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Closure of Central Public Sector Enterprises in India: a case study

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Abstract

Changing objective circumstances over time often warrant the closure of public sector enterprises that may have originally been established due to compelling public purposes. Many public enterprises lose their relevance and public purpose, become chronically loss making and are a recurring drain on public resources. Yet it has been found to be extremely difficult to actually close down any such enterprise due to a host of institutional constraints unique to the public sector. Closing down a public enterprise is difficult but not impossible, given the will and sincere execution. It has been done in India. While the practicalities have to be worked out, closure of any entity needs to be implemented sensitively given the human dimensions involved. This paper brings out a case study of the experience in implementing the closure of five public sector enterprises in India during the period 2014-16.

KEYWORDS: Public Sector; State Owned Enterprise; Public Enterprise Governance; CPSE

Introduction

The first Central Public Sector Enterprises (CPSEs) in India were set up shortly after India attained its independence in 1947. The first was the Indian Telephone Industries established as a departmental factory in 1948 and incorporated as a public company in 1950 (Gupta, 1994, p. 168). The country had emerged from an impoverishing colonial rule, and was an underdeveloped, largely agrarian economy. Rapid economic development was seen as a national imperative to improve the living standard of the people. This was sought to be achieved through central economic planning and a policy emphasising industrialisation and import substitution (Weisskope, 1967; Krueger, 1975).

However, there was limited capital available and hardly any capacity in the private sector to establish new industry. In the absence of private sector capacity at the time, it was felt that the industrialisation would have to be led by the establishment of public sector enterprises. The concept of "commanding heights" of the economy came into vogue at the time to describe the role of these enterprises (Tharoor, 2011). CPSEs were intended to build the industrial base, which in turn would spark growth in the economy. At the same time, CPSEs were also expected to bring about regional balance by being located in the backward regions of the country, generate employment and contribute to public welfare.

The CPSE focus was further sharpened with the theoretical foundation of the Mahalanobis Model propounded in the Second Five Year Plan (Mahalanobis, 1953). This prioritised investment in capital goods, or the machines that make machines. Production of capital goods would enable the buildup of domestic capacity for manufacturing, and eventually for consumer goods. This strategy was expected to accelerate the pace of industrialisation and speed up economic growth. Consequently, a number of CPSEs in the areas of heavy industry and engineering goods came up. Public sector industrial development in this phase was in areas like mining, metals, steel, energy, telecom. The number of CPSEs kept growing over the decades, expanding into new areas. The trend of expansion continued partly due to waves of nationalisation. Industries like coal and banking were fully nationalised. Other major areas in which CPSEs established a strong presence included oil, power, aviation, shipping, textiles, tourism, civil construction and trading.

From a modest beginning of just five enterprises in 1951, there were as many as 366 CPSEs in existence in 2020. The number of CPSEs in existence in recent years is given in Figure 1. 171 of these CPSEs are profitable, while 84 were loss making. The total losses of these loss-making CPSEs were Rs. 448 billion - approximately US $ 6 billion at current exchange rates (GOI, 2021). While most of the profit making CPSEs continue to be relevant in the current context and contribute to the public exchequer, many others became less relevant over time. Over time many of the CPSEs have achieved the purpose for which they were set up and have sparked industrial development in their area of operation. A strong industrial base has been created, as envisaged by the decision-makers in the 1950s. A vibrant private sector has come up in the same areas of operation as the initial CPSEs, albeit with more modern technology and higher levels of efficiency.

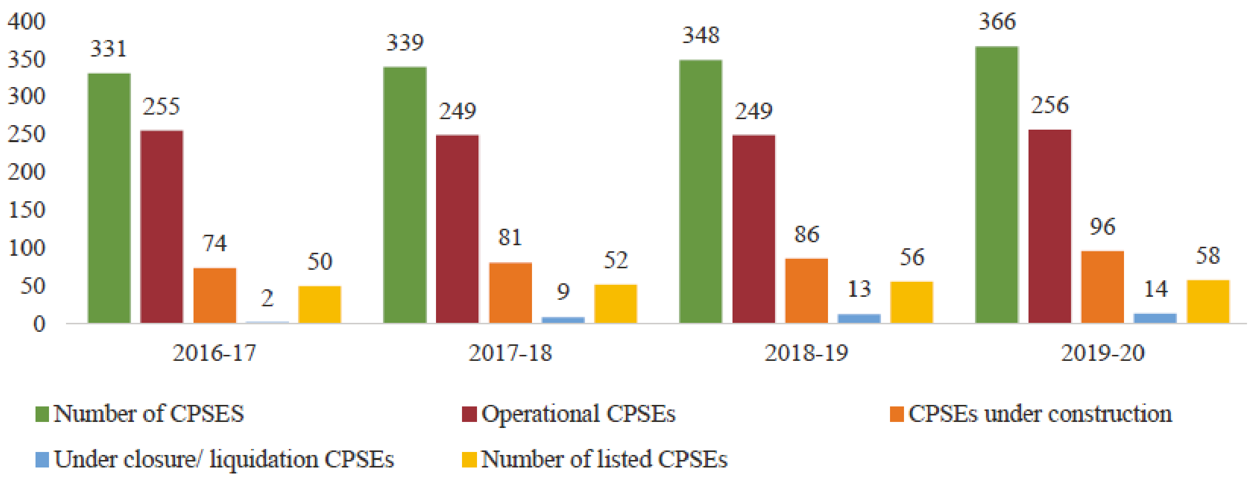

Figure 1. Number of CPSEs
Source: GOI (2021)

Consequently, many of the CPSEs outlived their utility. They started making losses. Some became totally unviable and ceased production. However, the socialistic oriented and pro-public sector policy mindset prevailing did not encourage closure and/or disinvestment of these enterprises. Instead, repeated efforts were made to restructure and revive them by infusing fresh capital.

Post Liberalisation Policies on Disinvestment/ Closure of CPSEs

Major structural economic reforms were taken up in India from 1991, as part of these reforms, a wave of liberalisation in industrial and trade policies took place (Ahluwalia, 2002). Only then did disinvestment, privatisation, and closures of CPSEs come into the policy discourse. The broad thinking as it evolved was as follows. CPSEs considered to be of strategic importance and those that were viable and profit making were to be continued and strengthened. For them, mechanisms for devolving greater autonomy in decision-making at the enterprise level were put in place. For others, various forms of disinvestment were considered, depending on the circumstances. These forms of disinvestment included outright privatisation, sale of minority shares, winding up and closure of the enterprises.

Closure of enterprise ideally needed to be considered when the enterprise was found to

- have outlived its purpose
- become non-competitive due to changed market environment
- be chronically in losses
- have ceased production
- require budgetary support just to exist and pay salaries.

However, the political ecosystem has been traditionally highly sensitive to any proposals for closure of a CPSE. Part of the reason was ideological, resting on the deeply ingrained notion of CPSEs being “good” and the private sector “bad”. Other factors too made decision-makers reluctant to bite the bullet of closure. Regional and local interests felt it was a setback for them if a CPSE located in their local area were to close down. The location of the CPSE very often was a matter of prestige. In keeping with the early policies aiming at balanced regional development, many of these CPSEs were located in relatively backward areas. It was felt that even sick CPSEs had a welfare role and workers jobs should be protected. The first effort should be to revive sick CPSEs rather than close them down. There was apprehension regarding the alienation of the lands held by CPSEs, which over time had become prime urban property.

As a result, while there was progress in privatisation and stake sale of CPSEs after 1991, not much progress could be made in closures. Attempts that were made got bogged down in litigation and scam allegations. For example, the closure and sale of textile mills by e-auction by the National Textile Corporation became the subject of a criminal investigation over allegations of land having been sold below market value (Financial Express, 2015). The closure of another CPSE Hindustan Photo Films could not be effected for decades after the cessation of production due to protracted litigation by employees who were going to lose their jobs. Even though the continuance of many CPSEs had become totally unsustainable, public money was being spent every year on keeping them afloat.

Roadmap for Closure

A new Government took office in India after the General Elections in 2014. This government immediately sought to impart a fresh thrust to the disinvestment and closure initiatives. The Government directed all administrative ministries and departments to review the portfolio of CPSEs under their administrative jurisdiction and working on the assumption that such budgetary financing would not be available to support loss-making CPSEs in future, propose a roadmap for closure of those CPSEs that required budgetary support to exist.

It was in this backdrop that the Department of Heavy Industry (DHI) reviewed the position each CPSE under its domain with the chief executives of the concerned CPSEs. It was agreed that here was a high opportunity cost of continuing with the status quo, in terms of alternate uses of public funds foregone. It was felt that DHI needed to make a determined effort to implement the closure policy, as it would enable budgetary funds and assets to be released from unproductive assets and be better utilised for public welfare. Further, it was clearly understood that in view of the fact that such efforts had not made much headway in the past, DHI must be willing to make special efforts to execute the closure policy of the government. Accordingly, a Roadmap for closures for the enterprises in the jurisdiction of DHI was formulated. Before final approval of the Roadmap, DHI shared it with the stakeholder departments of the Government, i.e. the ministries/departments of Finance, Planning, Public Enterprises, Labour & Employment, Land Resources, and Urban Development, and obtained their support. The Roadmap noted that over Rs. 3,000 crores had been provided as direct budgetary support by Government to eleven CPSEs over the last ten years (financial years 2004-05 to 2014-15). It was projected that out of these eleven, four would not require budgetary support any further. Two others would require financial support only for another year till 2015. The remaining five CPSEs were not found to have any prospects of being viable or existing without budgetary support Therefore they met the criteria to be closed.

The Five CPSEs

The five non-viable CPSEs were HMT Bearings, HMT Watches, HMT Chinar Watches, Tungabhadra Steel Products Ltd. (TSPL), Hindustan Cables Ltd. (HCL). The three HMT companies had been spun off from the parent Hindustan Machine Tools (HMT) that was a pioneer in the establishment of the machine tool industry in India. All had negative net worth. A brief picture of these enterprises is given in Table 1

In each of these cases, it was found that the products of the enterprise had become obsolete or irrelevant. HMT Watches once had a near monopoly on watch production in India and its watches were highly sought after. Post liberalisation, more modern and attractive watches started to be produced in the private sector, slowly reducing the market for HMT watches. Similarly ball bearings became readily available more competitively in the private sector, rendering the company HMT Bearings virtually defunct. The purpose for which TSPL had been set up was to provide equipment for construction of Tungabhadra Dam in the 1950s. That purpose had long since been fulfilled, and TSPL's operations were at a standstill. The telecom cables used in fixed line telephony had become obsolete with the shift to wireless technology, and Hindustan Cables Ltd. found itself producing items that no one wanted any more.

Table 1: Snapshot of the five CPSEs identified for closure

S.No.	Company	Established	Product	Employees	Pay Scale
1	HMTBL	1964	Ball bearings	62	1992
2	HMTWL	1961	Watches	1055	1992
3	HMTCWL	1971	Watches	34	1992
4	TSPL	1948	Gates and spillways for irrigation dam	84	1992
5	HCL	1952	Telecom Cables	1709	1997

In some of these cases, there were also management issues that sometimes arise in public sector entities. Often, it is an inability to respond quickly to changing circumstances that is responsible for the decline in relevance. In all the cases, the net worth of the companies had been totally eroded. Due to institutional constraints, neither could they change course easily, nor could a timely decision on winding up be taken, leading to these enterprises becoming a recurring financial burden on the owner i.e. the exchequer. The closure strategy that was proposed in the Roadmap and approved by the Government of India was as follows:

Employees

The CPSEs would be closed under the provisions of the Industrial Disputes Act, 1947. Under this Act, the employer can close a unit after giving sixty days' notice to the appropriate government stating clearly the reasons for the intended closure of the undertaking. It was proposed that all the employees of these five CPSEs be offered an attractive Voluntary Retirement Scheme (VRS) calculated at notional 2007 CPSE pay scales instead of the actual pay scales prevalent in the CPSE.

The Government of India lays down the guidelines for setting pay in CPSEs. Common pay scales are set for all CPSEs, and these pay scales are revised every five years. The common CPSE pay scales are known by the year of revision e.g. 1992, 1997, 2002, 2007 etc. If the financial health of the CPSE does not permit it to bear the additional burden of revision from its own resources, the CPSE cannot revise the existing scale, and continues to implement the scale that it is already at. The pay scales of these loss-making CPSEs were of 1992 and 1997, which were substantially lower than the 2007 pay scales. Normally, VRS offered is linked to the actual pay been received by the employee. The significance of the "2007 CPSE pay scales" in this package was that for the first time the VRS offer was delinked from the actual and made more generous. It was also provided that employees not opting for VRS in the prescribed period would be retrenched by following the procedure prescribed under the Industrial Disputes Act.

Assets

Movable assets like plant and machinery, fixtures, vehicles etc. would be either auctioned or transferred to holding/subsidiary CPSEs or Government controlled bodies. Immovable assets like land and buildings would be transferred to Central/State Government or Government entities/PSUs only, depending on the terms of the lease/ownership in each case

Dues to creditors

While not explicitly mentioned in the Roadmap, the understanding was that dues owed to Government would be written off, while a One Time Settlement (OTS) would be negotiated with financial creditors like banks.

Rationale for the Roadmap

The Roadmap for closure of CPSEs drew on the lessons learnt from the experience of unsuccessful attempts at closure in the past, and sought to put in place a practical and workable strategy that addressed key institutional constraints upfront, and did not brush them under the carpet as in some cases in the past.

What then were the big steps forward, and how were the key constraints addressed? The most important institutional issue identified from past experience was that of the process of disposal of land assets of the enterprise to be closed. Senior officers were extremely reluctant to get into the decision making on disposal of land to private parties. The legal framework and experience of the actual application of the legal framework was not encouraging. No matter how transparently land assets are disposed of, their post disposal value shoots up. This may even be due to normal escalation in land prices. When this happens, and there is a complaint, the concerned officer is vulnerable to the charge of criminal misconduct under the Prevention of Corruption Act. Under Section 13(1)(d)(iii) of the Act as it then stood, a public servant was said to have committed the offence of criminal misconduct, if he/she "obtains for any person any valuable thing or pecuniary advantage without any public interest".

Notably, it was not necessary under this provision for the public servant to have had criminal intent and to have personally benefited (quid pro quo) from the decision. Any land sale in a growing and urbanising economy, would with passage of time be likely to lead to a "pecuniary advantage" to some person, and it is up to the agency investigating to determine whether this was "without public interest." Unfortunately, there had been a number of such cases in which it has been so determined, and the dealing officers prosecuted. The sale of textile mill land by the National Textile Corporation was one such instance. Understandably, officials dealing with closure and land alienation of public enterprises would find ways and means to ensure that they did not have to take such decisions during their tenures. This was a major impediment to implementation of a closure policy. The problem was tackled in a practical manner by restricting the disposal of immovable assets primarily to Central and State Governments, their enterprises and state entities. This makes sense if we look at government as a whole, and not enterprise wise or departmentally.

Most of the CPSEs set up earlier were able to obtain land at prime locations near urban centres at nominal cost. These areas developed and then became heavily urbanised. To meet fresh requirements of urban land for public entities, the costs of acquiring land are now high, and prime locations are no longer available. Locations are available only at a high cost and at considerable distance from the urban centres. With this strategy, idle productive assets of PSUs could be gainfully utilised for alternate public purposes, reducing the cost to the taxpayer of these public purposes. Also, a window was opened to meet priority land requirements of governments and public projects in suitable locations nearer urban centres. Most importantly, there would be no reason for any reluctance on the part of the concerned officials to take decisions, since any land value related windfall benefit that may arise in future would accrue only to a government or public entity. There would be no possibility of allegations of providing pecuniary advantage to any private buyer.

The second key institutional constraint that was addressed was the resistance from employees and their unions. Fresh thinking was needed in structuring an employee friendly settlement. Past efforts had often been derailed by the reluctance of employees to sever their ties with their company, particularly due to a sense that the financial incentives for doing so were inadequate. Brought up in a welfare state ethos, managements were also less than enthusiastic in implementing steps for separation of employees. Government efforts to force the pace usually ended up in protracted litigation. An example was the case of Hindustan Photo Films (under the Department of Heavy Industry) which was first declared bankrupt in 1996 but in the face of fierce resistance by a section of the employees could be finally closed after lengthy litigation only in 2018 (Times of India, 2018).

The new strategy provided for a Voluntary Retirement Scheme (VRS) and the calculation of a separation package for the VRS on the basis of the 2007 CPSE pay scales. This was a departure from existing guidelines of the Department of Public Enterprises, which did not provide for determination of VRS on the basis of notional pay scales. Notably, employees of most sick/loss-making PSUs were on the 1992 or 1997 pay scales, and this decision was substantially beneficial to them, as it calculated the severance package on the basis of a higher notional scale which was not actually being received by the employees of these PSUs. While this would mean a higher one-time outgo from the public exchequer, it would be well worth it if it could result in stemming the continuous drain on budgetary resources.

Along with the VRS, the Roadmap required the invoking of the Industrial Disputes Act, 1947. This permits the employer to announce the closure of the enterprise and seek permission from the Government of India’s Ministry of Labour & Employment for implementing closure in 90 days. This put in place a supporting incentive structure so that incomplete acceptance of VRS by a few holdout employees did not indefinitely hold up the closure process. Once the deadline for

VRS was reached, any remaining employees who did not opt for the generous VRS would necessarily have to be retrenched as per law, and the retrenchment package would obviously be less generous than the VRS.

In the cases of the five identified PSUs, employee unions (with one exception, that of the Raniganj unit of HMT Watches) generally welcomed the package. In the face of imminent closure of the unit, unions appreciated and that what was being offered represented a very fair deal. Accordingly, they urged DHI for its expeditious implementation.

Regarding the dues to Government, there was no option but to write them off, as it was Government which had proposed closure to stem the recurring drain on its resources once and for all. For financial creditors, it was assessed that since presently they were unable to get anything at all from the loss-making enterprises, and were also unable to exert any pressure on the owner i.e. Government, most would be very keen for a OTS so that they could at least get some of their money back.

Outcome

All the five CPSEs covered in this case study were successfully closed. Considering that closure efforts in the past had got bogged down and could not be implemented successfully, this was a big step forward. HMT Bearings, HMT Watches, HMT Chinar Watches and Hindustan Cables were closed in 2016 while Tungabhadra Steel Products Ltd. was closed in 2018. Except for one unit of HMT Watches, settlement was reached with the employees and creditors on the proposed lines prior to closure. In the case of one unit of HMT Watches, 146 employees approached and obtained a stay from the concerned High Court. Disposal of land and movable assets went according to the Guidelines. A separate Land Management Agency was designated to handle the disposal process, while another CPSE (the Metals Scrap Trading Corporation or MSTC, which specialises in e-auctions) was nominated to handle the disposal of the movable assets.

Conclusion

CPSEs in India continue to have a twin objective of commercial efficiency and social responsibility. The challenge for these enterprises arises out of the need for them to ensure a good return on investment, while discharging their social obligations. They are expected to act as model employers, and conduct their business in a transparent manner protecting interests of all stakeholders e.g., the employees, customers, suppliers, creditors, and the community. The current environment, including aspects of competition and globalisation being faced by the CPSEs, makes these tasks all the more challenging and the rationale for their existence as the remnants of India’s socialistic legacy is being questioned (Chhibber and Gupta, 2019).

Notwithstanding economic liberalisation, Government of India still views the role CPSEs as important in fostering economic growth, infrastructure development, healthy market competition and corporate social responsibility, especially in the fields of health, education and skill development. There is less enthusiasm for continuing CPSEs in the field of industrial production.

Closing down five CPSEs was a trailblazing initiative, since at the time other Central Government departments preferred to adopt a more conservative and cautious approach on the implementation of the policy regarding closures of their CPSEs. As a result, the approach adopted by the DHI Roadmap became the template on which the government developed its Guidelines for all future closures of CPSEs. The Guidelines (GOI, 2018) adopted in 2016 further refined, clarified and detailed the steps to be followed in such cases. These Guidelines, with some amendments made in 2018, continue to set government policy and guide implementation today.

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Author's Note

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