuance and transfer ledger.
- All equity subscription agreements, option agreements, etc.

Corporate Documents

- Memorandum and articles of association.
- Bylaws.
- Minutes of shareholder and board meetings for last five years.

Licenses and Permits

- List of all required licenses and permits.
- All licenses/permits.
- All correspondence relating to revocation, modification, or non-issuance of any license or permit.
- All laws and regulations applicable to the company (including any laws relating to environmental and safety matters).
- All environmental and safety permits.
- All tariffs applicable to the company in last five years.
- All environmental and safety reports prepared in last five years.

Litigation

- Status report of all litigation, disputes, etc., pending or concluded in last five years.
- Litigation files relating to pending matters.

Employee Matters

- List of all employees indicating name, years of service, position, and salary (employees below a particular grade could be classified in groups).
- List of all welfare, pension, and health plans, together with a brief description of each and a financial summary relating to each (i.e., the company's assets and liabilities).
- List of unionised workers and unions.
- All unions and collective bargaining agreements.
- Employment agreements.
- Description of bonus and profit sharing arrangements, together with any related documents.

Tax Matters (including income tax, sales tax, excise duty, and other taxes)

- List of tax liabilities and payments during last five years.
- Tax filings and notices for last five years.
- All disputes relating to tax matters.

Real Estate

- List of all owned and leased real property, together with schedule of annual lease payments and lease expiry dates.
- Title documents relating to owned real property.
- Leases relating to leased real property.

Property, Plant and Equipment

- List of all owned/ leased tangible property (if appropriate by class) and inventory, together with schedule of annual lease payments and lease expiry dates.
- All purchase and services contracts under which equipment and services are to be provided to the company.
- Plant accounts

Intellectual Property

- List of all intellectual property owned or used by the company.
- All intellectual property ownership, license, royalty and similar documents.
- Description of computer systems and hardware.

Customer Documents

- Standard forms, if any, of customer contracts, billing documents, etc.
- Customer service policies and records of service.
- Copies of material customer complaints.
- Customer statistics for each class of customer.

Technical Data

- System maps.
- Technical assessments and reports prepared in last five years.

C) Negotiations & Finalisation Of Contractual Documents

During the course of due diligence, and thereafter, the qualified bidders are also invited to offer their comments on the contracted documents (i.e. the draft Share Purchase and the Shareholders Agreement) provided to them, with a view to finalizing those and making terms and conditions thereof uniform, so that the bids are submitted by all bidders on same terms and condions.

d) Details Of Technical & Financial Bids

Form and Content of the Technical Bid

In its Technical Bid, the Bidder must provide the following:-

- i) The ownership structure and the investment route which the Bidder / Member proposes to adopt for its investment in the company with a diagram or corporate structure chart showing the shareholding relationship between the Bidder / Member and the Group Company through which the equity stake in the company is to be held;
- ii) Confirmation whether there has been a change in the Consortium or formation of a Consortium consequent to the submission of EOIs;
- iii) The details, with respect to any Member who may have joined the Consortium;
- iv) Evidence that the Bidder / Member has the necessary corporate authorisations to enter into and perform its obligations as per the Contractual Documentation, and
- v) Response to the Technical Bid.

The Technical Bid must be signed by the Bidder / all Members of the Bidder consortium and submitted as an original version in one sealed package. The covering envelope of the Technical Bid should be clearly marked 'Private and Confidential - Technical Bid for the Strategic Sale'.

Details of Financial Bids

Form and Content of the Financial Bid

The Financial Bid must be:-

- In the form to be provided by GoI;
- (ii) Expressed in Indian Rupees;
- (iii) Made on the basis of the terms of the revised final drafts of the Contractual Documentation as may be circulated to the Bidder

- (iv) Unconditional and open for acceptance for a period of 180 days from the stipulated deadline;
- (v) Must be signed by the Bidder or, where the Bidder is a Consortium by all the Members of the Bidder, and
- (vi) Submitted to GoI on or prior to the stipulated deadline.

The Bidder submits to GoI one copy of its Financial Bid, contained in a separate sealed package. The covering envelope on the package containing the Financial Bid must be clearly marked 'Private and Confidential - Financial Bid for Strategic Sale' and include on the envelope the name of the contact person and address of the Bidder (to whom any unopened Financial Bid should be returned).

Earnest Money Guarantee

The Bidder or in the case of Consortium any of the Member of that Consortium, singly or jointly, shall be required to enter into an Earnest Money Guarantee agreement for a stipulated amount. The draft of the Earnest Money Guarantee agreement is provided to the Bidder.

All the bids have to be submitted before a stipulated deadline.

The selection of Purchaser is based on an evaluation of the Bidder's Technical Bid as well as the Financial Bid.

Principles of Evaluation of Technical Capabilities

The principles underlying the evaluation of the technical capabilities of the Bidder are twofold: -

- Bidder's understanding of the industry in which the company operates and of the company's existing and proposed business(es), including its strengths, weaknesses, areas of concern, future potential, etc, and
- (ii) Bidder's views as expressed in its Technical Bid as to how it will use its experience and expertise in the operation and management of the company for its existing and / or proposed business activities.

A Bidder can be disqualified for any of the reasons listed below:-

- (i) if a material misrepresentation is made by the Bidder / Member, whether in the Technical Bid, the Financial Bid, supporting documentation or otherwise;
- (ii) if the Technical Bid submitted by the Bidder is in any material respect inconsistent with, or demonstrate any failure to comply with, the provisions of RFP;

- (iii) if the Financial Bid is not submitted separately from the Technical Bid of the Bidder;
- (iv) failure to comply with any other material requirement of RFP, and failure to comply with the reasonable requests of GoI in relation to the Strategic Sale process.

Stage III-Completion

Bids are opened before an empowered committee. The Technical Bid and the Financial Bid are submitted in separate envelopes. First, only the technical bids are opened and the names of firms, who have submitted the technical bids, are recorded. The financial bids are placed in one package, the contents recorded and sealed. In reviewing a bidder's methodology, the committee looks at its business plan and its approach to fulfill the government's objectives for the transaction, qualifications and experience of permanent staff, innovative ideas, and technology proposed to carry out the objectives as outlined in the RFP. After the technical evaluations have been completed those proposals, which do not fulfill the technical criteria, are rejected. Once the technical evaluation has been done, financial bids of only those parties are opened who fulfill the technical evaluation criterion. Financial bids of those parties, who have been rejected in the technical evaluation, are not considered and they are kept aside in a sealed cover. The whole process is carefully minuted, incorporating all the details.

Post Closing Adjustments

The bidder submits his bid based on information supplied to him in the data room. This information is the last audited balance sheet. However from the date of the last audited balance sheet, till the date of handing over (called the closing date), there may be accretion or depletion in the current assets, current liabilities resulting in the change in Net working Capital and the debt position. The difference between these figures between the date of the last audited balance sheet and the closing date is called post closing adjustment and depending on whether there is an accretion or depletion of the current assets and debts, this amount is paid by the government/purchaser to the other party.

Within 90 days following the closing date, an accounting firm is jointly selected by the Government and the purchaser, from the CAG's approved panel or otherwise as mutually agreed. The firm finalizes the "Closing Date Net working Capital Amount" and the "Closing Date Debt Amount". These computations are final and binding on both the parties.

If there is accretion in the Net working capital on the closing date, the purchaser would pay the differences to the government. Conversely, if the working capital decreases on the closing date, the government would pay the difference to the purchaser.

Similarly if the closing date debt amount exceeds the amount given in the last balance sheet (which was the basis of the bid), then the government would pay the difference to the purchaser. Conversely if the closing date debt amount is less than the debt amount given in the last balance sheet, the purchaser would pay the difference to the government.

All payments are normally settled within 45 days of the date of handing over the closing date accounts by the auditors.

Indemnification by the Government

The Government indemnifies the purchaser from any actual losses, liabilities, damages, judgments, settlements and expenses arising out of any breach by the government of any representations and warranties contained in the agreement.

A cumulative aggregate amount of losses (called the Aggregate Liability threshold) is decided, below which all minor losses are ignored. This mutually decided threshold is normally 3-4% of the total Purchase Price. If the losses are more than this threshold level, and arise out of some breach or violation by the government, then the purchaser is indemnified these losses by the government. For calculations of Purchase Losses in individual events, a figure (say Rs.1 lakh in each incident) is agreed to, which is called De-Minimis Purchaser loss. All individual amounts less than this De-Minimis figure are ignored in calculating the purchaser loss. The total amount indemnified by the government is limited to an agreed limiting percentage of the purchase price. Normally, irrespective of the loss, the indemnified amount will not exceed 70% of the total purchase price. All the claims of indemnity are to be preferred within the survival period (normally 24 months) after which they become time-barred.

Tax-liabilities

If there is any liability at closing time of sales tax, income tax or excise duty, which is disputed, the company pays that under protest. If that dispute is resolved unfavourably against the company, the government would indemnify that amount to the company, provided the purchaser has informed the government within the stipulated period and provided that the purchaser has not been compensated for this liability earlier.

Litigation

If there are certain litigations, which are listed in the schedule of agreement, the government may retain all liabilities in their respect, subject to the clauses of the agreement and would make all efforts to resolve them. Subject to the conditions of agreement the government would indemnify all liabilities arising out of these litigations to the purchaser.

Environmental Liabilities

If there are any claims regarding environmental damages arising out of the acts of commission/omission on the part of government during the period prior to disinvestment, and the claim has been preferred during the survival period, then subject to the clauses of the agreement, the government would indemnity the liabilities arising out of these claims to the purchaser. It is advisable to have an environmental audit done prior to the disinvestment to benchmark the extent of such liabilities.

CHAPTER - 18

VALUATION

1. Introduction

In any sale process, the sale will materialize only when the seller is satisfied that the price given by the buyer is not less than the value of the object being sold, which in his perception is adequate. Determination of that threshold amount, which the seller considers adequate, therefore, is the first pre-requisite for conducting any sale. This threshold amount is called the Reserve Price. Thus Reserve Price is the threshold amount below which the seller generally perceives any offer or bid inadequate. Reserve Price in case of sale of a company is determined by carrying out valuation of the company. In companies, which are listed on the Stock Exchanges, market price of the shares is a good indicator of the value of the company. However most of the PSUs are either not listed on the Stock Exchanges or their shares are highly undervalued. Therefore, deciding the worth of a PSU is indeed a challenging task.

Another point worth mentioning is that valuation of a PSU is different from establishing the price for which it can be sold. Experts are of the opinion that valuation must be differentiated from price. A purchase and sale would be possible only when two parties form different views as to the value of an asset but are able to reach agreement on the same price. It would be better appreciated by all that the Government can only realise what a buyer is willing to pay for the PSU, as the purchase price ultimately agreed reflects its value to the buyer.

Another notable point is that valuation is a subjective figure arrived at by the bidder by leveraging his strengths with the potential of the company. Depending on the synergy of various bidders with the company and the assumptions of the bidders on potential of the company regarding productivity and capex, this figure may vary from bidder to bidder.

2. Disinvestment Commission's Recommendations

Keeping in view the above problems regarding valuation, specific to a PSU, the issue was discussed in detail by the Disinvestment Commission in its 1st Report. Underlining the importance of valuation, the Commission felt that the valuation of equity of a firm gains importance in case of disinvestment of companies which are not listed or in cases where capital markets may not fully reflect the intrinsic worth of a share disinvested earlier.

Disinvestment Commission while emphasizing that valuation should be independent, transparent and free from bias has recommended three methods of valuation:

 The discounted cash flow relates the value of an asset to the present value of expected future cash flows of the asset.

- The relative valuation is used to estimate the value of an asset by looking at the pricing of comparable assets relative to a common variable like earnings, cash flows, book value or sales.
- 3. The net asset value of the shares is used as a basis for valuation.

Regarding the application of Valuation Methods, Disinvestment Commission felt that the use of a particular method of valuation will depend on the health of the company being evaluated, the nature of industry in which it operates and the company's intrinsic strengths. The depth of capital markets will also have an impact on the valuation. For example, in the United Kingdom, the London Stock Exchange has helped in creating markets by enabling credible price discovery for the shares of privatized companies listed on the exchange. Although valuation methods will indicate a range of valuations, Disinvestment Commission felt that some discounts might need to be applied for arriving at the final value depending on the liquidity of the stock and the extent of disinvestment.

- a) Lack of marketability discount takes into account the degree of marketability (or the lack of it) of the stocks being valued. This is applicable especially to cases, which had been disinvested earlier and have been referred for disinvestment again. Discount on this consideration stems from the fact that investor will probably pay more for a liquid stock than for a less liquid one. However, the concern of overhand of supply may adversely affect valuation even for liquid stocks.
- b) Disinvestment Commission felt that the extent of disinvestment in core, non-strategic & non-core PSUs will have a bearing on the valuation process. The transfer of a controlling block may help to reduce the discount that has to be applied. If all the businesses of a PSU are not equally profitable, it may be necessary to restructure the business before disinvestment. However, if this is not possible, a minority discount may have to be applied.

Disinvestment Commission also sought to correct some erroneous perceptions about valuation. There is a general perception that since valuation models are quantitative, valuation is objective. The Commission felt that though it is true that valuation does make use of quantitative models, yet the inputs leave plenty of room for subjective judgments. At the same time, there may be no such thing as a precise estimate of a value. Even after the end of the most careful and detailed valuation of a company, there could be uncertainty about the final numbers, as they are shaped by assumptions about the future of the company.

Another wrong perception sought to be corrected, by the Commission was the relationship attributed between valuation and market price. The benchmark for most valuations remains the market price (either its own price, if it is listed or that of a comparable company). When the value from a valuation analysis is significantly different from the market price, the two possibilities are that either one of the valuations could be incorrect. The Commission felt that the valuation done before listing takes into account anticipated factors, whereas market price reflects realized events that are influenced by unanticipated factors. However, a specific valuation itself may not be valid over a period of time. It is a function of the competitive position of the company, the nature of market in which it operates and Government policies. Therefore, it may be appropriate to update or revise valuations.

In cases where strategic sale is done with transfer of management control, the Commission felt that asset valuation should also be done. The views of the Commission in this regard are as follows:

"Strategic sale implies sale of a substantial block of Government holdings to a single party which would not only acquire substantial equity holdings of upto 50% but also bring in the necessary technology for making the PSU viable and competitive in the global market. It should be noted that the valuation of the share will depend on the extent of disinvestment and the nature of shareholder interest in the management of the company. Where Government continues to hold 51% or more of the share holding, the valuation will relate mainly to the shares of the companies and not to the assets of the company. On the other hand, where shares are sold through strategic sale and management is transferred to the strategic partner, the valuation of the enterprise would be different, as the strategic partner will have control of the management. In such cases, the valuation of land and other physical assets should also be computed at current market values in order to fix the reserve price for the strategic sale.

To get best value through strategic sales, it would be necessary to have a transparent and competitive procedure and encourage enough competition among viable parties."

3. Valuation Methodologies being followed

Making a valuation requires an examination of several aspects of a company's activities, such as analysing its historical performance, comparisons with the other players in the industry, forecasting performance, estimating the cost of capital, estimating the continuing value, calculating and interpreting results, the regulatory frame work, the global competition, the level of technology and several other environmental factors.

Based on the recommendations of the Disinvestment Commission and in keeping with the best market practices the following four methodologies are being used for valuation of PSUs:-

- a) DCF Method.
- b) Balance Sheet Method.
- c) Transaction Multiple Method.
- d) Asset Valuation Method.

While the first three are business valuation methodologies generally used for valuation of a going concern, the last methodology would be relevant only for valuation of assets in case of liquidation of a company.

A. Discounted Cash Flow (DCF) method

The Discounted Cash Flow (DCF) methodology expresses the present value of a business as a function of its future cash earnings capacity. This methodology works on the premise that the value of a business is measured in terms of future cash flow streams, discounted to the present time at an appropriate discount rate.

The DCF methodology is the most appropriate methodology in the following cases:

- Where the business is being transferred / acquired on a going concern basis:
- Where the business possesses substantial intangibles like brand, goodwill, marketing and distribution network, etc;
- Where the business is not being valued for the substantial undisclosed assets it possesses.

The DCF methodology is considered to be the best methodology for valuation the world over because it takes into account all the factors relevant for valuation:

- It takes care of all the free cash flows available to stakeholders of a firm. The free cash flows are calculated taking into account the average cost of capital, cost of debt, cost of equity and market returns.
- 2. It also takes into account the risk factor to which the enterprise is exposed. The discount rate is based on the risk perception of the business.
- 3. It also takes into account the value of the core assets of the company. Any business has two kinds of assets core assets that are a part of the business and non-core assets that are not directly a part of the business. The asset value of core assets is reflected in the cash flows of the company and therefore should not be added separately to it. However non-core assets are not reflected in the cash flows. Therefore asset valuation of non-core assets should be done separately and should be added to DCF valuation.
- 4. A prudent DCF valuation should also capture the capital costs for renovation and modernization of plant and machinery. The age and condition of assets like plant and machinery and their replacement value would be relevant for estimating expenditure on their replacement whenever necessary. This expenditure will reduce cash flows and DCF value. Valuation of plant and machinery would be a relevant item that would influence the DCF valuation. For example, a person acquiring a company operating a fleet of taxis would examine the conditions of vehicles for valuation of the company. If the vehicles need replacement of a low cost item like hub caps the impact on DCF will be less than if they need to replace gear boxes in a high proportion of vehicles. The person would also calculate DCF with reference to the demand for taxis, the average mileage, cost of maintenance etc. Valuation of plant and machinery is not a simple addition to DCF, but a factor to be taken into account while calculating DCF. In such calculation, plant and machinery may be a net negative factor in the DCF if replacement costs are high. Where surplus land would be sold this would be a positive factor. If the sale of land can cover the cost of plant replacement the net effect would be neutral on DCF.
- 5. For a going Concern, various intangibles like market share, competition, etc have a significant bearing on the valuation of the company. One cannot place a money value for these factors. They have no financial value of their own that can be merely in money terms. Hence, there is no way of evaluating them in any other methodology. DCF is the only methodology, which takes into account these factors by incorporating them in various cash flows. In calculating DCF different assumptions will be made of market share, competition from imports etc, which are translated into financial terms. Sensitivity analysis can also be made for different assumptions. The Financial Advisor and the Seller should exercise the

judgment on the most likely financial values for the market share etc. and also on the discount rate to be applied while arriving at the optimum DCF value.

- 6. In a strategic sale the bidders take into account not only DCF valuation, but also a premium for management control. Premium for management control would be a subjective item for each bidder and will be reflected in the competitive bids. Therefore, this premium need not be incorporated in the valuation amount separately.
- 7. In DCF method, while computing the cash flows, cash out flows for renovation and modernization of plant and machinery need to be discounted for arriving at realistic figures. Since non-core assets are not reflected in the cash flows, the non-core assets need to be separately valued by the Asset Valuation method and added to the valuation figure arrived at by the DCF method.

B. Balance Sheet method

The Balance sheet or the Net Asset Value (NAV) methodology values a business on the basis of the value of its underlying assets. This is relevant where the value of the business is fairly represented by its underlying assets. The NAV method is normally used to determine the minimum price a seller would be willing to accept and, thus serves to establish the floor for the value of the business. This method is pertinent where:

- . The value of intangibles is not significant;
- . The business has been recently set up.

This method takes into account the value of the assets of a business or the net-worth as represented in the financial statements. Hence, this method takes into account the amount that is historically spent and earned from the business. This method does not, however, consider the earnings potential of the assets and is, therefore, seldom used for valuing a going concern. The above method is not considered appropriate, particularly in the following cases:

- When the financial statement sheets do not reflect the true value of assets, being
 either too high on account of possible losses not reflected in the balance sheet or
 too low because of initial losses which may not continue in future:
- Where intangibles such as brand, goodwill, marketing infrastructure, and product development capabilities, etc., form a major part of the value of the company.

C. Transaction Multiple method

This method takes into account the value paid for similar transactions in the industry and benchmarks it against certain parameters, like earnings or sales. Two such parameters are:

- Earnings Before Interest, Taxes, Depreciation & Amortisations (EBITDA)
- Sales

Although the Transaction Multiples method captures most value elements of a business, it does not properly reflect the cash flows generated by a business, or take into account the time value of money. However, it is considered as a useful rule of thumb, in valuing businesses by various valuation experts. Accordingly, one may have to review a series of

comparable transactions to determine a range of appropriate capitalisation factors to value a company as per this methodology.

a) EBITDA multiple

The EBITDA multiple or the earnings method is based on the premise that the value of a business is directly related to the quantum of its profits. The adjusted maintainable profits are capitalised by an appropriate factor ("capitalisation factor") to arrive at the business value. The profits are adjusted to reflect the operating recurring profits of the business on a standalone basis (i.e. after deducting extraordinary or unusual items, or items of a non-recurring nature). As a further refinement, the profits may be adjusted for non-cash items (including depreciation and amortisation) and other factors, such as interest and taxation (which vary from business to business) to derive EBITDA (Earnings Before Interest, Taxation, Depreciation and Amortisations).

The EBITDA multiple method takes into account the value or consideration paid by acquirers of similar businesses, and is computed by dividing the total consideration paid (after adjusting for any debt assumed) by the EBITDA to derive a multiple, which can be applied to the EBITDA figure of the business being valued.

EBITDA multiple = Enterprise Value / EBITDA

zWhere:

Enterprise Value = Market value of Equity + Market value of Debt EBITDA = Earnings Before Interest, Tax, Depreciation and Amortization

b) Sales multiple

The sales multiple technique is based on a similar analysis of relevant acquisitions and is the ratio of Enterprise Value to the current sales. It is calculated as follows:

Sales multiple = Enterprises Value / Net sales of the current year

The Transaction Multiple methodology suffers from the following drawbacks:

- Actual monies required to earn the maintainable profits / sales of the business as a going concern (for instance, future capital expenditure) are not reflected.
- This methodology does not take into account the time value of money.

Notwithstanding these limitations, these multiples are widely used by investors to arrive at benchmark values for a company.

D. Asset Valuation Methodology

The asset valuation methodology essentially estimates the cost of replicating the tangible assets of the business. The replacement cost takes into account the market value of various assets or the expenditure required to create the infrastructure exactly similar to that of a company being valued. Since the replacement methodology assumes the value of

business as if we were setting a new business, this methodology may not be relevant in a going concern. Instead it will be more realistic if asset valuation is done on the basis of the new book value of the assets. The asset valuation is a good indicator of the entry barrier that exists in a business. Alternatively, this methodology can also assume the amount which can be realized by liquidating the business by selling off all the tangible assets of a company and paying off the liabilities.

The asset valuation methodology is useful in case of liquidation/closure of the business.

In a strategic sale process, the proposal is normally to transfer management control of an on going concern to a strategic partner and restrictions are imposed on the SP. The land and property of the business cannot be sold or put to alternate use by the strategic partner. Moreover, its value is already reflected in the cash flows from the business, which are valued in other methodologies of valuation. Therefore, asset valuation method is not the correct reflection of the value of the enterprise. However, it has been used so far in the valuation of CPSUs under disinvestment because the Disinvestment Commission had recommended that this method should also be followed for valuation in the case of strategic sale.

The asset valuation methodology also fails to factor in some important aspects for a running business such as the following and is normally not favoured for pricing equity:

- Value of intangibles like brands, goodwill, marketing, distribution, development and research capabilities, etc.;
- Profit or cash generating ability of a business;
- Opportunity loss during the period before a business is fully operational.

The asset valuation methodology is particularly questionable in the following circumstances:

- Where it is impossible to replicate a business intended to be transferred on account of a complete change in technology;
- Where a business was set up several years before its competitors and has a real cost advantage reflected in a higher return on invested capital;
- Where a business set-up several years ago had witnessed a significant appreciation in the value of real estate, which is not reflected in the earnings capacity of a business.

The Asset Valuation would be more realistic, if we compute the value of only the realizable amount, after discounting the non-realizable portions. The realizable market value of all real estate assets, either owned by the company as freehold properties or on a lease/rental basis may be determined, assuming a non-distress sale scenario. The value would be assessed after taking into account any defects/restrictions/encumbrances on the use/lease/sublease/sale etc. of the properties or in the title deeds etc.

Since Assest Valuation normally reflects the amount which may need to be spent to create a similar infrastructure as that of a business to be valued or the value which may be realized by liquidation of a company through the sale of all its tangible assets and repayment of all liabilities, adiustments for an assumed capital gains tax consequent to the (hypothetical) outright sale of these assets as also adjustments to reflect realization of working capital, settlement of all liabilities including VRS to all the employees will have to be made.

CHAPTER - 19

EMPLOYEES' ISSUES

A general fear among the employees at the time of disinvestment is that they may be retrenched or their pay scales and services conditions may be adversely affected. Global experience shows that if the privatised companies grow rapidly, labour re-structuring may not be required. A number of protections are available to the employees under various labour laws. These labour laws are applicable to the company irrespective of whether it is in the Public Sector or in the Private Sector. Besides this, employee protection can be ensured by incorporating suitable clauses in the Shareholders' Agreement.

Applicability of Industrial Disputes Act 1947

The provisions of Industrial Disputes Act, 1947 are applicable to the company even after disinvestment. Under the Industrial Disputes Act, "Industrial establishment or undertaking" has been defined under Section 2(Ka). The Section reads as follows:

2(Ka) "Industrial establishment or undertaking" means an establishment or undertaking in which any industry is carried on:

Provided that where several activities are carried on in an establishment or undertaking and only one or some of such activities is or are an industry or industries, then, -

- if any unit of such establishment or undertaking carrying on any activity, being an industry, is severable from the other unit or units of such establishment or undertaking such, unit shall be deemed to be a separate industrial establishment or undertaking;
- (b) if the predominant activity or each of the predominant activity carried on in such establishment or undertaking or any unit thereof is an industry and the other activity or each of the other activities carried on in such establishment or undertaking or unit thereof is not severable from and is, for the purpose of carrying on, or aiding the carrying on of, such predominant activity or activities, the entire establishment or undertaking or, as the case may be, unit thereof shall be deemed to be an industrial establishment or undertaking.

In view of the above definition the company will remain an industrial establishment even after the disinvestment and all the provisions of Industrial Disputes Act will automatically apply to the company. The trade unions may be having an apprehension that workers of a PSU enjoy more protection under the law of the land than those in the private sector. As a matter of fact, so long a venture is "industrial establishment", the provisions of Industrial Disputes Act are applicable to that venture, irrespective of it being in public sector or private sector.

Provisions governing service conditions

The companies normally have "Certified Standing Orders" for their workmen. The Standing Orders have been certified under the Industrial Employment (Standing Orders) Act, 1946. The service conditions of the workmen of the company are normally governed by the said "Certified Standing Orders". If, after disinvestment, the prospective buyer proposes to make any change in the service conditions applicable to the workmen, he has to give a notice in the prescribed manner under Section 9-A of the Industrial Disputes Act. Section 9-A of the Industrial Disputes Act reads as follow:

SECTION 9-A

NOTICE OF CHANGE

No employer, who proposes to affect any change in the conditions of service applicable to any workman in respect of any matter specified in the Fourth Schedule, shall affect such change-

- (a) without giving to the workmen likely to be affected by such change a notice in the prescribed manner of the nature of change proposed to be affected; or
- (b) within twenty-one days of giving such notice

Provided that no notice shall be required for affecting any such change-

- (a) where the change is affected in pursuance of any settlement or award; or
- (b) where the workmen likely to be affected by the change are persons to whom the Fundamental and supplementary Rules, Civil Services (Classification, Control and Appeal) Rules, Civil Service (Temporary Service) Rules, Revised Leave Rules, Civil Service Regulations, Civilians in Defence Services (Classification, Control and Appeal) Rules, or the Indian Railway Establishment Code or any other rules or regulations that may be notified in this behalf by the appropriate Government in the official Gazette, apply.

The Fourth Schedule as mentioned in the above definition is being reproduced below:-

THE FOURTH SCHEDULE (See Section 9-A)

CONDITION OF SERVICE FOR CHANGE OF WHICH NOTICE IS GIVEN

- Wages, including the period and mode of payment;
- Contribution paid, or payable, by the employer to any provident fund or pension fund or for the benefit of the workmen under any law for the time being in force;
- Compensatory and other allowance;

- Hours of work and rest intervals;
- Leave with wages and holidays;
- 6. Starting, alteration or discontinuance of shift working otherwise than in accordance with standing orders;
- Classification by grades;
- 8. Withdrawal of any customary concession or privilege or change in usage:
- 9. Introduction of new rules of discipline, or alteration in existing rules, except in so far as they are provided in standing orders;
- **10.** Rationalization, standardisation or improvement of plant or technique, which is likely to lead to retrenchment of workmen;
- 11. Any increase or reduction (other than casual) in the number of persons employed or to be employed in any occupation or processes or department of shift (not occasioned by circumstances over which the employer has no control).

Thus under the provisions of Industrial Disputes Act, 1947, read with the provisions of Industrial Employment (Standing Orders) Act, 1946, any change in the service conditions of the workmen will be governed by the provisions of the law of the land as applicable in the company prior to the disinvestment. It is not to say that Certified Standing Orders cannot be changed even prior to the disinvestment by the company management. But as law prescribes, a notice has to be given by the management to the workmen which does not necessarily mean that just by giving a notice, service conditions may be changed in a manner detrimental to the interest of the workers. If the workers find that notice envisages change in working conditions detrimental to their interests, they can immediately raise an "Industrial Dispute" before the Appropriate Authorities defined under the Act. The "Industrial Dispute" has been defined under Section 2K of the Industrial Disputes Act, which reads as follows:

"Industrial Dispute" means any dispute or difference between employers and employees, or between employers and workmen, or between workmen and workmen, which is connected with the employment or non-employment or the terms of employment or with the conditions of labour of any person;"

Chapter II of the Industrial Disputes Act deals with Authorities under the act and subsequent chapters lay down procedures etc. with regard to the redressal of Industrial Disputes. Hence, under the existing provisions of Industrial Disputes Act, 1947, the interests of the workmen will remain protected as much as these are protected now under the present dispensation.

In an organised sector, the issues of job security, wage structure, perks, welfare facilities, etc. of the workers are governed by bipartite/tripartite agreements. These agreements are in the nature of "settlement" as defined under Section 2p and as protected under various provisions of the act. Even after the disinvestment, the company management will be required to enter into bipartite/tripartite agreements with the workmen through Unions, and

the terms and conditions in the agreement would be always governed by the practices and procedures applicable under collective bargaining. It is a fact that any agreement between two or more parties is based on the principles of mutual consent. Hence, the consent of the management to better service conditions, etc. would certainly depend on the achievement of the productivity and production targets by the workers from time to time.

Protection against arbitrary/closure of an undertaking

Regarding protection against arbitrary closure of any establishment of the Company, it is to be noted that the "Closure" of an Industrial Establishment is governed by Section 25(O) of the Industrial Dispute Act. Section 25(O) reads as follows;

(1) An employer who intends to close down an undertaking of an industrial establishment to which this chapter applies shall, in the prescribed manner, apply, for prior permission at least ninety days before the date on which the intended closure is to become effective, to the appropriate Government, stating clearly the reasons for the intended closure of the undertaking and a copy of such application shall also be served simultaneously on the representatives of the workmen in the prescribed manner:

Provided that nothing in this sub-section shall apply to an undertaking set up for the construction of buildings, bridges, roads, canals, dams or for other construction work.

- (2) Where an application for permission has been made under sub-section (1), the appropriate Government, after making such enquiry as it things fit and after giving a reasonable opportunity of being heard to the employer, the workmen and the person interested in such closure may, having regard to the genuineness' and adequacy of the reasons stated by the employer, the interests of the general public and all other relevant factors, by order and for reasons to be recorded in writing, grant or refuse to grant such permission and a copy of such other order shall be communicated to the employer and the workmen.
- (3) Where an application has been made under sub-section (1) and the appropriate Government does not communicate the order granting or refusing to grant permission to the employer within a period of sixty days from the date on which such application is made, the permission applied for, shall be deemed to have been granted on the expiration of the said period of sixty days.
- (4) An order of the appropriate Government granting or refusing to grant permission shall, subject to the provision of sub-section (5), be final and binding on all the parties and shall remain in force for one year from the date of such order.
- (5) The appropriate Government may, either on its own motion or on the application made by the employer, or any workman, review its order granting or refusing to grant permission under sub-section (2) or refer the matter to a Tribunal for adjudication:

Provided that where a reference has been made to a Tribunal under this sub-section, it shall pass an award within a period of thirty days from the date of such reference.

- (6) Where no application for permission under sub-section(1) is made within a period specified therein, or where the permission for closure has been refused, the closure of the undertaking shall be deemed to be illegal from the date of closure and the workmen shall be entitled to all the benefits under any law for the time being in force as if the undertaking had not been closed down.
- (7) Notwithstanding anything contained in the foregoing provisions of this section, the appropriate Government may, if it is satisfied that owing to such exceptional circumstances as accident in the undertaking or death of the employer or the like, it is necessary so to do, by order, direct that the provisions of sub-section (1) shall not apply in relation to such undertaking for such period as may be specified in the order.
- (8) Where an undertaking is permitted to be closed down under sub-section(2) or where permission for closure is deemed to be granted under sub-section(3) every workman who is employed in that undertaking immediately before the date of application for permission under this section, shall be entitled to receive compensation which shall be equivalent to fifteen days' average pay for every completed year of continuous service or any part thereof in excess of six months.

From the above definition it is clear that the company management before or after disinvestment is not free to close down any part of the company at their sweet will. The closure is governed by the law of land and so for the existing provisions of Industrial Disputes Act are concerned, "genuineness and adequacy of the reasons stated by the employer" and "the interests of the general public and all other relevant factors", have to be examined by the appropriate Government and, for doing that the Government has to give a reasonable opportunity of hearing to the employer and workmen and the persons interested in such closure. It means that unless and until the appropriate Government grants permission, the company management will not be competent to close down any undertaking of the company even after disinvestment. So there are protections available under the Act against arbitrary closure of any undertaking of the company after disinvestment.

At times, some trade unions demand assurances regarding peripheral development after the disinvestment of the company, which are being enjoyed by the villages adjoining the plant. Contract labourers also demand regularization of their jobs before the disinvestment. Under the law, no employer can be forced to make investment in the peripheral development. However, as a prudent management practice, bigger companies invest substantially in the development of the areas around them. It is expected that the successor management will consider this issue favourably. So far the regularization of contract labour is concerned, PSU or no PSU, an industrial undertaking in this regard is governed by the provisions of Contract Labour (Regulation and Prohibition) Act, 1970 and Rules made thereunder. Hence, the contract labourers and unions representing their interest may take recourse to the said Act and Rules after the disinvestment and may pursue the matter in furtherance of their demands.

Regarding functional Directors, provisions are made in the Share Purchase Agreement that they shall be deemed to be nominees of the buyer. However, the buyer has been given an option to remove them. But, in that case, they may be given a notice of six months or pay in lieu thereof. The Government of India may also take steps to relocate them in case of

Strategic Partner not retaining them. In any case, functional Directors are contractual appointees and after termination of the contract, they are entitled to terminal benefits, leave encashment, gratuity etc. as per the rules of the company.

Provisions in the Shareholders' Agreement

Shareholders' Agreement generally incorporates the concerns of the Government regarding employee protection. Normally, the following clauses are kept in the Shareholders' Agreement:

- 1. The parties envision that all employees of the company on the date hereof shall continue in the employment of the company. (If there are surpluses, the Government tries to give VRS/VSS before disinvestment).
- The Company shall not retrench any part of its labour force for a stipulated period from the closing date other than any dismissal or termination of employees of the Company from their employment in accordance with the applicable staff regulations and standing orders of the Company or applicable Law.
- 3. Typically the agreements include a recital stating that the strategic partner recognizes that the Government in relation to its employment policies follows certain principles for the benefit of the members of the Scheduled Caste/Scheduled Tribes, Physically Handicapped persons and other socially disadvantaged sections of the society and that the strategic partner shall use its best efforts to cause the company to provide adequate job opportunities for such persons. Further, in the event of any reduction in the strength of the employees of the company, the strategic partner shall use its efforts to ensure that the physically handicapped persons are retrenched at the end.
- 4. Subject to the above Clauses, any restructuring of the labour force of the Company shall be implemented in the manner recommended by the Board and in accordance with all applicable laws. The strategic partner in the event of any reduction of the strength of its employees shall, ensure that the Company offers its employees an option to voluntarily retire on terms that are to, in any manner, less favourable than the voluntary retirement scheme offered by the Company on the date of the agreement.

CHAPTER 20

FOREIGN DIRECT INVESTMENT CAPS

FDI Caps for disinvestment, unless other wise indicated, would be the same as for investment in the sector. Currently, the investment guidelines in different sector are indicated below:

		Guidelines
i.	Banking	NRI 40%. Foreign investment of up to 20% by banking companies or finance companies including multilateral financial institutions.
	Non Banking Financial Companies (NBFC)	NRI holding upto 40%. Foreign investment of upto 20% by foreign banking companies or finance companies including multilateral financial institutions.
		The automatic route is not available.
		b. Minimum Capitalisation Norms for fund based NBFCs:
		For FDI upto 51% - US\$ 0.5 million to be brought upfront
	:	For FDI above 51% and upto 75% - US \$ 5 million to be brought upfront
		For FDI above 75% and upto 100% - US \$ 50 million out of which US \$ 7.5 million to be brought upfront and the balance in 24 months
		100% NBFC Holding Company with a minimum capital of US \$ 50 million allowed to set up a 100% downstream subsidiary to undertake specific NBFC activities. Such a subsidiary required to dis-invest its equity to the minimum extent of 25%, through a public offering only, within a period of 3 years.
		c. Minimum capitalisation norms for non-fund based activities: Minimum capitalisation norm of US \$ 0.5 million is applicable in respect of all permitted non-fund based NBFCs with foreign investment. The automatic route is not available.

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2.	Civil Aviation (detailed guidelines have	(detailed guidelines have been issued by Ministry of Civil Aviation) In the domestic Airlines sector:
	been issued by Ministry of Civil Aviation)	i. FDI upto 40% permitted subject to no direct or indirect equity participation by foreign airlines is allowed.
		ii. 100% investment by NRIs/OCBs.
		iii. The automatic route is not available.
3.	Telecommunication	i. In basic, Cellular Mobile, paging and Value Added service, Global Mobile Personal Communications by Satellite and Internet Service Provider (ISP), FDI is limited to 49% subject to grant of licence from Department of Telecommunications and adherence by the companies to the licence conditions for foreign equity cap and lock in period for transfer and addition of equity and other licence provisions.
		ii. No equity cap is applicable to manufacturing activities.
4.	Petroleum(other than Refining)	a. Under the exploration policy, FDI utpo 100% is allowed for small fields through competitive bidding; upto 60% for unincorporated JV; and upto 51% for incorporated JV with a No Objection Certificate for medium size fields.
	·	b. For petroleum products and pipeline sector, FDI is permitted upto 51%.
		c. FDI is permitted upto 74% in infrastructure related to marketing and marketing of petroleum products.
		d. 100% who'lly owned subsidiary(WOS) is permitted for the purpose of market study and formulation.
		e. 100% wholly owned subsidiary is permitted for investment/Financing.
		f. For actual trading and marketing, minimum 26% Indian equity is required over 5 years.
	Petroleum (Refining)	a. FDI is permitted upto 26% in case of Public Sector Units. PSUs will hold 26% and balance 48% by public. Automatic route is not available.
		b. In case of private Indian companies, FDI is permitted upto 100% under automatic route.
5.	Housing & Real Estate	No foreign investment is permitted in this sector. NRIs/OCBs are allowed to invest.

6.	Coal and Lignite	 i. Private Indian companies setting up or operating power projects as well as coal or lignite mines for captive consumption are allowed FDI upto 100%. ii. 100% FDI is allowed for setting up coal processing plants subject to the condition that the company shall not do coal mining and shall not sell washed coal or sized coal from its coal processing plants in the open market and shall supply the washed or sized coal to those parties who are supplying raw coal to coal processing plants for washing or sizing. iii. FDI upto 74% is allowed for exploration or mining of coal or lignite for captive consumption. iv. In all the above cases, FDI is allowed upto 50% under the automatic route subject to the condition that such investment
7.	Venture Capital Fund(VCF) and Venture Capital Company(VCC)	shall not exceed 49% of the equity of a PSU. An offshore venture capital company may contribute upto 100% of the capital of a domestic venture capital fund and may also set up a domestic asset management company to manage the fund. VCFs and VCCs are permitted upto 40% of the paid up corpus of the domestic unlisted companies. This ceiling would be subject to relevant equity investment limit in force in relation to areas reserved for SSI. Investment in a single company by a VCF/VCC shall not exceed 5% of the paid-up corpus of a domestic VCF/VCC. The automatic route is not available.

8	Trading	Trading is permitted under automatic route with FDI upto 51% provided it is primarily export activities, and the undertaking is an export house/trading house/super trading house/star trading house. However, under the FIPB route:- i. 100% FDI is permitted in case of trading companies for the following activities: • exports; • bulk imports with export/exbonded warehouse sales; • cash and carry wholesale trading; • other import of goods or services provided at least 75% is for procurement and sale of goods and services among the companies of the same group and for third party use or onward transfer/distribution/sales. ii. FDI upto 100% permitted for E-commerce activities subject to the condition that such companies would divest 26% of their equity in favour of the Indian public in five years, if these companies are listed in other parts of the world. Such companies would engage only in business to business (B2B) e-commerce and not in retail trading.
	companies in infrastructure/service sector	Infrastructure/service sector direct investment upto sector cap. Investing company will not set off against this cap. The automatic route is not available.
10.	Atomic energy	FDI/NRI/OCB investments through FIPB (as per detailed guidelines issued by Department of Atomic Energy vide Resolution No.8/1(1)/97-PSU/1422 dated 6.10.98) allowed in: a. Mining and mineral separation b. Value addition per se to the products of (a) above c. Integrated activities (comprising of both (a) and (b) above. The following FDI participation is permitted: i. Upto 74% in both pure value addition and integrated projects. ii. For pure value addition projects as well as integrated projects with value addition upto any intermediate stage, FDI is permitted upto 74% through joint venture companies with Central/State PSUs in which equity holding of at least one PSU is not less than 26%. iii. In exceptional cases, FDI beyond 74% will be permitted

		subject to clearance of the Atomic Energy Commission before
		FIPB approval.
11.		No FDI/NRI/OCB investment is permitted
		- Defence and strategic industries
		- Agriculture (including plantation
		- Print Media
		- Broadcasting
12.	Power	Upto 100% FDI allowed
13.	Drugs & Pharmaceuticals	 FDI upto 74% in bulk drugs, their intermediates and formulations (except those produced by the use of recombinant DNA technology) would be under automatic route.
		ii. FDI above 74% for manufacture of bulk drugs on case to case basis.
14.	Roads & Highways, Ports and Harbours.	FDI upto 100% under automatic route.
15.	Hotels & Tourism	100% FDI is permissible in the sector.
		Automatic route is available upto 51% subject to:
		foreign technology agreements covers
		 upto 3% of the capital cost of the project is proposed to be paid for technical and consultancy services including fees for architects, design, supervision, etc.
		ii upto 3% of net turnover is payable for franchising and marketing/publicity support fee, and
		iii upto 10% of gross operating profit is payable for4management fee, including incentive fee.

16.	Mining.	 i. "For exploration and mining of diamonds and precious stones FDI is allowed upto 74% under automatic route. ii. For exploration and mining of gold and silver and minerals other than diamonds and precious stones, metallurgy and processing FDI is allowed upto 100% under automatic route. iii. Press Note No. 18 (1998 series) dated 14.12.98 would not be applicable for setting up 100% owned subsidiaries in so far as the mining sector is concerned, subject to a declaration from the applicant that he has no existing joint venture for the same area and / or the particular mineral.
17.	Postal services	Couriers carrying packages, parcels and other items which do not come within the ambit of Indian Post Office Act 1998 shall not be permitted.
18.	Pollution Control and management	FDI upto 100% in both manufacture of pollution control equipment and consultancy for integration of pollution control systems is permitted under automatic route.
19.	Advertising and Films	 Upto 74% FDI in advertising sector Upto 100% FDI in film industry (i.e. film financing, production, distribution, exhibition, marketing and associated activities relating to film industry) subject to the following: Companies with an established track record in films, TV, music, finance and insurance would be permitted. The company should have a minimum paid up capital of US \$ 10 million if it is the single largest equity shareholder and at least US \$ 5 million in other cases. Minimum level of foreign equity investment would be US \$ 2.5 million for the single largest equity shareholder and US \$ 1 million in other cases. Debt equity ratio of not more than 1:1, i.e., domestic borrowings shall not exceed equity.

CHAPTER 21

THE WORLD BANK'S PRIVATIZATION GUIDELINES

In Privatisation: The lesson of Experience the authors Sunita Kikeri, John Nellis & Mary Shirley, officials of the World Bank, make the point that governments intent on privatising face a challenge: the benefits of efficiency and innovation only materialize if privatisation is done correctly. The following checklist provides some basic guidelings.

- The more market-friendly a country's policy framework and appropriate
 policy is corrected with capacity to regulate- the less difficulty it will have in
 privatising on Sate Owned Enterprises (SOE), and the higher the likelihood
 that the sale will turn out positively.
- SOEs functioning in competitive markets, or in markets, or in markets easily
 made competitive, are prime candidates for privatisation. Their sale is simple
 compared with that of public monopolies, and they require little or no
 regulation.
- An appropriate regulatory framework must be in place before monopolies are privatised. Failure to regulate properly can hurt consumers and reduce public support for privatisation.
- Countries can benefit from privatising management through management contracts, leases, contracting out, or concessions.
- The primary objective of privatisation should be to increase efficiency not to maximize revenue (for example, by selling into protected markets) or even to distribute ownership widely at the expense of managerial efficiency.
- Rather than restrict the market by excluding foreign investors and favouring certain ethnic groups, governments should experiment with "golden shares" (devices that prevent complete takeover by non-government interests without retaining management control by government) and partial share offerings. These could help to win acceptance for foreign and other buyers.
- Avoid large new investments in privatisation candidates; the risks usually outweigh the rewards. Rather prepare for sale by carrying our legal, managerial and organisational changes.
- Experiences shows that labour does not, and need not, lose in privatisation, if governments pay attention to easing the social cost of unemployment

through adequate severance pay, unemployment benefits, retraining and job search assistance.

- Ideally, let the market set the price, and sell for cash. Realistically, though, negotiated settlements and financing arrangements or debt-equity swaps may be unavoidable.
- In all privatisations, in all countries, the transaction must be transparent.