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Privatisation of Central Public Sector Enterprises in India

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Abstract

This paper investigates the different phases of reform state owned enterprises (SOEs) that India had been experience since the beginning of reform and analyses the policy objectives behind the policy of SOEs reforms introduced. Having evaluated the policy objectives based on various source the paper seeks to find the degree to which the objectives have been achieved and had an impact on the performance of SOEs. The paper finds three different phases of privatisation with different objectives and that the of performance of SOEs during these phases have been different. The analysis of performances of SOEs in different phases leads to questioning of the need for privatisation and speculation as to whether the actual objective behind the overall privatisation process is to generate revenue to cut the government fiscal deficit.

KEYWORDS: Privatisation, state owned enterprises, CPSE, Memorandum of Understanding

Introduction

In the recent economic history of the world, public sector has been an inalienable part of any nation's economic development process. The process began with setting up of enterprises of natural monopolies in the 'core industries'. The reasons for setting up the public sector was to create the necessary infrastructure for rapid economic growth, balanced regional development, entrepreneurial leadership and employment generation. The Indian experience was no different. The Central Public Sector Enterprises (CPSEs), which are also called Public Sector Enterprises (PSEs), Public Sector Undertakings (PSUs) or more generally State Owned Enterprise (SOEs), have been endowed with an important role and constitutes a major portion of the public sector. The first CPSE came into existence in 1950 and the number kept growing. In 2020 there were a total of 366 CPSEs (GOI, 2021).

With the rise of the neoliberal paradigm in the 1980s, state involvement in economic affairs was challenged and the privatisation of state-owned firms moved to the top of political agenda of many a western democracy. However, there were significant cross-national differences, both in the historic involvement in business affairs and in the degree to which governments retreated from entrepreneurial activities. In India was no exception to this movement, but it began with a slow start. India first looked at internal reforms: deregulation and Memorandum of Understanding (MoU) during the 1980s with the objective of enlarging competition and allowing new firms to enter the markets. Eventually, it started to reform extensively from 1991 onwards with de-reserving the industries for PSUs (Public Sector Undertakings) from 17 to 8 areas and disinvestment of SOEs as dominant aspects of reform.

Public Sector in India could take three organisation forms: departmental enterprises, statutory corporations and joint-stock companies (Iyer, 1991). Department enterprises are entity or unincorporated enterprise which are owned and controlled by public authorities. Examples are the Railways, the Department of Posts. These enterprises do not come under the SOEs or PSEs. SOEs are inclusive of statutory corporations, constituted under specific status of the Indian parliament and those established by the Government of India as government companies where government equity holding is more than 50 per cent. The largest number of SOEs belongs to the second category. A centralised coordinating unit for continuous appraisal of the performance of public enterprises was set up as a Bureau of Public Enterprises in 1965. Eventually, in May 1990, the bureau was turned into a full-fledged department, known as the Department of Public Enterprises (DPE), under the Ministry of Heavy Industries & Public Enterprises. Recently, DPE has been transferred to the Ministry of Finance.

The influence of politics on SOEs is much deeper in India's case. The influence is not limited to the United Progressive Alliance (UPA) led by Indian National Congress and National Democratic Alliance (NDA) led by Bhartiya Janata Party governments in the centre but extends to various regional parties involved in the democratic process with varying strength. As has been found by Dinc & Gupta (2011) the profitable firms and firms with lower wage bill were more prone to privatisation with the government delaying privatisation in regions where the governing party faces more competition from opposition parties. This is done to avoid loss of popularity of a particular political party or government (Gupta, 1996).

The issues of performance of SOEs and the need for privatisation has created much debate. The broad theme behind this paper is to outline how SOEs have been performing and analyse the various policy reform and its implication on the performance of SOEs. It has been argued that sub-national level SOEs are more inefficient and corrupt than the national level SOEs (e.g., Asthana, 2013; Bou, 2021). This paper avoids this issue and concentrates on CPSEs.

Rationale for Reform and Disinvestment

The debate on CPSE disinvestments in India as elsewhere straddles political and economic spheres. Several eminent scholars in papers (mainly in left wing journals like *Economic and Political Weekly*) have been arguing that performance of CPSEs has been good. Nagaraj (1991) on the basis of the National Accounts Statistics data concludes that the profitability of SOEs (gross profit as a proportion of total capital employed), for the period increased from around 8 per cent in 1980-81 to about 13 per cent during the end of the 1980s. However, the study by Joshi & Little (1996) and Mohan (1996) had a different take. They focused on the performance of SOEs in terms of return on investment and find that from 1976-77 to 1986-87, the returns to investment in public sector manufacturing have been as low as 3-5 per cent, whereas private sector manufacturing was 17-23 per cent.

One of the frequently stated reasons is the incentives factors which are poor in the case of SOEs. However, there is no shortage of incentives for politician, through their affiliation, there is common sight to see, an over-manning for the purpose of vote bank (Bagchi, 1999). The reforms in MoU system have been trying to overcome the incentive problem through the introduction of 'performance incentive system'. One of the proposal made for India was the performance related pay (PRP) which could reduce, if not solve the problem. Another problem commonly associated to SOEs is the principal-agent problem (Tandon, 1995). But this problem is not just limited to SOEs. Given the shape and the nature of new form of enterprise or large corporation is taking, the problem is common in both public and private.

According to critics, disinvestment has nothing to do with the performance of the public enterprises. Rather the objective was wholly focused on generating revenue by selling the these units to various financial institutions, cross holding by other well performing SOEs, and inviting NRI and foreign investors through GDR. The final objective of protecting employees' interest was only a decorative item in the list. According to *The Economic and Political Weekly,* the only purpose it serves is "to disarm a section of the critics" (EPW Editorial, 2009). But more pertinent question was- Is there really a shortage of funds? Despite these failures, the overall performances of SOEs have been good and this could greatly be contributed to reforms initiated in the marketisation process.

Table 1 gives a picture of performance of CPSEs from the year 1981-82 to 1990-91. In 1981-82, there were 188 PSEs out of which 104 were profit-making, 83 loss-making and 1 making no profit or loss. The situation did not change much even for the 1990-91 with the total number of enterprises at 236 out of which 124 were profit-making, 109 were loss-making enterprises and 3 making no profit and loss. The Table also shows the profit of profit-making enterprise increasing accompanied by the losses of loss-making enterprises also increasing (in real terms).

The gross margin or return on investment to national economy (which does not consider the element of depreciation, interest, tax, dividend, etc.) shows an impressive increase in 1981-82. But simultaneously, there has been equal increase in the capital employed during this period, thereby giving a better picture about the return of investment to the economy vis a vis the ratio of gross margins to capital. It was 18.29 per cent in 1981-82 but by the end of 1990-91 the ratio slid to 18.20 per cent, indicating a very marginal dip on the return on investment. The gross profit, which considers the depreciation, amortisation and deferred revenue expenditure written off but not the interest and tax, also show similar trend like the gross margin. Pre-tax profit, which is a very good source of revenue for the government, shows a very steady increase in profit margin since 1981-82. Similarly, the net-profit has an increasing trend and ration of net-profit to capital employed or net return on investment has increased from 2.03 per cent in 1981-82 to 2.33 per cent in 1990-91.

Table 1: Profitability Profile of Public Enterprises (INR in million at constant price with base year 2004-05)

	1981-82	1982-83	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	19889-90	1990-91
No. of operating Enterprises	188	193	201	207	211	214	220	226	233	236
i. Profitable Enterprises	104	109	108	113	119	108	114	117	131	124
ii. Loss-Making Enterprises	83	82	92	92	90	100	103	106	98	109
iii. Enterprises making no profit nor loss	1	2	1	2	2	6	3	3	4	3
Capital employed	1154747	1286531	1334978	1506198	1658087	1871520	1833967	2579925	2376837	2577654
Gross Margin	211208	251428	123923	305777	319152	357335	365428	499549	460225	469139
Gross Profit	139717	168007	159476	191597	204034	235443	228846	323313	297862	287870
Interest	85810	93267	93289	104699	120213	123480	118281	162204	149436	191077
Pre-tax Profit/Loss	53907	74740	66188	86898	83821	111963	110565	161108	148426	96819
Tax	30481	45009	55410	49265	38592	47984	43626	45779	42175	36801
Net Profit/Loss	23427	29731	10778	37632	45229	63979	66939	115330	106251	60017
Profit of profit making SOEs	68069	77407	79515	83668	110256	125574	124480	175049	161269	137675
Loss of loss making SOEs	44642	47676	68737	46036	65027	61596	57838	59719	55018	77658
Dividends	5738	5578	5948	7286	7371	10723	10552	9831	9058	9251
Retained Profit	17688	24153	4830	30346	37858	53255	56387	105498	97193	50766
Gross margin to capital employed	18.29%	19.54%	19.33%	20.30%	19.25%	19.09%	19.93%	19.87%	19.36%	18.20%
Gross profit to capital employed	12.10%	13.06%	11.94%	12.72%	12.31%	12.58%	12.48%	12.68%	12.53%	11.17%
Net profit to capital employed	2.03%	2.31%	0.80%	2.50%	2.73%	3.43%	3.65%	4.43%	4.47%	2.33%
GDP deflator	0.1900	0.2062	0.2236	0.2415	0.2591	0.2770	0.3033	0.3285	0.3566	0.3946

Source: Various Public Enterprise Surveys compiled into real value using GDP Deflator

Therefore, the profitability of PSEs since 1981-82 in terms of ratio of gross margins and gross profits to 'capital employed' had not improved over the last 9 years. In fact, it decreased by 1990-91. But the ratio of net-profit to 'capital employed' gives some relief with its improved performance. Although the overall performance is lower than private enterprises, in some cases, the performance varies widely in terms of profitability ratios comparable to private enterprises (GOI, 1993).

The first phase of reforms began in 1986 with the introduction of the MoU system. The introduction of a new economic policy (NEP) in 1991 marks the second phase, with the process of disinvestment of government shareholding in SOEs. This phase is known for sale of minority shareholding of SOEs. The third phase begins from 1999, when the policy shifted from sale of minority shares to majority shares. It was also called "strategic sale". It was during this phase that the sale of large blocks of shares in SOEs were made along with transfer of managerial right to private entity or institutions. The last phase covered in this paper began in 2004 with the reversal of strategic sale and revival of minority share sales. Since 2015, once again there is enthusiasm for privatisation but the results are not very significant.

Memoranda of Understanding

The first phase of reform in CPSEs (1986-91) was development of MoUs to address the immense pressure on the government's fiscal management due to falling profitability and accumulating losses. The common reasons quoted were the problem of "multiple principals" (Gunasekar & Sarkar, 2014; Kaur, 2004) with "multiple goals" (Trivedi, 2005). It was decided to tackle these problems through introduction of a managerial contract system based on three financial parameters to regulate the control-freedom interaction between the government and SOEs: price fixation, investment planning and financial management. Based on the French system (where it had originated), was a five-year agreement was drawn up and reviewed every year.

At the beginning the MoU was only experimented only on selected SOEs in the core sectors i.e., steel, coal, power, petroleum, fertilizer and petro-chemicals (Trivedi, 1990). This system may be best put as "essentially a system of management audit" (Depart of Public Enterprises, 2012). Therefore, it did not investigate setting new objectives or restructuring the whole SOEs system functionality but was more concerned in solving the problem of information or principal agent problem and specifying the target objectives.

In 1990, the old 'performance contract' was changed to a new performance evaluation system closer to a signalling system. This system was based on an annual target agreed upon between the government and the CPSEs, rather than the five-year target. The evaluation under the new system was done in "five point scale" and "criteria weight", which ultimately results in calculation of "composite score" or an index of the performance of the enterprise. The number of SOEs under MoU increased substantially. The continuous re-arrangement of the MoU system developed an enforcing mechanism. Also, the third party evaluation, Task Force and

High Power Committee, claimed to ensure "fairness" and "equality" in the process of negotiation and implementation of MOUs (Department of Public Enterprises, 2000).
Later the performance evaluation was changed by allocating weightages to “financial parameters” and “non-financial parameters” under the “Balance Score Card” approach.

India’s National Council of Applied Economic Research (NCAER) report of 2004 compared the performance of SOEs in the pre- and the post reform period, ranging over a period of 1986-87 to 1992-93 (NCAER, 2004). The positive impact that the MoU system has had on SOEs performance as reported by NCAER is generally accepted by scholars in this area. Mohan (2005) and Trivedi (1990) have been critical about the choice issues related to parameters, methodological issues, implementing, autonomy and problems related to the weight attached to the parameters. But most of these issues have been resolved over different stages of MoUs development.

The NCAER study consists of two important aspects; first, it has comparison of Total Factor Productivity (TFP) pre-and post- MoU periods and then a comparison of financial performance pre- and post MoU periods. The study concludes that the TFP analysis proves that the MoU system did not have a significant impact on the overall efficiency of the SOEs, but the financial performance in the pre and post MoU period at constant price has shown significant improvement.

The impact on MoU is evident from the fact that in the year 1986-87, there were 8 companies with ‘fair and poor’ status and only 2 with ‘excellent and very good’ status. In the following period, substantial improvements in the performance of SOEs can be noticed. After the first three years, the number of ‘excellent and very good’ PSEs increased and the number of companies under the ‘fair and poor’ category came down to 5. Finally, in the final phase of year 1992-93 (after six years), one can see substantial improvement compared to the 1986-87 phase. The number of ‘excellent and very good’ companies also drastically increased to seven and ‘fair and poor’ companies also improved its performance marginally. This data gives enough evidence to conclude that the MoU system had a great impact on the performance of SOEs even though it is not inclusive of all the factors, which would grade the MoU system to be an efficient one. Therefore, the hypothesis that the MoU system played an important role as a financial performance-enhancing instrument to the SOEs seems validated here.

The overall comparative study of the performance of pre and post MoU system with TFP as a core indicator for the measurement of efficiency level of SOEs A comparison of pre and post MoU performance of the enterprises/syndicates were done. The Total Factor Productivity Index (TFPI) was based on the Translog Production Function and the Total Factor Productivity Growth (TFPG) was estimated eventually on the Average Annual Growth Rate (AAGR) of productivity in the pre and post MoU period was calculated (NCAER, 2004). results show little empirical justification for a general presumption in favour of MoUs improving productivity” (NCAER, 2004).

The study also gives two reasons for such results. One, the performance indicators of MoUs is just financial in nature and financial indicators are not the only factor for measuring productivity. Second, the timing of the introduction of the NEP of 1991 also has had an impact. The NEP came with huge structural changes in terms of de-reservation (Ahluwalia, 2002) and deregulation (Goyal, 2001) in the economy beside the liberalisation policy and the MoU was made mandatory to 72 SOEs (Gunasekar & Sarkar, 2014; Mathur & Mathur, 2010). These policies have a great bearing on the nature of environment under which the SOEs were functioning because of which the profitability under the new competitive environment has come down e.g., SAIL (Naib, 2003). This makes the comparison of pre- and post- economic reform of 1991, done in NCAER (2004), not very credible to state the influence of MoU. Besides, it must also be understood that the very idea of measuring TFP has many methodological issue or there isn't a uniform method to measure TFP.

The overall performance of SOEs under the system of "five point scale" and "criteria weight" ultimately resulted in the calculation of "composite score" or an index of the performance of the enterprise, including both financial and non-financial indicators. Furthermore, the NIP of 1991 gave a great thrust to the MoU system; it stated that the "technical expertise on the part of the Government would be upgraded to make the MoU negotiations and implementation more effective".

The performance rating of SOEs in Figure 1 helps understand their performance under the MoU system. The performance of SOEs has changed dramatically since 1990-91.
In 1990-91, with only 23 companies under the MoU system, 14 companies (60.87%) had performed excellently and only one company received the 'Poor' status, which is a testimony of great progress. Also, in the following years, the number of SOEs under the MoU system increased manifold without a dip in the performance of SOEs.

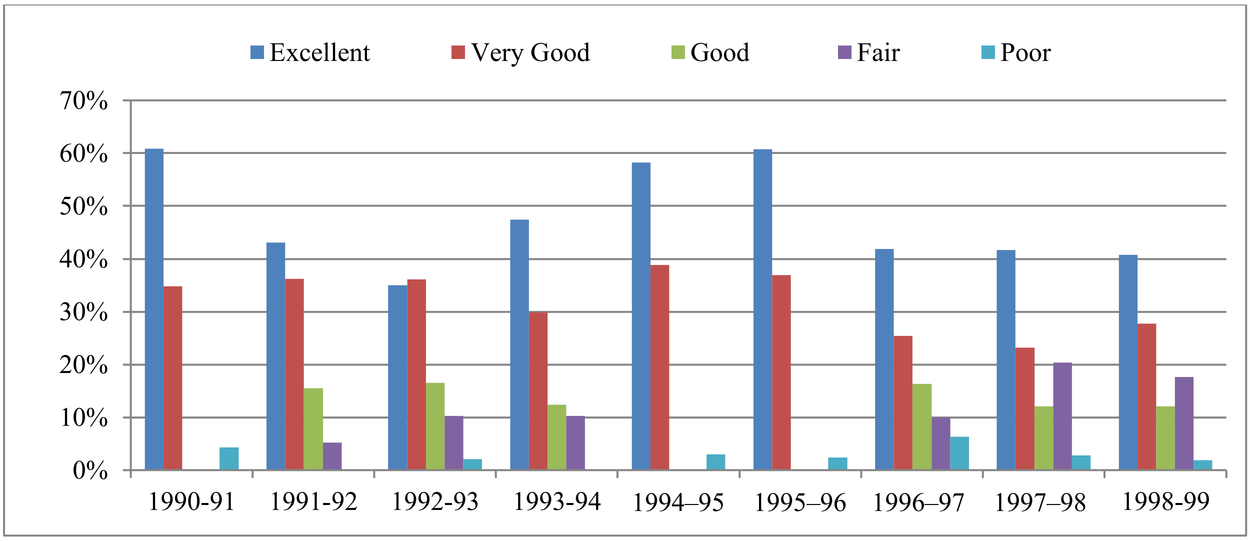

Figure 1: Performance Indicator of SOEs under the MoU system
Source: Various Public Enterprises Surveys

The number jumped to 72 in the year 1991–92 (while total SOEs stood at 237) when the new economic policy was introduced, though it rose only marginally thereafter. At the end of the phase 1998-99, the number of enterprises under the MoU system had increased to 108 (while total SOEs stood at 236). The year also saw an increase in the number of enterprises under the 'Excellent' category at 44 (40%), and the number of enterprises under 'Very Good' category climbed up to 32 (28%). On an average, the number of enterprises graded 'excellent' and 'very good' together consists of 68 per cent for the year 1998-99. With only two enterprises performing poorly. Here, too, the NCAER hypothesis or paradox, is very much relevant i.e., does the improving performance of MoUs during this phase indicate the same for the overall performance of SOEs? The performance of SOEs under the MoU system has indeed improved and we look further into finding that this completely represents improvement in the overall performance of SOEs.

Disinvestment policy

This phase witnessed quite a few changes in the way disinvestment policy began and ended. It began with concern for poorly performing SOEs but later, with the establishment of the Disinvestment Commission, the policy concern was more on the disinvestment of healthy SOEs to overcome the fiscal deficit problem. Industrial policy of 1991 was an important aspect of the New Economic Policy of 1991. Besides dereservation and delicensing, MOU and Disinvestment were the important components of this policy. The number of SOEs signing MoU increased to 72 from 23 SOEs in 1990-991. This is a very positive sign of bestowing confidence on the MoU system and its impact on the performance of SOEs. Given the amount of confidence bestowed on the MoU and, along with other reforms in internal liberalisation, a very important question crops up. Why was there a need to shift the policy towards disinvestment of SOEs?

Looking at the nature of the crisis, it can be speculated that the disinvestment of SOEs was done to cover up accumulating fiscal deficit rather than concerns over efficiency. What led to such a transition requires some investigation.

The introduction of disinvestment policy in 1991 marks a major shift from the institutional reform introduced before this. According to an Industrial Policy statement, in "the case of selected enterprises, part of government holdings in the equity share capital of the enterprises will be disinvested in order to provide further market discipline to the performance of public enterprises". Therefore, the NEP of 1991 focused on four issues: "strategic industries, sick industries, raise resources through public participation and greater thrust on MOU". Furthermore, the interim budget speech of 1991 made the industrial policy much clear by outlining the cap of 20% for disinvestment and distinguishing the eligible investors': mutual funds and investment institutions in the public sector and the workers in these firms.

This phase predominates with disinvestment policy, which is also accompanied by other structural reform that has complemented the performance of SOEs. But it has also made it challenging to segregate the impact of different policy on the performance of SOEs. It began in 1991-92 and, within a few years, foreign participation (1994-95) was allowed beginning with non-resident Indians (NRI) and then foreigners through global depository receipts (GDR). The Rangarajan Committee in 1992 and Disinvestment Commission in 1996 were set up with the sole objective of making the experience of disinvestment successful. Finally, “Navartnas” and “Mini-Ratnas” were introduced in 1997 with the objective of granting greater autonomy and making SOEs more competitive and eventually generate better performance from the selected premier SOEs. Classification of SOEs based on the performance and providing greater autonomy.

The objective for the disinvestment policy was also specified to broad-base equity, improve management, enhance availability of resources for these PSEs and yield resources for the exchequer. It has been argued by many that the primary objective of disinvestment policy was to generate resources to meet the expanding fiscal deficit of the government (Ahluwalia, 2002; Basu, 1993; Kaur, 2004).

To sum up, it can be said that to make SOEs more efficient, the government had three broad objectives of disinvestment: broad base ownership, revenue generation through disinvestment by focusing more on the core industries, relieving the non-core to the public. Finally, protect employee interests. However, from the unfolding of disinvestment over this phase, the objective looks more to garner revenue through disinvestment to meet the fiscal deficit (also claimed by Ahluwalia, 2002; Basu, 1993; Kaur, 2004) and rhetoric in nature.

To redefine the economic reforms in the country and the performance of PSU's, a new Industrial policy was drawn up in 1991, which discussed the role of PSU and came up with a comprehensive policy for disinvestment of public sector undertakings. The policy brought autonomy to the PSU boards and encouraged them to improve efficiency in their operations. Until 1994, however, in most cases of disinvestment involved only 5 per cent of equity. Even though the year 1994 and 1996 saw participation from Non-resident Indians and foreign investors respectively, the this phase of disinvestment of equity did not exceed 20 per cent. In 1996, the Government of India set up a Disinvestment Commission to advise the Government on disinvesting various CPSE's. Moreover, in addition to sales in domestic capital markets, the government sought greater foreign participation through selling of share via Global Depository Receipts in the international market. In December 1999, the commission was dissolved and all the decisions on disinvestments in India were taken by a separate Department of Disinvestments that was formed under the Ministry of Finance. In 2001, the Government upgraded the Department of Disinvestment to a full-fledged Ministry. But in 2004, the first among many decisions taken by the new Government was to shut down the ministry and merge it in the Finance ministry as the Department of Disinvestments. This department was renamed later as Department of Investments and Public Asset Management.

In the second phase, the number of SOEs making profit or loss has been very irregular (Table 2). The number of enterprises making profit at the end of the phase, after some ups and down, has fallen to 126 from 133 in the beginning and the number of loss-making enterprises has also from 102 enterprises to 107.

Table 2. Profitability Profile of Public Enterprises *(INR in million* at constant price with base year 2004-05)

	Particulars	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
1	Operating enterprises	237	239	240	241	239	236	236	235
	Profit making PSEs	133	131	121	130	132	129	134	126
	Loss Incurring PSEs	102	106	116	109	102	104	100	107
	PSEs No profit/loss	2	2	3	2	5	3	2	2
2	Capital Employed	2629283	2868016	2974778	2754083	2702308	3332061	3377795	3316686
3	Profit before dep, int, tax & EP (PBDITEP)	495234	516390	515667	565969	623907	640776	717346	706832
4	Depreciation	190482	189755	170313	182316	195339	195186	214358	209791
5	Profit before int., tax & EP (PBITEP)	304753	326636	345354	383653	428568	445590	502989	497041
6	Interest	215551	222731	221495	218054	216964	223941	243207	250541
7	Profit before Tax & EP (PBTEP)	89202	103904	123859	165600	211604	221649	259782	246500
8	Tax Provision	36701	36948	39270	43756	62871	74834	76166	81312
9	Net Profit (7-8)	52501	66957	84589	121877	148734	146815	183615	165188
10	Profit of Profit-making PSEs	135463	151149	181797	204626	229345	232416	274152	281607
11	Loss of loss-making PSEs	82962	84192	97208	82783	80596	85601	90537	116419
12	Dividend	15309	16212	19133	24345	34255	40876	48790	61706
14	Retained Profit	37192	50744	65456	97498	114479	102177	128552	96763
Financial Ratios (%)									
15	PBDIT EP to Capital employed	18.8	18	17.3	20.6	23.1	19.2	21.2	21.3
16	PBITEP to Capital employed	11.6	11.4	11.6	13.9	15.9	13.4	14.9	15
17	Net Profit to Capital employed	2	2.34	2.84	4.42	5.89	4.41	5.43	4.98
18	Dividend payout	29.2	24.2	22.6	20	23	27.8	26.6	37.4
	GDP deflator	0.4488	0.4885	0.5373	0.5899	0.6437	0.6938	0.7397	0.7993

Source: Various Public Enterprise Surveys, compiled into real value using GDP Deflator

In terms of real profit and loss, there has been many-fold increase in both. Overall, we can say that there is improvement in the performance in terms of profitability and losses generated by the SOEs during this period. The Table 3 also shows an impressive trend of improvement in the financial performance of the SOEs. The profit before depreciation, interest and tax (PBDITEP - also called gross margin in phase one) has increased by 42.73 per cent. The rate of return to capital employed has also seen a jump from 18.8 per cent to 21.3 per cent by the end of year 1998-99, thereby registering a very impressive return compared to the previous phase, which saw a fall in the rate of return. This was also a very strong indicator of improving the performance of SOEs.

The return on investment after considering the depreciation or profit before interest and tax (PBITEP) during this period increased by 63.10 per cent. PBITEP to capital employed i.e., return on investment went up from 11.6 per cent to 15 per cent, which is much better placed than in the first phase with its falling rate of return.

Finally, the net profit during this period registered an increase of 107.88 per cent. Also, the ratio of net profit to capital employed showed tremendous improvement, registering improvement of more than double. This was again a far better performance than the net profit performance in the first phase.

The good innings in the second phase saw the number of enterprises under MoU system increase to 108 out of a total of 235 SOEs, which constitutes nearly half of the SOEs and a very good representation unlike the earlier phase. Under the MoU system, 74 % of enterprises came to be categorised as either 'excellent' or 'very good', which clearly indicates the performance of SOEs in this phase. Also, the indicators of profitability performance show tremendous improvement in the performance of all the enterprises. Thus, it can be concluded that the second phase was a much better performing phase than the previous one.

This phase also saw introduction of economic reforms both externally and internally which are improving the competition and marketisation environment. These could have further impact on the performance of SOEs. To begin with the de-reservation and deregulation policy followed in 1991 and the introduction of Navaratna and Mini-Ratna (1997) schemes through MoUs improved the performance of SOEs in terms of productivity. Also, in order to strengthen the overall autonomy of the SOEs and distance the presence of government in issues of micro-management, 696 guidelines issued over the last three decades (since 1997-98) on SOEs were withdrawn in this phase. These changes could also have indirectly amounted to an improvement in the performance of SOEs.

There were three specific objectives laid down before the start of this phase which includes first, market discipline through disinvestment and broad-based ownership, second, revenue generation, and, finally, protection of employee's interest. The disinvestment policy in this phase has failed in most of these aspects.

Strategic sale policy

The policy of 'disinvestment' in SOEs has evolved over the past two phases. Reform of SOEs from 1986, with the introduction of MOU and disinvestment of government equity in SOEs in 1991-92, with minority share sale, has now come to affect even greater changes in the privatisation policy.

The third phase of disinvestment marks the beginning of majority sale of SOEs' share or total transfer of management. This phase took an even greater leap from the original disinvestment policy and at a greater pace. It must be said here again that given the performance of SOEs in the previous phase, the reform was not called for. However, unlike the second phase, the third phase of disinvestment took place as an outcome of the formation of the new NDA government on March 19, 1998. It can largely be said that the outcome of change is greatly attributed to the political inclination of the new government and the discontinuation of this policy is also attributed to the same reasoning.

Strategic sale is the method through which sale of large block of shares (23%) in a SOEs are conducted with private partners and, most import of all, with the transfer of management control. It is based on the transfer of management control that the State expects to get 'control premium' on the shares sold and also expects to get better value to the shares sold than the earlier phase.

In February 2001, Government of India announced that there will be more emphasis on strategic sale and the government will reduce its stake in the non-strategic PSEs even below 26%, if necessary. In December, 2002, the government specifically laid down the objectives of disinvestment as modernization and upgradation of PSEs, creation of new assets, generation of employment, retiring of public debt and setting up a Disinvestment Proceeds Fund. The objective of the new policy can be deduced from three important aspects. First, strategic sale of non-strategic SOEs; second, proceed from strategic sales to be directed towards investment in social sector, restructuring of SOEs and, finally, retirement of public debts.

With the coming of the new UPA government in 2009, the reversal of strategic sale was initiated and a new disinvestment policy with a different set of objectives was announced in 2009 declaring that the Public Sector Undertakings (PSUs) are the wealth of the nation, and part of this wealth should rest in the hands of the people. While retaining at least 51 per cent Government equity in the enterprises the rest could be passed on the people. The reversal policy in 2004 shifted the policy of disinvestment again to minority share sale. The objective was more focused on people-ownership of public sector along with investment in social sector and retirement of public debts.

Figure 2 makes thing clearer vis a vis the performance of SOEs under the MoU system. The number of SOEs with 'Excellent' grade increased from 49 enterprises in 1998-99 to 69 in 2011-12 with an average increase of 45 per cent. The SOEs under the 'Very Good' category has gone up from 29 in 1989-99 to 39 in 2011-12, a jump of 27 per cent during this phase. Together, on an average, the number of enterprises with 'Excellent' and 'Very Good' SOEs is 72 per cent of the total. This kind of performance is maintained in spite of there being increase in number of SOEs under the MoU system and structural change in the nature of evaluation of MoU under the 'balance score card', which is a very good sign of progress.

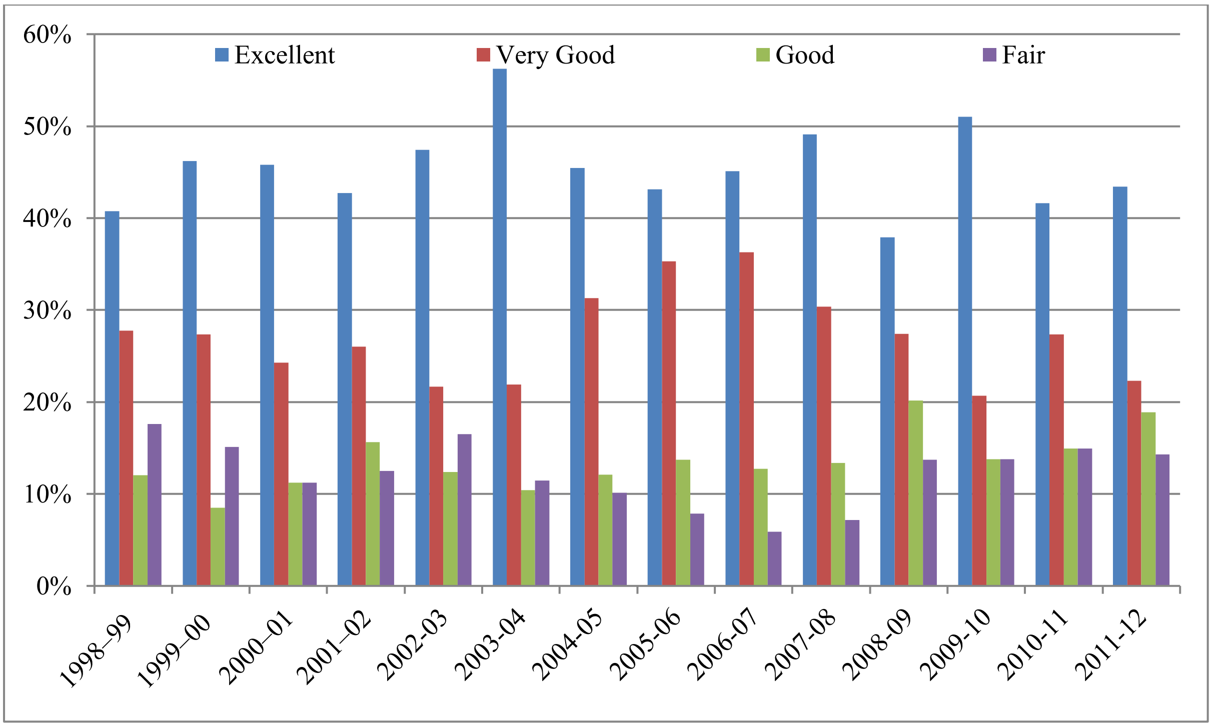

Figure 2: Performance Indicator of SOEs under the MoU system in Third Phase
Source: Various Public Enterprise Surveys

The performance of SOEs, at an aggregate level, vis-à-vis the different financial ratios for the last 12 years is shown in Table 4. The number of enterprises operating has come down from 232 to 220 because of government policies and strategic sale during this phase. The number of enterprises making profit has gone up from 126 in year 1999-00 to 158 in the year 2011. Similarly, the number of loss-making SOEs has also come down from 105 enterprises in 1999-00 to 62 in 2010-11, which is very progressive. Overall, there have been some improvements, thereby making this phase much better than the previous two phases.

As seen before, the analysis of financial performance, profitability and return on investment in SOEs can be made in several ways. Unlike the previous two phases, the analysis of overall financial performance in the third phase of SOEs reforms has many more variants of financial indicators. Along with evaluation of financial performance of SOEs such as gross margin, gross profit, profit before tax, as also post tax position of profits/losses, dividend paid by enterprises on share capital and generation of internal resources, there were also other financial ratios indicating different aspects of financial performance.

Table 4: Overall Profitability Trend from 1999-2012 (Third Phase) (Rs. in million) (at constant price with base year 2004-05)

	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
No. of operating Enterprises	232	234	231	226	230	227	226	217	214	213	217	220
i. Profit making PSEs	126	123	120	119	139	143	160	154	160	158	157	158
ii. Loss Incurring PSEs	105	110	109	105	89	73	63	61	54	55	60	62
iii. No profit/loss	1	1	2	2	2	---------	1	1	---------	---------	---------	---------
Capital employed	3676279	3889659	4436582	4961578	4781637	5044070	5617521	5964132	6157020	6212114	6712581	6450665
Turnover	4722951	5378806	5446894	6918059	6667162	7443070	8033562	8701650	9323075	9970416	9202411	10009371
Total Net Income	4900257	5632360	5669716	6731612	6487476	7349440	7962351	8750944	9378045	10269248	9405074	10176389
Net Worth	1949788	2011971	2565370	3201000	3084909	3415950	3811719	4095508	4409230	4572596	4827351	4858107
Profit before dep, int, tax EP (PBDITEP)	754946	813294	1018880	1396546	1345898	1425540	1441713	1605164	1658710	1465034	1561210	1546504
Depreciation	2426307	240865	299918	342786	330354	331470	334355	298875	311827	288402	307557	292152
DRE/Prel. Exps. Written Off	--------	---------	----------	11243	10835	9860	9518	52676	49341	60072	70711	95174
Profit before int., tax & EP (PBITEP)	512949	572429	718962	1042463	1004656	1084200	1097840	1253613	1297542	1116559	1182950	1159185
Interest	245529	279365	283955	261441	251959	228690	227470	247831	273202	308162	266579	264943
Profit before Tax & EP (PBTEP)	267420	293064	435006	780364	752062	855500	870370	1005782	1024340	808397	916371	894242
Tax Provisions	93513	109328	139435	242783	233978	216620	233822	309796	346532	265255	295839	307778
Net Profit before EP	173907	183736	295572	537580	518084	638890	636548	695986	677808	543142	620532	586464
Extra-Ordinary Items & prior Period Adj.	----------	----------	----------	-43140	-41576	-10750	-30626	-34991	-13351	-114483	-61093	-39084
Profit of profit-making PSEs	298923	334464	414515	675743	651236	744320	732859	807867	778777	772272	801615	772926
Loss of loss incurring PSEs	125015	150728	118943	93476	90086	90030	65675	76890	87617	114647	119990	147377
Dividend	66197	96956	91796	167691	161609	207180	219583	241861	239160	199961	245606	242408
Dividend tax	9587	9883	91	21510	20730	28520	30847	37038	40156	32400	38080	36646
Retained profit	98124	76896	203685	537569	518073	413940	416744	452077	411843	425256	397873	346495

Source-Various Public Enterprise Surveys; compiled into real value using GDP Deflator

Table 5: Financial Ratios

		1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
1	Sales to Capital employed	128.47	138.28	122.77	137.32	139.43	147.56	143.01	145.90	151.28	160.30	137.09	155.17
2	PBDITEP to Capital employed	20.54	20.91	222.97	24.38	28.15	28.26	25.66	26.91	26.91	23.55	23.26	23.97
3	PBTEP to Net worth	13.72	14.57	16.96	20.10	24.38	25.04	22.83	24.56	23.12	17.55	18.98	18.41
4	PBDITEP to Turnover	15.98	15.12	18.71	17.75	20.19	19.15	17.95	18.45	17.79	14.67	16.97	15.45
5	PBITEP to Capital employed	13.95	14.72	16.21	17.39	21.01	21.49	19.54	21.02	21.05	17.95	17.62	17.97
6	PBITEP to Turnover	10.86	10.64	13.20	12.66	15.07	14.57	13.67	14.41	13.92	11.18	12.85	11.58
7	PBTEP to Turnover	5.66	5.45	7.99	8.49	11.28	11.49	10.83	11.56	10.99	8.09	9.96	8.93
8	Net Profit to Turnover	3.68	3.42	5.43	5.65	8.40	8.73	8.30	8.40	7.41	6.59	7.41	6.25
9	Net Profit to Capital Employed	4.73	4.72	6.66	7.75	11.71	12.88	11.88	12.26	11.21	10.57	10.15	9.70
10	Net Profit to Net Worth	8.92	9.13	11.52	13.37	18.16	19.02	17.50	17.85	15.60	14.28	14.12	12.88
11	Dividend payout Ratio	38.06	52.77	31.06	42.57	28.85	31.89	32.91	33.09	35.33	31.06	35.87	38.81
12	Tax Provision to PBTEP	34.97	37.31	32.05	35.99	31.11	25.32	26.86	30.80	33.83	32.81	32.28	34.42
13	Interest to Gross Profit	32.52	34.35	27.87	23.52	18.72	16.04	15.78	19.77	21.06	27.60	22.54	22.86

Source-Various Public Enterprise Surveys

From Table 5 it may be seen that there has been an impressive trend of improvement in the financial performance. In spite of increase in capital employed by 75.47 per cent (in real term), profit before depreciation, interest, tax and 'extra-ordinary items' (PBDITEP) showed an increase of 104.85 per cent in a span of 11 years. In addition, the ratio of PBDITEP to capital employed or in other words the rate of return on investments to national economy continued to do much better than the previous phases. It increased from 20.54 in year 1999-00 to 23.97 in 2010-11.

During this phase, the profit before interest, tax and EP (PBITED), after accounting for depreciation during this period, had decrease from Rs. 512948.777 million to Rs. 1159184.76 million. The decrease amounts to increase of -97.74 per cent. In addition, the ratio of profit before interest and tax to capital employed i.e., return on investment has gone up from 13.95 per cent to 17.97 per cent. The Net profit during this period also increased by 237.23 per cent, thereby showing a much better performance than the previous phases.

In this phase, the profitability ratios have also improved since 1999-00, whether measured in terms of Net Profit to Turnover, Net Profit to Capital Employed, Net Profit to Net Worth or Dividend Payout. Net Profit to Capital Employed, which is an important indicator for investors, has more than doubled during this phase. It stood at 4.73 per cent in year 1999-00 but went up to 9.70 per cent for the year ending in 2010-11. Similarly, other ratios for Net Profit have shown very impressive trend.

However, the same cannot be said about other ratios where the performance was erratic and the dividend payout ratio fluctuating. It was 38.06% in 1999-00, it peaked to 52.77% in 2000-01 and then again came down to settle at 38.8% in 2010-11. Very similarly, the interest burden on SOEs measured as 'interest to gross profit' also showed an erratic behaviour; it first declined till 2005-06 and subsequently, it shows an upward trend till 2008-09 and thereafter it again falls finally settling at 22.86 per cent in 2010-11. The ration of tax provision to PBTEP, the tax burden on SOEs, initially showed some signs of improvement but with a significant fall in 2004-05, it got worse. Thereafter, it was 34.42 per cent in 2010-11, which was as low as 15.78 in 2005-06.In conclusion, it can be said that the SOEs in this phase outperformed the previous two phases. In spite of the increase in number of SOEs under MoUs and reform with management transfer, this phase witnessed an improvement in the performance of SOEs under MoU system and also in their overall financial performance. There was also no dip in the performance of the SOEs after the reversal of strategic sale from year 2004, thereby also questioning the necessity of the strategic sale. From 2010 onwards the Navratna scheme was further extended to the Maharatna Scheme with the objective of further enhancing financial autonomy of the SOEs and providing further scope of improvement for the Navratana SOEs

CONCLUSION

It is evident from the Indian experience of privatisation that the performances of SOEs have been improving gradually from phase to phase. Like China, the change has been gradual and experimental in its nature. It started with the inception of the MoU system in a few enterprises and to this day continues with extensive inclusion of SOEs under this system. The continuity and performance under the system are proof in itself of the success of this system, though the debate on the MoU completely responsible for the performance of SOEs continues.

The performance in the later phases shows around 74 % of enterprises under the MoU system were graded either as 'excellent' or 'very good'. In both the phases, the number of enterprises under MoU only went up, indicating a very good overall representation of SOEs. Furthermore, the overall financial performance of SOEs in both these phases showed excellent performance. Though number of loss-making SOEs still exists, their total number seems to have fallen dramatically when compared with the previous phases. Also, the loss margin in such enterprises continues to fall. These, too, are indicative of the improving performance of SOEs.

On the institutional front, the credibility of the MoU system of categorisation of SOEs can still be questioned. The MoU system should not end up being an aid to bureaucrats and be victim of political interference or increase the paperwork that the SOEs were required to carry out earlier. Also, in the incentive structure of the MoU, it pays for the manager to set lower targets and to get better performance record. The government is simultaneously working on this through the participation of agencies outside the government. However, competition and deregulation, the important constraints for the pursuit of efficiency, continues to be lacking in the system.

Overall, the reforms in SOEs can be concluded in three important points. First, the credit for the successful performance of SOEs goes to multiplicity of reform policies introduced. Second, the Indian experience of SOE reforms, the relevance of management transfer of SOEs i.e., strategic sale is still questionable. Third, the initiative of the Navratna, Mini-Ratna and Maharatna schemes could also be thought of as a solution to tackle the inefficiencies of SOEs.

It may be noted that closing down unviable CPSEs that employ a large number of workers is a difficult process (Katoch, 2021). Disinvestment could be better option than MOUs. Chhibber and Gupta (2019) analyses the performance of India's Public Sector Undertakings using measures of labour and overall efficiency and productivity indicators using methods that correct for selection bias and show that performance contracts do not improve firm efficiency, but disinvestment has a very strong positive effect on firm efficiency. Disinvestment improves labour productivity and efficiency, which is not surprising, but it also improves overall efficiency. In addition, disinvestment unlocks capital for use elsewhere, especially in public infrastructure, and reduces the possibility of political interference in their functioning in the future. Finally, in the Indian context, it is the ruling government's ideology that determines reform policies which lack long-term vision and absence of proper privatisation policy.

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