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THE LIMITS TO INDIA'S PRIVATIZATION PUSH

Relevant for: Indian Economy | Topic: Effects of Liberalization on the economy, changes in industrial policy and their effects on industrial growth incl. Economic Reforms

About 10 days after the central government iterated on the floor of Parliament its resolve to privatize businesses owned by it on a scale and sweep never done before, Anil Agarwal announced his Vedanta Group would set up a $10 billion fund to invest in them. Another week later, the mining and metals major was placing full-page ads in papers that, while promoting itself, alluded to themes dear to this government—nation building, economic self-sufficiency and value creation.

The association between Anil Agarwal and disinvestment runs long. In the early part of this century, Agarwal did with Bharat Aluminium Company (Balco) and Hindustan Zinc what he would like to do an encore of now: buy a government asset, with all its complexities, and create value for all stakeholders. In oil major Bharat Petroleum (BPCL), Vedanta is among the three preliminary bidders.

Going by this government's words, BPCL is the start of a long process that will alter the philosophy and landscape of government companies. On Wednesday, Prime Minister Narendra Modi outlined the government's thinking. "The government has no business to remain in business," he said. Under an umbrella entity called the National Asset Monetisation Pipeline, the government is looking to sell about 100 "underutilized and unutilized assets" and raise 2.5 trillion.

While this is a broader, longer-term exercise, Budget 2021 has set the disinvestment target for 2021-22 at 1.75 trillion. The plan is to sell majority stakes in select companies and two of its 12 banks, and a minority stake in the Life Insurance Corporation (LIC). However, getting buyers to joust for these assets and pay top bucks isn't that straight-forward.

Tucked away in the government's grand design are three hard truths, show data on businesses owned by the government. One, the realizable potential of disinvestment—crucial to the government from the perspective of revenues—is significant, but comes with limits. Two, the value offered by government companies is concentrated in about one-third of the 290-odd businesses, perhaps even less. Three, there are only a handful of sectors where a disproportionate market share and the nature of business gives government companies a case to command a premium over market prices.

The backdrop

It is valuable to understand the larger context of disinvestment policies pursued by various regimes since 1991. Businesses owned and operated by central governments are referred to as central public sector enterprises (CPSEs). Then, in the financial sector, there are public sector banks and insurance companies.

As part of the larger economic liberalization policy changes which were adopted in 1991, the number of industries reserved for the public sector was reduced to 8 in 1991, 6 in 1993 and 4 in 1998-99.

Further, a dilution of the Centre's equity was sanctioned in select CPSEs: up to 49% in sectors reserved for the public sector, and up to 74% or 100% in other sectors. The Congress-led government at the time started offloading small stakes in CPSEs, primarily with the objectives of

listing them on the stock market and monetizing value that was politically palatable.

In 1998-99, during the first tenure of the BJP-led National Democratic Alliance (NDA), the Budget announced that government shareholding would be reduced to 26% in the “generality of the cases". Further, it initiated a policy of strategic sale—selling a large chunk of equity along with management control.

Between 1999-2000 and 2003-04, the government made strategic sales in several businesses. This included Balco and Hindustan Zinc in metals and mining to the Anil Agarwal Group, IPCL in petrochemicals to the Reliance Group, and VSNL in telecom and CMC in information technology to the Tatas. This was the last time any central government truly pursued a policy of privatization—till now.

In 2004, disinvestment ground to a halt due to the UPA-I’s common minimum programme with its Left allies. It was revived in 2009, with a new disinvestment policy that allowed minority stake sale (up to 51%, with the government retaining management control). When the NDA returned in 2014, another shift in policy followed: sale of majority stakes in CPSEs not of strategic interest.

However, this stake wasn’t sold to private players, but to other CPSEs. So, for instance, ONGC bought the government’s stake in HPCL, for 36,915 crore. The Centre met its short-term objective of raising funds for itself. However, it was debatable if this strategy contributed to the larger objective of fully unshackling these CPSEs as businesses and unlocking value.

Given this backdrop, the NDA-II’s disinvestment policy that is being enunciated now represents a paradigm shift. The government gave an “in-principle" agreement for disinvestment in 34 CPSEs, and minority stake sales in several others. It set an ambitious divestment target of 2.1 trillion for 2020-21, but in the backdrop of the covid-19, raised only 18,534 crore, or about 8.8% of the target amount.

The announcements in the latest Budget, while not fully new, are therefore crucial. The new strategic sector policy entails the government retain at least one CPSE in four sectors: atomic energy, space and defence; transport and telecommunications; power, petroleum, coal and other minerals; and banking, insurance and financial services. In non-strategic sectors, all CPSEs will be privatized or merged or closed.

The market value

The government’s portfolio contains 274 CPSEs, plus 12 public sector banks and seven insurance companies (LIC in life insurance and 6 others in general insurance). A good starting point to estimate how much the government can realize from the disinvestment of CPSEs is the market valuation of 54 CPSEs listed on stock exchanges.

As on 20 February, the government’s stake in these 54 CPSEs was valued at about 7.3 trillion, according to the Department of Investment and Public Asset Management, which manages the disinvestment process.

These 54 listed CPSEs represent the cream. In 2018-19, they accounted for 80% of turnover and 92% of net profit of all CPSEs, according to data from the Department of Public Enterprises. If the Centre makes strategic sales in all these listed CPSEs and pares its holding to 26%, it will realize 2.6 trillion at current prices (or a little over the target for this year alone). In other words, there are limits to the revenues from disinvestment.

A majority stake sale in BPCL and Air India are first up. Further, an initial public offering (IPO) is

proposed for LIC, and two public sector banks are to be privatized. The current market value of the government's 53% holding in BPCL is 45,000 crore. Further, a 10% IPO of LIC is reportedly estimated at between 80,000- 110,000 crore.

It is farfetched to extrapolate that such sums would also be realized for other entities. As one goes down the list of CPSEs, business performance dips. Of the 274 CPSEs, 178 reported a net profit in 2018-19. Of this, 32 reported a net profit above 1,000 crore.

A majority of revenues and profits are generated by a small set of CPSEs, which embody the most value. The top 10 CPSEs, ranked by turnover, account for around 73% of the total turnover of CPSEs and 54% of the total net profit (see Chart 1). Seven of these 10 companies are in the oil and gas sector, which is battling economic headwinds in the short term and a shift to renewable energy in the long term.

Beyond the CPSEs, there's the set of 12 public sector banks. Over the past decade, they have been mired by bad loans and a capital crunch. As of 20 February, their cumulative market worth was around 5.9 trillion.

The government's shareholding in them ranges from 58% to 96%. Back in the mid-2020, the central bank had suggested the government trim its holding to 51%, as a precursor to their eventual sale. At current rates, a dilution to 51% would fetch it 1.02 trillion (see Chart 3).

Strategic premium?

Be it CPSEs or banks, the government is hoping to price a premium for their size and assets, and the value that a private buyer can unlock by making operations more efficient. ONGC paid a 15% premium for HPCL over market price. HPCL was one of the better government assets and this was a sale where the government was both the parties. When the counterparty is the private sector, premiums get harder unless an asset is valuable or strategic.

CPSEs have been dominant in certain crucial sectors of the Indian economy such as oil and gas and mining, and it is from the disinvestment of companies in these sectors that the government is likely to realize maximum revenues. Access to strategic assets such as mines and oilfields is a likely draw for potential buyers.

However, even in these sectors, the clout of CPSEs has decreased in the past decade. For instance, in 2008-09, CPSEs accounted for about 75% of net sales in the oil and gas sector. This share had fallen to 67% in 2018-19. A similar decline in observed in fertilizers and mining sectors, where CPSEs have been important historically. The most dramatic fall is seen in the telecom sector, where the capitulation of BSNL and the rise of private players has led to the revenue share of CPSEs dropping from 26% to 8% over the past decade (see Chart 2).

Even as it articulates a significant shift in its disinvestment policy, and sets ambitious targets, the government will face these variables in its revenue maximization efforts. How it manages the sale of BPCL and the IPO of LIC this fiscal, and how much it realizes, will lay down a significant marker for the new disinvestment regime.

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