



## Extent of Disinvestment and the Performance of Public Sector Enterprises in India

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Seema Gupta, P. K. Jain and S. S. Yadav

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### **Research Problem (RP)**

The RP has been identified after going through a brief literature review as follows:

Denationalization of public industry serves multiplicity of objectives such as improving economic performance, resolving the persistent problems of management and control, ensuring discipline among the power of public sector trades unions, promoting popular capitalism through wider share ownership, restructuring the organization, emphasis on cost reduction by enhancing the operational efficiency and commercialization, de-licensing attracting global and domestic capital, reducing fiscal deficits as well as releasing public investment in essential areas like primary education and basic health (Kay and Thompson, 1986; Basu, 1994; Kaur and Singh, 2005; Naib, 2004; Arnold et. al., 2008 and Singh, 2004). The primary objective of disinvestment policy is to revive potentially viable loss-incurring enterprises, safeguard the interest of the workers and establishing a system of good corporate governance practices with the intent to enhance transparency and accountability in their operations to stimulate their performance (Roli and Zhan, 2011).

Disinvestment Manual (2007) contains no standard recipe for disinvestment in PSEs at the national level or at the state level. It suggests that country would do well to learn from the successful experiences of the West; the experience of others will become a way of guidance. Hamid and Chao (2006) use a simple model to identify the conditions for assessing the privatization effect on environment and have shown privatization can have a negative effect on the environment. Rossitza (2009) states the strategic interdependence between market reforms and foreign direct investment in transition economies; it contributes to economic restructuring through acquisitions in host countries with rapid market reforms. However, the pace of policy reform has varied across sectors and determined primarily by political considerations (Hoekman et. al., 2007). Bradbury (1999), Abelson (2003) and Sueyoshi (1998) have adopted case studies approach to assess the performance of disinvested PSEs. The Growth in revenue is also measured. Similar measures are employed in major studies that utilize accounting ratios to examine economic performance (Rumelt, 1974).

Sueyoshi (1998) noted that partial privatization had an impact on its productivity enhancement, primarily due to a natural reduction in personnel. It had failed to achieve any significant improvement in cost management even after its privatization. Miguel (2008) has used panel data econometric model to assess the quality of service of electric distribution utilities in Latin America and its effect on the sustainability of privatization. He opines that the quality of service could be a hidden cost of privatization because the policies of regulation have neglected the quality-of-service issue.

Kaur and Singh (2005) state that the PSEs operated under the heavy weight of non-commercial obligations of the state and untrammled discretionary power with the government erode their autonomy. They caution that disinvestment does not mean that there is a move to withdraw investment; rather, it is the canalization of the investment in a more productive and efficient way so that it can prove itself as an acceleration of growth. Naib (2004) has revealed that the vast investments have failed to produce the

surpluses and the return on capital employed is quite low. This raises the issue whether the present ills of the SOEs can be corrected by change in their ownership. Gouri (1997) observes that privatization in India is low and is limited to disinvestment of PSEs for raising non-inflationary resources. Vadlamannati (2007) finds very feeble and weak relation in view of the very small sized and slow paced disinvestment and privatization program.

### **Research Gap**

It has been identified that the results of several studies pertaining to the disinvestment of public sector enterprises (PSEs) are varying as per the economic environment and policy framework of that economy. However, there has been no single study which examines in-depth the impact of disinvestment as well as extent of disinvestment on all major parameters of financial performance (related to profitability, liquidity, solvency, efficiency, productivity etc.) of PSEs in India for the time span of more than two decades. The present paper is a modest attempt to fill this gap.

### **Objective of the Study and Summary**

Due to unbounded and cumulative financial burden, the Indian economy was almost on the verge of financial disaster. Therefore, disinvestment was conceived as an important measure to salvage such a grim situation; it was expected that the disinvestment process would also act as a catalyst to improve the financial performance/ business performance and management practices of these PSEs. Evidently, it was conceived to have larger implications rather than just selling the government equity at the best price. It was expected to contribute towards the growth of Indian economy by promoting competition; it, in turn, promotes the market friendly economy than the command economy which leads to cost reduction, improved quality and operational efficiency. Likewise, disinvestment was also expected to attract global capital as well as domestic capital. Above all, disinvestment of government equity in PSEs has many social, economic and political implications (Ray and Maharana, 2002; Kaur and Singh, 2005; Naib, 2004; Arnold et. al., 2008).

Therefore, the objective of this paper is to assess the impact of disinvestment on the financial performance of disinvested central public sector enterprises (PSEs) during the time span of more than two decades. The paper also aims at analyzing the role of degree of disinvestment on the performance/improvement of the sample disinvested PSEs.

### **Research methodology**

The sample to the study consists of 38 non-financial disinvested central PSEs in India where less than 50 per cent of the disinvestment has been undertaken up to the year 2001-02. The sample represents all the industrial groups that have gone for the disinvestment as per Public Enterprises Survey. The performance of the enterprises has been compared five years before and after eight years after the disinvestment for the time span of 23 years (1986-87 to 2009-10) on rolling basis; the purpose is to ascertain whether there has been any significant change in the financial performance during the long tenure of eight years in the post-disinvestment period due to disinvestment or not. The period of the study is restricted to the year 2010 due to the change in reporting standard of financial statements from the year 2011-12 as per

Revised Schedule VI of Company Act 1956<sup>1</sup>; this, in turn, has brought change in many figures/constituents of balance sheet and income statement. Therefore, we were constrained to have the present study restricted to 23 years (where financial reporting requirements remain virtually same over a period of time of the study).

Relevant secondary data has been collected from the various volumes of Public Enterprises Survey. Financial performance has been measured on the aggregate and dis-aggregate basis. In each analysis, we have relied primarily on 19 financial ratios pertaining to profitability, operating efficiency, leverage, liquidity and productivity. Profitability has been assessed on the basis of rate of return on investment and sales. The return on investment has been computed in three ways, *viz.*, return on total assets (ROTA), return on capital employed (ROCE) and return on net worth (RONW). The first two rates of return highlight how efficiently financial resources are deployed by the PSEs and RONW indicates the return provided to the equity-owners (primarily government in the context of PSEs).

Secondly, return on the basis of sales has been computed on the basis of operating profit margin (OPM) and net profit margin (NPM). The OPM provides a clear view of profit margin (undistorted by financing pattern and tax calculation) referred to as earnings before interest and tax (EBIT) relating to sales. The NPM determines the relationship of reported net-profit after taxes to sales; it indicates the management's ability to carry on the business profitably and expresses the overall cost/price effectiveness (Helfert, 2003).

Similarly, efficiency or effectiveness in utilization of resources has been determined on the basis of three dimensions. The first one is concerned with the efficiency in utilization of assets, determined through assets turnover ratios, *i.e.*, total assets turnover ratio (TATR), fixed assets turnover ratio (FATR) and current assets turnover ratio (CATR). Low turnover is indicative of under-utilization of available resources and presence of idle capacity.

The second dimension of efficiency is based on examining the change in holding period (in number of days) of various types of inventories and collection period of debtors which are the sub-constituents of current assets with the objective to minimize the investment in the inventory and to meet the demand of products. Inventory consists of raw materials, spare parts and other stores as raw-material inventory holding period (RMIHP), work-in-progress inventory holding period (WIPiHP) and finished-goods inventory holding period (FGIHP). Debtor collection period (DCP) presents the relationship between gross sales and average debtors in the beginning as well as in the end of the year.

The third variant of efficiency measurement explores the change in the capacity utilization of fixed assets over a period of time. The fixed assets have been grouped into four categories on the basis of their usage,

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<sup>1</sup> Schedule VI Companies Act, 1956, it is applicable to all companies for preparation of the Financial Statements from the financial year commencing on or after April 1, 2011. Financial statements are to be prepared for the year 2011-12 (1st April 2011 to 31<sup>st</sup> March 2012) onwards as per revised/changed schedule.

i.e., CU of fixed assets below 50 per cent, between 50 to 75 per cent, between 75 to 100 per cent and above 100 per cent.

Capital structure practices and liquidity position are measured through total debt to total equity (TD/TE) and current ratio (CR) as well as acid test ratio (ATR). The PSEs should maintain adequate liquidity in terms of satisfactory CR and ATR which depends on their access to sources of funds and ease with which these funds can be tapped in times of need.

Further the productivity of capital per employee which has been determined in terms of level of employment, sales efficiency (SE) and net income efficiency (NIE) ratios.

To determine the change over a period of time and across the phases on the same set of companies paired t-test and descriptive statistics has been carried out; analysis of variance (ANOVA) has also been applied on more than two sets of companies to determine the change within a group (or same set of companies) and with the other group of companies. Survey findings are predominantly based on 15 responses received from disinvested PSEs.

### **Findings of the Study**

Contrary to the expectations, the sample disinvested enterprises has shown dismal performance. The findings indicate that disinvestment brings no major improvement in the parameters related to the profitability, assets turnover and capacity utilization even after eight years of disinvestment. A marginal decline in the mean values of all the five profitability and assets turnover ratios has been observed during the post-disinvestment period *vis-à-vis* pre-disinvestment period. Though, improvement has been noted in respect of productivity of capital and liquidity only; as disinvested PSEs are able to decrease the manpower employed (pronounced in VRS). In fact, findings are not in conformity with normal expectations that disinvested PSEs perform better, probably high government involvement and lesser autonomy could be one of the factors of low performance. The others may be, low profit margin, competitive environment, administrative prices control and decline in usage of debt have been listed as the probable reasons for decrease in profitability of disinvested PSEs (Gupta et. al (2011); under partial disinvestment, control continues to remain with government and hampers faster decision-making which lead to an adverse impact on the performance of PSEs.

However, extent of disinvestment has shown mixed results in the parameters of profitability across the six groups. No uniform pattern has been observed. The position of liquidity, leverage, inventory holding period (IHP) and productivity have shown improvement to a large extent due to higher disinvestment. ANOVA test has also corroborated positive relation between the quantum of disinvestment with higher financial performance.

In sum, it is worth stating that partial disinvestment has not derived the results which was expected from them; it may be virtually due to number of problems faced by PSEs even after disinvestment, such as inefficient, high cost and non-competitive industrial structure, operational inefficiency due to high

governmental interference, environment restrictions (delegation of operational and functional autonomy to the managers through performance contracts), less disinvestment (for filling fiscal deficit gaps) and capital market discipline. Koen (1998) has suggested that privatization alone is not the answer of good governance; managerial skills, the existence of performance incentives, transparency and a sound legal system are also required.

### **Recommendations of the Study**

It is recommended that the government henceforth should aim for strategic disinvestment; as small and modest sizes of disinvestment are not likely to be fruitful. The government's intervention in the operational functioning and managerial decision-making should be a matter of last resort; disinvested public enterprise needs major structural changes including replacement of leadership, existence of performance incentives, transparency and education to managers in order to successfully shift to competitive firm.

The government should adopt a selective policy in the case of closing the loss-incurring PSEs. It is understandable that for social reasons, the government normally finds difficult to close the sick/loss-incurring PSEs. The government may sell such PSEs to private sector. For the purpose, it may invite tenders from the private sector. Obviously, in some cases, it may be very difficult to sell them at positive price. Since, the condition would be to run them in future; it may sell them with minimum negative tender price as followed in Germany (Gupta, 2005).

### **Implications of the Study**

The research should be of value to the academicians, government, policy makers, management of the public sector enterprises and international development agencies. The study suggests strategic disinvestment since small amount of disinvestment or partial disinvestment do not yield desired results in majority of the cases.

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