Disinvestment for development

July 19, 2019
Source: *Rajya Sabha TV Debate*

Manifest Pedagogy

Disinvestment is an important topic for both Prelims and Mains. The types of Disinvestment and the targets are very important for prelims. The issues like advantages and disadvantages of Divestment and the 51 % stake sale are important topics for Mains. The Air India Disinvestment case is a case study of Public Sector Enterprises which have become a drain on public resources

In news

Strategic sale of Air India

Placing it in the syllabus

Indian Economy; Planning and mobilization of resources

Static dimensions

- Divestment definition
- Types of disinvestment
- Advantages of Disinvestment
- Disadvantages of Divestment
- Regulatory Capture

Current dimensions

- **Target in the current Financial year 1.3 lakh crores past 4-year targets and achievements**
- Major Divestments – Air India Sale – Brief case study

Content

Disinvestment definition

- Disinvestment is the action of an organization or government selling or liquidating an asset or subsidiary.
- Disinvestment also refers to capital expenditure reductions, which can facilitate the re-allocation of resources to more productive areas within an organization or government-funded project.
- It is also known as divestiture, it is the opposite of an investment and is usually done when that subsidiary asset or division is not performing up to expectations.

Types of disinvestment

- **Initial Public Offering (IPO)** – offer of shares by an unlisted CPSE or the Government out of its shareholding or a combination of both to the public for subscription for the first time.
- **Further Public Offering (FPO)** – offer of shares by a listed CPSE or the Government out of its shareholding or a combination of both to the public for subscription.
- **Offer for sale (OFS) of shares by Promoters through Stock Exchange mechanism** – method allows auction of shares on the platform provided by the Stock Exchange; extensively used by the Government since 2012.
- **Strategic sale** – sale of substantial portion of the Government shareholding of a central public sector enterprises (CPSE) of up to 50%, or higher percentage as the competent authority may determine, along with transfer of management control.
- **Institutional Placement Program (IPP)** – only Institutions can participate in the offering.
- **CPSE Exchange Traded Fund (ETF)** –Disinvestment through ETF route allows simultaneous sale of GoI’s stake in various CPSEs across diverse sectors through single offering. It provides a mechanism for the GoI to monetize its shareholding in those CPSEs which form part of the ETF basket.

Advantages of Disinvestment

  - **Increase the Competitiveness:** The result of disinvestment would increase the competitiveness of the company
  - **Reduce the burden on the government** Disinvestment of loss Making PSU’s, would help the government to invest in profit making PSU’s which will minimise the burden on the government
  - **Increase the efficiency:** It would force the companies to become more efficient and survive or cease on their own financial and economic strength once they are exposed to market forces.
  - **Introduction of corporate governance:** It would result in introduction of corporate governance in the privatized companies by freeing the PSEs from the Government control and give more sco[e to innovation.
- **Benefit to small investors and employees: The disinvestment would benefit the small investors and employees as it would lead to a wider distribution of wealth in the form of public offerings of privatized companies.**
- Inflow of private capital: It would also help in achieving greater inflow of private capital that has a very positive effect on the capital market

Disadvantages of Disinvestment

- **It may lead to the loss of public interests: It is believed that the PSU’s are the assets of the nation and belongs to the people. The selling of them to private companies would affect the welfare of the people**
- Fear of foreign control: it is stated that the selling equities to foreign companies will result in serious consequences shifting the nation’s wealth, power and control to outsiders.
- **Loss of employment**: the Privatization would affect the

jobs of lakhs of workers in the PSU's and they would fall in danger by privatization.

- **Less number of bidders:** The loss of the PSU's may attract less number of bidders, for example **Air India.**
- **Pricing** : Privatization would pay the way for monopoly of the market which would lead to price rise
- **Regulatory Capture**

It is an economic theory which says that regulatory agencies may come to be dominated by the industries or interests they are charged with regulating. The result is that the agency, which is charged with acting in the public's interest, instead acts in ways that benefit the industry it is supposed to be regulating.

In other words, Regulatory capture is a form of government failure where those bodies regulating industries become sympathetic to the businesses they are supposed to be regulating. Regulatory capture can mean monopolies can continue to charge high prices.

Gains from the disinvestment to the government and future disinvestments

- If we see the disinvestment pattern over the last 15 years, then between 2004-05 to 2013-14, we could raise about Rs 1,07,000 crore. In 10 years, the average yearly collection of Rs 10,700 crore.
- However, from 2014-15 to 2017-18, this collection went up to Rs 2,12,000 crore. These four years, outstripped the previous 10 years by twice as much, because new instruments were used
- The Indian government has plans to raise as much as Rs 3.25 lakh crore ($47.4 billion) in the next five years by reducing its stakes in some large state-owned firms to 40%. The plan will open up a steady stream of state companies to greater private investment, and target the kind of annual divestment revenue that will be crucial

to meet fiscal deficit targets

- The government has identified a number of state-owned firms, including explorer Oil and Natural Gas Corp, oil refinery Indian Oil Corp, gas transmitter GAIL (India) Ltd, power producers NHPC Ltd and NTPC , miners NMDC Ltd and Coal India, and Bharat Heavy Electricals Ltd

51% direct ownership is not needed

- Bringing down the government ownership: Besides enlarging the scope of disinvestment significantly in most listed PSUs, the FY20 Budget proposal to bring down direct government ownership in many PSUs to below 51% will unburden these companies from 4Cs – Comptroller and Auditor General (CAG), Central Vigilance Commission (CVC), Central Bureau of Investigation (CBI) and courts.
- According to the Budget proposal, the Centre could bring down its direct holding in non-financial PSUs to below 51%, but it can still retain majority stake in some of these companies by taking into account the stake held by government-controlled institutions like LIC. This would provide it significantly higher headroom for disinvestment in energy PSUs, among others.

Major Divestments – Air India Sale – Brief case study

- Air India has a debt burden of Rs 55,000 crore. In November last year, a ministerial panel headed by Finance Minister had approved transferring Rs 29,000 crore debt to a special purpose vehicle (SPV)– Air India Asset Holding Company.
- Initially the government planned to offload 76 per cent equity share capital of the national carrier as well as transfer the management control to private players. The buyer was required to take over Rs 24,000 crore debt of the carrier along with over Rs 8,000 crore of

liabilities.

- However, the stake sale failed to attract any bidders when the bidding process completed on May 31.
- Now the government plans to sell Air India to a strategic investor this fiscal. Such a sale of a state-owned unlisted company could give a fillip to the government's divestment programme and spur stock markets in India.
- The government is targeting to gain USD1 billion from the sale of Air India in the next financial year.
- The government would initiate the process of strategic disinvestment of Air India in the second half of 2019-20 and in between it would work towards selling some of its subsidiaries and monetise assets.
- The ministerial panel has already cleared strategic sale of Air India's ground handling subsidiary, Air India Air Transport Services. Plans are afoot for selling another subsidiary, Air India Engineering Services.
- The proceeds from the sale of subsidiaries and land and building assets would go to the SPV and will be utilised towards lowering the debt burden of the airline.
- A comprehensive financial package, including transfer of non-core debt and assets to an SPV, implementation of robust organisational and governance reforms by the board and differentiated business strategies for each of the core businesses of Air India, are part of the plan