Disinvestments through Public Offers-Key Learnings

Nilesh Shah
Chief Executive Officer
Axis Capital Ltd.

Disinvestment by PSUs in India is one of the significant tools to achieve twin objective of raising resources for GoI and offering participation in the wealth of the PSUs to investors at large including retail investors. Disinvestment means conversion of the Government equity into cash. It is the process of dilution of Government ownership by selling parts of the equity of PSUs to institutional and retail bidders. Such disinvestment in India would release huge amount of scarce public resources locked up in non-strategic PSUs for development in areas much higher on social priority such as social and economic infrastructure. In the process it also results in increasing floating stock thereby providing more depth and liquidity to investors. It also improves the efficiency of the working of the enterprise. The induction of public into the ownership structure can also create conditions in which there could be greater autonomy for the functioning of the public sector enterprise. Disinvestment can, therefore, be regarded as a tool for enhancing economic efficiency. VSNL was the first PSU to be divested by way of a Public Offer in 1999-00. ONGC Public Offer in 2003-04 has been the largest PSU FPO raising Rs. 10,542 crore. Coal India Public Offer in 2010-11 has been the largest PSU IPO raising Rs. 15,199 crore. The maximum number of applications received in a PSU IPO/FPO since 2003-04 was in Coal India Limited (15.96 lakhs). Total disinvestment proceeds in FY 13-14 were Rs 15,819.45 crore. GoI has so far raised Rs 1,52,790 crore thru various forms of disinvestment.

Traditionally disinvestment has been conducted thru public offers as it was the most transparent process. However a public offer is a costly and time consuming process. Planning and good preparation are crucial for a successful flotation. It is not simply a question of appointing advisors but about ensuring that the company is ready to be listed on the public markets and that it is able to meet the challenges that such a listing brings. There are a number of key issues to address prior to a public offer:

- choosing the right market
- preparation of attractive investor story
- ensuring appropriate and adequate board of directors and management team
- establishing corporate governance structure, management information and management reporting systems
- assessing suitability of existing capital
- financial track record
- readiness to change and embrace a "listed company mindset"
- management and employee incentive arrangements

All these issues require a significant amount of time and resources and need to be undertaken in addition to the day-to-day requirements of running the business itself. Post the public issue managing investor relations and communications becomes important.

Performance of PSU stocks in the secondary market has seen mixed results from the point of view of capital appreciation. Generally PSU stocks have been regarded as safe and sometimes better investment opportunities since these are backed by strong fundamentals, rich asset base, strategic business of national interest and good governance. The response to the offer of PSUs from the investors at large has been encouraging and some of the PSU stocks have performed well in the secondary market creating value for investors. The disinvestment exercise has broad-based PSUs' equity in the last two decades. As on 30th April 2014 the 50 Central PSUs listed on the stock exchanges contributed to 15% of the total market capitalization.

The process of disinvestment has been loaded with challenges. Disinvestment is not favored socially in some quarters as it is perceived to be against the interest of socially disadvantaged people. Political pressure from opposition, loss making units not attracting investment, lack of well-defined investment policy are the other challenges. The tests applicable to private corporates such as pricing, timing, objects for which funds being raised are also equally applicable to PSUs. Selling shares to prospective investors in an uncertain market requires skilled marketing besides the following;

1. Offer price should be attractive enough for investors to gain from listing and trading;
2. Disinvestments should be spread out over a few months to avoid crowding amongst themselves as well as with the private sector;
3. Employees of PSUs should be rewarded with ESOPs / reservation in disinvestment

The PSUs that have strategically planned their issuances with proper pricing have been received well by the capital market and their performance in the stock market has yielded good results. A successful IPO has often resulted into further public offers (FPOs) thereby raising further resources and achieving disinvestment targets. However pricing of FPOs and marketing has always been a difficult task on account of availability of market price for the existing capital. Stocks of the companies selected by GoI for divestment thru FPO has historically seen continued selling pressure as traders place their sell orders in the futures markets whenever a divestment plan is announced. In several cases, the government had priced shares at discount to the market price. For traders, the discount offered becomes quite profitable as they seek an arbitrage opportunity, leading to continued selling pressure on the stock of the PSU. This is further accentuated by the 4-5 day gap between the price band announcement and offer closure in a typical public issue. Rush to disinvest at a discount often leads to existing shareholders losing out as the stock price of the company falls and the market cap gets eroded.

If the disinvestment policy is to be in wider public interest, it is necessary to examine issues such as correct valuation of shares. Further, in many cases, disinvestment has not really changed the ownership of PSUs, as the government has retained a majority stake in them. Disinvestment has not yielded desired results even after disinvestment, such as efficient, low cost and competitive industrial structure, operational efficiency and high capital market discipline.

The idea behind disinvestment should be to attract a large set of private institutional and retail investors and not other PSUs. It is increasingly clear that, without a class of people for whom investment in equity is a normal activity, selling stakes in the PSUs is fraught with danger. It is also important for the GoI to keep exploring various possibilities of divesting its equity from time to time as it has indeed done. One such successful method has been OFS thru stock exchange which has restricted the gap between announcement of floor price and the offer closure to 24 hours and resulted in quick and transparent settlement. Another is introduction of ETFs as a low-cost, transparent solution for disinvestment as compared to FPO which is more time consuming and costly. ETF is an innovative disinvestment strategy that provides a basket of PSUs to investors without exerting pressure on the price of individual stocks. It is expected that ETF will encourage long-term investors to participate in the divestment program. Yet another has been buyback thru a tender mechanism and off line book building process concluding in trades on the stock exchange platform.

Disinvestment will be extremely positive for the Indian equity markets and the economy. It would encourage citizens' participation in management of public enterprises and improve the capitalization of stock markets. It will draw lot of foreign and domestic money into the markets. It will allow PSU to raise capital to fund their expansion plans and improve resource allocation in the economy. As certain number of shares are reserved for retail investors splitting the stocks of some big PSUs will further attract retail investors. Market capitalization of PSUs can go higher up. Employee reservation in disinvestments will work as an incentive to keep momentum going. This will be true democratization of capital.

In India, some of the PSUs are best placed to tap the capital markets as they can capitalize on huge growth in their capacities, strong execution skills, enviable order book position, attractive financials and low risk model. The preparedness of PSUs to tap the capital market as and when the conditions are conducive is of utmost importance to achieve desired goals. Conscious effort needs to be made to develop a concrete plan to proceed with disinvestment and have a basket of PSUs ready and available to launch in the market at an appropriate time. The decision to disinvest should remain an economic decision and not a political decision. The Government should try to come out with achievable disinvestment targets and lay down a time bound program to conduct the process. Consensus amongst stakeholders is essential. Only then the real benefits can be reaped.