Disinvestment Through Public Offers

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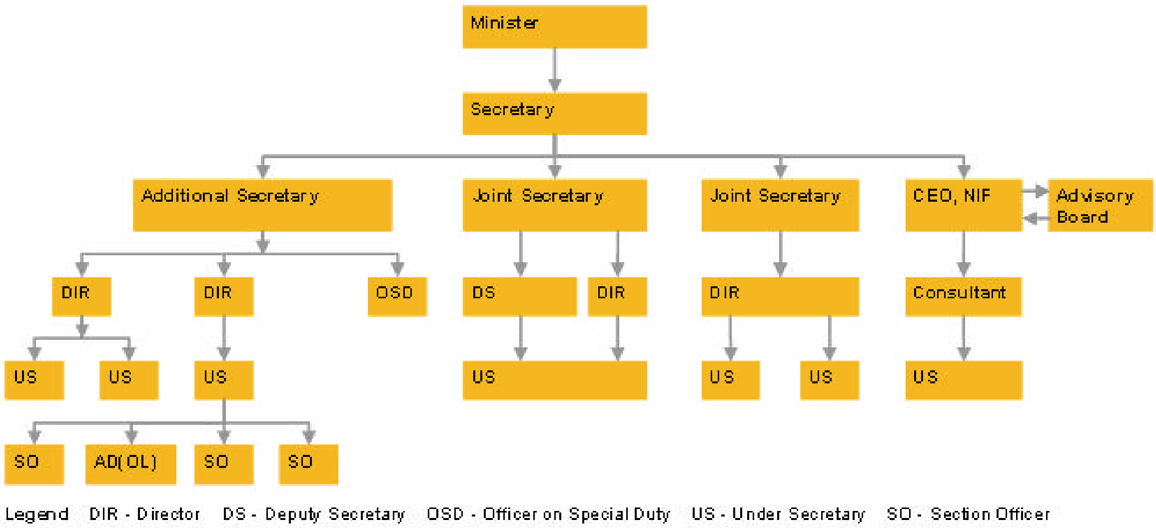
Introduction: The disinvestment of PSU's has not been a simple process of one owner being substituted by another owner. On the other hand, disinvestment has been looked upon as a process of substituting political philosophy, wherein the concept of Government does everything is replaced with, Government is capable of doing only a few things and the rest should be done by people who know it best. It is in this background that while economic planners have seen opportunities in disinvestment, there have also been equally difficult challenges.

The history of disinvestment can be traced back to the 1991 Balance of Payment crisis. The Government decided to disinvest public sector companies to raise enough capital to help reduce the fiscal deficit. A separate department called the Department of Disinvestment was set up in 1999. The vision statement of the Department of Disinvestment is to "*Promote people's ownership of Central Public Sector Enterprises to share in their prosperity through disinvestment*." The organisational structure and work allocation of the Department of Disinvestment is as follows:

Organisational Structure

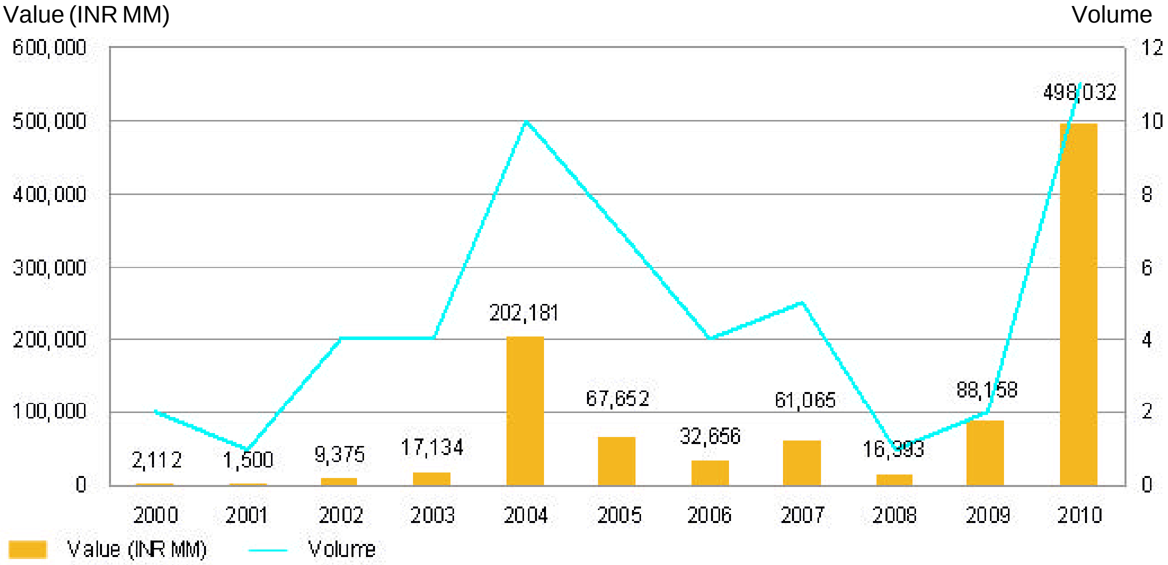


*** Source:** http://www.divest.nic.in/Org_str.asp

This department consists of some of the highly experienced bureaucrats: Shri Sidhartha Pradhan (Additional Secretary & Chief Vigilance Officer), Shri Pramod Agrawal (Joint Secretary) & Ms. Kalpana Mittal Baruah (Joint Secretary) to name a few.

The disinvestment program is assuming increased significance given the Government's ambitious growth program. The year 2010 was a landmark year, in terms of both value and volume, as can be seen by the graph below.

2010 Was a Landmark Year for the Disinvestment Program



* Source: Prime Database

Prior to 2010, the disinvestment program was moving at a slow pace. There is a renewed focus on disinvestment mainly because:

1) The Government has targeted to keep the fiscal deficit at 4.6% of GDP for 2011-12. Currently, it stands at 5.1% of GDP.
2) The Government needs to fund growth and programs like NREGS (National Rural Employment Guarantee Scheme), subsidies etc. The Government plans to spend Rs. 400 billion on NREGS in 2011-12.
3) The urgent need to professionalize Indian PSU's to compete with private players.

The various IPO's and FPO's that have taken place over the past decade are presented in the table below:

IPO's & FPO's in the Past Decade				
Year	**Company Name**	**IPO/ FPO**	**Disinvestment (INR MM)**	**Fresh Capital (INR MM)**
2000	Indian Overseas Bank	IPO		1,112.0
	Vijaya Bank	IPO		1,000.0
2001	Andhra Bank	IPO		1,500.0
2002	Canara Bank	IPO		3,850.0
	Punjab National Bank	IPO		1,644.9
	Union Bank of India	IPO		2,880.0
	Allahabad Bank	IPO		1,000.0
2003	UCO Bank	IPO		2,400.0
	Indian Overseas Bank	FPO		2,400.0
	Vijaya Bank	FPO		2,400.0
	Maruti Udyog Ltd.	IPO	9,933.5	
2004	Bank of Maharashtra	IPO		2,300.0
	Indian Petrochemicals Corp. Ltd	FPO	12,028.5	
	CMC Ltd.	FPO	1,904.4	
	IBP Co.Ltd.	FPO	3,506.6	
	Dredging Corp. of India Ltd.	FPO	2,212.0	
	Gail (India) Ltd.	FPO	16,273.6	
	Power Trading Corp. of India Ltd.	IPO		936.0
	Petronet LNG Ltd.	IPO		3,914.7
	Oil & Natural Gas Corp. Ltd.	FPO	105,424.0	
	National Thermal Power Corp. Ltd.	IPO	26,840.7	26,840.7

IPO's & FPO's in the Past Decade				
Year	**Company Name**	**IPO/ FPO**	**Disinvestment (INR MM)**	**Fresh Capital (INR MM)**
2005	Gujarat Industries Power Co. Ltd.	FPO		2,000.0
	Dena Bank	FPO		2,160.0
	Punjab National Bank	FPO		31,200.0
	Allahabad Bank	FPO		8,200.0
	Oriental Bank of Commerce	FPO		14,500.0
	Syndicate Bank	FPO		2,500.0
	Infrastructure Development Finance Co. Ltd.	IPO	3,012.4	4,080.0
2006	Gujarat State Petronet Ltd.	IPO		3,726.0
	Bank of Baroda	FPO		16,330.0
	Andhra Bank	FPO		7,650.0
	Union Bank of India	FPO		4,950.0
2007	Indian Bank	IPO		7,821.4
	Central Bank of India	IPO		8,160.0
	Power Finance Corp. Ltd.	IPO		9,971.9
	Bharat Earth Movers Ltd.	FPO		5,267.5
	Power Grid Corp. of India Ltd.	IPO	9,948.2	19,896.3
2008	Rural Electrification Corp. Ltd.	IPO	8,196.3	8,196.3
2009	NHPC Ltd.	IPO	20,128.5	40,257.0
	Oil India Ltd.	IPO		27,772.5
2010	NTPC Ltd.	FPO	84,801.0	
	Rural Electrification Corp. Ltd.	FPO	8,825.1	26,475.3
	NMDC Ltd.	FPO	99,304.5	
	SJVN Ltd.	IPO	10,627.4	
	Engineers India Ltd.	FPO	9,596.5	
	Coal India Ltd	IPO	151,994.4	
	Power Grid Corp. of India Ltd.	FPO	37,211.7	37,211.7
	Moil Ltd.	IPO	12,375.1	
	Shipping Corp. of India Ltd., [THE]	FPO	5,824.5	5,824.5
	United Bank of India	IPO		3,251.5
	Punjab & Sind Bank	IPO		4,708.2

* Source: Prime Database

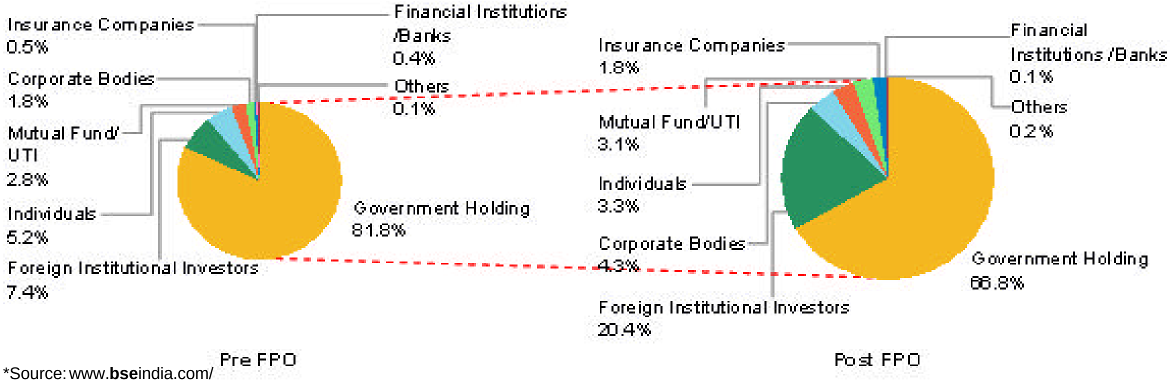
Opportunities And Challenges Presented By Disinvestment

Opportunities	**Challenges**
Improve Shareholder Base	Adverse Market Environment
Attract Global Investors Interest	Accurate Pricing
Broaden List of Financing Options	Competition from Private Sector
Enhance Corporate Governance Standards	
Improve Price Discovery	

Opportunities:

1) **Improve Shareholder Base**: Disinvestment will lead to an increase in the quality and diversity of the shareholder base. The Board of Directors will be answerable to a wide variety of shareholders. For example, Rural Electrification Corporation came up with an FPO in March 2008, which led to an increase in Non Government holding from 18.18% pre FPO to 33.20% post FPO. A diversified shareholder base allows for better price discovery and higher trading volume.

Shareholding Pattern of Rural Electrification Corporation Pre & Post IPO



*Source: www.**bse**india.com/

2) **Attract Global Investors Interest**: During the disinvestment process, the PSU's in order to attract investors need to go on roadshows. They need to convince potential investors that there exists value in the company. All these efforts lead to increased awareness of the company among national and international investors. As such, disinvestment brings companies that are not publicly well known into the limelight. For example, Coal India and NMDC met approximately 158 and 91 number of investors respectively over different asset classes and over different geographical locations (London, New York, Hong Kong etc).
3) **Broaden List of Financing Options**: A key benefit due to disinvestment is that companies will be able to secure capital market financing. The companies need not depend on World Bank & IMF loans to secure their financing needs. With ready access to capital markets they will be able to satisfy their financing requirements. Given the strong growth focus and the need to compete with well funded private players there is a significant need for capex for major PSU's.

Capital Expenditure Requirements (in INR MM)

Company Name	2011-12	2012-13
NMDC	25,978.7	24,157.3
BHEL	14,651.7	9,185.1
SAIL	143,049	146,887.1
PGCI	139,913.2	133,651.1

* Source: FactSet

Disinvestment will present before these companies a wide array of options to choose from to meet their future capital expenditure requirements.

4) **Enhance Corporate Governance Standard**: A major opportunity of disinvestment is that it will increase accountability and bring about corporate governance. When a company is listed, it needs to adhere to clause 49 of SEBI listing agreement. As per this clause:
   - The non-executive directors must comprise 50% of the Board of Directors.
   - If the chairman of the board is a non executive director then atleast one third of the board should consist of independent directors and if the chairman is an executive director then atleast half of the board must consist of independent directors.

   This clause also defines what the term independent director means. It is one who is not related to the promoters or the people in the management positions, does not have any pecuniary relationship with the company apart from receiving remuneration, should not hold two percent or more shares in the company etc. As such this will lead to management taking decisions in the best interests of the shareholders.

   According to clause 49 a company that is planning to get listed must set up an independent audit committee whose chairman must be an independent director. This committee shall have powers like investigating any matter within its power, obtaining information from any employee, it can also seek outside legal advise and if required seek attendance of outsiders with the related expertise. This will lead to a lot of checks and balances within the system. As such disinvestment will strengthen corporate governance.

5) **Improve Price Discovery**: Disinvestments done via public offers will help the Government realize the true value of the PSU's. In some cases, the valuation has gone far beyond the initial offer price. For example, in the public offering of NTPC, the Government sold shares in 2004 at Rs. 62 and in 2010; it was able to sell its shares at Rs. 201. As such this is a major advantage of an disinvestment through public offering as it leads to price discovery.

Challenges

1) **Adverse Market Environment**: One of the challenges is that of the market environment in which the firm operates. If the market environment is not favorable, disinvestments may not be undertaken. Post Coal India and Power Grid Corporation in 4Q 2010 there have not been any disinvestments because of the unfavorable market environment. Planned issues by SAIL, IOC & ONGC have been postponed due to adverse capital markets and operating environment. Factors such as high interests rates, global crude oil prices, inflation etc all play a major role in timing the issue.
2) **Accurate Pricing**: Maintaining strong retail and FII participation while also increasing Government proceeds is a key challenge. A comparison of Coal India and NMDC illustrates this fact. NMDC found it very hard to attract retail and FII investors for its FPO in 2010 as explained by the table below:

Response To Recent Disinvestments In NMDC & Coal India Ltd

Category	NMDC Times Subscribed	Coal India Ltd. Times Subscribed
Retail	0.21	2.21
NIB	0.2	24.95
QIB (Except Mutual Fund)	2.37	24.86
MF (QIB—Mutual Fund)	0.71	19.35
EMPL	0.06	0.1
Overall	**1.24**	**15.14**

*Source: http://www.divest.nic.in/RecentDis.asp

In contrast, the Coal India IPO was a major success. It was subscribed 2.21 times as compared to NMDC which was subscribed .21 times by the retail investors. The Government has divested 10 % stake in Coal India Ltd. It has earned approximately $3.5 billion through the stake sell in Coal India. The share price of Coal India has soared approximately 60 % since its IPO. When there are a few shares traded in the market a small increase in demand can lead to a spike in prices. This was the case with NMDC.

In an IPO the price has to be set in such a manner that it attracts sufficient amount of retail investors and at the same time it must make sure that the Government gets the optimum proceeds. The challenge is to maintain this balance while pricing the IPO. Also in case of an FPO care must be taken to make sure that the SEBI guidelines are adhered to. As such pricing is crucial.

3) **Competition From Private Sector**: Another challenge of disinvestment is that it must be timed to avoid conflicts with more attractive businesses. If there are two companies in the same industry issuing FPO/IPO at the same time it will lead to competition for the same capital pool. The retail investors usually have a cap as regards the amount of capital they wish to invest in a particular sector. Given a choice between investing in an IPO of a PSU and a private sector company, they may choose the latter. The recent conflict seen in the case of SAIL FPO & Tata Steel's FPO is a particular case.

Conclusion

Disinvestments are here to stay and will be an important area of focus for the Government, as it needs to fund its programs and better run its PSU's. The Government will have to balance its needs for funding with the need to make these issues attractive to the capital market. Government approval for disinvestment has been received for ONGC, SAIL, IOC, BHEL among others and it will be interesting to observe as to how the Government balances funding needs and capital market success.