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Public Sector Enterprises in India

The Impact of Disinvestment and Self Obligation on Financial Performance

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Dedicated to
Professor Max Peyrard
Emeritus Professor and Chair
Jean Monnet ad personam
University of Paris 1 Sorbonne
School of Management

Preface

Practice without theory is blind.
Theory without practice is sterile.
(Marx, Contribution to the Critique of Hegel's Philosophy of Law, Jan. 1844, MECW, Vol. 3, P. 182)

The public sector in India has played a dominant role in shaping the path of the country's economic development. Visionary leaders of independent India drew up a road map for the development of public sector as an instrument for self-reliant economic growth. The public sector has provided the much required thrust and has been instrumental in setting up a strong and diversified industrial base in the country. As a result of the initiatives taken during the five-year plans, the role of central public sector enterprises (PSEs) in terms of contribution to the Indian economy has been phenomenal. The number of PSEs as on 31 March 2009 was 246, with a total capital of nearly Rs. 5.3 lakh crores. The number rose to 260 on 31 March 2012 with a total capital of 13.43 lakh crores as against modest number of five PSEs having a total investment of Rs. 29 crores on the eve of the First Five-Year Plan (1 April 1951).

With the onset of economic reforms in 1991, the Government of India initiated a systemic shift to a more open economy with greater reliance on market forces and a larger role of the private sector including foreign investment. Accordingly, the PSEs were exposed to competition with domestic private sector companies as well as large multinational corporations. In order to compete in the new environment, the PSEs undertook significant initiatives for improving technology and scaling up capacities to operate at par with the private counterparts in the liberalized economy. Keeping pace with the global changes over a period of time, the PSEs in India also have adopted the policies like disinvestment, self-obligations (MoU), restructuring, etc. Thus, the continued focused efforts towards achieving excellence have helped several of the PSEs to become self-reliant, and they are playing a critical role in building the Indian economy.

It was, therefore, considered worthwhile to carry out a comprehensive study which assesses the performance of PSEs as well as the impact of MoU and disinvestment on the financial performance. Further, the liberalization of Indian economy had effects of global upheavals on Indian enterprises; the most recent event being the global recession in 2008. The study also attempts to analyze whether there was any impact of this recession on Indian PSEs.

This research monograph covers 209 non-financial central public sector enterprises (PSEs) in India. A time span of 20 years (1991–1992 to 2010–2011) has been considered; this period has been divided into four different sub-phases (1991–1992 to 1995–1996, 1996–1997 to 1999–2000, 2000–2001 to 2007–2008, and 2008–2009 to 2010–2011). From the statistical point of view, the "first" phase, "second" phase, "third" phase, and "fourth" phase have been considered as four independent samples. The performance of the MoU PSEs, subsequent to the recommendations of the National Council of Applied Economic Research (NCAER), which have been implemented from the year 2004 to 2005, has also been evaluated. For this purpose, the third phase period (2000–2001 to 2007–2008) has been sub-divided into two phases: 2000–2001 to 2003–2004 is referred as pre-NCAER recommendation phase two, and 2004–2005 to 2007–2008 corresponds to post-NCAER recommendation phase two. The subsequent period (i.e., 2008–2009 to 2010–2011) is of particular importance, due to the recession (caused by American financial crisis) that had impacted the world economy during the second half of 2008. Hence, to assess the impact of recession on the performance of these PSEs, fourth phase (2008–2009 to 2010–2011) is marked as post-recession phase.

In this research, primarily 18 ratios related to profitability, efficiency, liquidity, leverage, and productivity of capital have been used for assessing financial performance, pertaining to the sample public sector enterprises (PSEs), disinvested PSEs, and MoU PSEs. Another set of classification (1) in terms of manufacturing PSEs and service PSEs and (2) profit-making and loss-making PSEs has also been followed for the purpose of analysis. Apart from secondary data, the inferences have been drawn from the questionnaire survey based on the 30 responses from PSEs.

The sample virtually covers the universe of the central PSEs in India. Based on the major findings, some concrete suggestions/recommendations have been made for government/management of PSEs for their better functioning.

The findings suggest that liberalization and economic reforms have yielded positive impact on the performance of the sample PSEs in India as reflected by the majority of the ratios over a period of time. Survey findings have indicated satisfying compounded annual growth rate in their net profits over the time.

Sector-wise disaggregate analysis shows that there is no sector-wise statistically significant difference, though better profitability and liquidity have been recorded in service sector PSEs than those of manufacturing sector PSEs. It is worth noting that the loss-making PSEs have positive operating profits as well as positive rates of return on their investments from year 2005–2006 onwards. This is a signal for their turnaround. There is a need to review the policy of their closure. In operational terms, closure of sick/loss-making PSEs should be taken on the merits of each case instead of having blanket policy of closing them.

The study has inferred that there is better profitability, assets turnover, productivity of capital, and liquidity position in disinvested PSEs vis-à-vis non-disinvested PSEs.

MoU has brought about a positive impact on the financial performance of MoU PSEs; the increase in profitability, efficiency, liquidity, and productivity is commendable during the post-MoU phase; *t*-test has also corroborated significant difference between MoU and non-MoU PSEs in many ratios. Phase three has shown marked improvement in the parameters of profitability and productivity compared to previous two phases in MoU PSEs. Similarly, efficiency, liquidity, and leverage ratios have also shown satisfactory results in sizable number of cases.

The study indicates that MoU has made significant impact in improving the profitability, operational efficiency, liquidity, and productivity of PSEs. It is important to note that the loss-making MoU PSEs have reduced their losses and have turned their losses into profits by enhancing their productivity and operational efficiency over period of time. Further, manufacturing PSEs over which service PSEs have an edge have shown better profitability after signing MoUs. In sum, MoUs have yielded the desired results. *Therefore, it is recommended that MoU should be mandatory for all the PSEs (instead of the current practice of its being voluntary in nature).*

It is reasonable to infer from the study that economic reforms, liberalization policies, and MoU have laid positive and salutary impact in improving the financial performance of PSEs in a large number of cases over the phases. The study is useful for the government, ministries, academics, and the public at large to develop the policies as well as strategies for the development of PSEs in India.

It would not, therefore, be out of context to state that contrary to the normal expectation, the disinvestment has not made the desired impact on financial performance. It may be due to the inadequate level of disinvestment (partial disinvestment), on the one hand, and the lack of full autonomy in their functioning, on the other. *Therefore, the study suggests that the government henceforth should aim at 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.*

It is also for consideration of the government that the disinvestment should be driven by the objective of most efficient allocation of resources, both monetary and non-monetary. The resources currently blocked in non-strategic PSEs should be released as soon as possible through sale of government stakes in such PSEs for redeployment.

Another important outcome is that the global recession has not made any significant dent on Indian PSEs. It may be, therefore, inferred that the Indian economy has remained insulated to a large extent from the recessionary influences in the recent past. However, this needs to be taken with a note of caution as the impact may be felt with a time lag or in a gradual manner.

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Abbreviations

ANOVA	Analysis of variance
APM	Administrative price mechanism
ATR	Acid test ratio
CATR	Current assets turnover ratio
CR	Current ratio
DCP	Debtor collection period
DPE	Department of Public Enterprises
EBIT	Earnings before interest and taxes
EMP	Employment level
FATR	Fixed assets turnover ratio
FGIHP	Finished-goods inventory holding period
FP	Financial performance
GDP	Gross domestic product
GDRs	Global depository receipts
HPC	High Power Committee
IHP	Inventory holding period
LM	Loss making
MoU	Memorandum of understanding
NCAER	National Council of Applied Economic Research
NCMP	National Common Minimum Program
NIE	Net income per employee
NPM	Net-profit margin
OPM	Operating profit margin
PM	Profit making
PRP	Performance related pay
PSEs	Public sector enterprises
Q1	Lower quartile
Q3	Upper quartile
R&D	Research and development
RMIHP	Raw-material inventory holding period

ROCE	Return on capital employed
ROI	Return on investment
RONW	Return on net worth
ROR	Rates of return
ROTA	Return on total assets
SE	Sales efficiency per employee
SEBI	Security and Exchange Board of India
SPSS	Statistical Package for Social Sciences
TATR	Total assets turnover ratio
TD/TE	Total debt to total equity
TF	Task force
VRS	Voluntary Retirement Scheme
WIPIHP	Work-in-process inventory holding period

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