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# DISINVESTMENT COMMISSION

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Report I

February 1997

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*Note : The Tables contained in this Report are based on information received from Management of the PSUs and other sources.*



## Summary of Recommendations

Disinvestment Commission has submitted four sets of recommendations to the Government. A summary of the recommendations is given below:

Table 1 Disinvestment Modalities Recommended in Reports I,II,III &IV

Modalities of Disinvestment	No.	Name of PSU
Trade Sale	3	ITDC <sup>1</sup> , MFIL, PHL <sup>2</sup>
Strategic Sale	7	HTL,ITI,BALCO,BRPL., KIOCL, MFL <sup>3</sup> , HCL
Offer of Shares	4	GAIL, CONCOR, MTNL, MOIL <sup>3</sup>
Offer to Stable Shareholders (Cross holding)	1	SCI
No disinvestment	1	RITES
Disinvestment deferred	3	OIL, ONGC, POWERGRID
Total		

1. Lease-cum-management contracts for hotels in prime locations like Delhi and Bangalore

2. Offer to sell the total Government holdings to ONGC in the first option

3. At a later stage

The Commission has made General Recommendations which are as under:

Table 2 General Recommendations

Recommendations	Remarks
Establishment of Disinvestment Fund (I:3.1)	The proceeds from the disinvestment may be placed separately in a "Disinvestment Fund" and the National Renewal Fund should also be merged with this Fund. The resources of the Fund may be primarily used for temporarily meeting the losses of some PSUs before disinvestment, where required, for a limited period during the process of short term restructuring or closure, for strengthening marginally loss making PSUs in preparation for disinvestment and for providing benefits to workforce found to surplus during restructuring or closure.
Formation of Standing Empowered Group (I:4.1)	Given the advisory nature of the Commission, the Commission recommends the formation of a Standing Empowered Group (SEG) to ensure smooth implementation. The SEG could comprise the Cabinet Secretary, Secretaries of the Ministry of Finance, Department of Public Enterprises, Administrative Ministry of PSU alongwith the CEO of the concerned PSU.
Guidelines on Modalities - Offer of Sale (I:4.2) & (II:1)	"Book building" process similar to that followed in the international market for GDR issue should be followed for Domestic Offer of Sale to institutions also.

Guidelines on Modalities - Strategic Sale (I:4.2)	Detailed and transparent procedure for the selection of strategic partners recommended including the selection of Financial Advisors for strategic sale.
Guidelines on Selection of Intermediaries (I:4.3)	Detailed and transparent procedure for the selection of all intermediaries for the Offer of Sale of shares either in domestic or international market.
Retailing of PSU shares to small investors and Employees (I:4.4)	Detailed procedure for offer of shares to small investors and employees has been recommended by the Commission. The Commission has also recommended on the maximum number of shares and the discount to be offered to small investors and employees.
Recommendation on Joining the NSDL (II.1)	In order to enable the PSUs to prepare for meeting the demands of the capital market, Commission recommends that all PSUs which were earlier disinvested and which are proposed for disinvestment to join the NSDL.
Voluntary Retirement Scheme (II:1) & (IV:1)	Commission recommends that the Government to frame a clear cut policy statement on the terms of VRS on a stable and long term basis and also suggests a modality for the implementation of VRS.

Commission has recommended delegation of autonomy on a graded scale as given below :

**Table 3 Corporate Governance for PSUs - All PSUs**

Professionalising the Board of Directors (I:3.4)	The Commission recommends that the Government initiate necessary steps to select experts and professionals from outside the Government as non-executive Directors on the Board of Directors of PSUs.
Provision for Elected Directors (I:3.4)	Government in the interest of efficient management of the PSU, enable election of Directors who would represent the minority shareholders in the PSUs. Also the Government should enable election of employee representatives on the Board of Directors in proportion to the extent of employee shareholding.
Selection of Top Management (I:3.4)	The Commission recommends that the Public Enterprise Selection Board (PESB) should be broadbased. PESB has to be given more powers to select the CEOs and other functional directors without going to the Appointments Committee of the Cabinet. Minimum tenure of five years for the CEOs and Functional Directors are recommended and the age of superannuation be relaxed, if necessary for this purpose.



Salaries and Incentives for Top Management (I:3.4)	In order to attract and retain talents, the salaries and allowances for CMDs in Schedule (A) post should be raised to Rs.50,000 per month immediately and should be reviewed and brought in line with industry in a gradual manner. Similar revision should be undertaken for all in other Schedules.
Autonomy in Price Fixation (I:3.4)	PSUs should be fully empowered on par with the private sector units to determine the prices of their products and services.
Accountability (I:3.4)	Present MoU should be revamped in order to measure the performance of PSUs more qualitatively with reference to meaningful and challenging targets. Performance assessments should be carried out at routine intervals by a joint team of the Secretary of Ministry, CEO and an outside senior professional.
Setting up of Pre-Investigation Board (I:3.4)	An independent specialised institution viz, the Pre-Investigation Board is to be set up to evaluate the instances of malfeasance in PSUs. It should evaluate all questionable commercial decisions at the Board level to determine whether the decisions were taken with malafide or corrupt intent. The members of the Pre-Investigation Board could include among others retired top executives from the financial sector, former CEOs of leading PSUs and professionals with relevant business experience.
Strengthening the Investor Interface (I:3.4)	PSUs in general should equip themselves to meet the investor queries by setting up investor relations group. This group should regularly communicate with the investors and update them with the performance of the PSU.

Apart from the corporate governance recommendations mentioned above which are applicable to all PSUs, the Commission recommends additional autonomies to Moderate Performers and Strong Performers.

Table 4 Corporate Governance - For Moderate and Strong Performers

Moderate Performers	
Powers to Dispose of Assets (I:3.4)	Board of Directors should be empowered to transfer assets to a subsidiary or for the propose of outright sale, with requiring Government approval.
Freedom of Investment within certain limits (I:3.4)	The Government should enhance the investment limits in cases where banks or institutional lenders have appraised and financed the projects. The investment limits for each PSU could be fixed on the criteria of the company's turnover and requirement of funds in the medium term.

Strong Performers	
Powers to form joint ventures (I:3.4)	The Board of Directors of these PSUs should be empowered to form joint ventures with Indian or foreign companies so long as the other partner holds less than or equal stakes, without prior approval of the Government other than the regulatory approvals as applicable to private sector.
Full freedom with regard to investments (I:3.4)	Recommended complete autonomy to these PSUs with respect to investment decisions subject to the condition that these projects are appraised and financed by banks or institutional lenders or where the total requirements of funds are met from internal accruals.

Table 5 Specific Recommendations for 19 PSUs

Name of the PSU	Recommendations
Modern Food (Industries) India Limited (I:5.1)	Sale of the entire Government holding on as-is-where-is basis is recommended.
Gas Authority of India Limited (I:5.2)	Delegation of powers to Board of Directors be maximum in accordance with definition of Strong Performer. Disinvestment upto 25% of the total equity capital between domestic and international market depending upon the market condition.
India Tourism Development Corporation (I:5.3)	Restructuring of the operations of ITDC by handing over the hotels located in prime locations like Delhi and Bangalore to established hotel chains through a competitive bidding process to run on long term structured contract on lease-cum-management basis. Hotels located in other places may be demerged into separate corporate entities and disinvest 100% Government holding in these new entities.
Bharat Aluminum Co.Limited (II:2.1)	Immediately disinvest 40% of the equity to a strategic partner either domestic or foreign through a transparent and competitive global bidding process with an agreement that Government within 2 years will make a public offer in the domestic market to institutions, small investors and employees to bring its holding to 26%. Further, there should be an ongoing review of the industry situation and the Government may disinvest its balance equity of 26% in full in favour of investors in the domestic market at the appropriate time.
Bongaigaon Refinery & Petrochemicals Limited (II:2.2)	Strategic sale of 50% of shares of BRPL may be offered immediately to Indian or foreign oil companies either on their own or in association with one another with an agreement to make a public offer in the domestic market to institutions, small investors and employees to bring its holding to 26% at a later date.

HTL Limited (II:2.3)	<p>Recommends three options for disinvestment -</p> <ul style="list-style-type: none"> <li>• sale of 100% shares in HTL alongwith ITI in the process of strategic sale</li> <li>• of shares of HTL may be offered to a strategic partner through a global competitive bidding</li> <li>• if none of the above options is feasible, straight sale of assets of the company through competitive bidding</li> </ul>
ITI Limited (II:2.4)	<p>Immediate steps to reduce manpower through VRS. Hiving of the Defence Division in Bangalore and merge with Bharat Electronics Limited before the strategic sale. Strategic sale of 50% of the shares of ITI with an agreement with the strategic partner specifying further dilution of government equity to 26% through public offer to Indian institutions, small investors and employees.</p>
Madras Fertilisers Limited (II:2.5)	<p>Immediately initiate negotiations with National Iranian Oil Company to change the terms of the agreement which would permit sale of 50% of the shares of the company to a strategic partner through a competitive bidding.</p>
Manganese ore (India) Limited (II:2.6)	<p>Recommends granting of full autonomy. Disinvest upto 49% in one or more tranches in the domestic market with preferential allotment to small investors and employees after the establishment of the ferro alloy production facility of viable capacity and captive power plant.</p>
Container Corporation of India Limited (III:2.1)	<p>Disinvestment of Government holdings upto 100 lakh shares through book building process to institutional investors in the Indian market to be followed by a retail offering to small investors at a discount of 10% and the company to make a public issue of 125 lakh shares to bring down Government holding to 51%. It is also suggested that CONCOR should join the NSDL before the proposed disinvestment or public offer.</p>
Kudremukh Iron Ore Company Limited (III:2.2)	<p>Strengthen the management of the company by inducting competent professionals from outside. Strategic sale of 30% of equity with an agreement that Government within 2 years will further offer 10% of the equity to the strategic partner and public offer in the domestic market to institutions, small investors and employees in order to enable Government to hold 26%.</p>

Mahanagar Telephone Nigam Limited (III:2.3)	<p>Recommends granting of full autonomy in line with its performance. Resource raising function for DoT if required, should be taken away from MTNL and should be vested with some other entity. Disinvest 60 million shares (10%) in the international market through book building process at an appropriate time to be decided by SEG. After the international offering, the balance 28.3 million shares consisting of 4.73% of the equity may be offered institutional investors and to small individual investors at a discount over the institutional price. It is also suggested that MTNL should join the NSDL before the proposed disinvestment.</p>
Oil India Limited (III:2.4)	<p>Disinvestment of Government shares as also company's IPO need not be considered for the present and could be considered after a year or so when the company's own prospects would be clearly established through the outcome of exploration activities in the North Brahmaputra area and Government's policy on APM.</p>
Oil and Natural Gas Corporation Limited (III:2.5)	<p>Disinvestment be considered after the organisational changes are in position and Government's policy on APM.</p>
Rail India Technical and Economic Services Limited (III:2.6)	<p>No disinvestment</p>
Hindustan Copper Limited (IV:2.1)	<p>Suggested two options:</p> <ul style="list-style-type: none"> <li>• HCL to implement the Khetri Smelter expansion project as also restructure the ICC mining operations by closing down unviable mines through VRS. After the completion of these project, disinvest 51% of the equity to a strategic partner. Government may also disinvest 22% of the equity through offer of shares in the domestic market to institutions, small investors and employees.</li> <li>• Immediately disinvest 51% of the equity to a strategic partner and after the restructuring and expansion, further disinvest 22% of the equity through offer of shares in the domestic market to institutions, small investors and employees.</li> </ul>
Pawan Hans Helicopters Limited (IV:2.2)	<p>Recommends writing off the Westland loans together with interest. Offer the entire Government holding to ONGC. In the event that ONGC is not interested, the Commission recommends that the Government sell its entire holding of 78.5% to an investor.</p>

Power Grid Corporation of India Limited (IV:2.3)	Disinvestment only after entire electricity sector is fully restructured.
Shipping Corporation of India (IV:2.4)	Government to disinvest 40% of the Government holding to oil refineries. 30% of the equity to public sector oil refining companies and 10% to private sector refining companies. The Board of Directors should be broad-based with the induction of non-executive Directors from the relevant disciplines. After this disinvestment, SCI could go for its equity raising in the domestic market to institutional investors through book building process. This can be followed by disinvestment of government holding to small investors and employees in the domestic market at a discount of 10% over the institutional price.



REPORT

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# DISINVESTMENT COMMISSION

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# PART A



## INTRODUCTION

The Disinvestment Commission has been set up with terms of reference which appear in Annexure 1. Government of India has referred 40 central PSUs to the Commission for Disinvestment.

Since inception, the Commission has had consultations with a wide cross section of persons and organisations interested in the disinvestment process. These include senior Government officers in the various Ministries, management experts, representatives of the Central Trade Unions and academicians. The Commission also organised two Conferences in Delhi and Mumbai focusing on the strategy and issues involved in the disinvestment process. The Commission has taken due note of the various views expressed during these meetings and the Conferences including experiences of other countries in disinvestment and privatisation.

In order to enhance enterprise value and maximise Government's capital receipts, the recommendations set forth in this and the forthcoming reports should be taken in totality. If recommendations as outlined in Parts B and C of this report are not implemented in full, it is felt that benefits may not be fully realised and hence may result in a loss to the exchequer.



# 1. PUBLIC SECTOR - AN OVERVIEW

## 1.1 Evolution of Public Sector Policy

Historically, public sector undertakings (PSUs) have played an important part in the development of the Indian industry. At the time of independence, it was felt that political independence without economic self-reliance would be detrimental to the country's sovereignty and autonomy in policy-making. Hence, the basic objectives of starting the public sector were :

- To build infrastructure for economic development and promote rapid economic growth and industrialisation of the country;
- To create employment opportunities and promote balanced regional development;
- To create a self-reliant economy through the development of local industries for import substitution and by encouraging and promoting exports;
- To generate investible resources for development by earning suitable returns; and finally
- To prevent / reduce concentration of private economic power.

In the sixties and seventies the Public Sector policy has been largely guided by the Industrial Policy Resolution of 1956 which gave the public sector a strategic role in the economy. Massive investments have been made over the past four decades to build a public sector which had a commanding role in the economy. Many key sectors of the economy are today dominated by the mature public enterprises that have successfully expanded production, opened up new areas of technology and built up a reserve of technical competence in a number of areas.

**As a result, the country's ranking in terms of industrialisation with other developing countries is quite high. India's comparative advantages such as a large pool of well-trained work-force, technical skills in manufacturing and chemical industries primarily stem from the public sector.**

However, after the initial exuberance of the public sector entering new areas of industrial and technical competence, a number of problems began to manifest themselves in many enterprises. Problems were observed in terms of low productivity, poor project management skills, overmanning, lack of technological upgradation, inadequate attention to R&D and low priority to human resource development.

## 1.2 New Orientation

These problems and other economic compulsions led to the adoption of a new approach towards the public sector. In July 1991, the Government issued a Statement on Industrial Policy which had the following decisions<sup>1</sup>

- Portfolio of public sector investments will be reviewed with a view to focus the public sector on strategic, high-tech and essential infrastructure. Whereas some reservation for the public sector is being retained there would be no bar for areas of exclusivity to be opened up to the private sector selectively. Similarly the public sector will also be allowed entry in areas not reserved for it.
- Public enterprises which are chronically sick and which are unlikely to be turned around will, for the formulation of revival/rehabilitation schemes, be referred to the Board for Industrial and Financial Reconstruction (BIFR), or other similar high level institutions created for the purpose. A social security mechanism will be created to protect the interests of workers likely to be affected by such rehabilitation packages.
- In order to raise resources and encourage wider public participation, a part of the Government's share-holding in the public sector would be offered to mutual funds, financial institutions, general public and workers.
- Boards of public sector companies would be made more professional and given greater powers.
- There will be a greater thrust on performance improvement through the Memoranda of Understanding (MoU) system through which management would be granted greater autonomy and will be held accountable. Technical expertise on the part of the Government would be upgraded to make the MoU negotiation and implementation more effective.
- To facilitate fuller discussion on performance, the MoU signed between Government and the public enterprises would be placed in Parliament. While focusing on major management issues, this would also help place matters on day to day operations of public enterprises in their correct perspective.

The impact of these policy decisions on the performance of the PSUs is, as

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<sup>1</sup> Statement on Industrial Policy, Govt. of India, Ministry of Industry, dated July 24, 1991

yet, debatable. As regards the private sector, the Government has granted freedom to add new capacities, delicensed some industries and has allowed investments in certain sectors. The public sector has to still obtain multi-level and time consuming clearances for such decisions and is accountable to multiple agencies. This lack of autonomy has created a somewhat unequal playing field for the PSUs in an increasingly competitive environment.

### 1.3 Common Minimum Programme

The Common Minimum Programme has stressed that PSUs will continue to be an important component of Indian industry. In a competitive and technology-driven economy, the public sector should conduct its business on commercial lines. For this, it has been acknowledged that the public sector requires to be reformed and restructured. Those PSUs which have comparative advantages to be global giants will be identified and supported. Other profit making PSUs will have to be further strengthened. The management of these PSUs will be professionalised and encouragement would be given to worker's participation in management. As regards sick or potentially sick PSUs, they will have to be rehabilitated through different options including handing over management to professional groups or worker's co-operatives.

### 1.4 Profile of PSUs

An overall profile of the central PSUs is presented in the table below.

Table 1 Profile of PSUs (Rs. '00 crores)

	FY 95	FY 94	FY 93	FY 92	FY 91	FY 90
Operation Units (No)	241	240	239	237	236	233
Net Profits	72.2	45.5	32.7	23.6	22.7	37.9
Profitable Units (No)	130	121	131	133	123	131
Net Profits	121.2	97.7	73.8	60.8	53.9	57.5
Dividend	14.4	10.3	7.9	6.9	4.1	3.2
Loss making Units (No)	109	117	104	102	109	96
Overall Losses	49.1	52.9	39.5	36.7	30.4	19.6

### 1.5 Composition of Public Sector Plan Outlays

An important aspect relating to the performance of the PSUs has been the incidence of budgetary support. Till the nineties, PSUs in general, had access to funds from the government in the form of budgetary support. Widening fiscal deficits since the early nineties has however led to a

sudden withdrawal of budgetary support for PSUs as is evident from the following table.

Table 2 Composition of Public Sector Plan Outlays (%)

	FY 95	FY 94	FY 93	FY 92	FY 91	FY 90
Net Internal Resources	46	34	41	39	34	34
Extra Budgetary Resources	41	52	45	42	42	34
Total Budgetary support	13	14	14	19	24	32
Plan Outlay	100	100	100	100	100	100

Budgetary support as a percentage of the total Plan outlay on the public sector has declined considerably from 32% in FY90 to 13% in FY95. This has been offset by the increased component of extra budgetary resources from sources other than the government which has grown from 34% to 41% during the same period.

In addition, increasing levels of deregulation and globalisation have ushered in an era of intense competition in the economy, the effects of which have been felt on certain PSUs. In some cases, even profitable PSUs have been adversely affected, while in some other cases, the losses of the loss making PSUs have compounded. This and the effect of sudden withdrawal of budgetary support have led to increased level of overall losses from about Rs. 1960 crores in FY90 to about Rs. 4910 crores in FY95 as shown in the table below:

Table 3 Profile of Loss making Units

	FY 95	FY 94	FY 93	FY 92	FY 91	FY 90
Total No. of Units	109	117	104	102	109	96
Total Loss (Rs. '00 Cr)	49.1	52.9	39.5	36.7	30.4	19.6
% Loss in Taken Over Units	20	24	24	15	16	24
% Loss in Other Units	80	76	76	85	84	76

The composition of the overall losses reveals that almost three-fourths of the overall losses are cash losses (as opposed to book losses). The percentage of cash losses have remained more or less constant over the five years and the extent of depreciation provision has also remained more or less constant (Table 4).



Table 4 Composition of Net Losses (%)

	FY 95	FY 94	FY 93	FY 92	FY 91	FY 90
Cash Losses (a)	71	81	73	73	71	77
Depreciation (b)	33	23	34	30	40	39
Cash Profits (c)	4	4	7	3	11	16
Net Losses (a+b-c)	100	100	100	100	100	100

In the future, increasing globalisation and the orientation towards a market driven economy will bring more competitive pressures on these loss making PSUs. Thus it would be quite reasonable to conclude that unless a viable and a rational strategy is evolved for these companies, they will continue to be an increasing draft on the budget.

Further, it is interesting to study the composition of the losses in terms of the major sectors. As can be seen from Table 5, major losses were accounted in Fertilisers, Heavy Engineering and the Consumer Goods sector in FY95. These industries are characterised by the presence of a large number of players, most of them being in the private sector. The fully contestable nature of these markets has ensured fair competition and also provided a fair degree of protection to the consumer's interest.

Table 5 Sectoral Composition of Losses (% of total losses)

Sector	FY 95		FY 94		FY 93		FY 92		FY 91		FY 90	
	No	%	No	%	No	%	No	%	No	%	No	%
<b>MANUFACTURING</b>												
Fertilisers	3	16	6	15	5	18	2	15	3	14.9	4	18.3
Consumer Goods	15	14	15	14	15	9.5	14	6.1	14	7.2	13	13.3
Heavy Engg.	8	11	8	9.6	9	6.2	8	7.4	8	5.5	7	3.9
Textiles	13	9	14	12	12	15	11	8.4	11	7.5	11	11.6
Steel	5	8.2	5	13	4	16	4	28	2	20.4	3	7.5
Coal	4	8.1	2	2	3	2.9	2	1.9	5	9.4	3	3.3
Medium Engg.	11	4.9	9	3.9	8	1.4	11	3	12	1.7	8	1.5
Transport Equip.	6	4.7	7	5.6	7	6.7	7	6.6	6	4.1	8	10.9
<b>TOTAL</b>	<b>65</b>	<b>75.9</b>	<b>66</b>	<b>75.0</b>	<b>63</b>	<b>75.7</b>	<b>59</b>	<b>76.4</b>	<b>61</b>	<b>70.7</b>	<b>57</b>	<b>70.3</b>
<b>SERVICES</b>												
Trans. Serv.	3	11	3	11	4	12	3	12	4	10.1	4	8.5
Contact & Const.	7	4.6	8	4.8	5	3.6	5	3.5	6	4.5	5	7.1
<b>TOTAL</b>	<b>10</b>	<b>15.6</b>	<b>11</b>	<b>15.8</b>	<b>9</b>	<b>15.6</b>	<b>8</b>	<b>15.5</b>	<b>10</b>	<b>14.6</b>	<b>9</b>	<b>15.6</b>
Others	34	8.5	40	9.1	32	8.7	35	8.1	38	14.7	30	14.1
<b>GRAND TOTAL</b>	<b>109</b>	<b>100</b>	<b>117</b>	<b>100</b>	<b>104</b>	<b>100</b>	<b>102</b>	<b>100</b>	<b>109</b>	<b>100</b>	<b>96</b>	<b>100</b>
Total Net Losses (Rs. '00 Crores)	49.1		52.9		39.5		36.7		30.4		19.6	

Thus, it may be worthwhile to determine whether public sector presence is required in markets which are fully mature. This understanding will, in turn, help determine areas in which public sector needs to have a strong presence.

### 1.6 Budgetary Support in 1996-97

According to the Expenditure Budget document of 1996-97, the Plan outlay for public sector amounted to Rs. 50,400 crores of which about Rs. 46,700 crores would come by way of internal accruals and extra budgetary resources and the balance of about Rs. 3700 crores by way of budgetary support. It is necessary to examine this figure in order to segregate the support for profitable and loss making PSUs. The Expenditure Budget classifies budgetary support to PSUs under two heads: Plan Investments and non-Plan outlays. Plan investments are taken up by both profitable and loss making PSUs while non-Plan loans are primarily meant for the latter.

### 1.7 Support to Loss making PSUs in 1996-97

The following table lists loss making units which have been provided with both Plan assistance and non-Plan loans in 1996-97.

Table 6 Support to Loss making Units (Rs. Crores)

Sl. No.	Name of PSU	Plan Assistance			Non Plan Loan	Total Assistance
		Equity	Loan	Total		
1	Nuclear Power Corp.	325		325		325
2	Fert. Corp. of India	19	20	39	277	316
3	National Text. Corpn.				243	243
4	Hindustan Fertilisers	4	5	9	144	153
5	National Jute Mfg. Corp				80	80
6	Delhi Transport Corp.		10	10	53	63
7	HEC	15	15	30	18	48
8	Cent. Inland Water Transpt.	6	7	13	8	21
9	Food Corporation	18		18		18
10	Cement Corp. of India	7	8	15	2	17
11	Hindustan Shipyard	8	7	15		15
12	HMT	5	4	9		9
13	Others	70	54	124	203	327
14	Naptha Jakri Power*	179	254	433		433
15	Tehri Hydro Electric*	170		170		170
	Total	826	384	1210	1028	2238

\* Enterprise yet to be commissioned.

The support from the budget in the form of Plan investment to loss making PSUs in the form of equity and loans amounted to about Rs.1210 crores and on account of non-Plan outlays amounted to about Rs.1028 crores. Thus, the total assistance provided to loss making units aggregated to Rs. 2238 crores.

### 1.8 Budgetary Support to Profitable PSUs in 1996-97

The budgetary support provided as Plan assistance to profitable PSUs is as under.

Table 7 Support for Profitable Units (Rs. Crores)

Sl. No.	Name of PSU	Equity	Loan	Total
1	PFC		550	550
2	PGCIL*	8	313	321
3	NHAI		250	250
4	FACT*		240	240
5	NTPC*	70	152	222
6	NHPC*	50	99	149
7	NLC*		126	126
8	Singerani Collieries		119	119
9	IREDA		115	115
10	Coal India		100	100
11	HUDCO		51	51
12	Airport Authority		50	50
13	REC		50	50
14	MFL*		37	37
15	Paradip Phosphates		33	33
16	SCI*		30	30
17	DVC		20	20
18	Uranium Corp.		15	15
19	Semi Conductor		12	12
20	HLL*		1	1
21	MFIL*		1	1
	TOTAL	128	2364	2492

\* Referred to the Disinvestment Commission.

## 1.9 Analysis of Budgetary Support in 1996-97

The following table summarises the position of budgetary support to PSUs in 1996-97.

Table 8 Composition of Budgetary Support (Rs. Crores)

Category	Plan			Non Plan	G. Total
	On-lending	Direct	Total		
Profitable	1114	1378	2492		2492
Loss making	254	956	1210	1028	2238
Total	1368	2334	3702	1028	4730

- It would emerge from the above table that support to profit making PSUs is limited to two counts. Firstly, external loans from multi-lateral agencies were on-lent to PSUs through the central budget. These PSUs were NTPC, NLC, Power Grid, PFC and the total amount of on-lending was about Rs. 1114 crores. It can therefore be concluded that these loans are not a draft on the budget. Thus, out of the total budgetary support of about Rs 2492 crores to the profitable PSUs, the net draft on the budget is limited to Rs. 1378 crores. This support has been provided to PSUs where normally, external assistance is not available.
- The budgetary support to loss making PSUs is about Rs. 2238 crores out of which Rs.254 crores is on-lend support to Naptha Jakri Power Ltd. Thus the actual draft on the budget is Rs.956 crores on the Plan account and Rs.1028 crores on the non Plan account. The total budgetary support to loss making PSUs is Rs. 1984 crores which constitutes about 60% of the total direct support to the PSUs.

### 1.10 Conclusions

The following conclusions can be drawn from the above study:

- **The losses of loss making PSUs have increased in the nineties due to withdrawal of budgetary support as well as increased competition. Most of these losses are cash losses and occur in sectors which have become fully competitive and where perhaps, PSUs have no special role.**
- **Losses in loss making PSUs account for about 60% of the total direct budgetary support and will in all probability, keep increasing each year. This will be a recurring draft on the budget.**

Keeping these conclusions in mind, the Commission has evaluated the likely consequences of the future support to be provided to loss making units and recommendations in this regard follow in Part B.

## 2. DISINVESTMENT: STRATEGY, PRINCIPLES AND CRITERIA

### 2.1 Need for a Long Term Disinvestment Strategy

The public sector in India continues to be an important component of the Indian industry even after liberalisation unlike the experience in many other countries which went in for wholesale privatisation. Therefore, the Commission reiterates that the PSUs in general, must be managed on sound commercial lines and must generate adequate surpluses and make contributions commensurate with the quantum of public resources invested in them. Specifically, in the strategic sector, the public sector is expected to have a commanding presence. PSUs will be called upon to play an important role in certain core sectors of the economy. However, this should be achieved with minimum dependence on budgetary resources while government policies should provide a level playing field for PSUs to compete with the private sector.

Government's withdrawal from non-core sectors is indicated on considerations of long-term efficient use of capital, growing financial unviability and the compulsions for these PSUs to operate in an increasingly competitive and market oriented environment. A large number of PSUs in these sectors is either marginally profitable or loss making. Budgetary support to these loss making PSUs has been a recurring feature over the last several years. Increased competitive pressures have adversely affected some PSUs which were earlier profitable. Growing financial stringency will reduce the capacity of Government to support them and consequently lead to their closure with loss of employment in large numbers. Thus, in all probability, loss making PSUs will continue to be an increasing drain on the budget unless a viable policy of disinvestment is evolved and implemented for them.

Viewed in this scenario, disinvestment has larger implications than just selling government equity at the best price in profitable enterprises, as this alone may not provide long term budgetary benefit unless the question of recurring budgetary support to loss making PSUs is also addressed. The essence of a long term disinvestment strategy should therefore be not only to enhance budgetary receipts, but also minimise budgetary support towards loss making units while ensuring their long term viability and sustainable levels of employment in them.

Disinvestment as a strategy should also aim at wide dispersal of Government shareholding in the domestic market and broadbase ownership in the process. This of course, will be subject to limitations of the capital market in its capacity to absorb the proposed disinvestment and the private sector's capital requirements from the same market. Sale of shares in the foreign markets may, therefore, also become necessary and the extent would be determined on a case to case basis depending on the market conditions etc.

## 2.2 Long Term Disinvestment Strategy

Accordingly, the Commission's long term strategy on disinvestment would revolve around four long-term objectives:

- Strengthen PSUs where appropriate in order to facilitate disinvestment;
- Protect Employee Interests;
- Broadbase ownership; and
- Augment Receipts for Government

The resulting long term strategies that arise out of the above objectives are:

### Strengthen PSUs

- Strengthen profitable PSUs to promote greater competitiveness and profitability to enable payment of higher dividends to the Government and to enhance share values
- Strengthen other marginally profitable PSUs and reduce their future dependence on the budget
- Financially restructure and revive loss making PSUs to invite private capital for long term turn around

### Protect Employee Interest

- Sustaining long term employment by financial turn around of loss making PSUs
- Providing adequate and fair compensation through VRS to surplus work force
- Provide for employee participation in management.

## **Broad Base Ownership**

- Enhance retail reach of PSU shares to small investor and offer at suitable price discount as compared to the institutional investor

## **Augment Receipts for Government**

- Enhance Government receipts by disinvestment in profitable PSUs
- Eliminate the need for budgetary support for loss making PSUs

### **2.3 Approach to Disinvestment of Loss making PSUs**

The approach to disinvestment in profitable PSUs is fairly straightforward, subject of course, to restructuring where appropriate. The question of eventual disinvestment in loss making PSUs raises the issue of the funds required for revival and restructuring. As analysed earlier, the direct draft on the budget on account of loss making PSUs during 1996-97 is around Rs. 1984 crores under both Plan assistance and non-Plan outlays. This constitutes about 60% of the total direct support to PSUs under the budget. Assuming conservatively that this current draft remains constant over the next five years, the total budgetary support would work out to Rs. 9920 crores. The net present value of Rs. 9920 crores discounted at 12% works out to around Rs.7200 crores.

This figure needs to be compared with the one-time upfront expenditure which will be required to restructure and revive loss making but potentially viable PSUs and the cost of VRS in order to enable closure of other unviable PSUs after taking into account sale of assets, if any. If this one-time expenditure to be incurred in this process in the aggregate is less than Rs.7,200 crores, it may be financially prudent for the Government to initiate this process. This will eliminate the need for recurring budgetary support for the loss making PSUs.

Considering the above, it may therefore be worthwhile to undertake a comprehensive study of all loss making PSUs to classify them as follows:

- Those in which Government could disinvest as a going concern on an as-is-where-is basis;
- Those which could be restructured and turned around before disinvestment; and
- Those which may need closure.

In all cases, it will be important to protect the interests of affected labour by devising suitable schemes either for retraining, redeployment or for voluntary retirement with adequate compensation. The costs of such schemes could be met to varying degrees by the sale of assets of the companies concerned. The balance where necessary could be met from the Disinvestment Fund (suggested later in this Report) supplemented if needed in any particular year by a provision in the budget.

Since only 40, mostly profitable PSUs, out of the 245 have so far been referred to the Commission it is unable to undertake this detailed exercise. This exercise is however, urgently needed for evolving a rational strategy for all the loss making PSUs. The Commission will apply these principles with respect to disinvestment in the PSUs referred to it.

**The advantages of the above long term strategy are:**

- **This holistic view of disinvestment will tackle the larger problem of the drain on the budget from losses in PSUs which need as much attention as the profit making PSUs.**
- **The saving in recurring budgetary provisions towards loss making PSUs can then be released for investments in sectors like infrastructure, education and health. Retirement of debt from disinvestment proceeds can also be an option.**
- **Dispersal of ownership will exert necessary pressure on the PSUs to improve the performance, earn profits and declare dividends.**

#### **2.4 Approach to Disinvestment Process**

The approach to the disinvestment process is to evolve general principles and criteria encompassing all PSUs and apply them across different PSUs as and when they are referred. This will enhance the transparency of the disinvestment process.

In this regard, the Commission has evolved principles for the extent of disinvestment in PSUs by categorising them as strategic, core and non-core. The Commission has taken note of the Government policies and statements on this issue. The criteria for disinvestment will be based on these principles and the analysis of each PSU.

#### **2.5 Principles for Extent of Disinvestment**

**The extent of eventual disinvestment in a particular PSU will depend on the classification of the PSUs as strategic, core and non-core. Since**



**public sector units were set-up with objectives relevant at different times, it has become necessary to review whether their continuation in public sector is justified at present.**

In this context, it may be useful to trace the evolution of the policy relating to Public Sector since independence.

## **2.6 Evolution of Public Sector Policy**

In the 1948 Industrial Policy Resolution, the manufacture of arms and ammunition, production and control of atomic energy, ownership and management of railways became the State monopoly. Six basic industries viz., iron & steel, coal, aircraft manufacture, ship building, mineral oils, manufacture of telephone, telegraph and wireless apparatus were to be developed by the State. All other areas were left open to private initiatives.

Within a decade of laying down the policy parameters in 1948, another policy statement was issued in April, 1956 by the Government to give a new orientation to the "mixed economy" concept. This Policy Resolution categorised industries into three groups.

- Industries exclusively reserved for development by the State viz., arms and ammunition, iron & steel, heavy castings and forging, heavy plant & machinery required for iron and steel production and mining, heavy electrical plant, coal and lignite, zinc, copper, lead, aircraft, ship building and telecommunication equipment.
- Industries which would progressively be State owned and in which the State will therefore, generally take the initiative in establishing new undertakings but in which private enterprise will also be expected to supplement the efforts of the State. These include aluminium, fertilisers, other minerals, machine tools, ferro-alloys and tools, basic and intermediate products required by chemical industries, antibiotics and other essential drugs, synthetic rubber, carbonisation of coal, chemical pulp, road transport and sea transport.
- The remaining industries were left open for private sector initiatives.

In the context of the significant changes in fiscal, monetary, trade and industrial policies, the need for a review of the continued presence of the public sector in a wide range of activity was felt in the nineties. A new strategy for the public sector was spelt out in the policy statement in July 1991 which marked a turning point in the policy guidelines as far as public sector was concerned. The philosophy behind the New Economic Policy

(NEP) was that the State should, by and large, leave industry and commerce to the private sector and concentrate on those areas where it had a special or unique responsibility.

The list of industries reserved for public sector was reduced from 17 included in the Industrial Policy Resolution of 1956 to only eight by the July 1991 policy statement. Subsequently in March 1993, two more items were dereserved. The six industries for exclusive operation in public sector are (i) arms and ammunitions and the allied items of defence equipment, defence aircrafts and warships, (ii) atomic energy, (iii) coal and lignite, (iv) mineral oils, (v) minerals specified in the schedule to Atomic Energy (Control of Production and use) Order 1953, and (vi) railway transport.

Other developments since then are :

- De reservation of mining activity; as a result of which coal extraction has been permitted for captive use by user industries
- Invitation has been extended to private sector to invest in oil exploration and refining which is otherwise reserved for public sector as well as in infrastructure projects like roads, ports, telecom etc.
- Private sector venture in power generation even with 100 % foreign equity has also been allowed.

In the post 1991 scenario, it is necessary to refer to the Rangarajan Committee report on Disinvestment of Shares of Public Sector enterprises wherein targets level of disinvestment has been recommended. The Committee concluded that the percentage of equity to be disinvested should be generally under 49 % in industries reserved for the public sector and over 74 % in other industries.

## 2.7 Classification of Industry Groups

The perusal of public sector policy statements and other documents reveals that there is considerable amount of flexibility with respect to the definitions of strategic, core and non-core sectors and the extent of disinvestment in the corresponding sector. In the context of rapid globalisation and the significant investments by the private sector in many areas hitherto reserved for the public sector, a need to clearly demarcate these sectors has been felt.

The analysis of the public sector policy statements reveal that the emphasis of public sector investments has been in areas which are considered important from a national view point or where private sector

would find it unremunerative and thus can not be expected to take the lead in promoting investments. Accordingly, some industries have been exclusively earmarked for public sector investments while in some other areas, the private sector is expected to supplement the efforts of the State in promoting economic development.

## 2.8 Strategic Group

At present as per the policy statements of Government, only four industries viz., (i) arms and ammunitions and the allied items of defence equipment, defence aircrafts and warships, (ii) atomic energy, (iii) minerals specified in the schedule to Atomic Energy (Control of Production and use) Order 1953, and (iv) railway transport are the exclusive preserve of the public sector. A perusal of the above list would imply that these industries are important from the national security angle. Thus, it may be more appropriate to term these four industries as "Strategic". The question of disinvestment in such industries does not arise.

## 2.9 Core Group

In sectors which are capital or technology intensive, the most prevalent market structure may be an oligopoly. With the entry of private sector into these capital intensive areas, there may be a tendency towards an oligopolistic market structure. Examples are telecom, power generation and transmission or petroleum exploration and refining industries. It has been felt that the presence of the public sector will be necessary for sometime as a countervailing force and prevent concentration of private economic power. At the same time a proper regulatory mechanism should be put in place in order to regulate industries particularly in a non-competitive market for protecting interests of consumers.

In addition, it may be appropriate to look at basic industries with extensive and dispersed forward linkages. In some of these sectors, PSUs have a considerable market presence and the private sector is yet to mature fully. Hence it may be desirable to continue public sector presence in these basic industries till such time that the market becomes fully competitive.

By this analysis, such industries may be classified as "core" and public sector disinvestment be limited to a maximum of 49%. However, it may be noted that the composition of "core" industries may change over a period of time as further private investments make the market

fully competitive and PSUs may not be required to play a special role. In addition, it is expected that a proper regulatory mechanism would be in place to protect the interest of consumers. The question of disinvesting beyond 49% may be considered at that time.

## 2.10 Non-Core Group

Over the last four decades, private sector investments have grown considerably in many industries. The presence of a large number of players including matured private sector players, and the forces of competition in these industries have made these markets fully contestable. These would ensure that the consumer's interests are well protected. It can therefore be concluded that the initial objectives of the public sector in such industries have been met. Further investments in such industries will be driven more by demand - supply imbalances and Public investment may no longer be necessary. It may be useful to categorise such industries as non-core. The existing public sector in these industries may not have any unique or special responsibilities. Therefore, it would be desirable to disinvest upto 74% or more in such cases.

## 2.11 Industry Grouping

With this framework in place, the Commission has classified the 40 referred PSUs. These appear in the table below. The classification of Bharat Electronics Ltd. (BEL), Garden Reach Shipbuilders & Engineers Ltd.(GRSEL), Hindustan Aeronautics Ltd.(HAL), Rail India Technical & Economic Services Ltd. (RITES) and Engineers India Ltd.(EIL) will be considered by the Commission at a later date.

Table 9 Grouping of PSUs

Group	Name of the PSUs
Core	ONGC, OIL, BRPL, SAIL, MTNL, GAIL,
	AI, CONCOR, PHL, NLC, NCL, SECFL,
	WCFL, BALCO, NALCO, IBP,
	NTPC, PGCIL, NHPC, KIOCL,
	(20 PSUs)
Non-Core	SCI, ITDC, IPCL, FACT, NFL, MFL,
	HCIL, HTL, ITI, MFIL, HLL, BEML,
	HCL, HZL, MOIL
	(15 PSUs)

## 2.12 Framework for Analysing PSUs

In addition to the above, the approach to the disinvestment process will also centre on the analysis of specific PSUs. While the framework is outlined below, the actual analysis is available in Tables 10 to 17 in Annexure 3.

## 2.13 Analysis based on Net Profits

A useful starting point for analysis would be to segregate the PSUs on the basis of reported net profits or losses during the preceding five years. However, it has to be borne in mind that profits are determined by the accounting policies adopted. While PSUs in general have relatively more conservative accounting policies than their counterparts in the private sector, it will still be necessary to examine the extent of profitability by analysing the trend in gross margins and that of return on capital employed. In addition, a comparison of the return on capital employed with the company's cost of capital will help understand whether the company has earned adequate returns. Given the fast-changing economic scenario and the emerging competition, the past performance of a given PSU may not be necessarily sustainable. Therefore, in addition, it may be useful to add other analytical criteria, like the company's competitive position and the prospects for future growth in sales and net profits.

The above analysis will help classify PSUs into two broad categories. The first category of PSUs consists of **Strong Performers**, i.e. those which have reported consistent profits and are well positioned to grow strongly in the future. The second category of **Moderate Performers** would include those which have demonstrated profitability, but are positioned to grow moderately in the future.

## 2.14 Analysis by Industry Classification

The objective of the industrial classification is to understand the attractiveness of the industry in which the PSUs operate, as it is expected that the competitive and regulatory scenario in an industry will determine the interest of investors - especially institutional investors - in PSU stocks. This is especially true of PSUs which operate in commodity sectors such as metals and whose profitability is directly impacted by changes in international prices.

It may be noted that the PSUs referred have a presence in industries some of which may be attractive and some of which may not be currently

attractive. Therefore it may be necessary to further classify the industries on the basis of current attractiveness. Accordingly, the Commission has classified PSUs into three categories: those with **High, Medium or Low Potential**. This classification is based on the assessment of current and expected levels of business profitability, competitive nature of the market and impact of Government policies on the operations of the company.

The classification of a PSU may change over a period of time depending on changes in the business environment. It may be cautioned that the categorisation of a PSU as "High Potential" does not necessarily mean that there is no scope for further share value enhancement.

### 2.15 Analysis based on Paid-up Capital

Size is a criterion for classifying a group of companies. In the context of disinvestment size may be appropriately measured in terms of the paid-up share capital. The level of paid-up share capital and the current share holding of the Government will be important considerations in determining the phasing of the disinvestment programme.

### 2.16 Analysis based on Accumulated Reserves

In some cases, it may be necessary to understand the extent of accumulated reserves vis-à-vis the paid-up share capital. By capitalising reserves, companies can issue bonus shares to the government, which can then be disinvested. This has to be balanced with the dilution in the earnings per share and the increased dividend payout.

### 2.17 Analysis based on Listing & Trading

It is possible that in some of the PSUs referred to the Commission disinvestment has already occurred and the shares are listed on the stock exchanges. It may be useful to classify the PSUs as under:

- **Disinvested & Listed :** In case of liquid stocks, the stock price can provide a basis for valuation. In cases where trading volumes are insignificant, stock prices may not be appropriate for valuation.
- **Disinvested & not yet Listed :** These comprise those stocks which have been disinvested and which have still not yet been listed. In these cases, it may be necessary to ensure that this does not act as an impediment to the process of further disinvestment.
- **Not Disinvested so far :**

## 2.18 Criteria for Disinvestment

As a general principle the Commission recommends that where appropriate, PSUs should be restructured before disinvestment in order to enhance enterprise and the intrinsic share values. Given the rapidly changing economic scenario, it is possible that some PSUs may already have initiated such changes. In some other cases it is possible that the extent of restructuring required may be minimal.

2.19 Based on the above principles and specific analysis of PSUs, the Commission's recommendations for disinvestment will be based on the following considerations :

- Extent of Restructuring required and the potential for improving share values;
- The permissible extent of disinvestment with reference to the classification of industry as core or non-core;
- The size of the company and the phasing of disinvestment;
- Equity fund raising programme of the concerned PSU;
- Categorisation of the Industry as High, Medium or Low Potential;
- Alternative modalities of disinvestment





# PART B



### 3. GENERAL RECOMMENDATIONS ON DISINVESTMENT

#### 3.1 Establishment of Disinvestment Fund (DF)

An issue that has been raised by a wide cross section of opinion relates to the use of the proceeds of disinvestment. Although this is not directly related to the terms of reference of the Commission, it has nevertheless an important bearing on the public awareness of the disinvestment process and on the protection of the interest of affected employees. Both these matters come within the purview of the Commission.

The conventional view stated about two decades ago in the context of British privatisation programme was that blue chip PSUs should not be sold to meet budgetary deficits as this would amount to "selling the family silver to pay the butler". It was argued that the proceeds of disinvestment should go towards retirement of Government debt and thereby reduce the burden of interest payment on the budget.

Another point of view expressed by the official agencies is that all monies in the budget are fungible and it matters little whether the proceeds of disinvestment are merged with capital receipts and used to reduce the fiscal deficit or to retire Government debt. The argument further points out that in a situation of Government having to borrow to meet the fiscal deficit, the use of disinvestment proceeds for this purpose would reduce borrowing. The capital receipts from disinvestment are therefore effectively used to reduce Government's capital liabilities and have the same effect as retiring Government debt.

It is necessary to examine both points of view in order to build public awareness on the need for an orderly disinvestment programme for profitable PSUs as well as loss making PSUs.

While the argument of fungibility of resources is plausible, it has to be examined with reference to budgetary practice and convention. Broadly, budgetary expenditures are classified as Plan and non-Plan, Revenue and Capital. Similarly, revenue and capital receipts are treated as Government income, apart from receipts in the public account. These conventional classifications in the budget are intended to inform Parliament and the public about the Government's sources of income and the purposes for which the funds are spent.

The various kinds of deficits in the budget indicate different aspects of budgetary imbalance. The revenue deficit indicates the excess of revenue expenditure over revenue receipts. The large interest payments which now run to around Rs.60,000 crores per year are the main cause of the revenue deficit. The budgetary deficit indicates the excess of total expenditure over total receipts. The fiscal deficit indicates the extent of Government borrowings from all sources necessary to balance the budget. The primary deficit is fiscal deficit minus interest payments. Thus, this classification is useful for bringing out both the fungibility of resources and for identifying areas of weaknesses in the budget. The revenue deficit highlights the need to bring down expenditure and broaden the tax net to augment revenue income. The fiscal deficit indicates the Government's need to borrow and encompasses the revenue deficit. It can be argued that the undifferentiated use of disinvestment proceeds to reduce the fiscal deficit will only obfuscate the need to focus attention on balancing the revenue budget. Moreover disinvestment proceeds arise from a one-time sale of Government shares in PSUs, while the revenue deficits and fiscal deficits can be recurring and even increasing on a long term basis.

As indicated in the overall approach to disinvestment in loss making PSUs, several of them need funds for financial restructuring and for downsizing the workforce through acceptable Voluntary Retirement schemes (VRS). Disinvestment only in the most profitable PSUs will be of temporary and limited benefit to the budget unless the recurring draft on the budget from loss making PSUs is eliminated on a long term basis. This would require an initial release of funds from the budget which can be recovered from later disinvestment after restructuring. In the absence of this initial funding, a large number of PSUs will remain unsuitable for disinvestment and may become a progressively increasing burden on the budget. It is therefore necessary to take a long term view of disinvestment instead of its being driven by immediate budgetary compulsions.

It could be argued that the funds for the financial restructuring and for VRS in loss making units prior to disinvestment could come from fungible resources of the budget. This would not, however, bring out clearly the interconnection between disinvestment proceeds and the long term relief to the budget by elimination of losses from the loss making PSUs. If the disinvestment proceeds from the currently profit making units in the first few years are used to revive and prepare potentially viable but currently loss making units for eventual disinvestment, this will eliminate the recurring draft on the budget and make a net positive contribution to the budget in

the long run. Additionally, this explicit link would help establish the credibility of the disinvestment process.

The advantages are not merely cosmetic. The separation of disinvestment proceeds from the other non-debt capital receipts in the budget

- will help in highlighting the seriousness of the fiscal and revenue deficits and can compel actions to deal with them in the context of taxation, subsidies etc.;
- will demonstrate that disinvestment in the profitable PSUs will initially go to take care of employee interests through VRS and other measures and for preparing the potentially viable PSUs in non-core and core sectors for eventual disinvestment;
- will prevent the short term budgetary compulsions from obscuring the long term benefits of disinvestment in loss making PSUs; and
- will provide greater public awareness of the justification for disinvestment as a long term solution to the problems connected with improving efficiency in the use of capital, reducing budgetary drain from loss making PSUs and persistent shortage of budgetary resources for accelerating growth, for alleviating poverty.

**The Commission, therefore, recommends that the proceeds of disinvestment be placed separately in a Disinvestment Fund (DF) and not be fungible with other government receipts. The National Renewal Fund (NRF) should be merged with this fund. The resources in the Disinvestment Fund may be used for temporarily meeting the losses of some PSUs before disinvestment, where required, for a limited period during the process of short term restructuring or closure, for strengthening marginally loss making PSUs in preparation for disinvestment and for providing benefits to workforce found to be surplus during restructuring or closure. The savings to the budget on account of such recurring budgetary support to loss making PSUs could be diverted for investment in sectors like infrastructure, education and health and retirement of public debt. In addition, it is proposed that the funds for conducting the publicity campaign for the disinvestment of PSU shares be drawn from the Disinvestment Fund. Since the PSUs come under various administrative Ministries, it is proposed that the Disinvestment Fund be administered by the Ministry of Finance in order to facilitate better co-ordination and smoother administration.**

### 3.2 Restructuring

**As a general principle the Commission recommends that, where appropriate, PSUs should be restructured before disinvestment in order to enhance enterprise value and intrinsic share value. This should be done by balancing the potential benefits to be achieved vis a vis the costs and time involved in restructuring. The three broad areas of restructuring would be Corporate Governance, Business and Technological Restructuring.**

Recommendations in respect of Corporate Governance apply to all PSUs and are dealt with in detail in succeeding paragraphs. In some cases, it may be necessary to restructure businesses in order to provide a focus on the core competency of the PSU. Business restructuring will involve hiving off businesses which are no longer attractive from the view point of returns or are a drag on the other profitable operations. In addition, business restructuring will also encompass workforce restructuring and financial restructuring of the Balance Sheet. Technology upgradation will be an important factor for PSUs which operate in industries where access to latest technology is a key success factor. Restructuring could also involve de-mergers and mergers with other PSUs. It could also include exchange of technology between PSUs to strengthen synergy in operations. Recommendations on business and technological restructuring will be specific to each PSU and will be covered under specific recommendations.

### 3.3 Corporate Governance and Autonomy

Recent international studies have clearly established that a majority of investors attach considerable importance to the quality of Corporate Governance in a company and are even willing to pay a premium for better managed companies. In order to enhance intrinsic share value, it is recommended that the PSUs should be restructured in terms of corporate governance prior to disinvestment.

It is expected that with disinvestment, the share holding of the Government will decline steadily. Hence there is need to establish systems and procedures in PSUs to promote the interests of minority shareholders and also enhance long term enterprise value.

This issue assumes importance due to the following reasons:

The present MoU system has, in reality, failed to distance the Government from the PSUs.

- As part of the disinvestment programme, Government as a shareholder will approach the capital market repeatedly in the future and hence will have to create confidence in the minds of the investors with regard to the quality of Corporate Governance in PSUs.
- Strategic investors will be interested in picking up sizeable stakes only if they can have management control or at least a voice in the management.
- The rapidly changing economic scenario has already put considerable competitive pressure on PSUs. They have to respond to rapidly changing market conditions and technological developments which will require prompt decision making. Therefore it is essential that PSUs are granted managerial autonomy in their operations failing which there could be erosion in their margins which can lead to industrial sickness.
- Disinvestment of PSUs is expected to lead to a significant dilution of Government shareholding in some cases. Hence, the importance of other share holders on the Board of the PSU is expected to grow steadily and would assume overriding proportions in cases where Government's disinvestment would go beyond 49%.

**It is recommended that there be greater autonomy to the Boards of PSUs along with proper delineation of accountability. To begin with, it is recommended that all strategic and important decisions concerning PSUs be taken by the Board and not by the Government. Government's role should be limited to the issue of written directives concerning broad policy matters. The Board should be the final forum for all corporate decisions and Government as the majority shareholder should exercise its right only through its representatives on the Board. Over a period of time, as disinvestment proceeds beyond 50% in some cases, Government's role as the single largest shareholder in the company will have to be substantially redefined to reflect its reduced shareholding interests.**

**The audit by the Comptroller and Auditor General of India (CAG) and the examination of PSUs by the Committee on Public Undertakings (COPU) may need to take into account the changing commercial environment in which PSUs are operating and the need for PSU management to take quick entrepreneurial decisions to promote the interest of the company and the shareholders. Government may initiate necessary dialogue with these authorities to achieve this objective.**

### 3.4 Delegation of Powers to PSUs

It is proposed by the Commission that the delegation of autonomy may be on a graded scale with greater delegation to the better performing PSUs. For this purpose the Commission's recommendations use the classification suggested in Section 2.13 of Part A. For Strong Performers, it is recommended that the delegation of powers be maximum. In case of Moderate Performers, the delegation of powers would be more restricted than those given to the strong performers in order to induce them to improve their operations and graduate into the strong performer category. It is presumed that both these categories of PSUs do not depend on the budget except in cases where the Government has to subscribe to rights issue in order to maintain its equity stake and in cases where multi-lateral funding has been made available for on-lending. For All PSUs including even loss making PSUs, it is recommended that there should be a minimum level of delegation of powers which would be more restricted than the delegation of powers to Moderate Performers. The actual delegation of powers and its extent will be specific to each PSU and will be detailed in the specific recommendations.

The advantages of such an approach are

- Government's acceptance of this recommendation itself would give a strong signal to potential investors and will lead to an enhancement in equity valuation of those PSUs which are being considered for disinvestment
- The delegation of greater powers to better performing PSUs will act as an incentive to other PSUs to improve their performance and qualify for greater autonomy in operations.

Recommendations applicable to all PSUs

#### *1. Professionalising the Board*

At present the Board of Directors of PSUs by virtue of their being fully owned Government companies have CEOs and Functional Directors appointed by the Government. While the CEOs and Functional Directors are selected by the PESB and on that basis appointed by the Government, the other non-executive Directors are generally appointed on an ex-officio basis from the administrative and Finance Ministries. The Commission recommends that the Government initiate necessary steps to select experts and professionals from outside the Government as non-executive Directors on the Board of Directors of PSUs. The Government may



request the PESB to expand the scope of its activities to prepare a comprehensive list of professionals who are willing to serve on the Boards of PSUs. From this list, the Government could make a selection and get them elected as non-executive Directors on the Boards of different PSUs. In order to promote effectiveness of the non-executive Directors, the Government should restrict the number of elected directorships held by each person in the PSUs.

## *2. Provision For Elected Directors*

The Government would need to recognise the role of the legitimate institutions of Corporate Governance such as the Boards and the general body meetings of the shareholders. The composition of the PSU should also reflect the changing pattern of shareholding. As long as the Government continues to remain the single largest shareholder in a PSU even after disinvestment, the Government should, in the interest of efficient management of the PSU, enable election of Directors who would represent the minority shareholders in the PSUs. The number of such Directors should be in proportion to the extent of non-government share holding. The Government should also enable election of employee representatives on the Board of Directors in proportion to the extent of employee share holding.

## *3. Selection of Top Management*

The selection of CEO and other functional directors also needs to be streamlined and should be time bound to ensure that vacancies are filled up without any delay. Care should be taken that the new incumbent is appointed reasonably ahead of time particularly if he is an outside candidate. The recommendation of the Public Enterprises Selection Board (PESB) should, as a rule, be accepted by the concerned ministry without having to go to the Appointments Committee of the Cabinet (ACC). PESB itself should be more broadbased with the induction of professionals and management experts.

The tenure of the Functional Directors needs special mention. It is reasonable to expect that Functional Directors and the Chief Executives are given sufficient time to evolve and implement plans and demonstrate results; however, it should be made clear that the continuation of contracts will be specifically linked to performance. The Commission recommends that the initial contract of appointment for CEOs and Functional Directors should be for a minimum tenure of five years and the age of superannuation be relaxed, if necessary for this purpose.

**It is recommended that the above provisions relating to composition of elected board, and the term of the CEOs and Functional Directors should be applied to companies prior to disinvestment even where the government holding will continue to be 51% or more even after disinvestment.**

#### *4. Salaries and Incentives for Top Management*

With increasing opportunities being available in the private sector, the public sector has, of late, witnessed exodus of manpower at the senior and middle levels. One widely accepted reason is that the remuneration of PSU managers is generally poor across the board. **Specifically, the remuneration (salary and allowances) of PSU Chief Executives is significantly lower than that for the corresponding position in the private sector. In order to attract and retain talent for these important posts, it will be necessary that the salary (basic plus allowances) of CMDs in Schedule (A) post be raised to at least Rs. 50,000 per month immediately and should be reviewed and brought in line with industry in a gradual fashion. In addition other normal perquisites such as housing, conveyance etc. should be admissible. The salaries of Officers in Schedule B & C should also be suitably raised. Further, the top management should be entitled to incentives and bonuses linked to performance parameters. The appointment should be on contractual terms and should be liable for termination within the contract period for proven non-performance. The Board of Directors should be empowered to take decisions on incentive measures for all levels including the Functional Directors.**

#### *5. Autonomy in Price Fixation*

Several PSUs today are subject to non-statutory Government control in the matter of pricing of their products and services. **In the interest of the commercial functioning of the PSUs, the Commission recommends that the PSUs be fully empowered on par with the private sector units to determine the prices of their products and services. This will be subject to any price regulatory mechanism that the Government may establish for the industrial sector as a whole.**

#### *6. Accountability*

As has been pointed out in the earlier sections, the MoU system has failed to distance the Government from the operations of the PSUs. The present MoU system is an adaptation from the South Korean model but differs in

many crucial areas. One of the drawbacks of the present system is that the annual targets set for each PSU are independently assessed by a third party. As a result there is an incentive to deliberately set low targets so that the performance of the PSU as well as the administrative ministry is rated as "excellent". **It is therefore recommended that the MoU system be revamped in order to measure the performance of PSUs more qualitatively with reference to meaningful and challenging targets. Performance assessments should be carried out at routine intervals by a joint team of the Secretary of the Ministry, CEO and an outside senior professional.** Failure to live upto expectations should be brought to the notice of the officer concerned, and inability to perform over a period of time should lead to discharge.

#### *7. Setting up of Pre-Investigation Board*

The multi dimensional accountability of PSUs to various agencies such as COPU, CAG, CVC., etc. have considerably constrained the risk taking ability of the top managers of PSUs. Considering the fact that PSUs must respond to changing opportunities, it is desirable to provide a system that would seek to encourage entrepreneurial decision making and yet minimise personal risks to senior managers and Board level officers. It is necessary to provide an environment to the Boards in which decisions involving normal commercial risks are taken without inviting unwarranted allegations of malfeasance. It is also necessary to install a mechanism to deal with cases of prima-facie malfeasance. **The Commission, therefore, recommends that an independent specialised institution viz, the Pre-Investigation Board be set up to evaluate the instances of malfeasance in Public Sector enterprises. It is proposed that the Pre-Investigation Board should evaluate all questionable commercial decisions at the Board of Directors level to determine whether the decisions were taken with malafide or corrupt intent. In cases where it is proved so, the Pre-Investigation Board in turn, should refer such cases to the CBI/ CVC. Unlike under the present system, CBI/CVC may not institute any investigations or proceedings against the Board level PSU executives without the prior determination by the Pre-Investigation Board. In cases of decisions taken below the Board of Directors level, it is proposed that the Board of Directors should be empowered to evaluate questionable decisions before referring them to investigating agencies. The members of the Pre-Investigation Board could include among others retired top executives from the Financial sector, former CEOs of leading PSUs and professionals with relevant business experience. The setting up of such**

**a Pre-Investigation Board should instil confidence in the Board of Directors of PSUs and encourage genuine risk-taking abilities and provide protection for bonafide intentions.**

The PSUs on their part should lay down transparent systems and procedures for decision making especially in vital areas like procurement, tendering and sales in the interest of the officers and the organisation. While most of the business will be conducted according to the systems and procedures, such of the commercial decisions which are unique to occasions or opportunities should be justified in the special context of the prevailing circumstances and recorded in writing at the earliest and brought to the notice of the next higher level in the decision making process. The vigilance set up in the PSUs should also be suitably strengthened.

#### *8. Strengthening the Investor Interface*

As part of improved corporate governance, it is recommended that the PSUs should be transparent in sharing information and in reporting to the investor community. This will enhance the confidence of minority share holders and small investors to feel comfortable in investing in the shares of these PSUs. Investor relations and information sharing are crucial and may have a bearing on the prospects of accessing the markets for future disinvestment by Government and equity fund raising by the PSUs. PSUs in general should also equip themselves to meet the requirements of the investors in terms of issue of share certificates, transfer of shares, etc. prior to disinvestment.

#### **Additional Autonomy to Moderate Performers**

In addition to the above minimal but essential grant of autonomy to all PSUs under the Central Government, it is proposed that the following additional areas of autonomy be granted to this category of **Moderate Performers**.

##### *1. Powers to Dispose of Assets*

**The Board of Directors of a PSU should be empowered to transfer assets to a subsidiary or for the purpose of outright sale, without requiring Government approval.** Government's representatives on the Board can reflect government's views on such matters. These PSUs can take appropriate action to dispose of such assets and the proceeds can be used in strengthening their business.

## *2. Freedom of Investment within certain limits*

Investment proposals of PSUs beyond certain limits currently require multiple clearances such as those from the Administrative Ministry, the Public Investment Board and the Cabinet Committee on Economic Affairs. It is the view of the Commission that these clearances are time consuming and have often resulted in heavy cost and time overruns to the PSUs implementing these projects. As a result, the project viability is often eroded. In any case, lending agencies appraise investment proposals of PSUs and hence Government clearances could be dispensed with. **It is recommended that in cases where banks or institutional lenders have appraised and financed the projects, the Government should fix up fresh limits. The investment limits for each PSU could be fixed on the criteria of the company's turnover and requirement of funds in the medium term. Any investment proposals upto this revised limit should not require prior clearance from the Government.**

### *Further Autonomy to Strong Performers*

Over and above the foregoing set of recommendations on the grant of autonomy, it is proposed that the following additional areas on autonomy be granted to **Strong Performers**.

#### *1. Powers to form Joint Ventures*

**The Board of Directors of these PSUs should be empowered to form Joint Ventures without prior approval of the Government. As compared with the private sector, no extra or special permission should be required for these PSUs to form joint ventures, with Indian or foreign companies so long as the other partner holds less than or equal stakes with the PSUs. Joint ventures with foreign parties will necessarily be subject to approvals of FIPB as is applicable to the private sector.**

#### *2. Full freedom with regard to Investments*

It is also recommended that the category of Strong Performers be granted complete autonomy with respect to investment decisions subject to the condition that these projects are appraised and financed by banks or institutional lenders or where the total requirements of funds are met from internal accruals.

In summary, the following table highlights the recommended areas of autonomy to different categories of PSUs.

STRONG PERFORMERS	MODERATE PERFORMERS	1	Professionalising the Board	ALL PSUs
		2	Provision for Elected Directors	
		3	Selection of Top Management	
		4	Salaries & Incentives for Top Management	
		5	Autonomy in Price Fixation	
		6	Accountability	
		7	Setting up of Pre-Investigation Board	
		8	Strengthening the Investor Interface	
	9	Power to Dispose of Assets		
	10	Freedom of Investment within certain limits		
	11	Power to form Joint Ventures		
	12	Full freedom with regard to Investment		

## 4. GUIDELINES ON DISINVESTMENT IN PSUs REFERRED TO THE DISINVESTMENT COMMISSION

The Commission after due deliberations has evolved guidelines on modalities of disinvestment and on different aspects of the disinvestment process. The objective of evolving these guidelines is to enable consistent application across all PSUs and also enhance the transparency of the disinvestment process. These are detailed below. The guidelines on modalities will be applied by the Disinvestment Commission while formulating specific recommendations for each PSU. It is recommended that the broad guidelines with respect to selection of intermediaries and strategic partners be followed by the Standing Empowered Group.

### 4.1 Formation of Standing Empowered Group (SEG)

In view of its advisory nature, the Commission will bring out recommendations on disinvestment in each of the PSUs referred to it. To ensure smooth implementation, the Commission recommends the formation of a Standing Empowered Group (SEG). The SEG could comprise the Cabinet Secretary, Secretaries of the Ministry of Finance, Department of Public Enterprises, Administrative Ministry of the PSU alongwith the CEO of the concerned PSU. This Group will provide continuity to the whole process of disinvestment in various PSUs. It is necessary to provide for such continuity for learning from experience and to bring about refinement in the process. The selection of financial advisers, supervision of the overall sale process and decisions on instrument, pricing, timing, etc. as per Terms of Reference VI & VII may also be entrusted to the SEG. The SEG should ensure that the proposed disinvestment should be widely publicised and should draw funds from the Disinvestment Fund for this purpose. This group should undertake all the activities of the disinvestment process on the lines recommended by the Commission. In order to enable the Commission to monitor the progress of the disinvestment process as per Terms of Reference IX, it is proposed that the SEG should keep the Disinvestment Commission informed on the various steps undertaken from time to time.

### 4.2 Guidelines on Modalities

#### *1. Offer of Sale*

This measure involves a total or a partial change of equity ownership through a direct sale of shares at a fixed price or by a book-building

process. Depending on the size of the offer and the state of the capital markets, the process may need to be phased over a period of time. The need of the PSU for additional capital will also be taken into account.

## *2. Strategic Sale*

A strategic sale alternative for select PSUs may involve selling a substantial stake with management control or a minority stake supplemented by technology transfer arrangements. The joint venture route could also be an alternative in some special cases. In all these cases, the original share holding of the Government could be diluted either by negotiation with joint venture partners or by shortlisting partners through the process of auction. Necessary guidelines for selection of partners/buyers is given later in this report.

## *3. Sale of Units after Corporate Restructuring*

This option has to be explored if a holding company structure has to be devised in order that the operating companies under the holding company could be disinvested. This is also applicable in cases where a multi-unit organisation could be spun off into independent companies which could then be disinvested.

## *4. Leasing and Management Contract*

Leasing of assets is an attractive method of disinvestment in cases where it may not be feasible to value the underlying assets of the PSU. This would involve leasing out certain assets of a PSU to the best bidders, so that the Government retains the benefits of ownership, but the operational efficiencies are improved due to leasing. Another modality for disinvestment to be followed in some of the units may be management contract. In the case of leasing of assets, management contract will automatically follow while in the case of management contract alone, it may not be necessary to lease the assets.

## **4.3 Guidelines on Selection of Intermediaries**

For any successful disinvestment programme, intermediaries play an important role. The role of merchant bankers in case of offer of sale, the role of financial consultants in strategic sale and role of specialist consultants in business and corporate restructuring assume importance.



### *1. Selection of Merchant Bankers/Global Co-ordinators*

An offer of sale can be done either in the domestic or in the international market or in both. The selection of intermediaries for each of these should be separate. A two stage process of selection of merchant bankers/investment bankers is recommended. The selection should be PSU specific and will depend upon the suggested mode of disinvestment.

Since there are a large number of merchant bankers/investment bankers operating, an initial shortlisting may be necessary. The initial shortlist may be based on the following factors.

- *Experience and capabilities.* The track record of the intermediary in terms of the major debt and equity issues handled over the past five years should be assessed. In case of international merchant bankers, the experience of managing issues in the concerned industry from emerging market countries should also be considered.
- *Commitment to India.* In case of international merchant bankers, their local presence either independently or in strategic alliance with a local partner will assume importance in view of the close interactions that will be required during the process.
- *Research Capability.* It is reasonable to expect that the selling of equity especially in the international market should be backed by research. The research strength of the intermediary in terms of the industry analysis, the operations of the PSU and the continuing coverage of India's economic development will assume importance.
- *Qualification of Personnel.* The composition of the team which will be managing the proposed issue and the overall manpower strength should also be assessed. The size of the marketing set up and their global coverage in case of international floatations have to be assessed.
- *Marketing Strategy.* The intermediary's strategy in terms of investor perception for the stock, potential market for the proposed offering under current market conditions, proposed syndicate structure and plans of post issue market operation for the specific PSU should be taken into account.
- *Conflict of interest.* The commitment of the intermediary becomes important in case the intermediary is undertaking any other major floatations. Such details on pending transactions from either the same industry or the country should be assessed before final shortlisting.

The final selection of the intermediary should be made taking into account fees and expenses in a transparent manner. An additional factor for the final shortlist would be the willingness of the intermediary to undertake hard underwriting at a pre-determined price. In these cases, the fee quoted by the intermediary could be higher.

In order to facilitate better co-ordination, it is recommended that the selection of co-leads and co-managers should be decided by the global co-ordinator(s) in case of international floatations. However, before the syndicate is finalised, the SEG should retain the right to ask for any change in the syndicate structure where necessary.

## *2. Selection of Strategic Partners*

While the procedure for selection of global co-ordinators for straight forward disinvestment of around 10 to 25 per cent of Government holdings in profit making Undertakings can be made on a competitive basis in a transparent manner on the lines indicated above, a more elaborate procedure is necessary in the case of PSUs considered appropriate for strategic sale.

Strategic sale implies sale of a substantial block of Government holdings to a single party which would not only acquire substantial equity holdings of upto 50 per cent but also bring in the necessary technology for making the PSU viable and competitive in the global market. It should be noted that the valuation of the share will depend on the extent of disinvestment and the nature of shareholder interest in the management of the company. Where Government continues to hold 51 % or more of the share holding, the valuation will relate mainly to the shares of the companies and not to the assets of the company. On the other hand, where shares are sold through strategic sale and management is transferred to the strategic partner, the valuation of the enterprise would be different as the strategic partner will have control of the management. In such cases, the valuation of land and other physical assets should also be computed at current market values in order to fix the reserve price for the strategic sale.

To get best value through strategic sales, it would be necessary to have a transparent and competitive procedure and to encourage enough competition among viable parties.

The following steps should be necessary for the process :

1. (a) One or more global financial advisers with or without association with Indian advisers has to be selected in a transparent and competitive manner. Parties with experience in this field will have to be pre-

qualified and bids on fees related to the sale value have to be obtained. These advisers will have to work with the PSUs for some months for drawing up the terms and conditions for obtaining a large number of bids from viable parties, evaluating these bids and making appropriate recommendations to the seller i.e. the Government. Quotations should also be obtained alongwith the bids on fees for the initial expenses of the advisers, to be paid only in the case of the sale not going through owing to unacceptably low bids, and to be absorbed in the fees in the event of a successful sale.

(b) For going through this first step of selection of financial advisers for strategic sale, bids have to be obtained from the financial advisers in a transparent manner. For this purpose, it would be useful to have the services of an internationally experienced team of one or two Consultants for whom separate fees will have to be paid. These consultants will draw up the terms of reference for the financial advisers, invite bids and advise the SEG on the selection of the financial adviser.

2. The financial advisers selected through the step one process can then be utilised for actually putting through the strategic sale. Detailed rules of competitive bidding have to be drawn up with specific reference to the PSU under the terms of the strategic sale. There will be, apart from the bid for the block of shares to be sold, arrangements for other matters such as sharing of management between the existing majority share holders e.g. Government and the strategic partners, the terms for induction of new technology from the strategic partner or others and subsequent sale of shares by the Government to foreign and domestic investors which should be covered. The selected financial advisers for the strategic sale will have to draw up these terms to the satisfaction of SEG and the PSU management. It would also help if these draft terms are also discussed with the potential strategic bidders to test the acceptability of these terms and to avoid the need for post bid clarifications and variations. Thereafter, the SEG will authorise the selected financial advisers to canvass the strategic sale and to obtain sealed bids in accordance with these detailed terms. These bids will be opened by the SEG. The financial advisers will, thereafter evaluate the bids and give their advice to the SEG on the best evaluated bid. To minimise subjectivity in the evaluation and to make the whole process transparent, it may be necessary to indicate in the invitation to bid the criteria for evaluation and the weightage to be given for

different aspects of the bids. The SEG can then either accept the best evaluated bid or reject it, if it is considered low in financial terms or unacceptable in other ways.

3. For further disinvestment by the Government as agreed with the strategic partner at the time of the latter's selection, the same financial advisers can be engaged if there has to be a GDR sale. There is an advantage in this process as the financial advisers would already be familiar with the PSU. In this arrangement initial quotation of fees from financial advisers can be obtained for strategic sale and subsequently for the GDR book building sale. This will enhance competition, lower fees and speed up process.

In the alternative, a fresh selection of financial advisers / global co-ordinators will have to be made for the subsequent GDR sale and substantial fees will have to be paid for the services of the global co-ordinators.

4. It would also be desirable to offer Government shares in the rejuvenated PSUs, with a strong strategic partner, to the Indian investors also. At this stage, the company's own needs for IPO will have to be taken into account in consultation with the strategic partner.

#### 4.4 Retailing of PSU Shares to Small Investors and Employees

**In line with the objectives of the disinvestment strategy to disperse PSU shares widely in the domestic market, the Commission recommends reservation of a sizeable quantity of shares for offer to the small investors and PSU employees. Such offer will be made at a price upto 10% below the issue price to Indian institutional investors or investors in the GDR market. When GDR is not involved, the offer of shares to the small investors in the domestic market may be undertaken first and, at a later date, the balance remaining could be offered to the institutional investors at an appropriate price. A ceiling of 200 shares is recommended for such allotment to small investors.**

**Since it is considered desirable that the employees of the PSUs should also become share holders, it is proposed that preferential allotment be made to employees, with a ceiling of 200 shares per employee at the same price as the small investor. A separate ceiling of 500 shares may be fixed for preferential allotment to the employees. Where the shareholding exceeds 200, there will be a lock-in period for three years for such preferential allotment. In the case of high price shares, the**

**tradable lots would need to be reduced to enable the small investors to participate in the sale. In the case of employees, they may also be permitted to pay in instalment upto a maximum of two.**

Direct retailing by the Government for each PSU would increase cost of distribution and would also not be effective in terms of reach. It would be practical to use intermediaries such as mutual funds of public institutions like UTI/LIC/GIC for this purpose. As this is a new mechanism for distribution to small shareholders the framework has been broadly dealt with below :

If provident funds (PF) are allowed to deploy a part of the funds in mutual fund schemes for investment in PSU shares, an amount of Rs. 2000 crores can be initially be invested with UTI. It is proposed that UTI float a new scheme called "PSU Provident Fund Scheme" and receive PF monies. The scheme will invest these funds in acquiring PSU shares which will be offered at a discount to the institutional price. In turn UTI will retail these shares in marketable lots at cost to individual small investors. Any unsold shares can be sold to the institutions at the institutional prices. It is expected that good PSU shares will be made available to individual investors over a period of a month of retailing. The money recouped from these investors could be reinvested in acquiring shares of other PSUs offered through disinvestment. Thus the corpus can act as a revolving fund enabling disinvestment of other PSU shares. In the interregnum between disinvestment, UTI will deploy the funds in equity and debt and the earnings will be given as return to the Provident Fund Account. In order to protect the interests of the provident funds, Government may underwrite to the scheme any shortfall in annual returns compared to the average earnings now accruing to the provident funds. A higher return net of scheme expenses can be shared between the fund and the Government.

If however, provident fund monies are not available for investing in mutual funds, the above procedure can be modified as follows. Government shares for sale can be initially deposited with a mutual fund like UTI which will undertake to retail the shares to small investors over a suitable period of time. The monies realised through such a scheme can be paid back to the Government. The unsold shares if any, can be sold to institutional investors at the institutional price and can be repatriated back to the Government. However, in both these cases there may be a time lag between the deposit of shares and the realisation of proceeds to the Government.

A part of the shares proposed for disinvestment in a PSU could be dematerialised and placed with the National Securities Depositories Limited (NSDL) in the account of the mutual fund. The mutual fund in turn could retail the shares to small investors who are members of the depository participants and in this process they save on stamp duty on transfer and acquire instant tradeability. However, in the initial stages the extent of such sale may be restricted till the number of depository participants of the NSDL and investors linked to them increases.

In all the above cases it would be worthwhile to conduct a suitable publicity campaign for ensuring wide advertisement for the proposed sale of shares. The expenses incurred in this could be offset from the proceeds of disinvestment.

# PART C





## 5. SPECIFIC RECOMMENDATIONS

### 5.1 Modern Food Industries (India) Limited

#### Evolution

The company was incorporated on 1st October, 1965 as Modern Bakeries India Limited (MBIL) with the main objective of popularising wheat consumption and to set up model bread production facilities with emphasis on hygiene and nutrition. It started its commercial production in 1968 with four plants at Bombay, Madras, Ahmedabad, Cochin and Delhi. By 1979, the company had established thirteen bakery units spread all across the country.

In 1979, MBIL started manufacturing non-bakery products with the setting up of Rolling Flour mill at Faridabad. In 1980, Food Corporation of India (FCI) handed over the solvent extraction plant at Ujjain and Government of India (GoI) its Fruit Juice Bottling Plant at Delhi to MBIL. With these diverse operations under its wings and in order to reflect the changed nature of its operation, the name of the company was changed as Modern Food Industries (India) Limited (MFIL) in 1982.

In 1985, MFIL set up a Mango Pulping facility at Bhagalpur and a Pineapple Pulping facility at Silchar. Later in nineties, MFIL started supplying energy foods/extruded foods/care foods under the various Social Welfare Programmes of various State Governments and under the aegis of World Food Programme. The Ujjain Plant has been closed down, though thanks to a court stay, workers are being paid their salaries. The Silchar facility has also been closed down while the Bhagalpur facility has been re-organised to produce nutrient food.

#### Production Facilities

At present, MFIL is having 14 manufacturing facilities for manufacturing bread and other bakery products, 4 facilities for energy food and one unit manufacturing extruded food. In addition, it has 17 franchisees and eight ancillaries. All these manufacturing units are located all across the country.

## Installed Capacities and Capacity utilisation

The following table gives the Installed Capacities and Capacity utilisation for the past three years.

Table 1 Installed capacities and capacity utilisation

Particulars	Installed capacity	Capacity Utilisation %		
		FY 94	FY 95	FY 96
Bread/Bakery (mn. S L.)	268.6	66	72	90
Energy food & Care food (MT)	36000	37	110	115
Extruded Food (MT)	1500	96	99	130
Fruit juice & Drinks (lakh litres)	191.28	3	3	4

## Industry Profile

The bakery industry is a low tech and low margin industry. In 1977, GoI had reserved bread industry for Small Scale Industries (SSI). Accordingly, 60-70% of the total production today comes from the unorganised sector. Because of this SSI Status, existing players cannot expand their operations and hence MFIL adopted the strategy of indirect expansion through franchising and ancillarisation.

The total market size of this industry is 15 billion standard loaves (SL) or 1.5 million tonnes. The current growth is around 5-6% per annum and is expected to remain in the same level in the medium term. Since this industry is reserved, 35-40% of the total production comes from small scale sector with about 1500-1800 units in operation. The organised sector accounts for 25-30% of the total production. The balance production comes from the traditional bakery units operating under cottage/tiny sector numbering approx. 65000 units. The two major players in this sector are MFIL and Britannia Industries Ltd (BIL) and are having a market share of 10-12% and 7-8% respectively. Apart from these two, there are a few large regional players such as Spencer's in South India, Vibbs in Maharashtra, Harvest Gold and Perfect in Delhi etc.

Regional consumption and demand patterns indicate that Southern States consume 32% of the total bread consumption while Northern, Western and Eastern States consume 27%, 23% and 18% respectively of the total consumption.

## Key Success Factors in the Bakery Industry

- As bread is consumed by a wide cross section of the society, there should be a strong retail distribution net work in order to service the customers.
- Large players with established brand names are preferred by the middle/ upper segments. Hence, establishing a brand name is another essential factor.
- As bakery industry is a low margin business, cost control would be crucial in sustaining profitability in the long run.
- Packaging of the product is very important as the product is a perishable commodity and quality, hygiene etc. have to be maintained.
- Access to raw materials like wheat and sugar which are agro based and whose production is dependent on the monsoon is another important factor.

## MFIL - SWOT analysis

### *Strengths*

- Production facilities are spread across the country. It has one of the largest and dispersed manufacturing set up. This will help cater to a wide cross section of consumers.
- Fairly well established brand across the country. Modern Bread is an established brand and has the single largest market share.
- Fairly wide distribution network. MFIL uses a combination of distributor-wholesaler-retailer network and also uses its own vehicles to supply to retailers. 80% of its total sales is through the above network.

### *Weaknesses*

- Under utilisation of production facilities. The capacity utilisation of all product lines of MFIL is low.
- Large workforce and relatively low labour productivity compared to its competitor. MFIL has 14 workers per line as against 8 workers elsewhere for the same comparable capacity. Employee costs as a percentage of total income is in the range of 15-17% over the past five years where as it is 7-8% for comparable competitors. The main reasons for this are comparative overmanning, high rates of absenteeism, low productivity and overtime payments.

- Acquisitions /setting up of businesses under Government persuasion in the past have not provided synergy and have adversely affected the overall performance.
- MFIL has limited flexibility in decision making to respond to market changes and use marketing tools like discounts, rebates etc. in a highly competitive, low margin bakery industry.
- Poor public image as compared to organised competitors. Especially in the North Indian market.

#### *Opportunities*

- Existence of a large market
- Per capita consumption in India very low. significant opportunity to increase market shares and volume.

#### *Threats*

- Removal of subsidies will affect the financial performance in the future. MFIL in the past had a wheat allocation quota from FCI on preferential basis without being affected by aberrations of the market prices of wheat. This facility was withdrawn in FY 89. Like wise, GoI was offering wheat to MFIL at subsidised rates (Re.1/- per kg less than the PDS release price). This scheme was withdrawn from November, 1996. This will affect the financial performance of the company as the resulting higher input prices cannot be passed on to the consumers fully.
- Supply of nutritional/energy products under Social Welfare Programmes is vulnerable to variations in budget allocations at a time when the sales contribution by this division is increasing.
- Fragmented nature of the market and competition from the organised and unorganised sector. Increasing competition from a large number of small units with niche market segments, especially if Abid Hussain Committee recommendations to increase the investment limit for SSIs to Rs.3 crores is accepted.
- Presence of a number of non-functional and loss making units acting as a drag on the operations and profits.

## Financial Performance

The sales contribution of the major Products for the past three years are as follows:

Table 2 Sales

Division-% of Net Sales	FY 94	FY 95	FY 96
Bakery Activities	84	68	65
Non Bakery Activities -			
- Energy Food	14	27	27
- Care/Extruded Food	1	5	5
- Others	1	0	3
Total (Rs. Million)	800	1109	1378
Average Sales Realisation			
- Bread (Rs. S.L.)	3.79	3.90	3.72
- Energy Food (Rs./MT)	10332	11045	11244
- Care Food (Rs./MT)	6300	6300	5860
- Extruded Food (Rs./MT)	8109	8108	9608
Gross Profit Margin (%)	4.0	8.3	11.1

The financial analysis for the past five years are given as under :

Table 3 Past Financial Analysis (Rs. Million)

Particulars	FY 92	FY 93	FY 94	FY 95	FY 96
Total Income (Rs. Mn)	647	817	809	1121	1393
Operating Profit (Rs. Mn)	-33	20	-3	59	109
Profit after Tax (Rs. Mn)	-28	24	1	63	61
Op. Profit Margin (%)	-5.1	2.5	0.4	5.2	7.8
Net Profit Margin (%)	-4.4	3.0	0.1	5.6	4.4
Equity Capital (Rs., Mn)	85	90	96	96	111
Tangible Networth	96	115	128	179	248
ROCE (%)	-	22.3	7.7	28.7	46.2
Cost of Capital (%)		12.2	9.0	9.4	13.6
RONW (%)	-	23.0	0.8	40.9	28.7
EPS (Rs.)*		270.7	10	656	553.2
Book Value (Rs.)*	1133.2	1280.4	1336.4	1871.9	2239.0

(\*) Face value of share is Rs.1000

The Company's operating profit margins fluctuated during the past five years mainly due to the losses incurred in non-bakery operations and rise in prices of major raw materials for bread, which could not be passed on to the consumer because of the competitive markets. As can be seen from the above table, the equity capital of MFIL has gone up from a level of Rs.85 million in FY 92 to Rs.111 million in FY 96. This is because of Government funding. Government has been providing funds to the tune of around Rs. 10 million every year (50% as equity and 50% as loan).

### Recommendations

Based on the above SWOT analysis, the future outlook of MFIL in terms of financial performance as a public sector undertaking does not appear to be promising. The potential to improve share valuation through restructuring may not also be significant.

### Extent of Disinvestment

According to the principles for the extent of disinvestment evolved by the Commission, MFIL falls under the non-core sector in which disinvestment can go upto 74% or more. It is recommended that the Government should disinvest 100% of its shareholding in this company for reasons already stated.

### Modality of Disinvestment

The Commission evaluated the overall operations of the Company and it was felt that better realisation would accrue to the Government if all the units were sold together. The size of MFIL in terms of assets and operations is not large. It has a large number of small units. It may not be necessary to attempt any de-merger exercise before sale on a unit by unit basis. It is also felt that if the company is sold as a whole, potential buyers who could consolidate and run the operations would be interested.

On these considerations, a sale of the entire Government shareholding on an as-is-where-is -basis is recommended. The appointment of financial advisers, selection of buyers etc. through the mechanism of competitive bids should be undertaken by SEG. Guidelines for sales are given in Part B of this report.

## 5.2 Gas Authority of India Limited

### Background

The Gas Authority of India Limited (GAIL) was incorporated in 1984 with the objective of engaging in all post exploration activities such as transportation, processing and marketing of natural gas. The first project of the GAIL was the construction, operation and maintenance of the Hazira Bijaipur Jagdishpur (HBJ) pipeline with an installed capacity of 18.2 million standard cubic metres per day (MMSCMD) of natural gas, covering a total distance of over 1700 kms. As on today, the company has expanded and diversified its activities to other related areas such as LPG production. The company is in the process of completion of another major diversification programme for production of petrochemicals.

The major share of sales of GAIL comes through the business of transportation of natural gas through the HBJ pipeline. GAIL has also set up gas processing facilities at Vijaipur and Vaghodia for production of LPG, Propane, Pentane, and SBP. The details of GAIL's sales break up for the last three years from different operations are given below :

Table 1 Sales Break-up

	FY 96		Fy 95		Fy 94	
	Rs.Mn	%	Rs. Mn.	%	Rs. Mn.	%
Natural Gas	38633	92.2	31461	93.6	29029	93.0
LPG	2783	6.6	1831	5.4	2056	6.6
Others	494	1.2	336	1.0	119	0.4
Gross Sales	41910	100.0	33628	100.0	31204	100.0

At present, the company's paid up share capital is Rs.8453 million, out of which the Government has disinvested 3.37% during 1995-96 to institutional investors at a price of Rs.67 per share. In addition, the company has allotted 200 shares to employees at a price of Rs.18 per share in January 1997.

### Industry Overview

#### *I. Natural Gas Transportation*

The natural gas production in the country is owned by two public sector companies viz., Oil & Natural Gas Commission Ltd (ONGC) and Oil India Limited (OIL). GAIL has a near monopoly position in the marketing and

distribution of natural gas in the country. The market share of GAIL is close to 94 % and there are only four other small companies who operate only on regional basis. The natural monopoly characteristic of the pipeline distribution business consolidates GAIL's position. GAIL owns 19 of the 49 onshore gas pipelines in the country amounting to 89% of the overall approx. 3200 km pipeline length. GAIL also owns 3 of the 11 offshore gas pipelines accounting for 57 kms of 679 kms.

Use of natural gas in the overall energy consumption accounts for only 7%. The major consumer of gas supplied by GAIL are units in power sector and fertiliser sector who together account for more than 80% of the total gas sales.

#### Factors crucial for success in the Natural Gas Transportation

- Long term availability of natural gas is essential as the spot market is practically non-existent.
- Construction of processing plant, LNG plants and pipelines are capital intensive, sourcing of cheap capital is critical for company's profitability.
- Since all the facilities are capital intensive, effective utilisation of the capacity and achieving economies of scale are other key success factors.

#### Government Policy

The pricing of natural gas and natural gas products which include LPG, ethane and propane are administered and assure a 12% post tax return on networth. There are location specific subsidisation for North-east sector. Free import of liquefied natural gas is allowed. Transportation charges are also administered and are expected to increase from Rs.850/TCM to Rs. 1150/TCM in 1997-98 as per the T.L Sankar Committee recommendations. The allocation of gas is controlled.

#### 2. Liquefied Petroleum Gas

The LPG producers in India include ONGC, IOC, HPCL, BPCL, GAIL, OIL, CRL, MRL, MRPL and BRPL. The LPG covered under the administered pricing mechanism is marketed by IOC, HPCL, BPCL and OIL.

GAIL has an appropriate 13% share in overall LPG production in the country and about a 32% share in gas based LPG production. From 1998-99, its capacity will increase to around 1.3 MMT from the present 0.48 MMT on account of ongoing expansions. This would add considerably to its current market share.



## Factors Crucial for Success in the LPG Industry

- Under the Administered Price Mechanism
  - Increasing capital expenditures through internal accruals
  - Better performance than the standard laid down by Oil Co-ordination Committee for the refinery.
  - Being a net recipient from the oil pool accounts

### Under Decontrolled Price Scenario

- Long term availability of gas is crucial for LPG production. Consequently, effective negotiations in the various long term contracts are essential
- Adequate LPG extraction facilities and logistics for distribution
- Integrated operations with upstream and downstream petrochemicals and power generation
- Ability to source cheap capital

## Financial Analysis

The past financials of the GAIL are as under:

Table 2 Past Financial Analysis (Rs. Million)

	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	41648	33447	31118	27779	10412
Cost of Sales	35172	28101	25677	22849	6915
Operating profit	6476	5346	5441	4930	3497
Profit After Tax	5155	3676	3205	2105	942
Gross margin (%)	45.5	16.0	17.5	17.7	33.7
Net Margin (%)	12.4	11.0	10.3	7.6	9.0
ROCE (%)	21.1	18.1	18.8	15.5	10.9
RONW (%)	24.7	22.2	24.0	20.0	38.0

## Recommendations

Based on the analysis of the company performance and the outlook of the industry, the classification of the industry in terms of the framework evolved by the Commission, is "High Potential". The PSU is operating in a near monopolistic environment as regards its main business and has future

expansion plans in the main business. Moreover, GAIL's future financial performance is expected to be on an upswing, as all their new projects will be implemented in the next couple of years.

### Extent of Disinvestment

According to the principles for the extent of disinvestment evolved by the Commission, GAIL falls under the core sector. On this basis, it is recommended that the Government can disinvest upto 49%.

### Restructuring

At present, no business or technological restructuring is warranted. However, in order to enhance enterprise value and the share value, it is recommended that the delegation of powers to the Board of Directors be maximum in accordance with definition of Strong Performers as given in Part A of the report. Since GAIL will continue to be in the public sector even after disinvestment, adequate delegation of powers will instil confidence in the minds of the prospective investors that the management of the company will be run on professional lines.

### Modalities of Disinvestment

The PSU's strong finances and its near monopoly position in business will help attract both institutional as well as small investor interest. Keeping in mind the capital structure and the availability of investible resources in the Indian Capital Market, disinvestment to the extent of 25% of the total equity capital is recommended and this should be distributed between the domestic market and international market depending upon the market conditions. The price and exact timing may also be decided by Standing Empowered Group depending upon the market conditions.

The selection of global co-ordinators for the GDR issue should be done by the Standing Empowered Group. Guidelines for this have been evolved by the Commission and are available in Part B of the report.

As regards the domestic issue, the Commission has evolved guidelines for retailing the shares to small investors and are available in Part B of the report.

## 5.3 India Tourism Development Corporation

### Evolution

With a view to developing tourism in the country, the Government of India set up two separate undertakings namely India Tourism Transport Undertaking Ltd. and India Tourism Corporation Ltd. Subsequently these were amalgamated in 1966 which led to the emergence of India Tourism Development Corporation Ltd. (ITDC). The erstwhile Ashok Hotels and Janpath Hotels were also merged with ITDC in 1970.

### Present Activities

The main activities of ITDC include the following:

- *Construction, management and marketing of hotels and restaurants:* ITDC operates 26 hotels which can be classified into three categories on the basis of facilities and services offered. These are:

Table 1 Categories of Hotels

Segment	Service	No. of Hotels	Rooms Number	% of total
Elite	Luxury	6	1326	37%
Classic	Budget	15	1234	34%
Comfort	Economy	5	1049	29%
TOTAL		26	3609	100%

- *Provision of shopping facilities in the form of duty/tax free shops:* ITDC operates 30 shops in six locations in airports; but the bulk of the turnover is from two shops in Delhi and Mumbai Airports.
- *Provision of tourist transport facilities:* Ashok Tours and Travels provides travel and tourist services and exists mainly to add synergy to the hotel operations rather than as a profit centre on its own.

### Business Analysis

As mentioned above, a major part of ITDC's income comes from the hotel chains and the duty free shops. These businesses are analysed below:

## Hotels:

The 26 strong hotel chain of ITDC has a presence in various segments ranging from luxury to economy class. A brief description of these categories is given below:

Table 2 Break-up of Hotel Business

Category	Hotels	Description	Turnover 1995-96 (Rs. Cr.)	% to total	PBT 1995-96 (Rs. Cr.)	% of total
Elite	6	Luxury	116.7	63	35	79
Classic	15	Budget	50.7	27	8.5	19
Comfort	5	Comfort	17.3	10	0.9	2
Total	26		184.7	100	44.4	100

As may be observed from the table, the elite category is the most remunerative and profitable of all the hotels. This is in line with the industry trends which indicate that the luxury hotels are typically more profitable than lower standard categories.

The nature and quality of facilities are not at par with those provided by hotels in the corresponding competing categories. As a result the occupancy levels of the hotels are much lower than the corresponding occupancy levels of the competing hotels.

The overall occupancy levels at ITDC have more or less remained stagnant except in metro locations which have seen an increase. However, this increase has not been commensurate with the increase experienced by the other major players. This can be explained by the fact that though ITDC has 75% of its owned rooms in the metros, there is a fair proportion of budget and economy class hotels in this geographical segment. This is in contrast to its competitors who operate only luxury segment hotels in the metros.

The relative weak brand image of the ITDC and the lower standards of facilities and services as also its presence in the budget and economy segments of hotels has led to lower average room rents compared to its competitors.

Out of the 26 hotels only three hotels have computerised systems. As a result the control on guest billing, guest communication, material procurement, etc. is probably not as effective as with computer based

systems. Therefore it is reasonable to conclude that there is scope for cost reductions in operations. All these factors have resulted in lower net profits.

### Duty Free Shops (DFS)

Till 1992-93, the hotels and the tour divisions of ITDC were posting meagre profits or losses. Nearly all the net profits of ITDC were being contributed by the DFS division. In 95-96, DFS division contributed 38% of the net profits of ITDC.

The lease on the DFS of ITDC is due to expire in May 1997. There is some uncertainty regarding the renewal of the license from the Airport Authority of India (AAI). If renewed, AAI is likely to increase the license fee. This may adversely affect the profits of the company. In case the license is not renewed in May 1997, it may have a significant downward impact on the profits of ITDC.

### Employee Costs

Employee costs in ITDC are significantly higher than its competitors. This is attributed to the presence of ITDC in various travel related operations like Tours and Travels which employ a significant number of staff.

Further, this level of employee costs is expected to increase in the future due to two reasons. Firstly, the implementation of the Fifth Pay Commission will have a impact on the salaries of those staff who are employed at the Central Government pay scales. Secondly the wage agreement with the workers under the Industrial Disputes Act has expired on December 31st 1996 and is due for negotiations this year.

### Financial Analysis

The present capital structure of ITDC has an equity share capital of Rs.67.5 crores with a tangible net worth of about Rs. 1480 crores. The company has a very low proportion of debt in its operations and all financing of projects in the past has been done by internal accruals.

Financially the company's performance has improved over the last four years primarily due to improved performance in the hotel business. The gross and the net margins have shown a consistent improvement as shown in the table below:

**Table 3 Financial Highlights of ITDC**

Rs. Crores	95-96	94-95	93-94	92-93	91-92
Gross sales	135.83	111.2	83.63	67.45	63.71
Operating Income	288.88	233.56	189.74	160.34	140.78
Cost of sales	219.08	190.76	160.92	141.46	126.33
Profit After Tax	47.75	28.36	12.21	10.05	5.59
Total Assets	316.25	259.51	218.69	185.92	175.69
Net profit margin (%)	16.51	10.74	6.36	6.25	2.19
Gross profit margin (%)	24.16	16.93	15.19	11.17	10.26

The company's return on capital employed has shown a consistent upward trend over the past five years increasing from about 8% to about 39%. ITDC's ROCE is higher than all the other hotels in the hotel industry with the exception of Asian hotels. This is mainly on account of the company's duty free business which is not capital intensive and has a high turnover.

The key favourable and unfavourable issues which arise from the above analysis are as follows.

#### Areas of Strength

- ITDC operates a chain of hotels in different locations as compared to some other players in the industry who operate either one or two hotels. This can be considered as a strength as a chain provides easy access to both the business and tourist travellers and thus has a multiplier effect on revenue.
- ITDC owns properties in prime locations in Delhi and other places which provide an easy and convenient access to both business and tourist travellers. Given the scarcity of land in prime locations, this is a major factor in favour of the company. Some of these properties are on lease hold land.
- The demand for hotel rooms is dependent on the growth of the business and tourist travel. This is expected to grow at a healthy pace over the medium term.

#### Areas of Concern

- ITDC's presence in all the segments of the hotel industry viz., luxury, budget and economy has weakened the image among the business travellers. As a result, the luxury hotels of the group experience lower occupancy levels. However, given the prime location of these properties,

there is considerable scope for increasing turnover per room in the Elite category of hotels.

- Employee costs are high in ITDC. While it is acknowledged that the hotel industry is by itself a labour intensive industry, significant overmanning exists in ITDC which also provides labour using add-on services like travel and tours. The contribution to profits from these divisions is quite low.
- Unlike other major competitors, ITDC does not have the flexibility with regard to employee compensation which is considered essential if good talent has to be attracted to the company. Similarly, lack of autonomy at the Board level has adversely affected the decision making process. As the company operates in a highly competitive industry, some flexibility is considered necessary to enable the company to quickly respond to the changing needs of the market.

#### **Extent of Disinvestment**

**According to the principles established by the Commission, ITDC falls in the non-core category and hence disinvestment can go upto 74% or more.**

#### **Recommendations**

**It is evident from the above analysis there is some uncertainty about the operations of Duty Free Shops which have contributed significantly to the profits of the company in the past. At the same time there is considerable scope for improvement in the profitability of hotels which are situated in prime locations. One of the key success factors in the hotel industry is the ability to provide high quality of service especially in the luxury segment. It is felt that public sector is handicapped in providing this high quality of services in the luxury segment.**

**On the other hand, public sector as a whole does not have to play a role in providing hospitality services in metro locations where the private sector has established adequate presence in the market. In non-metro and other locations where the private sector hotels are yet to establish a presence, the public sector may be better suited to play the role of a facilitator rather than direct provider of services.**

**On these considerations, the Commission recommends that the ITDC should be suitably restructured in terms of its operations for the purpose of disinvestment. The restructuring proposed is as follows:**

1. In respect of the hotels situated in prime locations like Delhi and Bangalore, they may be handed over to established hotel chains through a competitive bidding process to run on long term structured contract on lease-cum-management basis. This will mainly take care of the problems of transfer of property in case of lease hold lands on which the hotels are situated. It would be ideal if a tripartite agreement between ITDC, trade unions and the concerned parties is concluded in each case to take care of the interests of the labour. The terms of contract and procedure for competitive bidding may be determined by the SEG with the help of financial Advisers and Consultants. The contract could have up-front fee and annual fee with an in-built indexation for annual revisions. Such fees should be significantly higher than the current level of profits of each of the hotels. The realisation on account of the up-front fees and annual fees will accrue to Government in the form of taxes and dividends.

2. Other hotels may be demerged into separate corporate identities. Shares will be issued in these companies to Government and other shareholders, if any, in exchange for ITDC Shares. The disinvestment in the new companies will be through sale of 100% Government share holdings in them. The SEG may again carry out this process with the help of Financial Advisers for proper valuation and terms of competitive bidding.

3. ITDC may continue to operate the business of duty free shops and travel and tours business subject to the viability of the operations. This should be decided by the Board of Directors of the Company.



# *ANNEXURE/APPENDICES*



## Analysis of the Referred PSUs

## Analysis on Net Profits

PSUs have been segregated on the basis of consistent profits or fluctuations between net profits or losses reported during the preceding five years from FY91 to FY96. Consistent profits indicates that category where the PSU has not slipped into losses during the last six years.

Table 10 PSUs with consistent profits

Category	Name of The PSUs
Consistent Net Profits Between FY91 and FY96-	ONGC, OIL, BRPL, SAIL, MTNL, GAIL, SCI, EIL, ITDC, HAL, AI, CONCOR, IPCL, FACT, NFL, PHL, NLC, NCF, HTL, BEML, BEL, GRSEL, BALCO, HZL, NALCO, IBP, NTPC, PGCIL, NHPC, RITES, KIOCL, MOIL (32 PSUs)

in the other category, companies which slipped into losses in one or more years in the referred period are presented below:

Table 11 PSUs with Inconsistent Profits /Losses

Category	Name of the PSUs
Fluctuation between Net Profits or Losses during FY91 To FY96	Hindustan Copper Ltd, South Eastern Coal Fields, Western Coal Fields, Madras Fertilisers Ltd., Modern Food Industries (India) Ltd., Hotel Corporation of India Ltd., ITI Ltd., and Hindustan Latex Ltd. (8 PSUs)

Out of the above eight, ITI is a special case as the company has posted increasing losses since 1994-95 and has currently initiated steps for application to the Board for Industrial and Financial Reconstruction (BIFR)

under the provisions of the SICA. The above PSUs may require additional preparation for them to be taken up for disinvestment.

#### Analysis by Industry Classification

The DPE survey classifies all the 245 central PSUs into 21 industry segments. The PSUs referred belong to 14 industry segments out of this total of 21. 28 PSUs belong to the manufacturing sector, with the remaining 12 in the service sector.

Table 12 Analysis by Industry Classification

Industry	No	Companies
<b>MANUFACTURING</b>		
Fertilisers	3	FACT, NFL, MFL
Petroleum	5	ONGC, OIL, GAIL, BRPL, IBP
Chemicals	1	IPCL
Coal & Lignite	4	NCF, SECF, WCF, NLC
Power	2	NTPC, NHPC
Minerals & Metals	6	HZL, HCL, BALCO, NALCO, KIOCL, MOIL
Steel	1	SAIL
Medium & Light Engg	3	BEL, HTL, ITI
Transportation Equip.	3	BEML, HAL, GRSEL
<b>SERVICE</b>		
Telecom Services	1	MTNL
Transportation Services	4	AI, PHL, SCI, CONCOR
Ind. Dev. & Tech. Consultancy	3	EIL, RITES, PGCIL
Tourist Services	2	ITDC, HCIL
Consumer Goods	2	HLL, MFIL
<b>Total</b>	<b>40</b>	

#### Analysis on Paid-up share Capital

The 40 PSUs referred to the Commission have a wide range of share capital. A frequency analysis on this parameter is presented in the table below.

Table 13 Analysis of Share Capital

(Rs. Crores)

Range of Share Capital	No.	Name of the PSUs
(> 5,000)	1	NTPC
(2,500 - 5,000)	3	SAIL, PGCIL, NHPC,
(1,000 - 2,500)	5	NLC, ONGC, NALCO, NCF, SECF
(500 - 1,000)	4	GAIL, WCF, KIOCL, MTNL,
(250 - 500)	6	NFL, BALCO, HZL, FACT, HCL, SCI
100 - 250	7	IPCL, BRPL, AI, MFL, GRSEL, HAL, PHL
< 100	14	OIL, EIL, ITDC, CONCOR, HCIL, HTL, ITI, IBP, BEML, BEL, MFIL, HLL, RITES, MOIL
Total	40	

## Analysis on Accumulated Reserves

For all the 40 PSUs, an analysis of the accumulated reserves with share capital was carried out in order to understand opportunities for capitalisation of reserves. The following table compares the accumulated reserves as a multiple of the paid up share capital. Only companies where the multiple is more than 8 have been included. In all other cases the above multiple was significantly lower.

Table 14 Accumulated Reserves

(Rs. crores)

Sl. No.	Name of PSU	Share Capital (a)	Total Reserve (c)	Times (c)/(a)	Govt holding
1	RITES	1.00	90.78	90.78	100.00
2	OIL	71.33	1782.21	24.79	100.00
3	BEML	36.86	536.16	14.30	61.10
4	IBP	14.76	205.41	13.92	59.62
5	EIL	18.00	238.19	13.23	100.00
6	ONGC	1525.92	16932.88	11.10	97.94
7	IPCL	248.95	2242.17	8.59	62.40
8	A. INDIA	153.84	1335.54	8.42	100.00

It is evident that in at least eight companies, there are significant opportunities for capitalisation of the reserves.

Analysis on Trading & Listing

Table 15 Stocks Disinvested and Listed

Sl. No	Name of PSU	Share Capital (Rs. crs)	Price*	GoI Holding (%)	Other Major Share holders
1	FACT	354.77	NA	87.35	
2	ONGC	1525.92	175.00	96.13	
3	NALCO	1288.62	38.00	87.15	FIs
4	SAIL	4130.40	22.25	85.82	UTI
5	SCI	282.30	32.00	80.12	UTI
6	CONCOR	64.99	375.00	76.92	M. Stanley
7	ITI	88.00	NA	76.67	FIs
8	HZL	422.53	15.85	75.92	FIs
9	BEL	80.00	NA	75.86	FIs
10	MTNL	600.00	237.00	65.73	FIs & FIIs
11	IPCL	248.95	131.50	62.4	FIs
12	BEML	36.86	141.50	61.1	FIs
13	IBP	14.76	103.75	59.62	FIs
14	GAIL	845.32	100.00	96.63	
15	BRPL	13.75	13.75	74.76	FIs & MFs

\* Price as on 18th February, 1997 on the Bombay Stock Exchange

Table 16 Stocks Disinvested but not yet Listed

Sl. No.	Name of PSU	Share Capital	GoI Holding (%)
1	NFL	490.58	97.65
2	HCL	330.20	98.88
3	NLC	1796.78	94.19
4	EIL	18.00	94.01
5	ITDC	67.52	90.00*
6	KIOCL	634.51	98.99

\* The other major share holder is the Indian Hotels Ltd

Table 17 Stocks not Disinvested so far

Sl. No.	Name of PSU	Share Capital	GoI Holding (%)
1	NTPC	7334.97	100
2	PGCIL	2972.24	100
3	NHPC	2832.48	100
4	NCF	1178.47	100 by CIL
5	SECF	1121.00	100 by CIL
6	WCF	711.00	100 by CIL
7	BALCO	488.85	100
8	AI	153.84	100
9	MFL	137.37	69.78 <sup>1</sup>
10	GRSEL	123.84	100
11	HAL	120.50	100
12	PHL	113.76	78.46
13	OIL	71.33	100
14	HCIL	40.60	100 by AI
15	MOIL	15.33	81.54 <sup>2</sup>
16	HTL	15.00	100
17	HLL	13.65	100
18	MFIL	9.58	100
19	RITES	1.00	100

<sup>1</sup> Balance held by National Iranian Oil Company

<sup>2</sup> Balance held by State Governments of Maharashtra (9.62 %) and Madhya Pradesh (8.81 %)





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DISINVESTMENT  
COMMISSION

APRIL  
1997

Disinvestment Commission  
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# INTRODUCTION



The Disinvestment Commission presented its First Report on 20th February, 1997. The report was in three parts : Part A dealing with an overview of the central Public Sector Undertakings; Part B containing general recommendations and Part C specific recommendations with regard to Modern Foods Industries Ltd. (MFIL), India Tourism Development Corporation (ITDC) and Gas Authority of India Ltd.(GAIL). It was emphasised that the recommendations in Parts B and C should be taken in totality in order to enhance enterprise value and maximise Government's receipts from disinvestment.

The Hon'ble Finance Minister, Shri. P. Chidambaram in his Budget speech on February 28, 1997 stated "We intend to proceed with the disinvestment in these companies along the lines suggested by the Commission". A reference was also made to the long term strategy formulated by the Disinvestment Commission. Quoting from the Commission's First Report, he stated "The essence of a long-term disinvestment strategy should be not only to enhance budgetary receipts, but also minimise budgetary support towards unprofitable units while ensuring their long-term viability and sustainable levels of employment in them." He further indicated that Government agreed with this view.

The Commission would like to emphasise once again that wherever there is an offer of sale of shares with government majority shareholding or a strategic sale with Government retaining at least 51% of the shares temporarily, the share values can be increased significantly by implementation of the recommendations relating to better corporate governance and managerial autonomy as outlined in Part B of the First Report. The Commission's examination of the PSUs has revealed that in several cases, the viability and operational efficiency of the undertakings has been adversely affected owing to protracted delays in getting government clearances for their investments. This further underlines the need for providing more autonomy to PSUs as already recommended in the First Report. There is also a negative perception among the investors that PSU managements are relatively underpaid and generally demotivated besides being excessively controlled and lacking in autonomy. **The Commission would, therefore, once again reiterate that there is likely**

**to be loss to the exchequer through lower realisation of sale value, in the absence of a co-ordinated approach to disinvestment keeping in view the general recommendations contained in the First Report and the specific recommendations made in respect of each of the referred PSUs.**

The Commission has made a study of the privatisation process in several countries around the world and as stated in the introduction to its First Report "has taken due note of ..... experiences of other countries in disinvestment and privatisation". Available studies on disinvestment in various countries have shown that there is no universally applicable model of privatisation programme and that every country has tailored its approach to its specific objectives and constraints. The process has evolved in most of the countries with mid-course corrections having been made in the light of experience gathered over the years. Various strategies have been adopted and implemented and a wide range of techniques used. There is thus no uniform recipe for success in privatisation and many countries have experienced successes and failures. Privatisation has also been a contentious issue in many countries. The success of the programme depends on the political consensus and the will to pursue a strategy for improving efficiency in the use of public resources invested in PSUs ensuring their competitiveness and providing sustainable employment. In many countries state ownership has been found to be less conducive to efficiency than private ownership in comparable cases. Wherever state ownership has promoted efficiency it has been possible through operation in a competitive environment and by providing autonomy and incentives to the PSU managements.

**In India what is needed is a pragmatic approach and not an ideological approach to public enterprises.** There are PSUs which have performed well and which could perform even better with greater autonomy and incentives to management. There are other PSUs in need of new technology, marketing skills etc. which can be accessed through strategic sale of shares to suitable private sector partners. **A differentiated approach to disinvestment will be necessary for each PSU with reference to its particular circumstances.**

The Commission has continued with its examination of the remaining 37 PSUs out of the 40 initially referred to it by the Government. A further list of 10 PSUs has been recently forwarded to the Commission. (The Hotel Corporation of India included in the recent list of 11 PSUs already figures in the original list of 40 PSUs referred to the Commission in September, 1996).

In this Second Report the Commission has made specific recommendation in respect of six PSUs. This is divided into Part A containing general issues and recommendations and Part B specific recommendations for each PSU.





# PART A



## 1. GENERAL ISSUES ON DISINVESTMENT AND RECOMMENDATIONS

In its First Report submitted to Government in February 1997, the Commission has outlined a long term strategy for disinvestment revolving around four long term objectives:

- To Strengthen PSUs where appropriate in order to facilitate disinvestment;
- To Protect employee interests;
- To Broadbase ownership; and
- To Augment receipts for Government.

The long-term strategies to pursue the above objectives which have been detailed in the First Report are as follows:

### *To Strengthen PSUs*

- By strengthening profitable PSUs to promote greater competitiveness and profitability to enable payment of higher dividends to the government and to enhance share values
- By strengthening other marginally profitable PSUs and reduce their future dependence on the budget
- By financially restructuring and reviving loss making PSUs to invite private capital for long term turnaround

### *To Protect Employee Interest*

- By sustaining long term employment by providing financial turnaround of loss making PSUs
- By providing adequate and fair compensation through VRS to surplus work force
- By providing for employee participation in management

*To Broadbase Ownership*

- By retailing PSU shares to small investors and employees and offering them at suitable price discount as compared to the institutional investor

*To Augment Receipts for Government*

- By appropriate levels of disinvestment in profit making PSUs
- By eliminating the need for budgetary support for loss making PSUs.

The Commission has already detailed its approach to disinvestment in loss-making PSUs in the First Report. After a comprehensive study of such loss making PSUs they would be classified for disinvestment as below:

- Those in which Government could disinvest as a going concern on an as-is-where-is basis;
- Those which could be restructured and turned around before disinvestment; and
- Those which may need closure.

In all cases, it would be important to protect the interest of affected labour by devising suitable schemes either for retraining, redeployment or for voluntary retirement with adequate compensation. The cost of such schemes could be met to varying degrees by the sale of assets of the companies concerned. The balance where necessary, could be met from the Disinvestment Fund supplemented if necessary, in any particular year by a provision in the budget.

As regards profit making PSUs, the Commission has, as already mentioned above, emphasised the need for managerial autonomy and better corporate governance for promoting greater competitiveness and profitability to secure for Government higher dividends and enhanced share value as also on increasing internal generation of resources and reducing dependence on budgetary outlays. The Commission has also underlined the importance of the pressure that disinvestment and dispersal of ownership would exert on the managements of the PSUs to improve their performance, earn profits and declare dividends.

The Commission at this stage would like to clarify further its approach to profit-making PSUs. These PSUs could be broadly classified into two groups. The first group would consist of those PSUs which operate in monopolistic or oligopolistic markets and enjoy certain special advantages in terms of Government policy. There are other PSUs which operate in a more competitive market environment and which are coming under progressively increasing pressure from private sector competitors in the current liberalised economic scenario.

As regards those operating in monopolistic or oligopolistic markets, while Government does derive recurring benefits through receipt of dividend, disinvestment provides it with an opportunity to cash in on the increases in the networth of the companies through off-loading of shares to institutional and individual investors while retaining control of the management wherever public purpose warrants it. Government, like any other shareholder in a company, needs to benefit not only from annual dividends but also from the appreciation of its investment.

As regards those which operate in internal or internationally competitive markets, some of them may be presently generating profits. However, a long-term view needs to be taken on their viability. Structured as they are today, with limited autonomy involving multiple layers of control and approval procedures, many of them may not be able to capitalise on their existing strengths and seize on new opportunities as they present themselves. There is a danger that they may succumb to the pressures of competition. They may not, therefore, remain profitable in the long run. Hence, there is an urgent need to consider the option of disinvestment in them.

Even where such dangers are not foreseen, disinvestment by the Government will have to be based on whether or not any public purpose is served by continued Government ownership and control in a PSU given the nature of the market in which it is operating.

The disinvestment proceeds from profit making PSUs would be available to the government to deal with the problems of loss-making PSUs thereby reducing the continued burden on the budget. In this connection, the Commission had emphasised the need to place proceeds from such disinvestment from profit making PSUs into a Disinvestment Fund and indicated the uses to which this Fund should be put. This is intended to

take care of the possible danger of mere short-term budgetary compulsions dictating the process of disinvestment in profit making PSUs.

In the First Report, the Commission had classified 35 out of the 40 PSUs referred to it into core and non-core categories for the purpose of determining the extent of disinvestment in accordance with the stated Government policy. It was also mentioned in the Report that this classification could undergo change over time. At that time the Commission had not yet gone in depth into the working of these 40 undertakings. As a result of further examination of the PSUs covered in this Second Report it has become necessary to reclassify some of them for the reasons stated in the specific recommendations relating to them.

**In the final analysis, the classification of the PSUs into core and non-core categories and the consequent extent of disinvestment have to be based on whether or not any public purpose is served by government ownership and control in a PSU, given the nature of the market in which it is operating.**

The Commission would like to emphasise four other issues which will have an important bearing on the disinvestment process.

1. As has been already outlined in the First Report, the strategic sale alternative is one of the various modalities of disinvestment proposed to be followed by the Commission. Detailed guidelines for the selection of a strategic partner have already been outlined in pp 38-40 of the above report. In addition, **the Commission would like to emphasise that the selection of the strategic partner should be through a process of pre-qualification in order to identify and shortlist only suitable bidders who could bring in necessary technological or financial inputs for the concerned PSU.**
2. One of the major problems that will be encountered in the process of disinvestment will be the redundant employee strength beyond what can be sustained for profit making and competitive operation of the undertakings. **There seems to be considerable uncertainty both among management and employees about the terms of the Voluntary Retirement Scheme (VRS). It will help the process of shedding surplus manpower if there is a clear-cut policy statement on the terms of VRS on a stable and long term basis.**

3. **It is equally important to provide adequate funds for this purpose to the managements of PSUs out of the Disinvestment Fund after merger of the National Renewal Fund (NRF) with it on the lines recommended in the First Report of the Commission.**
  
4. **With the large presence of FIIs in the Indian capital market and a significant number of these FIIs also participating in the GDR sales of PSU and private company shares, the Indian capital market is getting steadily integrated with the global capital market. The conditions for sale of PSU shares through the 'book building' process similar to that for GDRs can be established in India itself in the near future if the various requirements of investors are met. This process can be facilitated if PSUs which were earlier disinvested and which are proposed for disinvestment are directed to join National Securities Depository Ltd. (NSDL) and have their shares registered with it to meet the various concerns of the investors including the speedy transferability of shares. Where shares are offered to small investors they will have the facility of holding their shares in the depository after dematerialisation or of getting the share certificates, according to their preferences.**





# PART B



## 2. SPECIFIC RECOMMENDATIONS

### 2.1 Bharat Aluminium Co. Ltd.

#### Evolution

Bharat Aluminium Co. Ltd. (BALCO) was set up in 1965 in Korba in Madhya Pradesh for the manufacture and sale of Aluminium metal including wire rods and semi-fabricated products such as Extrusions, Sheets/Coils and Foils. Subsequently, the company was asked to take over a sick unit in Bidhanbag (West Bengal) in 1984 which added to the downstream facilities in sheets, foils and alloy rods. The production capacities and plant utilisation levels are as shown below:

Table 1 Production and Capacity Utilisation 1995-96

	Korba	Bidhanbag
Production (MT)	91,240	3,134
Capacity Utilisation		
Wire Rods	93%	21%
Sheets/Coils	80%	34%
Foils		21%

The Company's paid up equity was Rs. 488 crores as at March 31, 1996. There has been no disinvestment so far in BALCO.

#### Industry Analysis

The aluminium industry in India can be divided into two segments: primary aluminium manufacturers and secondary fabrication units. Primary aluminium can be sold in the form of ingots, billets and slabs. The secondary fabrication units process aluminium metal produced by the primary producers to manufacture three main categories of value added products: redrawn rods, rolled products and extrusions. The product manufacturers have the additional option of using imported aluminium under OGL.

The main primary producers of aluminium in India are National Aluminium Co.Ltd. (NALCO), Hindalco Industries Ltd. (HIL), BALCO and Indian Aluminium Co. (INDAL). Out of these the first three account for 90% of the total domestic output.

The industry structure in the primary segment is oligopolistic in nature due to high entry barriers such as high capital cost, restricted access to technology and long gestation periods. However, with the lowering of the import duties since 1992, the domestic prices of aluminium are strongly linked to the prices on the London Metal Exchange (LME) and hence the primary market may be considered to be competitive in spite of a limited number of players.

The industry structure in the secondary value added segment is fragmented with a large number of secondary producers (including BALCO) spread across the country.

The threat of substitutes has a bearing on the demand for aluminium products and this in turn limits the margins for both primary as well as secondary producers.

### Process and Technology

Aluminium is manufactured by refining bauxite and then processing the refined intermediary (alumina) in a smelter to extract aluminium. The process of producing alumina from bauxite is dependent on the nature of the ore

The reduction of alumina into aluminium is carried out in electric smelters. There are two technologies available for the reduction of alumina viz., the more recent and advanced pre-baked anode process and the older Sodeberg process.

Though there has been a shift in technology, it may be noted that the process technology for manufacture is not likely to exhibit significant changes. Improvements, if any will be gradual and can be easily sourced from other countries.

## Demand - Supply

Aluminium's varied properties make it suitable for diverse applications. The increase in applications and the rationalisation of duties are expected to be the key determinants for demand in the future. The major consuming sectors for aluminium and their expected growth rates in the medium term are as follows:

Table 2 Segment wise Domestic Demand Growth

Sector	Share FY 96	Growth Rate*
Electrical	34%	8%
Transport	22%	10%
Consumer Durable	11%	10%
Packaging	11%	15%
Building & Construction	8%	6%
Industrial	8%	7%
Others	6%	6%
Total	100%	9.1%

\*Expected growth rates for user industries in the medium term.

Based on the existing capacities of the four major players as well as their on-going and proposed capacity expansions, the demand supply gap is as projected below:

Table 3 Demand Supply Gap

(MT)	FY 96E	FY 97P	FY 98P	FY 99P	FY 2000P
Total Demand	5,60,135	6,10,690	6,66,557	7,27,214	7,93,390
Total Supply	5,29,000	5,49,000	5,90,000	6,25,000	6,45,000
Surplus/(Deficit)	(31,135)	(61,690)	(76,557)	(102,214)	(148,390)

The supply by domestic aluminium producers even at their full capacity will not be enough to meet the total demand and hence secondary producers and other producers would have to import metal.

## Global Scenario and India's Position

India has 12% of the world's reserves of bauxite but produces only 3% of the aluminium in the world. Despite higher power tariff prevailing in the country, domestic producers measure up to global standards due to captive power plants and low cost of bauxite. The sectoral usage of aluminium is quite different in India when compared with global usage patterns.

Table 4 Usage Pattern of Aluminium

Sector	India	Global
Electrical	34	8
Transport	22	27
Consumer Durable	11	9
Packaging	11	22
Building & Construction	8	20
Industrial	8	8
Others	6	6

The difference in the usage patterns can be ascribed to the Aluminium Control Order which stipulated that 50% of the aluminium produced in the country had to be reserved for the electrical sector. This had led to a lopsided consumption pattern. With the abolition of the Control Order in 1989, the growth of consumption in other sectors has picked up and the trend is towards replicating the international pattern.

Internationally, prices had fallen in 1996 due to a decline in copper prices as aluminium prices are strongly linked with the prices of copper. With no fresh additions to smelter capacity, the price of aluminium is likely to be sustained and even witness an upward trend in the medium term.

### Key Success Factors in Aluminium Industry

*Availability of raw materials* The availability of good bauxite ore in close proximity to the smelter will greatly determine the cost of production.

*Captive Power* Since power forms as much as 35% of the manufacturing cost, uninterrupted power supply in the form of captive power is a key success factor.

*Vertically Integrated Operations* Primary aluminium producing companies with a presence in the value added segment have a competitive advantage in terms of higher margins. In addition, nearness of the fabrication facilities to the consuming markets will determine freight costs.

### Business Analysis of BALCO

BALCO's performance has shown considerable improvement in the past few years due to a number of reasons. Primarily, BALCO's product mix consists of lesser low value products such as ingots and conductor rods as against its competitors. However, the company is unable to capitalise on a favourable product mix due to inappropriate quality and/or pricing. Hence the product price increase of downstream products is much lesser than that of competitors.

### Financial Analysis

The financial performance of BALCO for the past five years is given below:

Table 5 Financial Performance

(Rs. Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	601.4	598.9	506.5	389.6	394.3
Operating Profit	197.6	162.3	65.3	51.8	46.5
Profit After Tax	163.3	90.5	15.3	1.9	0.9
Equity Capital	488.8	488.8	488.8	488.8	488.8
Tangible Net Worth	757.5	608.2	517.8	502.6	500.7
Gross Margin (%)	32.9	27.1	12.9	13.3	11.8
Net Margin (%)	27.2	15.1	3.0	0.5	0.2
ROCE (%)	21.0	16.8	5.9	4.3	3.6
RONW (%)	21.6	14.9	3.0	0.4	0.2
Earnings Per Share (Rs.)	3.34	1.85	0.311	0.04	0.02
Dividend (%)	2.9	-	-	-	-

The performance of BALCO has shown a steady improvement partly due to the improved outlook of the industry and also due to improved levels of operations. The sales realisation has improved significantly due to the increase in the prices of aluminium on the LME. The effect on profit has been accentuated by a reduction in interest cost through retirement of Rs. 140 crores of debt between 1992 and 1996. All these factors have contributed to an increase in the earnings per share of the company from an insignificant level of 2 paise in FY 92 to Rs.3.3 in FY 96.

### Strengths and Areas of Concern

Based on the above industry, business and financial analysis, the strengths and areas of concern of BALCO are as below :

#### Strength

*Low Costs of Production* The depreciated plants even if based on outdated technology have helped in keeping costs of production low. This in turn, has led to increased profitability.

#### Areas of Concern

*Inadequate Supply of Ore* Although the operations of BALCO are vertically integrated, the ore production is not fully commensurate with the production of hot metal. As a consequence, BALCO has to source its ore requirements from other mine sources which may lead to an increased cost of raw materials. With the implementation of 36,000 tpa Cold Rolling Mill, the requirement of hot metal and the consequent requirement of ore will further increase. Further the cost of extraction and transportation of ore is high when compared with NALCO. This is on account of contractual (labour intensive) mining being carried out as opposed to mechanised mining and being transported in lorries/trucks as opposed to rail as in the case with NALCO.

*Relatively Old Technology* The use of the Sodeberg cells for the smelter as opposed to the pre-baked process results in a higher consumption. However, the company is in the midst of smelter modernisation which would reduce power consumption, improve yield levels and reduce consumption of anode paste.



*Higher levels of Employee Costs* BALCO's operations are less mechanised than other players and to that extent, higher employee costs seem justifiable. However, the merger of the erstwhile Aluminium Corporation of India (the present Bidhanbag unit) has created overstaffing problems. The company's VRS has not been too successful in downsizing the workforce.

*Captive Power Generation* Even though theoretically BALCO has enough captive power generation capacity, BALCO has to depend on the State Grid for meeting part of its power requirement. The power cost differential between generated power (Re 0.69/kwh) and purchased power (Rs.5.59/kwh) for 1995-96 puts BALCO at a disadvantage compared to its peers.

*Lack of Autonomy* The lack of autonomy in decision making which is an area of concern for most PSUs is particularly relevant in the case of BALCO. For example, the company had initiated a proposal to set-up a Cold Rolling Mill of 36,000 MT 8 years ago; the proposal has been only recently cleared.

*Bidhanbag Unit* The Bidhanbag Unit, a sick company in West Bengal was merged with BALCO. The low capacity utilisation, the high manpower costs, and the inconsistent level of quality of the products are a major drag on the profitable operations of BALCO.

## Recommendations

BALCO is a PSU which has posted impressive financial results in the last few years and its profitability in FY 1996 has in fact increased quite significantly. BALCO employs what could be considered an outdated smelter technology with its concomitant disadvantages of high power consumption and lower output in comparison to the advanced pre-baked process. However, because the plant has already been highly depreciated, this has contributed to its improved financial results. This is also a company which produces a whole range of products from metal to wire rods and semi fabricated products. Apart from the outdated smelter technology, BALCO also suffers from certain other disadvantages which need to be addressed quickly to sustain its competitive position in the market. At least during the next 2 years it will have to depend to a significant extent on out-sourced bauxite. Also it still depends on supply of power from the State Electricity Board to the extent of about 15% of its requirements, from time to time

with resultant higher cost. It also has a loss making unit at Bidanbagh which makes a negative contribution. In spite of all this, however, the company's internal generation is more than satisfactory and all the diversification projects it is considering to implement could be financed through such internal generation and could be supplemented by market borrowings. The projects which it needs to take up urgently would include :

- mechanising its mining activities to bring down the cost of bauxite
- adding to its captive power plant capacity to meet its power requirements which could result in savings of as much as Rs. 3000/- per tonne of metal.
- modernising its smelter operations to reduce power and material consumption and to improve yields to gain an overall benefit of upto Rs. 1000/MT of metal.
- cold rolled mill project(CRM) for a more diversified product mix, and modernisation of the Bidanbagh unit and implementation of the condenser foil project in that unit.

It would also be necessary to take steps to shed the surplus labour force particularly in Bidanbagh unit with an imaginative and acceptable VRS.

Once the above projects and the VRS are implemented, BALCO would be able to improve its profitability much further. BALCO as a PSU has suffered from procedural bottlenecks and lack of managerial autonomy. The CRM project at Korba has been cleared after 8 years with near-doubling of the capital outlay. The company was not able to get clearance from the government for setting up 100% captive power generation. As a result, the company had to depend on high cost power from the state electricity board which resulted in avoidable cost increases. The delays and the lack of autonomy have certainly affected its operating profits which would have been much higher had it been able to implement these projects earlier.

**The Commission had earlier categorised the company as belonging to the core group of PSUs which would set the limit on disinvestment at 49%. Having, however, considered the working of the unit in detail and the structure of the Indian aluminium industry the Commission has**

reviewed the position. There are three major players in the market other than BALCO viz. NALCO, HINDALCO, and INDAL. There are also a large number of small and medium units producing aluminium products. BALCO has a market share of around 17% in the market (including exports). Most of the other major players are also undertaking programmes to enhance capacities in the metal sector as also in the down-stream products. A new aluminium smelter project is being promoted by HINDALCO and Orissa Mining Corporation with a capacity of 2,50,000 tonnes in Orissa. With the commissioning of the new capacities in the domestic market, the market share of BALCO is expected to come down to 12%. In addition the user industry also has access to imports and the market is fully contestable. Under these circumstances, the Commission has concluded that BALCO be categorised as non-core rather than core for purposes of disinvestment.

The Commission has evaluated various modes of disinvestment and has concluded that the sale of shares in a public offer may get a lower realisation than the sale to a strategic partner through a competitive bidding process from domestic and foreign partners. The Commission recommends that Government may immediately disinvest its holding in the company by offering a significant share of 40% of the equity to a strategic partner either domestic or foreign through a transparent and competitive global bidding process. There should be an agreement with the selected strategic partner specifying that Government would within 2 years, make a public offer in the domestic market of further shares to institutions, small investors and employees thereby bringing down its holding to 26%. This process is likely to attract more and better offers. There should be an ongoing review of the industry situation and the Government may disinvest its balance equity of 26% in full in favour of investors in the domestic market at the appropriate time.

As already recommended by the Commission in Part B of its First Report (p.38-40), the Government would need to appoint a Financial Adviser who would undertake a proper valuation of the company and also conduct the sale. The Financial Adviser should also consider the desirability of capital restructuring by conversion of at least 25% of equity into long-term debt taking into account the degree of over-capitalisation in the company and its extremely low gearing.

## 2.2 Bongaigaon Refinery & Petrochemicals Limited

### Evolution

Bongaigaon Refinery & Petrochemicals Limited (BRPL) was incorporated on 20th February, 1974 as a refinery cum petrochemicals complex. The plant is located in Dhaligaon, Bongaigaon (Assam). The complex initially started as a part of M/s Indian Petrochemicals Corporation Limited and was later on made an independent public sector company. The Refining unit was Commissioned in 1979 while the downstream petrochemical units were commissioned in phases in 1985 and 1989.

The total share capital of BRPL is Rs. 199.82 crores and presently the Government of India (GoI) holds 74.5% and the balance held by UTI (17.3%), Mutual Funds (4.4%) and others. The shares of the company are listed on BSE and is currently trading at Rs 15 at a P/E multiple of about 3.5. This is quite low when compared with other peer companies such as CRL, MRL and IPCL.

Table 1 Production Capacity and Utilisation in FY96

Products	Capacity	Utilisation
Refinery	2.70 Million TPA	48%
Paraxylene	29000 TPA	99%
Orthoxylene	6000 TPA	6%
DMT	45000 TPA	92%
PSF	30000 TPA	70%

Lower refinery capacity utilisation is due to expansion in FY 96 from 1.35 million TPA to 2.70 million TPA. The Paraxylene production was more profitable and hence Orthoxylene production was curtailed. The PSF utilisation was lower due to market demand.

### Industry Analysis

#### Refinery Sector

Oil sector is highly controlled under the Administered Pricing Mechanism (APM). The marketing of petroleum products is in the hands of three major

players viz., IOC, HPCL and BPCL. In the refining capacity, Indian Oil Corporation (IOC) is the market leader with 42% share whereas BRPL has only 4.2%. The major feedstock for refinery is crude oil and 50% of domestic crude requirement is met through imports. IOC is the only importer of crude. There is a decline of crude availability in North Eastern region where BRPL is situated. Average Assam oil production in last five years is 4.83 million tonnes while the current refining capacity based on Assam crude is 7.65 million tonnes and another 3 million capacity addition is coming up with the setting up of the Numaligarh Refinery Ltd. This may affect the crude supply to BRPL, in the short run and will act as an impediment for future expansion.

In the liberalised environment, the Government has allowed setting up joint ventures and private sector refineries. Moreover, there may be further decontrol in distribution and marketing, tariff structure, abolition of APM etc.

### Petrochemicals

DMT and PTA are substitutes for manufacture of PSF/PFY. There are only three manufacturers of DMT viz., Bombay Dyeing (66%), IPCL (14%) and BRPL (20%) while there is only Reliance Industries Limited producing PTA (2.5 lac TPA). The production Capacity of BRPL is 45000 TPA and operates at 92% capacity utilisation. Since DMT and PTA are substitutes, the overall demand supply scenario shows an excess supply scenario emerging from 1998-99 at the latest. PTA is generally perceived to be a superior raw material for the production of PSF on account of higher yield, better quality and absence of methanol as a by product. All new PSF capacity is planned on the basis of PTA as raw material. Existing PSF manufacturers (except BRPL) have installed dual feed facilities using either PTA or DMT. This keeps the DMT manufacturers under competitive pressure. In case of DMT manufacturers with PSF units, this threat is mitigated to some extent.

In the case of PSF, the industry structure is more distributed with 11 players and Reliance as dominant player with 20%. Imports constitute 18% of domestic consumption. With additional capacities, a supply overhang situation is expected which may lead to softening of prices.

## Business Analysis of BRPL

BRPL is an integrated refinery cum petrochemical complex and has a unique position in the industry. Half its businesses (viz., refining) is under administered pricing while the other half (viz., petrochemicals) is under free market.

The company has undertaken an expansion of its refining capacity from 1.35 mmtpa to 2.70 mmtpa. This was done on the basis of ONGC's estimates of oil reserves in the North Eastern region. However the actual production has fallen short of these estimates. As a result of this, the crude availability is a major constraint due to which BRPL's capacity utilisation has been below 50%. In order to overcome this, the Government had appointed EIL to study the problems of crude availability to all refineries in North East including BRPL. The summary of EIL's recommendations is as follows :

The most economical and cost effective option is to augment the Haldia-Barauni pipeline (which is under execution) by providing one booster station for transporting an additional 1.28 mmtpa to BRPL and with minor modifications to the OIL pipeline for reverse pumping from Barauni to BRPL. The cost of this facility is estimated to be around Rs. 122 crores and will be completed only in FY 2000 assuming that there are no time delays.

The petrochemicals complex processes high aromatic naphtha cut from the refinery through a series of integrated plants. Efficient operations combined with a boom in the petrochemicals market has led to high contribution margins for the Paraxylene and DMT products. However, high operational costs, together with comparatively lower realisation has resulted in lower contribution from the PSF unit.

## Financial Analysis

The financial performance of BRPL for the past five years is as below:

Table 2 Financial Performance

(Rs. Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	716.4	640.5	574.0	483.5	416.6
Operating Profit	149.5	104.9	76.6	66.5	88.8
Profit After Tax	90.2	61.1	37.9	29.0	36.0
Equity Capital	199.8	199.8	199.8	199.8	199.8
Tangible Net Worth	508.3	444.5	402.2	381.2	362.1
Gross Margin (%)	20.9	16.4	13.4	13.8	21.3
Net Margin (%)	12.6	9.5	6.6	6.0	8.6
ROCE (%)	23.6	19.3	15.5	13.3	17.6
RONW (%)	17.7	13.7	9.4	7.6	9.9
Earnings Per Share (Rs.)	4.51	3.06	1.89	1.45	1.80
Dividend (%)	13.5	10	7	5	5

Refinery unit contributes 60% of the gross revenue while the balance comes from the petrochemicals and PSF units. Share of PSF unit has been going up over the last three years. Operating income has also shown a significant improvement. Operating margins have displayed a rising trend even though the refinery section is under APM. Due to improved profitability, the EPS has shown a steady increase.

### Strengths and Areas of Concern of BRPL

Based on the above industry, business and financial analysis, the strengths and areas of concern of BRPL are as below :

#### Strengths

*Forward integrated operations leading to value addition.* BRPL's operations are highly forward integrated leading to substantial value addition from refinery naphtha to DMT to PSF.

*Recently commissioned low cost refinery capacity expansion* BRPL's refinery capacity has been doubled from 1.35 million tonnes to 2.70 million tonnes at a relatively low cost in March 1996. The capacity addition was based on optimistic projections regarding Assam crude oil availability in future.

*Recent addition of LPG to product mix* With the commissioning of Delayed Coking Unit-II (DCU-II), and installation of LPG recovery facility in DCU-1. BRPL started recovering LPG, demand for which is projected to grow at 6-7% per annum.

*The Petrochemical section derives benefits of forward integration on account of raw material availability and cost* This integration helps the company to enhance production efficiencies and lower costs, thus adding to the company's competitiveness.

*Competitive technology from international Process Licensers* BRPL has got the competitive technology used internationally for the production of petrochemical products.

*Debottlenecking of DMT plant would substantially enhance capacity at low cost* A low cost expansion of DMT plant is expected to add substantial value to company's profitability.

### Areas of Concern

*Under-utilisation of capacity due to restricted availability of crude* This under-utilisation is mainly due to reduced crude production in Assam. The average Assam oil production in the past five years is only 4.83 million tonnes while the refining capacity drawing on Assam crude is about 7.65 million tonnes at present.

*Fuel consumption and refinery loss higher* Fuel oil consumption per unit of crude throughput of BRPL is 69 MT per 1000 MT where as that of HPCL is only 27. Similarly, gas consumption is 27 MT per 1000 MT as against 12 of HPCL. However, there are scope for improvement exists.

*Marketing products through IOC resulting in lack of in house marketing expertise and distribution network* This will be a major disadvantage under the liberalised regime with phasing out of APM and BRPL will have to incur considerable expenditure in setting up these facilities. Moreover, BRPL has to cater to a long distance market as there is already an oversupply situation in the North Eastern Region.



*Additional refining capacities* The proposed Numaligarh Refinery will enhance competition and will affect the crude availability due to low supplies. Moreover, there will be increased competition in HSD segment.

*Locational disadvantage* Major markets for DMT/PSF are situated in North and West.

*Low capacity utilisation for PSF* PSF capacity utilisation is 70% in FY 96 mainly on account of restricted demand and operational reasons.

*Business subject to relatively higher cyclicalities* Cyclicalities of prices affects margins. Pricing is linked to international prices which has shown a 50% decline in DMT prices and 35% in PSF.

*Emerging oversupply situation in PSF market* Additional capacity of 3.82 lac tpa is expected to come up by FY 97 and this could create a supply overhang. Low cost producers and integrated manufacturers like BRPL are better placed to survive.

*Reduction of import duties* There is a declining trend in custom duties for petrochemicals particularly on DMT which came down from 35% to 27%.

## Recommendations

BRPL is an integrated refinery with down stream processing and manufacture of petrochemical products. These integrated operations have helped the company to remain competitive even though in terms of the scale of operations, the size of the refinery is rather small. While the refinery capacity was recently doubled to 2.7 million tonnes, on account of non-availability of crude, capacity utilisation was less than 50% in FY 1996. Till arrangements for supply of imported crude through the Haldia-Barauni pipeline and reverse pumping from Barauni to Bongaigaon are completed in the next 2-3 years BRPL will continue to suffer on account of crude supply constraints.

Apart from improving crude availability, to capitalise on its strength of integrated operations, the company would need to improve the efficiency of its PSF operations particularly to control fuel consumption and waste reduction to increase profitability. Another area of attention from the point of view of improving its profitability would be to build up its capability

to market its products outside the North-Eastern region without depending on the Indian Oil Corporation as at present.

**The long-term viability of the company would hinge on arrangements for crude supply and development of marketing capabilities. This company suffers inherently from marketing disadvantages, situated as it is far away from its main market for the refinery products as well as petrochemical products. The Commission, therefore, feels that it would be desirable to associate a strong partner in the company's operations to enable it to make necessary investment to improve its operations and more importantly provide access to marketing techniques. Already in the oil sector and even in the N.E. region there is adequate presence of the public sector. In these circumstances, keeping in view the special locational problems of the company and the vital need for strong organisational and marketing inputs for its survival, it is considered necessary to reclassify it as a non-core PSU.**

**The Commission recommends that a strategic sale of 50% of shares of BRPL may be offered immediately to Indian or foreign oil companies either on their own or in association with one another. There could be an agreement with the selected strategic partner specifying further dilution of government equity to 26% or below through a public offer to Indian institutions, small investors and employees at a later date. The percentage of shares to be acquired by the successful bidder together from the public and the government to make up the 50% holding should be in accordance with the requirements of the Securities and Exchange Board of India (Substantial Acquisitions of Shares and Takeovers) Regulation 1997. Subsequent disinvestment by the government of its balance holding to Indian institutions, small investors and employees will be with reference to the agreement with the strategic partner and the requirement if any, for fresh listing.**

The procedures for strategic sale to be undertaken on an international basis have been detailed in Part B of the First Report of the Commission. **It needs to be emphasised however that, in order to attract sufficient interest among prospective bidders, it is essential that Government prior to the strategic sale make a policy statement on the phasing out of the Administered Price Mechanism (APM) for all petroleum products within a period of about two years. Subsidisation of any product, if considered necessary should be done through budgetary provisions.**

## 2.3 HTL Ltd.

### Evolution

HTL Ltd (HTL) was incorporated in 1960 for the manufacture of electromechanical teleprinters primarily to cater the needs of the telegraph wing of P & T Department. In the second half of eighties, the company diversified into manufacture of electric typewriters and electronic typewriters. In 1990-91, the company entered the area of manufacture of switches for telephone exchanges based on the technology of C-DoT. The current lines of business of HTL include manufacture of switches of all categories of exchanges i.e. small (less than 2000 lines), medium (upto 10000 lines) and large (greater than 40000 lines), manufacture of main distribution frames (MDF), transmission access and data communication products. The main manufacturing facility of the company is located at Guindy Industrial Estate in Chennai city and a supplementary facility is at Hosur in Tamil Nadu. The break-up of HTL's income for 1995-96 is given below :

Table 1 Break-up of Income for 1995-96

Product	Rs. (Cr.)	%
MDF	19.50	15
Small Switches (C-DoT)	19.81	14
Large Switches	85.50	61
Transmission & Access	1.98	1
Data Communication Products	13.12	9
Total	139.91	100

The company has a paid up share capital of Rs. 15 crores which is wholly held by the Government.

### Telecom Equipment Industry Analysis

The telecom equipment industry can be divided into three broad segments - switching equipment, transmission equipment and terminal equipment. These products are manufactured by a number of Indian and multinational companies.

### *Buyer Power*

DoT is currently the largest buyer of telecom equipment in India. Therefore, DoT's future plans, and its technology and product preferences, influence the investment decisions made by Indian manufacturers.

The industry structure is expected to change from a near monopoly, with the entry of private sector basic and cellular service operators, and therefore, DoT's bargaining power is likely to diminish over the next few years.

### *Dependence on Foreign Collaborations*

Indian manufacturers depend on foreign technology for higher-end equipment such as large switches. Continuous access to technology is critical in view of the high rate of product obsolescence and the need to offer the latest technology so as to remain competitive.

### *Severe Competition*

DoT's orders for telecom equipment are based on tenders, with the lowest bidder getting the largest order, and the balance order being split among the other bidders (at the price quoted by the lowest bidder). In order to penetrate the potentially large Indian market, multinational players seem to have quoted unrealistically low prices in tenders floated by DoT. The entry of multinationals in the switching segment has led to a reduction in prices from Rs. 7,000 to Rs. 4,300 per line. This has resulted in intense competition in the industry, forcing many players to exit the business.

### *Working Capital Intensity*

The manufacture of telecom equipment in India requires long cycle time, which could be increased further by delays in testing and inspection by DoT. This results in large work-in-process inventory in manufacturing units. Delay in payments by DoT and discontinuation of its advance system has led to high receivable levels for the domestic players.

### *Demand-Supply*

The switching equipment industry is expected to grow at an annualised 25% in the medium term as shown in the table below. The demand for

transmission equipment industry should increase at a Compounded Annual Growth Rate (CAGR) of about 15% in the same period. However, lack of funds with DoT could constrain growth in the short term. The industry will be characterised by overcapacity and severe competition, but prices will improve from current levels (at which existing manufacturers are making losses).

Table 2 Demand for Switching Equipment million lines

Equipment	FY 98	FY 99	FY 2000	FY 01	FY 02
Large	3.12	3.96	3.51	3.62	7.08
Small	1.21	1.56	1.33	1.44	2.90

### Competition

The large switch segment is dominated by large MNCs and ITI. DoT has approved seven switching technologies (from Siemens, AT&T, Fujitsu, GPT, Ericsson, Alcatel, and NEC) for integration with the local network. These multinational players have entered India through joint ventures with local partners as shown in table 3.

Table 3 Joint Ventures for Large Switches

Indian Partner	Foreign Partner	Product
BK Modi Group	Alcatel, France	E10B
Tata Group	AT&T, US	5 ESS
Siemens India	Siemens, Germany	EWSD
SR Jiwarajka	Ericsson, Sweden	AXE
Pubjab State Dev. Corpn.	Fujitsu, Japan	FETEX-150
KK Birla Group	GPT, UK	SYSTEM X

Competition in the medium and smaller segment is among HTL and about fifteen manufacturers in the private sector.

On the basis of the foregoing industry analysis, the Commission reiterates its classification of HTL in the non-core category.

## Business Analysis of HTL

The transformation of HTL from a manufacturer of teleprinters to a manufacturer of switching exchanges and transmission products is depicted in the table below:

Table 4 Pattern of Income Composition 1992-96

Income Composition in %	1996	1995	1994	1993	1992
Teleprinters and Typewriters	0	0	18	73	77
Switching - Large exchanges	61	37	0	0	0
Switching - Small exchanges	14	34	63	5	0
Main Distribution Frames (MDF)	15	14	15	17	16
Data, Access and Transmission	10	15	4	5	7
Total	100	100	100	100	100
Total Income (in Rs. Crores)	139.91	102.15	79.70	77.16	66.71

In 1995-96, the Company derived a large portion of its income from large switches for which the company has a commercial agreement with Siemens for technology. This arrangement is renewable but does not assure a sustained access to technology. Further HTL has an assured quota of 15% of all DoT purchases which makes its attractive for a multinational to ally with them.

## Financial Analysis

The following tables shows the financial performance of HTL for the past five years.

Table 5 Financial Performance

(Rs. Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	141.4	103.8	80.5	77.4	67.1
Operating Profit	9.7	6.1	7.4	17.0	9.9
Profit After Tax	0.5	0.4	2.6	6.6	6.7
Equity Capital	15.0	15.0	15.0	15.0	15.0
Tangible Net Worth	41.2	41.3	41.0	38.9	32.7
Gross Margin (%)	6.8	5.9	9.2	21.9	14.7
Net Margin (%)	0.3	0.4	3.3	8.5	9.9
ROCE (%)	8.9	7.0	13.0	30.4	40.1
RONW (%)	1.1	1.1	6.4	16.7	20.3
EPS(Rs.) Share value Rs.100/-	3.3	2.7	17.3	44.0	55.8
Dividend (%)	1	1	3	3	7.5

In the period shown in the table, the company has made the transition to the manufacture of switching products and was totally exposed to intense competition. There was a steady decline in profits although the availability of quota ensured growth in income. HTL's liquidity position has worsened significantly and it had already stretched its suppliers to the limit. The sharp increase in the external liability eroded the net margins.

### Strengths and Areas of Concern

Based on the above industry, business and financial analysis, the strengths and areas of concern of HTL are as below :

#### Strengths

*Strong electromechanical skills* The company has been manufacturing electromechanical switches over the past three decades and has consequently built up strong manufacturing skills. This however may not be relevant in the context of digital switching technology

*Emergence of new customers* The policy initiatives with regard to privatisation has led to emergence of new customers in the telecom equipment industry. However this may translate into orders at a much later date.

## Areas of Concern

*Dependence on multinationals* The component and technology base for telecom products in India is not developed as much as in other developed countries. Consequently domestic companies manufacturing large switches and transmission and access products have to depend on multinationals.

*Large workforce with unsuitable skills* As the company has changed its focus from electro mechanical switches to digital switches, the current workforce has become unsuitable for the production of digital switches. In addition the large number and the adverse age profile has contributed to the low productivity.

*Inadequate financial strength* As mentioned in the industry report, the telecom equipment industry is characterised by high working capital requirements. HTL has inadequate financial strengths in this regard.

*Possible loss of assured demand* Under the liberalised scenario, it is possible that HTL could lose the assured demand i.e., quota from DoT.

*Uncertainties in choice of technologies and commercial terms* HTL has to depend on technology on foreign players and therefore there may be uncertainty with regard to sourcing of technology as well as the commercial terms for the access with the technology players.

*Suppliers turning competitors* While multinationals offer technology to domestic telecom companies who have assured quotas from DoT there is an increasing possibility that these multinationals could quote in competition with the PSUs with whom they have a technical collaboration.

## Recommendations

In the report on ITI (which follows), the bleak financial future of that company has been brought out. HTL is even more vulnerable than ITI owing to its substantial dependence on imported components, low value



addition and lack of in-house R&D for products like large switches and transmission equipment. The company is unable to meet its existing obligations on debt owing to severe liquidity problems. The company has not been able to pay interest and loan instalments due to UTI and the Government. In the next one or two years, the networth of the company is likely to be substantially eroded and the company will most probably come under the purview of BIFR. On the other hand, the company has valuable assets in the form of industrial land in a prime location in Chennai.

The company has around 1600 employees mostly with electro-mechanical skills on its rolls. This manpower strength constrains HTL's competitiveness. In addition, the lack of electronic skills in the workforce necessary for its current line of production has a detrimental effect on the productivity. Already 175 employees have opted for VRS and there is a proposal to offer VRS to another 600 employees on receipt of a grant of Rs.14 crores from the Government of India. VRS should be initiated immediately as a prelude to disinvestment.

**Having classified HTL in the non-core category, the Commission recommends three options for disinvestment which may be considered in the order given below :**

- **The possibility of selling 100% shares in HTL along with ITI shares may be considered in the process of strategic sale on the lines recommended in the case of ITI.**
- **In the alternative, 50% of shares of HTL may be offered to a strategic partner through a global competitive bidding.**
- **Lastly if none of the above options is feasible it may be advisable to effect a straight sale of the assets of the company through competitive bidding, after providing fair and equitable terminal benefits to the employees.**

**In all cases, it would be necessary to appoint financial advisors to evaluate the company and enable completion of the sale transaction. However for the first two options, the government could appoint the same financial advisors for HTL and ITI. The procedure for appointing Financial Advisers for strategic sales and conducting the sale has been outlined in Part B of the First Report of the Commission (pp 38-40).**

## 2.4 ITI Limited

### Evolution

ITI Limited (ITI), India's first post-independence public sector undertaking, was set up in Bangalore in 1948, for the manufacture of electromechanical switching equipment. Subsequently, the company set up six more units, which currently manufacture the entire range of switching, transmission and terminal equipment.

The equity capital of the company as on March 31, 1996 was Rs.88 crores and the Government had disinvested about 23% of its holding to public and financial institutions. The shares of ITI has been listed in Bombay Stock Exchange and was quoted on 31st March, 1997 at Rs.7/- (face value Rs. 10/-) with a yearly high/low of Rs. 18/Rs. 6.

### Telecom Equipment Industry Analysis

The telecom equipment industry can be divided into three broad segments - switching equipment, transmission equipment and terminal equipment. These products are manufactured by a number of Indian and multinational companies.

#### *Buyer Power*

DoT is currently the largest buyer of telecom equipment in India. Therefore, DoT's future plans, and its technology and product preferences, influence the investment decisions made by Indian manufacturers.

The industry structure is expected to change from a near monopoly, with the entry of private sector basic and cellular service operators, and therefore, DoT's bargaining power is likely to diminish over the next few years.

#### *Dependence on Foreign Collaborations*

Indian manufacturers depend on foreign technology for higher-end equipment such as large switches. Continuous access to technology is critical in view of the high rate of product obsolescence and the need to offer the latest technology so as to remain competitive.

### *Severe Competition*

DoT's orders for telecom equipment are based on tenders, with the lowest bidder getting the largest order, and the balance order being split among the other bidders (at the price quoted by the lowest bidder). In order to penetrate the potentially large Indian market, multinational players seem to have quoted unrealistically low prices in tenders floated by DoT. The entry of multinationals in the switching segment has led to a reduction in prices from Rs. 7,000 to Rs. 4,300 per line. This has resulted in intense competition in the industry, forcing many players to exit the business.

### *Working Capital Intensity*

The manufacture of telecom equipment in India requires long cycle time, which could be increased further by delays in testing and inspection by DoT. This results in large work-in-process inventory in manufacturing units. Delay in payments by DoT and discontinuation of its advance system has led to high receivable levels for the domestic players.

### *Demand-Supply*

The switching equipment industry is expected to grow at an annualised 25% in the medium term as shown in the table below. The demand for transmission equipment industry should increase at a Compounded Annual Growth Rate (CAGR) of about 15% in the same period. However, lack of funds with DoT could constrain growth in the short term. The industry will be characterised by overcapacity and severe competition, but prices will improve from current levels (at which existing manufacturers are making losses).

Table 1 Demand for Switching Equipment million lines

Equipment	FY 98	FY 99	FY 2000	FY 01	FY 02
Large	3.12	3.96	3.51	3.62	7.08
Small	1.21	1.56	1.33	1.44	2.90

### *Competition*

The large switch segment is dominated by large MNCs and ITI. DoT has approved seven switching technologies (from Siemens, AT&T, Fujitsu, GPT, Ericsson, Alcatel, and NEC) for integration with the local network. These

multinational players have entered India through joint ventures with local partners as shown in table 2.

**Table 2 Joint Ventures for Large Switches**

Indian Partner	Foreign Partner	Product
BK Modi Group	Alcatel, France	E10B
Tata Group	AT&T, US	5 ESS
Siemens India	Siemens, Germany	EWSD
SR Jiwrajka	Ericsson, Sweden	AXE
Punjab State Dev. Corpn.	Fujitsu, Japan	FETEX-150
KK Birla Group	GPT, UK	SYSTEM X

**On the basis of the foregoing industry analysis, the Commission reiterates its classification of ITI in the non-core category.**

#### **Business Analysis of ITI**

Switching and transmission equipment have been the two key contributors to the company's turnover. Over the past five years, the company has been phasing out the production of electromechanical switches. In 1993-94, it began the manufacture of the state-of-the-art OCB-283 switch, with technology licensed from Alcatel, France.

ITI's production processes involve the assembly of components (partly manufactured in-house and the balance bought-out) into products and the subsequent testing of these products. The technology for lower-end products is available indigenously, but the company has to rely on large multinationals for sourcing technology for sophisticated products. ITI has large and well-equipped plants with modern plant and machinery, and excellent testing and inspection systems. The location of the plants and the product range of each plant is briefly summarised in table 3.

Table 3 Operating Characteristics of Different Units

Location	Product Range	Employee Strength	Operating Characteristics
Bangalore	OCB-283, Small Switches, Entire Transmission Equipment range, Telephone sets	10802	Skilled and mobile workforce but large surplus labour since component manufacturing units are unviable, Broad-product range, Strong manufacturing capabilities
Electronic City	C-DoT Switches	428	Compact unit, Optimal labour-force Productivity-based compensation systems, Completely dependent on C-DoT technology
Palakkad	DTAX, OCB-283	869	Focused product range
Mankapur	OCB-283	2455	Well-developed infrastructure, Modern production facilities
Rae Bareilly	Small Switches, Open wire equipment, MARR Masts, Optical Cables	6004	Very limited lower-end products, Heavily overstaffed since strowger and crossbar exchanges traditionally manufactured by the unit have been phased out, Redeployment of labour is difficult due to resistance to relocation, Unit does not appear to be viable in the current business environment with existing product line and labour force
Naini	Open wire systems, MARR and other radio systems, Multiplexers, Telephone systems	4618	Limited product range, large surplus labour, Unit does not appear to be viable in the current business environment with existing product line and labour force
Srinagar	Telephone sets	120	Small and unviable unit, Has been continuing production due to political compulsions

Currently, the company has a contract with Alcatel through which it has access to all upgradation in technology for large switches effected by Alcatel till 1999-2000. Alcatel's OCB-283 switch, being manufactured by

ITI at three locations, uses state-of-the-art technology. The recent joint venture between Alcatel with the B.K. Modi group places ITI in a vulnerable position as regards sourcing further technology after 2000.

In the transmission equipment business, the company has in-house technology for open-wire equipment, Multi Access Rural Radios (MARR) and VSAT equipment. ITI sources technology for higher-end radios from NEC, Japan; and Bosch, Germany; and has a joint venture with NKT for the manufacture of optical fibres.

The following table shows the technical collaborations of ITI.

Table 4 Technical Collaborations

Product	Technical Collaborator	Date of Expiry
Electronic Switch, OCB-283	Alcatel, France	March 2000
7 GHz 34 Mb/s Digital Microwave System	NEC, Japan	2004
6 & 11 GHz (SDH) Microwave Equipment	Bosch, Germany	10 Years from effective date or 7 years from date of commercial production whichever is later @
Switch Mode Power Supplies	Ascom, Switzerland	8 years from effective date or 7 years from date of commercial production whichever is later #

@ Agreement signed on August 31, 1994

# Agreement signed on December 11, 1995

ITI's Bangalore unit is its oldest manufacturing facility, and has the capacity to manufacture the entire gamut of telecom equipment. It also has a number of component units which have been rendered uncompetitive in the current business environment.

The Mankapur and Palakkad units are mainly single-product facilities, whose operating and financial performance is dictated largely by orders for the high value large switches from DoT and the price realisations on these products. The large labour force and limited (mainly lower-end, low value products) manufacturing capabilities have affected the performance

of the Naini and Rae Bareilly units. VRS schemes have not been successful at these units (particularly, at Rae Bareilly) since these units are in industrially less developed regions, which limits the availability of alternative employment opportunities for labour.

ITI's future market position is critically dependent on continuous access to technology, and its marketing abilities. In the short term, the company's market position could improve due to inefficiencies in DoT's systems. DoT has been unable to evolve a system of competitive bidding, and finalises prices for tenders on an ad-hoc basis. In the recent switching equipment tender, the minimum price quoted has been Rs 7,299 per line (as compared to Rs 4,273 per line in the last tender). However, DoT has made a counter-offer of Rs 5,112 per line, which has not been accepted by any player. Therefore, ITI, with its assured quantity preference, has been the only supplier of large switches to DoT in 1996-97

The procurement policies of DoT based on the competitive bids from various private parties with some of them with uncertain credentials quoting unrealistic prices at which they have not been able to supply and at which PSUs have to supply 35 per cent of the demand have accentuated problems of the two PSUs. Foreign suppliers who provide components to the PSUs also quote directly to DoT in competition with the PSUs. The pricing of the components is determined after the bids are received. The margin available to the PSUs are thereby squeezed and with the high labour component of the PSUs the purchase preferences given to them at the lowest tendered price very often enable them to meet material costs and only a part of the labour cost and results in losses.

It is necessary for DoT to streamline purchase procedures and provide for pre-qualification for bidders, substantial earnest money deposits and blacklisting of companies which fail to supply after quoting the lowest bid.

## Financial Analysis

Table 5 Financial Performance

(Rs. Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	782.6	1036.6	1527.2	1483.9	1084.7
Operating Profit	-101.8	45.3	369.6	293.1	252.2
Profit After Tax	-284.0	-81.9	84.4	79.6	57.2
Equity Capital	88.0	88.0	88.0	88.0	88.0
Tangible Net Worth	210.4	461.6	521.1	413.1	346.9
Gross Margin (%)	-12.9	4.3	24.1	19.7	23.1
Net Margin (%)	-36.1	-8.6	5.5	5.3	5.2
ROCE (%)	-	4.1	21.2	22.7	19.5
RONW (%)	-	-	16.2	19.2	16.5
Earnings Per Share (Rs.)	-	-	17.3	44.0	55.8
Dividend (%)	-	-	20	16	12

In 1994-95 and 1995-96, ITI's financial performance has been adversely affected due to low realisations resulting from severe price competition in all its key product areas, and the lack of orders from DoT (particularly in case of transmission equipment).

The company which made a pre-tax profit of Rs. 17.6 crores during 1993-94, made large losses during the next two financial years owing to:

*Fall in orders* During 1994-95 and 1995-96, the paucity of orders from DoT, the major customer for ITI, partially contributed to the losses. In 1995-96, due to the reduction in production and turnover, the value added per employee slipped to Rs. 104,244 as compared to Rs. 268,708 during 1993-94.

*Decline in realisations* The steep decline in realisations can be attributed to increasing competition, coupled with ITI's weak bargaining power with DoT.



*Increased interest outflow* Due to a strained working capital position, ITI had to resort to high cost borrowings, which increased interest outflow.

*Extraordinary items* The company has written off a sum of Rs. 17.0 crores in 1994-95, which is the value of obsolete raw materials and components relating to the OCB 181 technology. This had a direct adverse impact on the company's bottom line. Like many other PSUs, ITI has had to make provisions of about Rs. 40 crores for wage settlement with the employees in 1995-96. This increased employee costs and affected net profits.

### Strengths and Areas of Concern

Based on the above industry, business and financial analysis, the strengths and areas of concern of ITI are as below :

#### Strengths

*Wide range of telecommunication products* By virtue of being the sole supplier of telecommunication products, ITI's product range encompasses the entire range of telecommunication equipments from terminal equipment to switching systems.

*Strengths in digital switching* ITI is the only company in India to have built up expertise in the area of manufacturing digital switching. This experience will enable the company to indigenise and access future requirements of technology.

#### Areas of Concern

ITI had a near monopoly position in its key business segments till the late 1980s. Subsequently, with the entry of a large number of players in the small and medium switch and transmission equipment segments, and the strong presence of multinationals in the large switch market, the company's competitive position has been adversely affected.

In 1995-96, ITI derived 88% of its turnover from sales to DoT. In the recent past, DoT has not been able to make large investments in expanding the telecom network. This has affected ITI's business and financial performance. The high dependence on DoT will continue in the short to medium term.

ITI is a public sector undertaking, therefore, key decisions and investments have to be vetted by the government and DoT, which hampers the management's ability to react swiftly to the changing business environment.

India does not have a well-developed component base, which forces the company to import semi-conductors and other specialised components. The high dependence on imported raw materials (net foreign exchange outgo amounted to 34.5% of the turnover in 1995-96) makes the company's margins vulnerable to exchange rate fluctuations.

Technology for large size switches and higher-end transmission equipment is fast changing, with high risk of obsolescence. ITI does not have the research capability to keep pace with these advancements in technology. Therefore, it is entirely dependent on Alcatel for large switch technology. Since ITI derives about 50% of its turnover from the large switch, and sources key components for this switch from Alcatel, this is an area of serious concern.

Alcatel, the company's major raw material supplier, is also its competitor in the Indian market. Therefore, it provides very limited credit to ITI. ITI's inventory levels are high on account of long cycle time for manufacture of its products repeated changes in specifications made by DoT during the course of execution of orders, DoT's inability to test and certify equipment on time, location of plants in far-flung area and dependence on imported raw materials.

ITI is estimated to have substantial surplus labour despite reduction of labour force by 18% through a VRS in the past five years. The company's employee costs (as % of turnover) are the highest in the industry, which builds-in a high cost structure, and places the company at a crippling disadvantage in a competitive, low margin industry.

Traditionally, ITI has followed the business philosophy of integrating backwards into the manufacture of raw materials and components. The company's component manufacturing units have high overhead costs, which makes ITI uncompetitive with respect to other smaller domestic manufacturers.

Switching technology now incorporates more of firmware (i.e. software which is wired permanently) resulting in elimination of some switching circuits, thereby reducing costs. Thus, lower labour costs may no longer remain a competitive advantage for developing countries like India.

Purchases by DoT accounts for over 90 per cent of the sales of ITI. The expected private participation in the provision of basic services has been considerably delayed and this has resulted in ITI and HTL and other private sector equipment suppliers having capacities in excess of current demand.

### Recommendations

In an increasingly competitive market with the strong presence of multinationals and with ITI's high cost structure due to the significant surplus labour, the future of the company in its present form is an area of concern. The company's needs are in terms of the latest technology in the range of products for the communication industry, additional capital and national and international marketing skills. All these can be provided only by a strong strategic partner having the latest technology, capital and skills to develop and expand the activities of ITI. Such an arrangement will also avoid the need for large capital outlays by the Government or in the alternative avoid closure of the company and wholesale unemployment. The strategic alliance, after shedding surplus labour can provide sustainable long term employment for about 7,000 persons and improve the competitive strength of the company.

On the basis of the results for the financial year 1995-96, ITI made an advance report to BIFR under Section 23 of SICA as 50% of its net worth had been eroded on account of the past two year's losses amounting to Rs. 366 crores. However, it is understood that the company has posted a 20% increase in sales in FY 97 and the current year's losses are expected to be below Rs. 150 crores. In this situation, the company will still have a positive net worth and it is unlikely that the company will be referred to BIFR under section 15 of SICA in the short term.

The Commission has already classified ITI into non-core category. The following recommendations are therefore made :

Immediate steps may be taken to offer appropriate VRS facilities to the redundant employees in all its factories and to provide funds to the Company for meeting the costs of VRS.

In order to prepare for strategic sale to bring a strong technical partner/partners to ensure the future survival of the Company in one or two components, Technical Consultants and Financial Advisers may be appointed urgently to examine whether strategic sale can be made for the Company as a whole or for two components. The first component could for instance consist of the Bangalore, Palakkad and Hosur factories and the second component of Mankapur, Rai-Bareilly and Naini factories. The Consultants/Financial Advisers will also prepare the estimates of valuation for fixing a reserve price and identify the product lines that could be continued in the two components. The procedure for appointing Financial Advisers for strategic sales and conducting the sale has been outlined in Part B of the First Report of the Commission (pp 38-40).

The terms of sale can provide inter-alia for the sale of 50% shares of ITI of a strategic partner. There could be an agreement with the selected strategic partner specifying further dilution of government equity to 26% through public offer to Indian institutions, small investors and employees. The percentage of shares to be acquired by the successful bidder from the public and the government to make up the 50% holding will be in accordance with the requirements of the Securities and Exchange Board of India (Substantial Acquisitions of Shares and Takeovers) Regulations 1997. Subsequent disinvestment by the government to Indian institutions, small investors and employees will be with reference to the agreement with the strategic partner and requirement if any, for fresh listing. However, the Commission recommends that government should keep a minimum essential control by holding 26% of the shares in ITI.

If it is advised by the Consultants/Financial Advisers that sale can be for the two separate components mentioned above, it may be necessary to hive-off the second component consisting of the UP factories to a separate company. Shares in ITI and in the new

**company can then be sold through the process of competitive bidding to the extent of 50 per cent or more.**

**ITI has a Defence Division in Bangalore where some items of defence requirements are manufactured. This Unit may be segregated and merged with Bharat Electronics Limited (BEL) which is also located in Bangalore.**

HTL is a much smaller PSU with lines of manufacture similar to that of ITI. The separate report on HTL shows a bleak future for the Company with increasing losses in the next few years. The Company however has valuable assets in the form of land in a central location. The Consultants for ITI can be asked to examine the desirability of clubbing the sale of shares in ITI with the sale of shares in HTL contained in the specific recommendations for HTL.

## 2.5 Madras Fertilisers Limited

### Evolution

Madras Fertilisers Limited (MFL) was formed in 1966 to manufacture and sell nitrogenous and complex fertilisers. The company was set up as a joint venture with the American Oil Company (Amoco) with the Govt holding 51% and the JV partner the balance. At present Govt holds 70% of MFL's share and the National Iranian Oil Company (NIOC) holds the balance. The plant is located at Manali near Chennai in close proximity to Madras Refineries Ltd. (MRL) which supplies naphtha for producing ammonia.

### Industry Analysis

Fertilisers are basic nutrients to soil which help replenish the depletion or original deficiency in the soil. Nitrogen (N), phosphate (P) and potash (K) are primary nutrients whose percentage concentration in a chemical fertiliser is expressed in terms of NPK respectively. Nitrogenous fertilisers account for 70% of the consumption of chemical fertilisers in India.

There are 30 companies in the industry belonging to the public, private and the co-operative sectors with over 65% of the installed capacity in the public sector and co-operatives. However, the industry is dominated by five or six companies who account for more than 60% of the market share as shown in the table below :

Table 1 Capacity in Million Metric Tonnes per annum

UREA (62% *)		DAP (88% *)		COMPLEX (72%*)	
Company	Cap.	Company	Cap.	Company	Cap.
NFL	2.08	IFFCO	0.80	FACT	0.86
RCF	1.91	Paradeep Phosphates	0.72	IFFCO	0.80
IFFCO	1.62	GSFC	0.43	RFC	0.66
KRIBHCO	1.45	SPIC	0.42	Madras Fertilizer	0.54
Indo-Gulf	0.73	Godavari Fertilizers	0.30	Coromandel Fertilizer	0.35

\*Total markets share of top five producers.

The fortunes of the fertiliser industry are determined to a large extent by the Government policies. In order to promote the use of fertilisers among the small farmers, the Government virtually controls all aspects of operations including production, raw material sourcing and distribution. Urea pricing is controlled through the retention pricing scheme which assures 12% post tax return on networth. Both phosphatic and potash fertilisers were decontrolled in 1992 and are presently given adhoc subsidies by the Government.

Consumption of fertilisers depends on a combination of factors, the major ones being monsoon, irrigation facilities, availability of rural credit, pricing etc. The production and consumption of fertilisers have grown at a CAGR of 13.52% and 12.86% over the last 37 years but this has somewhat slowed down during the last three years.

### Business Analysis of MFL

MFL has facilities for the manufacture of 750 tpd of ammonia, 885 tpd of urea and 2900 tpd of complex (NPK) fertilisers.

In the past, the company's profitability was affected due to changes in Government policies and also due to operational problems such as availability of water etc.

The Company has embarked on a modernisation cum expansion project to revamp the old ammonia and urea plants and upgrade inefficient production technologies in order to extend economic life of the plant and also increase capacities of the ammonia and urea plants by removing production bottlenecks. This is expected to increase the capacity of ammonia production by 40%, urea production by 66% and NPK production by 55%. The project cost is estimated at Rs. 518 crores and is expected to be completed by April, 1997.

For its ongoing requirements of funds, the company has proposed a public issue of Rs. 42.95 crores at a premium of Rs. 5/- per share on a face value of Rs. 10. MFL has also obtained SEBI approval for this initial public offering.

## Financial Analysis

The financial performance of MFL for the past five years is as below:

Table 2 Financial Performance

(Rs. Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	686.3	645.1	476.6	430.9	456.5
Operating Profit	56.2	38.4	-10.9	52.2	41.0
Profit after Tax	21.1	7.5	-58.5	12.1	16.3
Equity Capital	137.4	137.4	106.4	98.3	55.7
Tangible Net Worth	126.8	105.1	65.7	115.3	72.2
Gross Margin (%)	8.3	6.6	-2.4	10.4	8.8
Net Margin (%)	3.1	1.1	-10.7	1.6	3.3
ROCE (%)	23.0	12.8	-	18.2	20.7
RONW (%)	18.1	7.7	-	8.4	25.2
Earnings Per Share (Rs.)	1.53	0.48	-	0.80	2.74
Dividend (%)	0	0	0	12	15

Due to the decontrol of complex fertilisers in FY 94 and withdrawal of subsidy, the financial performance deteriorated considerably as the company was forced to sell its main product below its average cost of production. Other factors which have led to varying profitability are delayed receipts of subsidy, high inventory build up and higher working capital requirements. Net profit margins have exhibited a fluctuating trend over the past five years. This is largely due to higher interest cost, delayed subsidy receipts, high inventory build up resulting in higher working capital requirements.

### Strengths and Areas of Concern

Based on the above industry, business and financial analysis, the strengths and areas of concern of MFL are as below:



## Strengths

*Fairly consistent overall performance over the years* In complex fertilisers, MFL currently enjoys market leadership in Tamil Nadu and Karnataka and ranks second in Andhra Pradesh. MFL's complex fertiliser, "Vijaya" enjoys a premium in the market in spite of the price being controlled by Government policies. The company compares favourably with its peer group in respect of wage costs and selling expenses.

*Expansion of Operations* Due to the strong brand image and the established market presence in the South Indian market, the company has significant opportunity to expand its operations and grow at a steady pace in the medium term.

## Areas of Concern

*Fertiliser industry is capital intensive and is characterised by low margins in the decontrolled sector* MFL's margins are the lowest among its peer group. Even though wage accounted for over 5% of cost of production, which compares not too unfavourably with comparable units, MFL still appears to have excess manpower to a significant level especially after the revamp project is completed.

*Operational constraints* The capacity utilisation of ammonia and urea have mostly moved in line with the availability of water during the last six years. Continued availability of water after the modernisation programme will be crucial for the continuous operations of the company. The company with its sewage treatment of plant of 2.4 mgd capacity has overcome this problem.

## Recommendations

The Commission has classified MFL as non-core. The Commission has noted that the IPO which is being put through by the company will reduce GoI holding to 57.7%.

In terms of the current agreement with NIOC, GoI is bound to hold a minimum of 51% shares in the company. **The Commission, therefore, recommends that Government of India may immediately initiate**

negotiations with NIOC to change the terms of the agreement which would permit sale of 50% of the shares of the company to a strategic partner through a competitive bidding process. The distribution of shares to be offered to the strategic partner between GoI and NIOC should be decided through negotiation and will be guided by the relevant sections of the Securities and Exchange Board of India (Substantial Acquisitions of Shares and Takeovers) Regulation of 1997. The balance shareholding of GoI can be offered to institutions, small investors and employees through a public offer once the revamp programme is completed and the company's performance improves. The Modalities for strategic sale have been detailed in pp. 38-40 of the First Report of the Commission.

## 2.6 Manganese Ore (India) Limited

### Evolution

The Manganese Ore (India) Limited (MOIL) was incorporated in 1962, in order to undertake manganese ore mining activity with Central Government and the State Governments of Maharashtra and Madhya Pradesh holding 17% each of its share capital and the balance 49% held by British company called Central Provinces Manganese Ore Company (CPMO). In 1977, the Central Government acquired shares held by CPMO and further in 1986, infused equity capital of Rs. 2.5 crores to strengthen the company. This has resulted in current Central Government holding of 82% of the equity of the Company with the State Governments of Maharashtra and Madhya Pradesh holding about 9% each.

### Ferro Manganese Industry Analysis

India accounts for about 8% of the world's total reserves of manganese ore. The ore deposits are located largely in the states of Karnataka, Maharashtra, Madhya Pradesh, Orissa and Goa. Almost the entire production of manganese ore is consumed by steel industry either directly or indirectly. High grade manganese ore (>42% Mn. content) is used to produce ferro alloys which in turn is used in steel industry as deoxidising agents and alloying agents. Low grade high siliceous ore (LGHS) with more than 25% Mn. content is used in blast furnaces as desulphuriser. Manganese in dioxide form ( $MnO_2$ ) with 72% to 80% Mn content is used directly or in the form of Electrolytic Manganese Dioxide (EMD) in dry cells as depolarisor. As the reserves of high quality low phosphorous manganese ore is limited, the Government has stipulated that exports should be carried out only after meeting all domestic requirements.

MOIL dominates the Mn ore sector in the Ferro grade and Dioxide grade ore. The other producers in the high grade segment are Orissa Mining Development Corporation (OMDC), Orissa Mining Corporation (OMC) and Sandur Manganese Ore Ltd. The low grade segment comprises small mining companies numbering over 200.

The high quality manganese ore is used in the manufacture of ferro alloys. The total ferro alloy manufacturing capacity in India is 1.35 million tonnes

of which manganese alloys account for about 50%. The capacities, capacity utilisation of the main producers are given below :

**Table 1 Capacity Utilisation of Main Producers of Ferro Alloys**

Company	Capacity (tpa)	Utilisation
Maharashtra Electromelt Ltd.(MEL)	100,000	90%
Sandur Manganese ore	72,000	29%
KFA Corporation	60,000	18%
Ispat Alloys	72,000	65%

Demand of Mn ore is a derived demand which has a direct relation to steel industry. SAIL and TISCO account for about 40% of the manganese alloy consumption and the balance is consumed by other mini and alloy steel producers. SAIL sources its requirements from MEL while TISCO has conversion arrangements with a number of small manufacturers.

Internationally the main ferro alloys producing countries are South Africa, China, Australia, Brazil and the CIS countries. In the past, international prices have varied considerably in the range of USD 420/ton to USD 690/ton (FOB China). However, in the past, Chinese producers have sold in the range of USD 420 - 440 per ton. With the declining duty structure, the following table shows the comparison with the domestic prices vis-à-vis the landed cost (including customs duty) for the past five years.

**Table 2 Domestic price v/s Imported price of Ferro Mn (Rs./Tons)**

Financial Year	Domestic Price (Avg.)	Landed cost (Avg.) incl. import duty (%)
1993	18000	30101 (85%)
1994	15000	21145 (65%)
1995	16000	21742 (50%)
1996	22000	22269 (30%)
1997	19000	21793 (27%)

A reduction in the duty by 5% in the Union Budget for 1997-98 has been proposed and the Chelliah Committee has recommended that the ultimate duty to be brought down to 15%. The fall in international prices coupled with reduction in import duty has put a lot of pressure to the Indian ferro alloy manufacturers.

The ferro alloy industry is power intensive and the power cost constitute more 50% of the cost of production. The high cost of power in India (Rs. 3/KWH as against Rs. 0.75/KWH in South Africa) increases the domestic cost of production.

On account of the reduction in import duties and the high cost of power, the viability of domestic ferro alloy industry has been threatened to a significant extent.

### Key Success Factors in Manganese Ore Mining

*Ore reserves* Since the operations of the company is mining of ore, the quality and quantity of deposits is one of the key success factor.

*Performance of ferro alloy and Steel industry* High grade manganese ore (>42% Mn content) is used in manufacture of ferro alloy. Ferro alloy is consumed by steel industry as a deoxidising agent. Hence the success of the manganese ore industry is related to performance of ferro alloy and the steel industry.

### Business Analysis of MOIL

MOIL is operating 10 manganese (Mn) ore mines in Maharashtra and Madhya Pradesh with current production level of 700,000 tonnes per annum. As a part of forward integration, MOIL has set up an unit for manufacturing EMD with a capacity of 700 MT per annum. It is producing 49% of the country's total output of manganese ore and 75% of high grade manganese ore. Out of this, four mines account for 68% of the total production. The high grade Mn ore account for 57% of the total production of MOIL in FY 96 while the LGHS account for 29% of the total production in FY 96. Over 55% of MOIL's production and 74% of its total income is from high grade ore.

MOIL sells about 25% of its ferro grade ore to Maharashtra Elektrosmet Ltd. (MEL) a subsidiary of SAIL. Bhilai Steel Plant of SAIL accounts for 90% of the sale of LGHS. MOIL exports a certain amount of ore through MMTC and the principal buyers are Chinese ferro alloy producers.

Apart from the mining process, MOIL started processing MnO<sub>2</sub> known as EMD. In FY 96 it produced 547 tonnes of EMD and sold 657 tonnes.

### Financial Analysis

The financial performance of MOIL for the past five years is as given below :

Table 3 Financial Performance

Rs. Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	103.9	80.1	61.4	76.3	71.3
Operating Profit	24.3	15.6	16.8	27.9	23.1
Profit after Tax	10.8	5.6	5.0	10.5	7.7
Equity Capital	15.3	15.3	15.2	15.2	15.1
Tangible Net Worth	49.7	42.0	39.3	37.3	30.4
Gross Margin (%)	23.4	19.5	27.5	36.5	32.4
Net Margin (%)	10.4	7.0	8.1	13.7	10.8
ROCE (%)	38.7	23.5	26.9	61.1	58.2
RONW (%)	12.2	13.9	13.0	30.9	27.9
EPS(Rs) Share value Rs.100/-	70.3	36.7	32.7	68.9	50.8
Dividend (%)	20.0	20.0	20.0	20.0	14.0

The total income has shown a cyclical trend on a year to year basis. However, MOIL has been able to maintain its profitability even during recessionary period due to its dominant position in the domestic industry. The return on capital employed (ROCE) was over 23% even in years in which the industry scenario was not favourable. The company has consistently paid dividend and the earnings per share has shown a smart jump from FY 95 to FY 96 due to improved financial performance.

## Strengths and Areas of Concern

Based on the above industry, business and financial analysis, the strengths and areas of concern of MOIL are as below :

### Strengths

*Rich reserves* MOIL's share of reserves of both dioxide ore and ferro grade ore is very high and account for 75% of India's reserves.

*Dominant producer in manganese ore industry in ferro grade and dioxide categories* MOIL has a production share of 73% in dioxide segment while in ferro grade segment, its production share is 78%.

*Cost competitive both domestically and internationally* The domestic price of manganese ore is at present lower when compared with international (fob) prices to the extent of 15-17%.

*Demand growth expected in Steel whereby the demand for Mn ore should also go up* The principal user of manganese ore is the steel industry and the steel industry is expected to grow at 10-11%. This gives a lot of opportunity for MOIL to expand its operation.

*Mining leases for longer period* Mining licenses are granted for 20 years while the land on which the mining is being carried out is leased to MOIL for 99 years.

### Areas of Concern

*Single user industry which is exposed to business cycles* Steel industry is the only user of manganese ore. Steel industry is exposed to business cycles and the fortunes of manganese ore is directly related with steel industry.

*Constraints on pricing ability* The pricing of ore is normally done on negotiated basis. The principal user is the ferro alloy industry and the ore accounts for 26% of ferro alloy cost while power costs more than 50%. This coupled with the falling international prices and reduction of import duties keeps a lot of pressure on MOIL not to increase prices.

*Limited flexibility in decision making* Mining operations involve constant developmental work and MOIL has limited autonomy in making capital expenditure programme. MOIL's proposal for forward integration into ferro alloys was made 20 years ago including a proposal to take over MEL. MOIL has not been able to get government clearance all these years.

*Lowering of custom duty on Mn ore and in steel products* The customs duty rates on manganese ore, ferro alloys and steel products have seen steady reduction. This has exposed Indian industry to international competition. There is a further reduction in import duty on ferro alloys by 5% proposed in the 1997-98 budget.

*Upward revision of license fee of mining activity* Currently license fees are nominal and the Government earns revenue from royalty and cess and the current rate is about Rs. 30 per ton. These rates are revised upwards once in three years and the normal escalation is about 10%.

*Export Restrictions* Government does not allow export of high grade ore at the discretion of MOIL. This reduces the profitability of MOIL.

## Recommendations

MOIL has emerged today as a profitable company with a good track record. It dominates the manganese ore industry in the ferro grade and manganese dioxide categories with nearly 70% share of reserves and nearly 75% of production. However, MOIL has not been able to venture into the downstream area of ferro alloy production. Only recently, it has decided to set up a small unit of about 10,000 tonnes capacity within the financial powers of the Board of Directors of the company. Earlier proposals of the company to take over the SAIL managed Maharashtra Elektros melt Limited or to set up plants of bigger capacity were not cleared. Given the constraints of the high cost of power, the Indian ferro alloy industry is always under potential threat from imports from low power-cost producers. MOIL with its captive mines could provide a much needed stability in the Indian ferro alloy industry if it were to be allowed to put up a large scale plant of viable capacity, at the pit-head, backed by a captive power plant. With its natural advantages, MOIL could establish on a sound base a domestic ferro alloy industry.



While the company has been categorised as a non-core PSU by the Commission, having regard to its dominant market share in manganese ore reserves and production, the Commission would not recommend disinvestment in the company beyond 49%. Control of the company by private investors has the potential of destabilising the ferro alloy industry. Also taking into account the limited reserves of high grade manganese ore in the country, continued Government control over this company may be desirable to conserve this precious material for the steel industry and safeguard against indiscriminate "slaughter mining" for short-term financial gains. No public purpose will be served by converting what is almost a public monopoly to a private monopoly and therefore disinvestment beyond 49% is not considered desirable. This issue can be reviewed once the situation changes in the future.

The Commission, therefore, recommends that the company which is a "Strong Performer" according to the Commission's classification, be given full managerial autonomy with due regard to its profitable track record and dividend pay-out so as to enable it to implement its projects of diversification relating to :

- establishing ferro alloy production facility of viable capacity,
- establishing captive power plant and
- expanding and developing mines for production of high manganese ore.

The company will be able to mobilise the necessary resources for investment in these projects. Once these projects are implemented and its bottom line improves further, Government should consider disinvestment upto 49% in one or more tranches in the domestic market with preferential allotment to small investors and the employees, as set out in the Commission's First Report. Prior to such disinvestment Government may also consider the option of capital restructuring in the company since its debt-equity ratio is very low at present. Through such restructuring and improved earnings per share of the Company, Government's realisation through disinvestment would be considerably enhanced.



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DISINVESTMENT  
COMMISSION

MAY  
1997

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# INTRODUCTION



This is the Third Report of the Disinvestment Commission<sup>1</sup> following the presentation of the First Report on 20th February, 1997 and the Second Report on 17th April, 1997. In the first two Reports, several recommendations have been made for improving corporate governance and enhancing the value of shares in the Central Public Sector Undertakings to be sold by the Government. These are contained in the general recommendations in Part B of the First Report and Part A of the Second Report. Different modalities for disinvestment have also been recommended for the nine PSUs covered in the first two Reports. Transparent and competitive procedures for disinvestment have also been suggested in these Reports. Apart from general analysis and recommendations, this Report contains specific recommendations for six more PSUs.

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<sup>1</sup> Constituted vide Government notification No. 11013/3/96-Admn. dated 23rd August, 1996 (Annex).





# PART A



## 1. GENERAL ISSUES ON DISINVESTMENT AND RECOMMENDATIONS

The First Report of the Commission was submitted more than three months ago. The Honourable Finance Minister had indicated in his budget speech that "the Government intend to proceed with the disinvestment in the three companies covered in the First Report along the lines suggested by the Commission". It is hoped that further steps for actual implementation of the Commission's recommendations in these three companies and decisions in respect of the other six companies covered in the Second Report submitted in April, 1997 would be expedited. The Commission would like to point out that unless there is speedy implementation of the recommendations made in the successive reports of the Commission, it would be difficult to achieve disinvestment of the order of Rs. 4800 crores as envisaged by Government for 1997-98 nor the other objectives of the disinvestment process itself.

The Commission is concerned that delays in taking a view on the recommendations of the Commission on individual PSUs particularly where these relate to bringing down Government's share holding below 50 per cent or strategic sale, could have adverse impact on the relationship of the concerned PSUs with their financing bankers and institutions, major creditors, and their investors where equity or debt has already been placed with private investors. The delays, similarly, may adversely affect negotiations that the concerned PSUs might be carrying on with regard to joint ventures, long term collaboration and similar arrangements. On this ground too, there is a need to reduce to the minimum the time lag between the submission of reports on individual PSUs by the Commission and Government's decisions thereon.

The Government has so far referred 50 PSUs to the Commission. In the preamble to the terms of reference for the Commission it has been stated that the Commission is being constituted in pursuance of the Common Minimum Programme (CMP) of the United Front. The CMP refers to the various aspects of public sector and states that "... it is widely acknowledged that the public sector required to be reformed and restructured ... the Government will identify public sector companies that have comparative advantages and will support them in their drive to become global giants ... other profit making and efficient public sector companies will

be strengthened and their managements professionalised .... sick or potentially sick public sector companies will be rehabilitated through a menu of options .... the question of withdrawing the public sector from non-core and non-strategic areas will be carefully examined .... the Government will establish a Disinvestment Commission to advise the Government on these steps .... Any decision to disinvest will be taken and implemented in a transparent manner .... revenues generated from such disinvestment will be utilised for health and education and a part of such revenues will be earmarked to create an Investment Fund which will be used to strengthen other public sector enterprises". Subsequent announcements of policy have clarified the levels of disinvestment in core and non core industries. In core industries disinvestment could go up to 49% and in non core industries it could go up to 74% or more.

In the 50 PSUs so far referred to the Commission there are both core and non-core PSUs. The Commission's recommendations made so far cover both categories of PSUs. The Commission has also proposed in some cases measures for restructuring and strengthening the PSUs prior to disinvestment. A Disinvestment Fund has also been recommended not only for strengthening PSUs and restructuring them before disinvestment to enhance share values but also for providing benefits to workers likely to become surplus in cases of restructuring or closure. The main intention in making these recommendations for the creation of the Fund and its use is to ensure, and demonstrate, that the proceeds of disinvestment are used for long term benefits to the budget and the economy. In this connection it would be relevant to quote the 22nd Report of the Parliamentary Standing Committee for Industry presented to the Parliament on 22nd April, 1997. "The Standing Committee hopes that the Disinvestment Commission will have a moderating influence on the government and the nation's 'crown jewels' ... are not frittered away."

One of the major objectives in establishing the Disinvestment Commission is to introduce transparency and establish the credibility of the disinvestment process. As noted above the Government is yet to announce decisions on the recommendations made in the first two reports of the Commission. **At the same time disinvestment in some other loss making PSUs has reportedly been suggested without reference to the Disinvestment Commission. The Commission would like to point out that such a course, if pursued, will not only be contrary to the major objectives and the terms of reference of the Commission but also prevent the**

**Commission from taking a coordinated view of disinvestment in PSUs in accordance with a broad based strategy.** In this context it would be relevant to note that the Parliamentary Standing Committee on Industry in its 20th Report presented to Parliament on 30th August 1996 has also observed that “ ... to suggest that the (Disinvestment) Commission will prepare long-term plans of disinvestment only for public sector undertakings that are referred to it will severely limit its authority.”

One other term of reference (No.V) of the Commission requires the Commission “to recommend a mix between primary and secondary disinvestment taking into account the Government’s objective, the relevant PSU’s funding requirements and the market conditions”. This term of reference recognises the need for coordination between the disinvestment of Government’s equity and the funding requirements of the relevant PSU. In the case of PSUs referred to the Commission, this has been kept in view while making specific recommendations. **However, the Commission has received a communication from Government that in particular cases of PSU’s own requirement of funds, their public offer of shares could proceed independently of the proposed disinvestment and the Commission could then take due note of such “primary disinvestment” while making recommendations for disinvestment of Government shares in those PSUs.** This has been justified on the ground that PSUs should have the autonomy of raising resources. While this shows a welcome change in the attitude to PSUs, the Commission is of the view that such an approach on this limited issue will be inconsistent with the terms of reference and will not enable the Commission to take a coordinated view or to recommend a mix between primary and secondary disinvestment. The need for coordination arises from the following considerations. Flotation of additional primary equity in the capital market by the PSU will reduce the percentage of Government holding. This will restrict the scope for disinvestment of the shares in the PSU by Government. In those cases where disinvestment has already taken place the exercise of such autonomy may result in some of the core sector PSUs going out of the Public Sector as a result of dilution of Govt. holding below 51%. In other cases the scope for disinvestment will be substantially reduced by some PSUs going for additional equity raising well ahead or in excess of their assessed needs. This may also create an overhang of shares and reduce the realization on disinvestment of Government shares. It is also possible that in certain cases debt may be a better alternative to raising equity for meeting the funding requirements

of the PSUs. **It is therefore suggested that Government reviews this position.**

The Commission would like to draw attention to another important area of 'corporate governance' relating to the composition of the Board of Directors of PSUs in which disinvestment has already taken place. Such disinvestment has taken place in 39 PSUs before the Commission was constituted. Further disinvestment would be required in many of them and indeed some of them are among the 40 PSUs referred to the Commission. It has, however, been noted that even where disinvestment has already taken place, by and large, there has been no change in the composition of the Board of Directors to give representation to the non-government share holders. In order to improve the investor perception of PSUs, and to enhance share value in subsequent disinvestment, it is necessary for Government to induct immediately representatives of non-government shareholders into the Board of Directors. This can be done by amending the Articles of Association where necessary to provide for election of directors and by Government exercising its rights as the majority shareholder to enable the election of competent nominees of non-government shareholders. This recommendation has already been covered in Part B of the First Report relating to provision for elected directors. A further recommendation has also been made to induct experts and professionals from outside as non-executive directors. For inspiring investor confidence in the disinvestment process, for enhancing Government's receipts and for promoting efficient management of the PSUs, it is important to implement these recommendations along with other recommendations in Part B of the First Report and Part A of the Second Report.

There are also reports about the Government giving greater autonomy to nine selected PSUs which have been identified as having the potential to become global giants. The Commission welcomes this move. However, the Commission is of the view that the requisite autonomy should be granted to all PSUs, particularly those being considered for disinvestment, to improve investor perception of these Undertakings as also for enduring improvement in their performance and enhancing disinvestment proceeds. The Commission has already made recommendations for a graded delegation of autonomy for three categories of PSUs, namely, general autonomy to all PSUs, additional autonomy to moderate performers and full autonomy to strong performers. The Commission hopes that a comprehensive view will be taken for providing greater autonomy to all PSUs on the basis of its recommendations.

## PART B





## 2. SPECIFIC RECOMMENDATIONS

### 2.1 Container Corporation Of India Limited

#### Evolution

Container Corporation of India Limited (CONCOR) was incorporated in 1988 under the Ministry of Railways with the objective of transporting international and domestic cargo by way of containers through the Indian Railways (IR).

Indian exports and imports are increasingly getting containerised and containerised cargo constituted about 6.8% of the total traffic handled by Indian ports in 1994-95. Assorted cargo called break-bulk, was increasingly transported by road rather than the railways. In addition, the break-bulk cargo had the potential to generate higher revenues per tonne per kilometre than any other segment. CONCOR was therefore established to cater to the growing market for assorted cargo and regain the market share from the road sector.

The paid-up capital of CONCOR as at March 31, 1996 was Rs. 64.99 crores and the Government of India had disinvested 23.06% of its holding in two tranches in FY1992 and FY1994. The current shareholding pattern is as follows :

Table 1 Shareholding Pattern (%)

Share holder	Holding
Government of India	77
Morgan Stanley	11
SBI Capital Market Ltd.	5
Henry Schroders	4
Jardine Fleming	2
Public	1
TOTAL	100

The shares of CONCOR were listed on the Bombay Stock Exchange (BSE) in February, 1996 and the share prices have shown a high volatility varying from a low of Rs. 86 in Feb. 96 to a high of Rs. 432 in April, 1997. Weighted by market capitalisation, the average traded price in 1996-97 was Rs. 287 with an average volume of 40,000 shares. The closing share price on the BSE on 28th May, 1997 was Rs. 585.

## Industry Analysis

### Containerisation - Rationale

Containerisation brought the benefits of road transport to the rail sector. Movement of assorted cargo in minimum units became possible directly from the place of production to the place of consumption. This led to the free flow of cargo between different modes of transport - roads, rail and waterways. Thus, containerisation has been used widely by all developed nations in international traffic. Containers were also adopted as basic storage units by shipping lines world wide for moving break-bulk cargo.

### Structure & Government Policy

The multi-modal transport industry caters to the transport of assorted cargo. The main players in this industry are CONCOR, IR and road transporters. The main activity of these operators is to consolidate cargo and then transport it from production centres to consumption centres either by rail or road.

Till 1990s the sector was highly regulated and the Customs did not allow private parties to move import/export containers by road. They were also not allowed to set up any bonded warehouses and thus, there was a shortage of inland container depots (ICDs).

The sector today, is largely liberalised. A large number of transport and freight forwarding companies have acquired the status of Multi-modal Transport Operators (MTOs). Private enterprises have been allowed to set up and operate ICDs with rail head and Custom Bonded Inland Container Depot (CFS) without rail head facilities, with the necessary approvals. This has resulted in a rapid expansion of business and has increased inland penetration of containers from Indian ports to the ICDs. The number of

containers that move to the hinterland from the ports has increased from 9.7% of the total traffic in FY 91 to about 26% of the total traffic in FY 96 and is expected to go upto 36% by the year 2000. The GoI has also passed the MTO Act in 1993 to regulate the growth of the industry.

Even though the terminal operations have been fully liberalised, haulage operations by rail remains a monopoly of CONCOR.

### Market Size and Competition

The cargo from international traffic formed around 44 million tonnes or 20% of the total exports and imports in FY 96. CONCOR transported nearly 8.5 million tonnes of international cargo and nearly 2.2 million tonnes of domestic cargo in 1995-96. In the international traffic, the rest of the cargo was taken by road while in the domestic sector it was taken by IR and the road sector.

CONCOR receives 63% of its traffic in the Delhi-Bombay corridor. The Bombay/JNPT ports account for 58% of the total container traffic in India. The company is well placed on high traffic paths-both in terms of infrastructure and haulage.

The main competition to CONCOR is from the road sector. Movement of goods through road-even though not economical-is ideal because of its flexibility, door-to-door services, greater reliability and speed. These factors have contributed to the success of the road sector in the seventies and eighties.

On the other hand, movement of goods through road has its own problems such as :

- The main road network comprising national and state highways has not matched the traffic growth. Much of the expansion of the road network has been through building of rural network.
- Inadequate road network has led to higher transportation costs.
- There are delays due to congested sections, existence of railway level crossings, octroi posts and other tax barriers.

Taking all the above factors into consideration and given the long distances involved between the main inland production centres and the gateway ports, a properly functioning system for movement of containers by CONCOR on rail would have a distinct comparative advantage over road in the long term. CONCOR is a natural monopoly player because of the support received from IR. Thus, CONCOR's competitive position is strong and is likely to remain so in the medium to long term.

### Business Analysis

The activities of CONCOR can be divided into two primary and non-overlapping operations viz., haulage of containers and terminal activities.

Haulage of containers involves charging the customer for carrying the containers and paying freight charges to the IR who provide the pathways.

The activities at the origin and the destination form the terminal activities. CONCOR renders two types of services. It provides revenue seeking activities such as handling manual labour for stuffing and destuffing the containers with cargo and mechanical loading and unloading through forklifts and cranes. Apart from this, CONCOR undertakes all documentation and clearance activities. The second service is rent seeking which is by way of ground rent and warehousing charges for providing storage space and proper upkeep of in transit containers.

The percentage of revenue from each of these operations for the last two years is given below :

Table 2 Break up of revenue

Activity	FY 95	FY 96
Haulage	79%	77%
Terminal Handling	21%	23%
Total	100%	100%

As can be seen from the above table three fourths of CONCOR's revenues comes from haulage. A profitability analysis of the haulage

activities and terminal activities reveals that CONCOR makes 36% operating profits on freight and has 18% profitability on terminal activities which is quite high when compared with companies in developed markets. This is due to the fact that CONCOR is able to pass on all freight increases to the customer because of its monopoly status and because of the large freight differential between rail and road haulage.

CONCOR's growth in the period FY92 to FY96 has been much higher than the growth rates of total international traffic. This has been possible due to increased containerisation of break-bulk traffic and also increased penetration of containers to the hinterland.

As shown in the table above, CONCOR gets 23% of its revenues from terminal handling operations. The company has built 16 ICDs in areas of large traffic. This well placed distribution network would pre-empt traffic from going to any fresh entrant. The threat from freight forwarders is therefore minimal.

In summary, it may be mentioned that CONCOR's performance with respect to growth in container traffic and increase in distribution network has been commendable. The company has capitalised on its monopoly status to pass on costs to consumer, but the management needs to be proactive against future competition.

### Financial Analysis

The financial performance of CONCOR for the past five years is given below:

**Table 3 Financial Performance**

Rs.Crores	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	389.4	217.3	114.5	81.1	50.0
Operating Profit	110.7	53.1	27.2	15.9	13.3
Profit after Tax	53.1	22.9	20.8	15.3	11.1
Equity Capital	65.0	65.0	65.0	65.0	47.0
Tangible Net Worth	181.4	136.9	116.9	98.5	65.3
Gross Margin (%)	28.4	24.4	23.8	19.6	26.6
Net Margin (%)	13.6	10.5	18.2	18.8	22.2
ROCE (%)	56.4	34.2	23.4	22.8	26.8
RONW (%)	29.7	16.7	17.8	15.5	17.0
Earnings Per Share (Rs.)	8.17	3.52	3.20	2.35	2.36
Dividend (%)	12.0	6.0	4.0	2.7	1.1

CONCOR's operating income has grown at a compounded rate of 67% and the profit after tax has grown at a rate of 41% over the five year period as given in the above table. The figures reflect the high growth rates in the industry and CONCOR's ability as a monopolist to pass on costs to the end user.

High operating margins have been contributed by increasing volumes and ability to pass on major costs to the end user. Improvements in cabotage traffic (carrying domestic break bulk traffic in containers such that empty container flow is reduced) also has resulted in improving profits in the last two years. With its earnings increasing by three times over the last three years, and a relatively low level of capital employed, the ROCE has exhibited a phenomenal growth rate.

#### Strengths and Areas of Concern

Based on the above business and financial analysis, the strengths and areas of concern for CONCOR are as below :

## Strengths

*Monopoly status* The operations of CONCOR are in the nature of a monopoly. CONCOR's monopoly would remain unchallenged in rail haulage till IR provides equal level playing field to all players; this is unlikely in the short-term. Further, gestation time of nearly 3-4 years would be required for any new private sector container projects to go on-line.

*Widespread Distribution Network* CONCOR has 16 ICDs and 10 CFSs spread across the country. Moreover CONCOR has developed a strong equation with the shipping industry which is expected to help consolidate business.

*Huge untapped market* Containerisation has not really got off in India and as per a NCAER study (1993), it is estimated that intercity containerised cargo potential is 113.53 million tonnes. Thus, there are significant opportunities for growth for CONCOR.

## Areas of Concern

*Competition from the Road sector* Road is an ideal medium for gathering non- bulk cargo even though it is not economical. This is because of certain factors which contribute to the success of road transport such as flexibility, door to door service, reliability and speed.

*Competition from private freight forwarders and consolidators* After the liberalisation and opening up of this sector, a large number of transport and freight forwarding companies have acquired the status of MTOs. Of these 10 are foreign companies. CONCOR is expected to face competition from these players.

*Reliance on Indian Railways* CONCOR's dependence on the railways is total. The business projections of CONCOR have to be matched by corresponding expansion of the Railway's capacity to handle the volumes especially in the busier corridors like Mumbai-Delhi.

## Recommendations

From the foregoing analysis CONCOR seems to be well entrenched with little threat of competition in the immediate future. Its well organized

distribution net-work, planned investment in rolling stock and technological improvements in operation would enable it to hold its own and maintain its market share. Its strong links with the Railways give it further competitive advantage.

The Commission has classified CONCOR in the core group of PSUs. A detailed analysis of the company would further reinforce this view. Its links with the Railways are critical for its operational efficiency. It also has a large volume of assets on lease from the Railways. It also has access to the railway personnel which enables close coordination with the Railways and contributes to improving efficiency in operations. **For all these reasons CONCOR, in the view of the Commission, should continue to be in the core sector and disinvestment in the company should be only upto a maximum of 49%.**

The requirement of funds for CONCOR for its capital expenditure programme needs to be taken into account before taking a decision on further disinvestment in the company. Over the next 5 years the business plan of CONCOR would envisage capital expenditure of Rs. 253 crores towards development of terminals, Rs. 380 crores towards rolling stock additions, Rs. 120 crores towards technological improvement in the areas of terminal handling operations, communications, database management and investment in specialised break-bulk containers. The rolling stock investment is covered by a World Bank loan of Rs. 380 crores. The other requirements would need to be raised by CONCOR on its own.

Government have already disinvested to the extent of 23% in the company in FY 92 and FY 94. The shares are mostly held by foreign financial institutions. Its current debt-equity ratio is low but the World Bank loan of Rs. 380 crores which would become repayable after 2002 could limit its ability to raise further debt in the market for its projected capital outlay. A public issue that would enable the company to raise Rs. 250-300 crores would need to be considered. **Taking this into account the Commission recommends that disinvestment of Government holdings may be restricted to 100 lakh shares and the company may also go in for public issue of 125 lakh shares. This would bring down Government holding to around 51%.**

**It is recommended that a book building process be adopted for disinvestment to institutional investors in the Indian market which could**



be followed with a retail offering to small investors at a discount of 10% to the institutional price. As has been mentioned in Report II of the Commission, it is suggested that CONCOR should join the National Securities Depository Limited (NSDL) before any issue is contemplated from either the company or from the Government. In addition to the benefits of dematerialisation, the other benefit to small investors is that they can buy shares in quantities much less than the normal tradable lots which can also be traded on the National Stock Exchange (NSE) without any discount for odd lots.

## 2.2 Kudremukh Iron Ore Company Limited

### Evolution

Pursuant to an agreement between the Government of India and Government of Iran, Kudremukh Iron Ore Company Limited (KIOCL) was incorporated as an 100% export oriented unit (EOU) in 1976 for mining low grade iron ore available in the Western Ghats. The arrangement was to supply iron ore concentrate to the National Iranian Steel Corporation (NISC) and the financing of the entire project which was estimated at Rs. 647 crores was to be borne by the Iranian government. However, due to the overthrow of the regime in Iran, the new Iranian government reduced the funding for the project and the Government of India had to supplement the balance project cost. The arrangement for supply of iron ore concentrate also fell through due to continued problems in Iran. KIOCL had to find a new customer for its product. While the plant was designed to produce 7.5 million metric tonnes per annum (mmtpa) for supplying to NISC, KIOCL had to make various process and plant modifications for meeting the requirement of a new customer from Romania which resulted in scaling down the plant capacity to 6.8 mmtpa.

In 1987, KIOCL undertook a project to set up a 3 mmtpa pelletisation plant in Mangalore. KIOCL is now in the process of expanding this capacity of the pelletisation plant to 4 mmtpa by enhancing the capacity of the existing plant by 0.5 mmtpa and by setting up a new shaft pelletisation plant with 0.5 mmtpa capacity.

The share capital of KIOCL as at March 31, 1996 is high at Rs. 634.51 crores on account of the conversion of debt into equity by the Government in the eighties in order to reduce the interest burden on the then loss making company. Government had disinvested about 1% of its holding in January 1995 to GIC and its subsidiaries, mutual funds and employees. KIOCL's shares are listed on the Bangalore and Chennai Stock Exchanges but no trading has taken place in the scrip.

## Industry Analysis

### Iron Ore

Iron ore constitutes the basic raw material for the manufacture of steel. Since the demand for iron ore moves in conjunction with the total steel production, the iron ore industry is cyclical in nature, with each upswing and downswing phase lasting about 3-4 years as shown in the table below:

Table 1 World Steel & Iron Ore Production

Year	Crude Steel (MT)	Iron Ore (MT)
1995	724	955
1994	730	931
1993	723	921
1992	737	951
1991	710	980
1990	786	991
1989	780	964
1988	737	946
1987	714	921
1986	719	910

In the medium term, it is estimated that the demand for steel will show a downward trend from the developed countries. Any subsequent growth in demand is likely to come mainly from the developing countries especially from the Asian region.

The total iron ore imports by the consuming countries in 1995 were 423 mtpa, which are expected to grow to about 480 mtpa by the year 2000. Almost 90% of the increase in the import demand in this period is expected to be from Asia, especially China, Korea and Taiwan.

Globally three leading iron ore companies namely CVRD, BHP and RTZ control nearly 35% of the world iron ore production and the ten largest companies together control almost 60% of the world iron ore supply. The major iron ore producing countries and their production and exports levels in 1995 are given below :

Table 3 World Production and Export of Iron Ore

Countries	Production (mmtpa)	% share	Exports (mmtpa)	% share
China	239.0	24.6	-	-
Brazil	167.8	17.3	125.0	7.4
Former Soviet Union	136.0	14.0	32.0	7.4
Australia	128.7	13.3	126.2	29.3
United States	58.4	6.0	-	-
India	57.5	5.9	28.5	6.6
Canada	37.0	3.8	30.1	7.0
South Africa	32.3	3.3	19.6	4.5
Sweden	19.9	2.1	15.4	3.6
Venezuela	16.1	1.7	10.7	2.5
World Total	970.7		430.5	

Prices of Iron ore are typically negotiated at the beginning of each year. The prices of iron ore follow the steel prices with approximately a two year lag as they are based on the demand pattern of the previous year. In 1995, international prices firmed up with an increase of 7.9% and 5.8% in the prices of lumps and fines respectively. In 1996, prices further increased by 5% and 6% respectively. The prices of pellets increased by 12% in 1995 and 6-7% in 1996.

India is the sixth largest producer of iron ore in the world with a 6.6% share of world trade in FY 95. Iron ore production in India has grown from 55.6 mmtpa in FY 91 to 66.2 mmtpa in FY 96. In India, the major reserves of iron ore are located in the states of Madhya Pradesh, Bihar,

Orissa, Goa and Karnataka. The supplies from Goa, Madhya Pradesh and Karnataka are presently exported. The two major steel producers in India viz., SAIL and TISCO meet their requirements of iron ore from their own captive sources. A profile of major iron ore producers is given in the table below :

Table 4 Profile of Iron Ore Producers

	KIOCL	NMDC	Sesa Goa Limited
Nature of Ore	Low grade ore (38% Fe content)	High grade ore (66% Fe content)	Medium-high grade (60-63% Fe content)
Products	Concentrate, Pellets	Lumps, CLOs, Fines	Lumps, Fines
Market	Exports - 93% Domestic - 7%	Exports - 52% Domestic - 48%	Exports - 97% Domestic - 3%
Major Customers	Iran, Japan, China, Turkey, Taiwan	Japan, Domestic sales	Japan, China Western Europe
Sales (mmtpa)	6.23	14.36	4.13

### Iron Ore Pellets

Iron ore pelletisation capacity is globally available in 20 nations with an installed capacity of 264 mmtpa. Worldwide around 18 million tonnes of pellets were exported in 1994. The major producers of pellets in the world are located in the USA and in Russia. Together they account for 52% of the world capacity.

Pellets account for about 80% of total DR feedstock used in the manufacture of Direct Reduced Iron (DRI). The DRI capacity has been increasing rapidly in gas rich countries as well as in India, requiring increased quantities of pellets owing to growth in world electric arc furnace (EAF) steel production. High steel scrap prices (the primary raw material for production of EAF steel) result in increased demand for DRI and HBI.

## Business Analysis

KIOCL is a 100% EOU which primarily exports iron ore in the form of concentrate and pellets. KIOCL's product mix consists of blast furnace (BF) pellet feed, DR pellet feed, high silica concentrate, broken pellets or chips and pellet fines. The break-up of exports is given in the table below:

Table 4 Exports

FY	Concentrate (mmt)	Pellets (mmt)
1996	3.65	2.58
1995	3.44	2.25
1994	4.20	2.34
1993	3.36	1.38
1992	3.92	2.15

KIOCL currently exports concentrate and pellets to 8 nations, most of them in the Asian continent. 70% of the KIOCL's sales are routed through long term FOB contracts except for China where the sales are through yearly contract. KIOCL's supplies are largely restricted to geographically proximate countries.

The average realisation per ton (fob) from exports for pellets have been about 35-40% higher than concentrates and have fluctuated within a narrow band over the past five years. KIOCL's domestic sales realisation per tonne has however been higher but the volumes have been much lower.

Although domestic realisations are much higher than exports, KIOCL prefers to export its products due to greater reliability of offtake by the foreign customers. Long term export contracts have helped KIOCL to plan its production even though realisations thereunder may be lower than the domestic realisation. As a 100% EOU, there is in any case a limit on the extent of sales in the domestic market.

KIOCL's mines are located in the Aroli Gangamula range of Western Ghats with average iron content of 38% while the iron content in the NMDC mines at Bailadila is about 66%.

Out of the total mineable reserves of about 430 MT in the existing mines, the ore available as on date for mining is about 165 MT. In addition, mineable reserves from the Nellibeedu deposits are estimated at about 80 MT. Taking into account all these factors, a reasonable forecast of the mine life is about 12-13 years. However, if the mining lease for the Gangrikal deposits is obtained by the company, the life of the mining deposits can be enhanced by a further period of 20 years.

Due to the inferior nature of ore, KIOCL has to undertake greater degree of beneficiation of the ore for improving the iron content. Power and consumable stores and spares utilised in the manufacturing process account for 70% of the cost of sales. The cost of power, fuel and utilities account for 27% of the operating income of KIOCL where as for NMDC it is quite lower. Similarly, the consumable stores account is much higher in case of KIOCL when compared with NMDC.

KIOCL has 2447 employees on its rolls as at 31st March, 1995. Employee cost as a percentage of operating income is lowest for KIOCL (6%) when compared with other players in the industry like NMDC (13%) and Sesa Goa (7%).

KIOCL plans to enter downstream value addition through manufacture of 0.155 mmtpa of low phosphorus-low sulphur pig iron and 0.05 mmtpa of ductile iron spun pipes annually at Mangalore through a joint venture (KISCO) with Mecon and MSTC. The total estimated project cost is Rs. 328 crores and KIOCL's share of equity would be Rs.45 crores. The plant is expected to be commissioned within six to nine months.

#### Financial Analysis

The financial performance of KIOCL for the past five years is given below:

Table 5 Financial Performance

(Rs. Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	476.5	373.9	415.1	316.8	388.3
Operating Profit	139.0	79.0	108.7	105.4	145.1
Profit after Tax	95.0	57.6	93.9	99.9	138.3
Equity Capital	634.5	634.5	634.5	634.5	634.5
Tangible Net Worth	859.4	784.8	740.0	664.5	583.2
Gross Margin (%)	29.2	21.1	26.2	33.3	37.4
Net Margin (%)	19.9	15.4	22.6	31.5	35.6
ROCE (%)	11.7	6.1	10.8	11.6	20.1
RONW (%)	11.1	7.3	12.7	15.0	23.7
Earnings per Share (Rs.)	1.50	0.91	1.48	1.57	2.18
Dividend (%)	3.25	3.0	3.0	3.0	0

Gross margins have been continually decreasing since FY 92, but it has shown an upward movement in FY 96 mainly due to higher realisation in the iron ore market and more economical power, fuel, stores and spares usages. The non-operating income from inter-corporate advances which was 9.3% of the total operating income in FY 93 fell to 1% in FY 96 leading to a widening gap between gross margin and net margin. The power and fuel cost constitutes a major element of cost (27%) is due to the power intensive primary operations for beneficiation of ore. Power costs are expected to increase in future due to the substantial power tariff hike by Karnataka State Electricity Board. The power tariff went from 0.75 per kwh in FY 92 to Rs. 3.75 in FY 97.

KIOCL's return on capital employed has declined over the five year period between FY 92 to FY 96. KIOCL has a very high equity and zero debt due to the conversion of the loan of over Rs.375 crores by the Government into equity. Notwithstanding this, the dividend given by the company, which was zero in 1992, has stagnated around 3% thereafter. The interest foregone by the Government on a loan of more than Rs.375 crores over several years



has enabled the company to achieve ROCE of 20% in 1992 which has since declined to 11.7% in 1996. The earning per share is hardly Rs.1.50.

KIOCL had made intercorporate deposits of more than Rs. 100 crores in FY 1992 and FY 1993 to some public sector companies. The repayment of interest and principal has been outstanding for the last four years. In the event of writing off these loans, the future profitability of the company could be substantially affected by a one time provisioning.

### Strengths and Areas of Concern

Based on the above industry, business and financial analysis, the strengths and areas of concern of KIOCL are as below :

#### Strengths

*Mining Company with downstream value addition facility* KIOCL is in the business of extraction of iron ore. However, it has set up a pelletisation plant which improves the realisation. The company has also ventured into a number of downstream projects like pig iron, ductile iron pipes and coking ovens, etc.

*Fully mechanised and integrated operations* KIOCL's operations are fully mechanised and integrated right from captive mines to port facilities. For transporting the ore from Kudremukh to Managalore port, KIOCL has laid a 67 km long pipeline which gives sizable savings in transportation costs keeping in view the difficult terrain from Kudremukh to Mangalore.

*Facility of captive berth for exports* KIOCL being a 100% EOU, has a captive berth which can handle ships upto 65000 DWT. All the exports of KIOCL are handled through this berth.

*Low employee cost* The total employee cost as a percentage of operating income is the lowest for KIOCL as compared to other major players in the industry.

#### Areas of Concern

*Low quality iron ore resulting in high cost* The iron ore available in KIOCL's mines has an average iron content of 38% where as for steel

making, iron content in the ore should be above 60%. Thus, a greater degree of beneficiation of the ore is required. This has resulted in increased cost for power, fuel, consumable stores and spares etc.

*Depleting reserves* Keeping the current levels of extraction of 22 mmtpa, the reserves may last for about 12-13 years. Even though the company has applied for fresh mining leases, there is uncertainty due to environmental regulations.

*Management Process* The past management process and philosophy with regard to the operations of the company and the investments made have not really helped KIOCL to position itself strongly for future growth.

## Recommendations

**The Commission has earlier classified KIOCL as a core group PSU. Having examined in detail the working of the company and the structure of the iron ore industry the Commission has now decided to review this classification.** KIOCL processes low grade iron ore and beneficiates and pelletises it for export. It is an EOU unit and 93% of its production is exported. It has a market share of 11% in the production of iron ore in the country and 23% of iron ore exports. There is already significant private sector presence in the industry. **In the light of the above, the Commission has decided to categorise KIOCL as a non core PSU.**

On an analysis of the company it would be seen that the company faces certain short-term and long-term issues which need to be tackled effectively on a priority basis.

The existing mining lease would sustain the company's operations for about 8 years. The Nellibeedu deposits in respect of which prospecting work has been completed would extend the period by another 4-5 years if the mining lease could be obtained. In the longer run the company would need to obtain mining lease for the more substantial Gangrikal deposits which, however, is be-set with problems on account of opposition from environmentalists. The company has, therefore, an assured life of operation of about 12-13 years in its current business.

The company's agreement with Karnataka Electricity Board (KEB) for supply of power has run into trouble with the KEB claiming a much

higher tariff for power supply than estimated by the company. The company has a claim of over Rs. 100 crores as arrears by the KEB on past supplies and also substantially higher power tariff in the future. Since the operations of the company are highly power-intensive, this has serious implications for the company's viability.

Faced with such prospects the company today could be said to be at the crossroads. Certain critical decisions would need to be taken to extend the operating life of the company through prudent and effective diversification programmes. The company is today without a permanent Chief Executive. **There is urgent need for strengthening the management of the company. A competent Chief Executive needs to be appointed immediately and the Board of Directors also needs strengthening by the induction of competent professionals from outside.**

Given the fact that the company has about 12-13 years of assured operating life and that major decisions regarding diversification need to be taken to ensure the future viability of the company, the Commission feels that this would be the opportune time for inducting a strategic partner into the company. Selection of the partner may be made in accordance with the recommendations of the Commission contained in the First Report, after the necessary pre-qualification procedure. Government has already disinvested about 1% its holding in the company and is left with 99% of the equity of Rs. 634.51 crores. The strategic partner may be offered 30% of equity to start with and also inducted in the management of the company. The Government may also enter into an agreement with the strategic partner providing for a further dilution of Government equity to the extent of 43% within two years, through a combination of further offer of equity shares of 10% to the strategic partner and public offer of the balance to the domestic institutional investors and the retail investors. This would leave 26% of the equity with Government. Such phased disinvestment would also enable the Government to realise a proper value for its shares and would balance the need for immediate management intervention in the company for business restructuring by inducting a suitable strategic partner with the possibility of securing higher value for Government shares while disinvesting beyond 30% in the next two years particularly if the Gangrikal deposits were to be available for exploitation by the company.

**KIOCL has a very high equity base thanks to the conversion of Government loans over Rs.375 crores into equity in the eighties. This would indicate the need for capital restructuring in the company before bids for strategic partnership are invited. The terms of conversion of a part of the Government equity into secured long term loan should take into account the fund requirements of the company for business restructuring and the company's ability to service the loan. Care should be taken not to lessen the attractiveness of the company to the strategic partners. The Financial Adviser to be appointed by the SEG for valuation and drafting the terms and conditions of the bid for strategic sale should be specifically asked to consider this for Government to take the appropriate decision.**

Another factor which needs to be reflected in the valuation is the establishment of the joint venture KISCO for production of pig iron and ductile iron spun pipes which is expected to go on stream by the end of 1997. The commissioning of these plants will add significantly to the value of the company and increase its attractiveness to potential strategic partners.

## 2.3 Mahanagar Telephone Nigam Limited

### Evolution

Mahanagar Telephone Nigam Ltd. (MTNL) provides basic telecom services in two metropolitan cities of Delhi and Mumbai. The company commenced operations in April 1986 after taking over the management control and operations of the basic telecom network in the two cities from the Department of Telecommunications (DoT). The separation of MTNL from the parent was intended to achieve various objectives such as clearing the large backlog of waiting applications and improving the quality of telecom services, etc. One of the main objectives of forming MTNL was to raise necessary financial resources for telecom development in areas managed by MTNL as well as DoT.

MTNL has an equity base of Rs. 600 crores. As of date, the Government has disinvested 34.27% of its holding in the following tranches:

Table 1 Past Disinvestment

Tranche	Year	%	Avg. Price Realised per share (Rs.)	Amount Realised (Rs. Crs)
I	FY 92	20.00	46.3	555.6
II	FY 94	12.82	171.9	1321.9
III	FY 96	1.45	156.3	136.0
	Total	34.27		2013.5

MTNL shares are listed on the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). The closing price of the scrip was Rs. 283.50 as on May 28, 1997 on the BSE. The 52-week high/low on the BSE was Rs.300 and Rs. 185 respectively. MTNL has a dominating 8% weight in the BSE-Sensex (second only to SBI with 8.03%). Its price movements have shown an 84% correlation with the BSE-Sensex.

The past disinvestments were made mainly in favour of financial institutions, mutual funds, and nationalised banks. Among all financial institutions, the

UTI is the largest non-governmental share holder with about 14% stake. The current shareholding pattern of MTNL is as given below:

Table 2 Share Holding Pattern

Name of the Shareholder	% age holding
Govt. of India	65.73
Financial Institutions	16.95
Foreign Inst. Investors	14.24
Banks and MFs	2.74
Public/Others	0.34
Total	100.00

### Industry Analysis

Upto March 1996, the national fixed telecom network comprised 12 million direct exchange lines (DEL) of which about 22% were operated by MTNL. The national telephone density in India is quite low at 1 line per 100 persons (Lph); however, the telephone penetration levels in Delhi and Mumbai are 10 and 13 respectively. A comparison with other countries in the Asia- Pacific region shows that the telephone density even in the metro cities of Mumbai and Delhi is still quite low.

The Indian telecom industry is government controlled. The DoT is at present the only fixed-line operator. While basic telephone services for Delhi and Mumbai are provided by MTNL, the Videsh Sanchar Nigam Ltd., (VSNL) provides international telecom services.

In the context of a pressing need for better and more extensive telecom facilities, the government realised that the rate of expansion of telephone services could be accelerated to the desired extent only if private sector funding and enterprise was permitted. The National Telecom policy enunciated by the government in 1994 ended the monopoly of DoT in basic telecom services and paved the way for the entry of the private sector. The policy also paved the way for the entry of the private sector in value added areas such as radio paging, cellular services, etc. As far as basic services were concerned, it was also decided that in each operating area, there would

be two operators, viz., one being DoT/MTNL (in Delhi and Mumbai) and the other a private operator.

However, the progress of implementation of privatisation has been tardy. As a result, the expected competition to MTNL from the private sector has not emerged and the monopoly status of its operations is likely to continue for some more time.

Notwithstanding this, the company has evolved counter strategies to meet emerging competition. These include offering value added services such as Integrated Services Digital Network (ISDN) which will help MTNL to offer a wide range of value added services like fax, voice mail and video conferencing through a single line. Other enhanced features which are being contemplated are intelligent networks, wireless in local loop (WILL) etc.

### Business Analysis

MTNL offers basic telephone services, telex, dedicated leased lines, multimedia services, voice mail service etc. to consumers in Delhi and Mumbai. As of March 31, 1996 MTNL had 2.6 million lines. Over the past five years, the company has aggressively expanded switching capacity at a CAGR of 18% as shown in the table below:

Table 2 Additions to Switching Capacities

During the Year	1996	1995	1994	1993	1992	CAGR
Switching Capacity (A)	3.1	2.6	2.1	1.8	1.6	17.9
DELS added (Mn)	0.4	0.4	0.3	0.2	0.1	
Total DELs (B)	2.7	2.3	1.9	1.6	1.4	16.9
B/A (%)	87	88	90	90	87	

As a consequence, there has been a fairly sharp decline in the waiting period for new connections from over 11 years in FY 91 to a few months currently. MTNL expects to be in a position to provide telephone services "on demand" from FY98.

An issue relating to the performance of MTNL is the issue of interconnectivity charges which is payable to DoT whenever its networks are accessed. Although these charges are essentially levied on the revenue from long distance calls, MTNL in practice pays them on the total calls to DoT (including local calls) due to the difficulty associated with segregating revenue from Subscriber Trunk Dialling (STD) and non-STD charges. In addition, DoT has proposed an increase in the interconnect charges, while MTNL has requested for continuing status quo for some more time.

### Network Technology

MTNL's switching exchanges compare very favourably with switching exchanges in other countries in the world with about 91% of its lines being electronic of which 83% are digital. The company has constantly upgraded its network as reflected in the increasing proportion of digital lines. The network performance parameters in terms of call completion and fault rates have improved substantially over the period FY 91 to FY 96 mainly due to technological upgradations. At the current levels, the call completion and fault rates have generally shown steady improvement, as shown in the table below:

Table 4 Network performance of MTNL

For the year	FY 96	FY 95	FY 94	FY 93	FY 92
Call completion - local (%)					
- Mumbai	90	93	92	89	93
- Delhi	95	95	95	95	77
Call Completion -STD (%)					
Mumbai	88	89	86	85	24
Delhi	89	88	87	85	30
Fault Rates (Nos./100Lines)					
- Mumbai	11	19	19	17	21
- Delhi	23	23	26	23	35



An analysis of the customer profile and revenue generation reveals that:

- about 10% of the customers contribute 90% of revenues. These are typically commercial establishments.
- about 70% of the revenues are contributed by STD and ISD calls taken together.
- about 40% of the total traffic is accounted for by incoming calls for which no share of revenue is received by MTNL from DoT.

### Financial Analysis

The financial analysis for the past five years is presented in the table below:

Table 5 Financial Performance

(Rs. Crores)	FY 96	FY 95	FY 94	FY 93	FY 86
Operating Income	3518.6	3015.1	2521.7	1860.8	1573.0
Operating Profit	1847.8	1649.8	1390.3	1061.7	885.2
Profit After Tax	691.2	576.7	377.0	208.4	164.3
Equity Capital	600.0	600.0	600.0	600.0	600.0
Tangible Net Worth	2736.9	2127.2	1610.6	1326.4	1166.0
Gross Margin (%)	52.5	54.7	55.1	57.1	56.3
Net Margin (%)	19.6	19.1	14.9	11.2	10.4
ROCE (%)	19.1	18.7	18.8	17.1	17.7
RONW (%)	28.4	30.9	25.7	16.7	15.0
Earnings Per Share	14.9	13.3	11.8	12.4	11.5
Dividend (%)	20	10	10	8	6

From the above table it is evident that despite the low growth in revenue per DEL (CAGR of 6% during the five years ended FY96) MTNL's total income grew impressively at a CAGR of 22.3% mainly due to aggressive line expansions. However, revenue per line registered a sharp increase from

Rs. 12706 in FY93 to Rs. 15172 in FY94. This was mainly due to a tariff increase and the introduction of the 3-minute unit call (for billing purpose) in May 1993. With no equity dilution and a good track-record of growth in profits, EPS has registered an impressive growth of 43% during the five years ended 31st March '96.

## Strengths and Areas of Concern

### Strengths

*Continued Monopoly Status* : Even with the privatisation of the telecom sector, the monopoly status of MTNL will continue for some more time due to the tardy progress of privatisation. In addition, the relatively low telephone densities even in these two metro cities is expected to help the company to grow further and thus retain its strong position. MTNL's depreciated network and high cash generation is expected to provide it with high financial flexibility in a technology and capital intensive business.

*Technological Capabilities* : MTNL has the benefit of integrating equipment supplied by different companies with different technological standards. As such, the company is placed in a unique position of understanding and integrating technologies into the switching network. This is expected to provide a competitive advantage to the company.

*Skilled Manpower* : MTNL has on its rolls, the most technically qualified and experienced workforce in the industry. However, there could be poaching from the private sector companies once they are operational.

### Areas of Concern

*Skewed Consumer Mix* : Currently about 10% of the customers of MTNL account for 90% of the revenues. This skewed mix of consumers makes MTNL vulnerable to skimming strategies by competition. The private operators are expected to skim the high end users by resorting to aggressive pricing strategies. MTNL with its present level of autonomy and given the present regime of accountability may not be able to match such strategies.

*Overmanning* : As against the international norm of about 8-10 employees per thousand lines, MTNL has about 23 employees per thousand lines

indicating substantial overmanning. However, the company has frozen all recruitment during the past three years notwithstanding aggressive capacity expansions. As a result, it has attained impressive increases in employee productivity levels. Efforts towards reducing the extent of overmanning would need to be sustained.

*Lack of Autonomy in operations* : The pace of project implementation in MTNL is adversely affected by the obligation to participate in DoT's centralised equipment procurement process. There is need for greater delegation of powers to the Board of the company.

### Recommendations

The Commission has already classified MTNL in the core group of PSUs. MTNL enjoys a virtual monopoly position in the provision of basic telephone services in the metropolitan areas of Delhi and Mumbai, competition being offered to a limited extent by operators of cellular phone service. While Letters of Intent (LoI) have been issued by DoT to Hughes-Ispat in Mumbai and HFCL in Delhi, it will be another year or two before any competition emerges in these areas for MTNL. While Hughes-Ispat has accepted the LoI, the LoI issued to HFCL is now sub-judice. The Telecom Regulatory Authority of India (TRAI) has now come into existence and is expected to take over from DoT the regulatory functions in the field. It is, therefore, expected that over the next 3-4 years the nature of the industry will undergo a major change. The top segment will sooner or later get saturated and the competition will percolate down the line to the entire range of services. The TRAI will also have a role to play in bringing this about. That would be the time for a review of the position of MTNL as a core PSU and to consider disinvestment beyond 49%. For the time being the classification of MTNL as a core PSU is retained and, therefore, disinvestment is recommended only upto 49%.

Already 34.27% of MTNL shares has been disinvested leaving a balance of 14.73% or 88.3 million shares for disinvestment. The earlier disinvestment was mainly in favour of FIs, Mutual Funds and Nationalized Banks. Given the strength of MTNL in a high growth area such as telecom services, MTNL's shares would attract considerable interest among investors abroad. The domestic market may also find it difficult to absorb a very large issue of this size. **The Commission, therefore, would recommend a GDR issue**

of 60 million shares (10%) and the appropriate timing may be decided by SEG keeping in view the market conditions. MTNL's shares are already listed and actively traded with a sizeable weightage in the BSE Sensex. Soon after the GDR issue through the book building process a domestic offer of the balance 28.3 million shares consisting of 4.73% of the equity may be made to the institutional investors and to small individual investors at a discount over the institutional price.

It is proposed that a book building process be adopted for disinvestment to institutional investors in the Indian market which could be followed with a retail offering to small investors at a discount of 10% to the institutional price. As has been mentioned in Report II of the Commission submitted in April, 1997, it is suggested that MTNL should join the National Securities Depository Limited (NSDL) before any issue is contemplated from either the company or from the Government. In addition to the benefits of dematerialisation, the other benefit to small investors is that they can buy shares in quantities much less than the normal tradable lots which can also be traded on the National Stock Exchange (NSE) without any discount for odd lot.

However, preparatory to disinvestment the Commission recommends that Government should address certain issues relating to corporate governance, and autonomy to MTNL. The policy of liberalization in the telecom sector has posed a challenge to MTNL and it has to respond by framing suitable strategies to counter competition and sustain its growth and profitability. Apart from upgrading the existing network of telephones and offering value-added services, MTNL would need to improve its service quality and customer relationship. In particular it would need to offer special treatment and resort to aggressive pricing strategies in the segment of high users which constitutes 10% of its total number of customers but contributes 90% of its revenues.

MTNL is not one of the 'Navratnas' selected for grant of greater autonomy. However, considering its impressive track record over the past 10 years, the Commission considers it to be a "Strong Performer" and recommends full autonomy to the Board of Directors to enable it to conduct its operations successfully in the increasingly competitive environment. In particular the following issues are highlighted for immediate attention.

The Board of Directors should be broad-based in line with the Commission's recommendations in its First Report with the induction of a few reputed professionals with expertise in areas like finance and marketing. Since already 34.27% of the equity has been disinvested, Government should consider giving representation to these shareholders in the Board of Directors.

Even after establishment of MTNL as a company, it still functions in many ways like other unincorporated circles of DoT. Over 99% of its staff and officers continue to be on deputation and even the top management personnel are reported to be transferred in and out by DoT without consultation with MTNL management. MTNL would need to phase out deputation from DoT according to a declared plan of absorption by offering senior executives attractive emoluments as recommended in the First Report of the Commission through performance related contracts for a period of 5 years.

The Board of Directors of MTNL would need to be given full autonomy to enable them to take crucial decisions covering long-term business plans, tariff fixation and rationalization, choice of appropriate technology, selection of equipment and purchases without the need for consultation and prior approval by DoT in these matters. In particular MTNL should be kept out of the centralized tendering system of DoT.

MTNL borrows funds from the market which are on-lent to DoT as part of the latter's funding requirements. As on March 31, 1996 MTNL had on-lent Rs.5932 crores to DoT. In this process, some of the transactional costs which are quite substantial are being absorbed by MTNL and consequently this depresses profitability and hence share value. It is recommended that all cost relating to the funds already raised for the DoT should be fully reimbursed to MTNL. In future MTNL may require funds for expansion programmes in the existing and new metro regions. In such a situation, MTNL may not be able to borrow further funds for DoT as the debt:equity ratio is already quite high. It is therefore recommended that the resource raising function for DoT if required, should be taken away from MTNL and should be vested with some other entity.

In a service sector like telecom, a public sector undertaking even after grant of full autonomy to the Board of Directors would have to face some constraints. Accountability on detailed micro commercial decisions to a multiplicity of institutions like Ministries, Parliamentary Committees, the Central Vigilance Commission (CVC) and the Comptroller and Auditor General (CAG) could act as constraints in dealing with competition, especially in the matter of differential pricing and discount policy. The Commission would like to reiterate the observation made in its First Report that "the audit by the CAG and the examination of PSUs by the Committee on Public Sector Undertakings (COPU) may need to take into account the changing commercial environment in which PSUs are operating and the need for PSU managements to take quick entrepreneurial decisions to promote the interest of the company and the shareholders". The Commission has also recommended the establishment of a Pre-Investigation Board to protect the management against action in respect of even bonafide commercial decision. Follow-up on these recommendations will be particularly crucial in the case of MTNL as its management gears itself to face the threat of competitors "skimming the cream" with their aggressive sales and pricing policies.

## 2.4 Oil India Limited

### Evolution

Oil India Limited's (OIL) origin dates back to the time when oil was first discovered in Assam in 1889. The Government of India which was a joint venture partner with Burmah Oil Company took over the latter's share holding in full in 1981.

OIL's primary activities are exploration, production and transportation of hydrocarbons. The contribution of various products and services to the total sales in 1995-96 was as follows: crude oil (90%), natural gas (5%), Transportation charges (3%), and LPG (2%). The company started exploration of hydrocarbons in upper Assam and has currently extended offshore exploration to Rajasthan, Uttar Pradesh and the Saurashtra region.

Presently, the Government holds 98.12% of the equity of Rs. 143 crores with the balance being held by the employees of the company. The company's shares are currently not listed.

### Industry Analysis

The demand for petroleum products is driven by the economic growth rate. For the last two decades, the growth rate of petroleum consumption in India has been higher than the growth of the Gross Domestic Product of the country. Thanks to this high growth rate in consumption, the development of hydro carbon resources available in the country has become a critical economic necessity.

In India, there are twenty six sedimentary basins covering around 1.78 mn. sq.km. The presence of hydro carbons has been established in nine sedimentary basins, while commercial production has been carried out in six of them. Exploration activity was intensified after the oil crisis in the seventies and eighties. This resulted in the major discoveries of the offshore Bombay High Field and the Gandhar Oil & Gas Field in Cambay basin.

Domestic crude oil production became stagnant in 1990 mainly on account of the following :

- Most of the fields including Bombay High reached a plateau with a number of wells requiring shutdown for repairs.
- No significant discovery of hydrocarbon after the discovery of the Neelam Oil Field in the Bombay High in 1987.

To supplement production, efforts were made to increase production through the use of enhanced oil recovery programmes. In spite of this, it is expected that the domestic production will remain more or less stagnant over the next few years unless there are significant discoveries.

There is no integrated company in the petroleum sector in India. The upstream oil exploration and production (E&P) sector in India is a duopoly of the national oil companies - OIL and Oil & Natural Gas Corporation Ltd. (ONGC). In the downstream sector, refining and marketing are done by a number of companies. In the case of Indian Oil Corporation Ltd. (IOCL), Hindustan Petroleum Company Ltd. (HPCL) and Bharat Petroleum Co Ltd. (BPCL), they carry out both the activities. Madras Refineries Ltd. (MRL), Cochin Refineries Ltd. (CRL) and Bongaigoan Refineries and Petrochemicals Ltd. (BRPL) market their produce through other oil companies. Lastly, IBP Ltd. (IBP) only markets petroleum products but does not do any refining on its own.

A comparison of the upstream companies on the basis of oil reserve characteristics is shown in the table below:

Table 1 Reserves position of crude Oil and Gas (1995-96)

Reserve Characteristics	Unit	ONGC	OIL
Proven + indicated Crude Oil Reserves	MMT	726.50	64.55
Proven + Indicated Gas Reserves	BSCUM	642.80	88.10
Crude Oil Production	MMT	31.89	2.80
Gas Production	BSCUM	20.87	1.43
Total Production (Oil & Oil Eq.)	MMT	52.76	4.23

Note : MMT is Million Metric Tonnes and BSCUM is Billion Standard Cubic Meters



As can be seen from the above table, OIL is approximately 1/11th of the size of ONGC in terms of production and reserves. Almost 92% of the domestic production is contributed by ONGC and 8% by OIL. Domestic production accounts for nearly 55% of the total crude consumption of the country with the balance being met through imports.

The demand for crude has increased steadily at a CAGR of 3.3% over the last decade and was 61 MMT in FY 96. However, domestic production which was 34.6 MMT in FY 96, has not kept pace with the growth in demand as a result of which the country had to resort to increased imports. This trend is expected to continue in the future too.

The declining oil reserve profile and the resource crunch with the national oil companies have prompted the Government to permit and encourage private sector investment in the E&P sector. Private participation has been sought by inviting bids for exploration, development and surveys. As part of these policy initiatives, the Government has formulated the New Exploration and Licencing Policy (NELP) in February, 1997. Some of the highlights of the NELP are:

- Companies including the national oil companies will be paid international oil prices for production from new discoveries.
- Royalty payments will be fixed on ad valorem basis instead of the present system of specific rates.
- Royalty payments for exploration in deep waters will be charged at half the rates for offshore areas for the first seven years after the commencement of commercial production.

### Pricing & Distribution

The sector came under complete government control in 1981 with the nationalisation of OIL. Since then, the administered price of crude oil and natural gas has been applicable to both OIL and ONGC. Under the Administered Pricing Mechanism (APM), the pricing of crude oil is fixed taking into account 15% post tax return on capital employed which in turn is based on the normative costs of the two E&P companies. The APM for crude oil is revised periodically by the Oil Co-ordination Committee

(OCC). Though revisions are to be done once every three years, there have been delays in the past. At present the administered price of crude is around USD 13 per barrel which is well below international prices. The distribution of both crude oil and natural gas is also decided by the Ministry of Petroleum and Natural Gas.

## Technology

Technology is a vital factor in E&P activities. Improvements in technology improve probabilities of success, reduce risks, lower finding and development costs and facilitate access to difficult terrain. Improved technology also reduces the threshold structure sizes and enables even marginal fields to become commercially viable.

## Business Analysis

OIL's operations are in Assam, AP, Rajasthan, Uttar Pradesh, Orissa and offshore Saurashtra. While OIL's drilling activities have been satisfactory in terms of the eighth five year plan targets, production has remained more or less stagnant at around 2.8 MMT mainly due to:

- Blow-out in a high potential area (Dikom) in 1992-93 leading to loss of one drilling rig and a well for one year
- Intermittent local problems in the operational areas
- Declining production levels from old fields

The last mentioned factor is expected to impact production costs significantly over the medium term. The share of production of crude oil from old and declining fields has dropped from 67% in FY 94 to 44% in FY 97 and is expected to drop down further to 25% in the near future. The future operating strategy of the company therefore is to concentrate its exploration activities in the North-East, especially in the virgin areas of the north bank of Brahmaputra which are estimated to have large hydrocarbon potential.

OIL's technological competence in terms of drilling technology employed is comparable with ONGC; however there is a gap when compared with the drilling technology adopted by the international E&P companies.

## Reserves

The crude oil reserve position of OIL as on April 1, 1996 indicated a total balance recoverable quantity of 64.55 MMT. The North East region contributes a significant portion of this and thus is of strategic importance for OIL. At the current level of production, the balance recoverable reserves will last for another 21-23 years.

In the case of natural gas, the balance recoverable reserves are estimated at 88.10 BSCUM. At the current level of production, these gas reserves will last for another 60-62 years.

## Financial Analysis

The financial performance of OIL for the past five years is indicated in the table below:

Table 2 Financial Performance

(Rs. Crores)	FY 96	FY 95	FY 94	FY 93	FY 86
Operating Income	1045.1	986.5	919.6	723.1	616.0
Operating Profit	344.5	365.7	267.4	155.2	101.1
Profit After Tax	206.5	258.2	97.8	37.8	46.4
Equity Capital	71.33	70.0	28.0	28.0	28.0
Tangible Net Worth	1853.5	1653.5	895.8	798.7	627.2
Gross Margin (%)	32.9	37.0	29.0	21.4	16.4
Net Margin (%)	19.7	26.1	10.6	5.2	7.5
ROCE (%)	17.8	18.7	14.6	8.1	10.5
RONW (%)	11.1	15.6	10.9	4.7	7.4
Earnings Per Share	28.9	36.8	34.9	13.4	16.5
Dividend (%)	30.0	24.0	24.0	16.0	16.0

Beginning in FY 95, the company has started following the Successful Efforts Method (SEM) of accounting for recognising its income and

expenses related to the exploration and drilling and development activities. The SEM is the generally accepted standard accounting policy for E&P companies. Because of this, the financial results of FY 96 and FY 95 are not strictly comparable with those of earlier years.

However, on a broad level, profitability has largely been determined by increases in Administered Prices of crude and exploratory write-offs as also due to the effect of the changed accounting policy. OIL's cost structure is comparable to ONGC because of similar royalty /cess on crude, comparable operating costs and depletion rates. In fact, OIL's performance is comparable to the mid-sized exploration and production companies internationally.

## Strengths & Areas of Concern

### Strengths

*Future market prospects bright* : Domestic crude oil demand in 1995-96 was estimated at 61.9 MMT out of which only 55% was met by domestic production. Thus, there is considerable scope for OIL to increase its production.

*Strong Financial Position* : OIL has built up a strong reserve position at about Rs. 1853.5 crores as against a paid up equity of Rs. 71.33 crores.

*Operational efficiency comparable to ONGC* : OIL compares favourably with ONGC on most efficiency parameters except manpower costs which are marginally higher.

### Areas of Concern

*Operational areas are subject to localised difficulties* : OIL's exploratory regions are concentrated in the North East which holds promising hydro carbon potential. However in the past, OIL's production and drilling targets have been affected by local disturbances, poor road conditions, and difficulties in land acquisition.

*Lack of Autonomy in decision making* : In the past, OIL has lost on opportunities due to delays in decision making resulting from inadequate Board level autonomy. With the entry of the private sector in this field,

it is desirable that adequate autonomy be granted to OIL consistent with its status as a "Strong Performer" as per the norms laid down by the Commission in its First Report.

## Recommendations

The Commission has already categorised OIL to be in the Core group of PSUs. Disinvestment in OIL would be conditioned by a realistic assessment of the company's prospects and earnings in the short-term which will determine the value of its shares and its requirement of funds for investment in its capital projects and consequently its need to take recourse to an initial public offering (IPO) on its own.

Owing to delays in decision making, OIL has lost out business opportunities in promoting joint ventures and has suffered considerable pruning of its new exploration programme in the last five years. After it ventured into exploration outside the North-East region, it has been to some extent successful in Rajasthan. Currently its exploration activities in the North Bank of Brahmaputra are expected to be profitable and success in this area will on the one hand increase its requirement for capital outlays but also improve earnings and share value.

The current policy of APM denies a proper value for its output from the old areas. Policy changes towards dismantling APM and giving international prices for its output as in the case of new fields would significantly improve its internal resource generation and will also make a substantial impact on the share value. Under this scenario, thanks to the improvement in internal generation, the company's need to look for resources through debt or through further issue of equity would be greatly reduced and prospect for disinvestment by Government would be enhanced.

**Taking into account all these factors, the Commission recommends that disinvestment of Government shares as also company's own IPO need not be considered for the present and could be considered after a year or so when the company's own prospects would be clearly established through the outcome of exploration activities in the North Brahmaputra area and Government's policy on APM. The scope for disinvestment of Government shares could then be determined after balancing the requirements of the company for equity issues. Any**

disinvestment prior to this could result in a loss to exchequer as an announcement regarding the dismantling of APM would significantly improve the share value both for disinvestment and for the company's own IPO. The Commission would like to review the position after a year and make specific recommendations on disinvestment in the company. The company's immediate requirement of funds could be covered through appropriate borrowing arrangements.

## 2.5 Oil And Natural Gas Corporation Limited

### Evolution

The Oil and Natural Gas Directorate was formed in 1955 to explore and develop the oil and natural gas resources in the country. As the structure of the Directorate was found to be inadequate for the effective execution of the task of oil exploration and production (E&P) it was converted into a statutory body the Oil and Natural Gas Commission in October, 1959 by an Act of Parliament. In 1994, it was incorporated as a public limited company under the Companies Act as Oil and Natural Gas Corporation Ltd. (ONGC).

ONGC's principal activity is the exploration and production of crude oil and natural gas which constituted about 73% and 23% respectively of its turnover of about Rs. 13000 crores in FY 96. It also processes gas and condensate into value added products like liquefied petroleum gas (LPG), natural gasoline liquid etc.

In FY 94, the government disinvested 2% of its shares to mutual funds, financial institutions, etc. In the same year, ONGC also issued 2% of its shares to employees. According to the current share holding pattern, Government holds 96% of the share capital of Rs. 1426 crores. The shares of ONGC are listed on the Bombay Stock Exchange (BSE) and was registered a high and a low of Rs. 273 and Rs. 120 (Rs. 10 paid up) respectively in 1996. The closing price as on 28th May, 1997 was Rs 253.25.

### Industry Analysis

The demand for petroleum products is driven by the economic growth rate. For the last two decades, the growth rate of petroleum consumption in India has been higher than the growth of the Gross Domestic Product of the country. Thanks to this high growth rate in consumption, the development of hydro carbon resources available in the country has become a critical economic necessity.

In India, there are twenty six sedimentary basins covering around 1.78 mn. sq.km. The presence of hydro carbons has been established in nine

sedimentary basins, while commercial production has been carried out in six of them. Exploration activity was intensified after the oil crisis in the seventies and eighties. This resulted in the major discoveries of the offshore Bombay High Field and the Gandhar Oil & Gas Field in Cambay basin.

Domestic crude oil production became stagnant in 1990 mainly on account of the following :

- Most of the fields including Bombay High reached a plateau with a number of wells requiring shutdown for repairs.
- No significant discovery of hydrocarbon after the discovery of the Neelam Oil Field in the Bombay High in 1987.

To supplement production, efforts were made to increase production through the use of enhanced oil recovery programmes. In spite of this, it is expected that the domestic production will remain more or less stagnant over the next few years unless there are significant discoveries.

There is no integrated company in the petroleum sector in India. The upstream oil exploration and production (E&P) sector in India is a duopoly of the national oil companies - ONGC and Oil India Limited (OIL). In the downstream sector, refining and marketing are done by a number of companies. In the case of Indian Oil Corporation Ltd. (IOCL), Hindustan Petroleum Company Ltd. (HPCL) and Bharat Petroleum Co Ltd. (BPCL), they carry out both the activities. Madras Refineries Ltd. (MRL), Cochin Refineries Ltd. (CRL) and Bongaigoan Refineries and Petrochemicals Ltd. (BRPL) market their produce through other oil companies. Lastly, IBP Ltd. (IBP) only markets petroleum products but does not do any refining on its own.

A comparison of the upstream companies on the basis of oil reserve characteristics is shown in the table below :



Table 1 Reserves position of crude Oil and Gas (1995-96)

Reserve Characteristics	Unit	ONGC	OIL
Proven + indicated Crude Oil Reserves	MMT	726.50	64.55
Proven + Indicated Gas Reserves	BSCUM	642.80	88.10
Crude Oil Production	MMT	31.89	2.80
Gas Production	BSCUM	20.87	1.43
Total Production (Oil & Oil Eq.)	MMT	52.76	4.23

Note : MMT is Million Metric Tonnes and BSCUM is Billion Standard Cubic Meters

As can be seen from the above table, OIL is approximately 1/11th of the size of ONGC in terms of production and reserves. Almost 92% of the domestic production is contributed by ONGC and 8% by OIL. Domestic production accounts for nearly 55% of the total crude consumption of the country with the balance being met through imports.

The demand for crude has increased steadily at a CAGR of 3.3% over the last decade and was 61 MMT in FY 96. However, domestic production which was 34.6 MMT in FY 96, has not kept pace with the growth in demand as a result of which the country had to resort to increased imports. This trend is expected to continue in the future too.

The declining oil reserve profile and the resource crunch with the national oil companies have prompted the Government to permit and encourage private sector investment in the E&P sector. Private participation has been sought by inviting bids for exploration, development and surveys. As part of these policy initiatives, the Government has formulated the New Exploration and Licencing Policy (NELP) in February, 1997. Some of the highlights of the NELP are :

- Companies including the national oil companies will be paid international oil prices for production from new discoveries.
- Royalty payments will be fixed on ad valorem basis instead of the present system of specific rates.

Royalty payments for exploration in deep waters will be charged at half the rates for offshore areas for the first seven years after the commencement of commercial production.

## Pricing & Distribution

The sector came under complete government control in 1981 with the nationalisation of OIL. Since then, the administered price of crude oil and natural gas has been applicable to both OIL and ONGC. Under the Administered Pricing Mechanism (APM), the pricing of crude oil is fixed taking into account 15% post tax return on capital employed which in turn is based on the normative costs of the two oil producing companies. The APM for crude oil is revised periodically by the Oil Co-ordination Committee (OCC). Though revisions are to be done once every three years, there have been delays in the past. At present the administered price of crude is around USD 13 per barrel which is well below international prices. The distribution of both crude oil and natural gas is also decided by the Ministry of Petroleum and Natural Gas.

## Technology

Technology is a vital factor in E&P activities. Improvements in technology improve probabilities of success, reduce risks, lower finding and development costs and facilitate access to difficult terrain. Improved technology also reduces the threshold structure sizes and enables even marginal fields to become commercially viable.

## Business Analysis

ONGC's primary function is to exploit India's petroleum resources. The company is not engaged in any refining activity, nor does it distribute natural gas and petroleum products.

ONGC's production is concentrated in six sedimentary basins out of which a major part comes from offshore installations in the Mumbai Regional Business Centre (Bombay High). Among the other areas, the Western Regional Business Centre (Cambay, Kutch, Saurashtra) contribute around 20% of crude oil and 14% of natural gas production.

Natural gas is available for distribution after meeting internal requirements. However, in the past, natural gas has had to be flared due to nonavailability of infrastructure of gas pipelines, variation of demand pattern of committed users, etc. However, over the years, the flaring of gas has come down from around 34% of total production in FY 1990 to 6% in FY 1996.

Crude oil and natural gas have been major contributors to income and profits in the past. In FY 1996 crude oil contributed to around 62% of profits and the balance was accounted for by the sale of natural gas, LPG etc.

In addition to its core activities of E&P, ONGC is also engaged in carrying out several non core activities ranging from providing logistics and support system to maintenance.

## Reserves

The reserve position of ONGC as on April 1, 1996 indicated a total balance recoverable crude oil reserves of 726.5 MMT. Out of this total, Bombay High contributes significant portion and thus is of strategic importance for ONGC. Production from Bombay High has been regulated since FY 92 for improving reservoir health and for rectification programmes for existing oil wells.

At the current level of production, the balance recoverable reserves will last for another 20-22 years.

In the case of natural gas, the balance recoverable reserves has been estimated at 642.8 BSCUM. At the current level of production, these gas reserves will last for another 30-32 years.

It must be mentioned that most of the exploration efforts so far have been concentrated in the known petroliferous basins both onshore and offshore. This indicates that the easy to find oil has already been discovered in the prospective basins. Thus the exploration strategy in the future will have to concentrate on deep water basins (offshore) and frontier areas (onshore). These would involve substantial investment and could be called "high risk and high return" ventures.

## Financial Analysis

The past financial performance of ONGC is shown in the table below :

Table 2 Financial Performance

(Rs. Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	13436	13614	8052	8668	8110
Operating Profit	6376	6618	3927	3687	3586
Profit After Tax	1945	2345	1595	788	408
Equity Capital	1426	346	343	343	343
Tangible Net Worth	17600	15448	12746	10777	9500
Gross Margin (%)	47.4	48.6	48.7	42.5	44.2
Net Margin (%)	14.5	17.2	19.8	9.0	5.0
ROCE (%)	13.3	17.9	18.3	12.8	12.3
RONW (%)	11.8	14.2	16.3	7.8	6.2
Earnings Per Share	13.6	58.1	55.8	23.0	11.9
Dividend (%)	14	20	18	18	18

Total income has shown a CAGR of 13% over the past four years ending March 31, 1996.

The improvement in profitability in FY 1994 in terms of gross and net margins and other ratios was mainly due to increase in net realisable prices given to ONGC in September, 1992 and April, 1994. This resulted in a total increase in revenues by about Rs. 800 crores. Profit after tax has shown a higher growth rate during the same period. During FY 95 and FY 96, profitability has shown a declining trend. This is due to the fact that there has been no change in the net crude oil price realised by ONGC since April, 1993 inspite of increased cost of production. Also, during FY 1996, ONGC had carried out a critical review of all wells in progress and had written off the cost of wells with no techno economic significance. This resulted in lower operating profit and net margins in FY 1996 as also lower return on capital employed inspite of write back of revenues of about Rs. 300 crores due to changed accounting polices.

## Strengths & Areas of Concern

### Strengths

*Dominant Position in the Petroleum Sector* : ONGC accounts for more than 91% of the domestic crude oil production and 94% of the crude oil production in India. This dominant position is also reflected in the strong financial position of the company with financial reserves of nearly Rs. 18,000 crores.

*Changed Policy Environment* : NELP presents an opportunity to ONGC to surrender less promising blocks and concentrate on more promising blocks. In addition, ONGC will get a number of benefits in new finds (international prices, lower royalty, abolition of cess, etc.). However, it is difficult to predict volume of production from new finds.

### Areas of Concern

*Lack of Managerial Autonomy* : Considering the size of the company and its scope of operations, the delegation of powers to ONGC is inadequate. Due to this, a number of potentially viable projects were affected due to delays in decision making.

*Declining Levels of Reserve Replacement Reserves* : For any E&P company, it is essential that it is able to replace its production of hydrocarbons with new discoveries and the absence of any major find in recent years is a cause of concern for ONGC.

### Recommendations

ONGC is undertaking a detailed review of its operations. It is reported that diagnostic studies have been completed and after discussions with the company and the Ministry of Petroleum and Natural Gas, recommendations would be made by the consultants. Reorganisation of ONGC on this basis will be undertaken after that. This entire process is expected to be completed over the next 2 years. This corporate reorganization and restructuring is expected to have a beneficial impact on the operations and performance of the company.

Apart from this, ONGC as in the case of OIL would stand to benefit by the changes in the petroleum policy being contemplated by the Government, especially with regard to pricing of crude oil produced from the existing fields. The switchover from APM to international prices for its production would add considerably to ONGC's operating margins and profits. **The Commission recommends that disinvestment in ONGC be considered after the organizational changes are in position and the new pricing policy is known. That would be the time to clearly assess ONGC's own requirement of funds and to plan the disinvestment of Government shares and the company's IPO requirement in a coordinated matter. Any disinvestment prior to this could result in a loss to the exchequer, as an announcement regarding the dismantling of APM would significantly improve share values. The Commission would review the position from time to time and make its recommendations at the appropriate time.**

## 2.6 Rail India Technical And Economic Services Limited

### Evolution

Rail India Technical and Economic Services Limited (RITES) was incorporated in 1974 under the Ministry of Railways with the object of rendering consultancy services primarily in all facets of rail transportation technology and management both in India and abroad. With technical and managerial support from Indian Railways, RITES has established itself as a leading international consultancy organisation in railway related technology. RITES has executed projects in developing countries of Asia and Africa. Several of these projects have been funded by major international financial institutions like the World Bank, the Asian Development Bank, UNDP, etc.

Major customers in India are the Indian Railways, central and state governments and their organisations like PSUs and SEBs. There are also a few private sector companies in its client list.

Since the mid-eighties, the company has followed a strategy of diversification from consultancy for the railways to that for the entire transport sector. It entered into consultancy for highways, ports & harbours, inland water transport, urban transportation, airports and other related areas. In FY 96, these sectors contributed to about 35% of the total turnover of Rs. 109 crores, while the balance was accounted by its core business of railway related consultancy.

The current equity capital of the company is Rs. 1 crore with the entire equity being held by the Government of India. The reserves and surplus are significant at about Rs. 91 crores as at March 31, 1996.

### Industry & Business Analysis

The field of technical consultancy in India is dominated by a number of leading private sector and public sector organisations. Since expertise in specific technical areas is essential, the market for consultancy is clearly demarcated into various niche segments, with no firm specialising in all segments. RITES started operations by rendering integrated design services, institutional management and technical support for new railway projects and rehabilitation and modernisation of existing railway systems. In

addition, the company has diversified into new areas to become a multi-disciplinary transport consultancy. The break-up of income over the past decade reveals that the income is broad based as shown in the table below.

Table 1 Break up of Income

(Rs. Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Consulting fees - Dom.	48.1	28.4	15.1	14.4	2.8
Consulting fees - Intl.	12.4	12.5	57.3	15.3	15.9
Inspection fees	9.4	8.3	4.8	3.4	2.0
Exports of Rolling Stock	21.2	-	-	-	-
Sub-Total	91.1	49.2	77.2	33.1	20.7
Other income	18.8	10.1	2.9	1.6	1.1
Total Income	109.9	59.3	80.1	34.7	21.8

The consultancy income from domestic business has grown at an average rate of 18% over the last six years. The domestic income comprises income from both railway related and non-railway groups such as Ports, Highways, Airports, Quality Assurance, etc. Railway related business still constituted about 65% of the company's turnover in FY96. Inspection services and operations and maintenance of railway related projects have maintained a share of 15% of the total turnover in FY96.

However, foreign consultancy income has been declining over the last decade. The exception has been the sharp increase in the revenue in foreign consultancy in FY 89 which was on account of the Iraq project. This was later foreclosed in FY 90 due to the United Nations sanctions.

#### Analysis of Railway Related Services

*Foreign projects* : India's level of railway technology (partly manual and partly mechanical) is ideally suited to the projects coming up in the developing countries. These projects are typically funded by development institutions like the World Bank, African Development Bank, etc. Internationally, India's share of consultancy business was 1.2% of the total business and it ranked 13th.



RITES has drawn up plans to arrest the declining trend in foreign consultancy income. It is making all out efforts to enter new markets particularly to take up rehabilitation and maintenance projects for coaches and locomotives. It also plans to play an active role in the privatisation of railway lines which is an emerging segment in the international market. The company has recently secured consultancy contracts from the Railways of Malaysia, Botswana, Cambodia, etc.

*Inspection Services* : For third party inspection services, the principal client is the Indian Railways. The company has secured ISO 9000 certification for its inspection services. RITES also provides consultancy services to clients to enable them to obtain these certifications and is also attempting to become a certification agency itself. The inspection service business has reached stable levels and is expected to continue to provide a steady stream of revenue and profits to the company.

*Quality assurance services* : RITES has specialised expertise in quality assurance services in power equipment, coal and oil sectors. Although, RITES has to face competition from domestic and international consultants, it is expected that this business will grow steadily in the domestic market.

*Export of Rolling Stock* : Over the last two years, RITES and Indian Railway Construction Corporation Ltd. have been permitted to export rolling stock on behalf of the Indian Railways. RITES has already exported diesel locomotives, passenger cars including air conditioned coaches, and spares to Vietnam, Bangladesh, Chile and Peru. RITES is able to supply an integrated package consisting of hardware, after sales service, spares, training and even Operations & Maintenance services of rolling stock on the client's railway system. However, the prospects of exports appear to be uncertain in the medium term because of change in the demand pattern from client countries, and competition from China, South Korea, and Romania whose domestic steel costs are relatively lower.

*Operation and Maintenance* : RITES has a strong track record in the business of operation and maintenance of locomotives, wagons and equipment. This business from PSUs, private sector and foreign railways is on a growth path.

In summary, the railway related business is expected to remain a monopoly and its profitability is expected to be sustained over the long term.

## Analysis of Infrastructure Sector Services

*Highways* : The privatisation of highway sector is yet to take off significantly in India and future growth is dependent upon the inflow of funds. Unlike in the railway sector, RITES position in the international market in highways is relatively weak when compared with consultants from the developed countries.

*Ports* : The business in this sector is slated to grow significantly. RITES is involved in major ongoing projects like Ennore, Kandla and Kakinada, and has tied up with international consultants for different projects.

*Urban Transportation* : RITES is handling the Delhi Mass Rapid Transit System and other projects. RITES has a strong market position as it is involved in almost all major on-going projects. It plans to diversify further in the field of urban planning, water supply, sewerage and waste disposal.

*Project Management* : RITES provides project management services to building work, industrial parks, ropeways, amusement parks and airports, inland waterways, energy management and environmental engineering. These sectors are expected to grow with the liberalisation of the economy and entry of private capital in the infrastructure sector.

In summary, the consultancy business for the infrastructure sector is competitive and it is expected to become more so with the entry of foreign capital and international consultants.

### Financial Analysis

The financial performance of RITES for the past five years is given below:

Table 2 Financial Performance

(Rs. Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	91.0	68.0	53.6	49.3	44.8
Operating Profit	23.2	21.2	13.8	10.7	8.3
Profit after Tax	15.7	12.2	8.3	7.5	4.8
Equity Capital	1.0	1.0	1.0	1.0	1.0
Tangible Net Worth	91.8	77.6	66.3	58.7	50.9
Gross Margin (%)	25.5	31.1	25.7	21.8	18.5
Net Margin (%)	17.3	17.9	15.4	15.2	10.8
ROCE (%)	11.2	11.7	8.7	7.5	6.5
RONW (%)	17.1	15.7	12.5	12.8	9.5
Earnings Per Share (Rs.)	157.40	122.0	82.86	75.00	48.36
Dividend (%)	60.0	50.0	45.0	40.0	37.5

The company is financially in a strong position due to consistently high profitability, low funding requirements, large investments and a small equity base. However, the company's profits have been depressed significantly due to the mounting interest liabilities on its over due loans taken for the execution of the Iraq project.

The company took on a construction and operations & maintenance contract for Iraq Railways in FY 89. RITES had borrowed about USD 8.9 millions both in Indian rupees and US dollars to execute this contract on a deferred payment basis. However, due to the UN sanctions against Iraq, the five year contract was foreclosed in FY 90. The company has been accruing interest on deferred receivables and the total amount receivable from Iraq amounted to USD 63.2 millions as at March 31, 1996. Against this income is the interest payable to banks on loans taken for the project. The total assets representing the above transactions in the books of RITES stood at Rs. 101.2 crores while the liabilities on this account was Rs. 114.7 crores in FY 96. These transactions continue to be translated in the books at the exchange rates prevalent on the date of the respective transactions.

Therefore the assets and liabilities shown in the books are lower as compared to the actual value at the current exchange rates.

The extent of liabilities is quite significant and it is likely that a one time provision could wipe out the networth of the company.

### Strengths and Areas of Concern

Based on the above business and financial analysis, the strengths and areas of concern of RITES are as below :

#### Strengths

*Strong linkage with Indian Railways* RITES has a unique advantage as it is among the only consultancy organisations in the world to be associated with an operating railway. As a company wholly owned by the Government under the administrative control of the Railway Board, it has the flexibility of drawing upon the large pool of talent available with the Indian Railways as and when required.

*Expertise in railways consultancy* Two thirds of the company's consultancy services are railway related and the company has developed expertise in this field. RITES has an established track record in advising foreign railway systems especially in the area of operations and maintenance.

*Manpower quality and cost* The company has a large base of experienced and qualified technical manpower which is available at much lower costs when compared with international levels. Thanks to its access to railway personnel at short notice, it is able to maintain a lean and efficient staff structure.

*Importance assigned to development of infrastructure sector* RITES has developed expertise to handle various projects in the areas of highways, ports, airports etc. Significant investments in the coming years are being planned in these sectors and this will have a positive effect on RITES

*Strategic alliances with foreign consultants* RITES has strategic alliances with foreign consultants in the fields of port development, airport projects etc. Collaborations with Haskoning of Netherlands, METOC of UK and Nipping Ku of Japan in the ports sector are in place. An MoU has been

signed with Jurtere Perunding Zaaba, consulting engineers of Malaysia for business and technical co-operation to identify projects suitable for joint ventures. RITES is also part of an international consortium which is bidding for project management of Senai Airport of Malaysia. This will help RITES participate in the infrastructural projects in the country as well as abroad. RITES's international experience -though principally in railway projects- is likely to prove useful in the era of international competitive bidding.

*Track record and extensive work experience* In the domestic business, the organisation has demonstrated capability in implementing projects from concept to commissioning stage both in the railways and other infrastructure sectors. There are few organisations in the government who can compete with RITES in terms of expertise, cost and quality which lends it a competitive advantage especially with government and PSU clients.

## Areas of Concern

*Marketing* The organisation's marketing abilities are relatively weak especially in international markets. The infrastructure available in terms of communication, software tools etc., for effective marketing in foreign countries is limited vis a vis its competitors especially in the international market.

*Dependence on a few large clients* The company is dependent on a few large clients like the Indian Railways, PSUs and state governments for the major part of its business.

*International experience mainly confined to railway projects* The company has limited expertise in the areas of urban transport, port development etc. which are fast growing segments of consultancy business.

*Uncertain timing of the growth in the infrastructure sector* Though the infrastructure sector requirements are extremely high, there could be a long waiting period before this sector actually takes off, considering the huge amount of resources required for it.

*Competition* The business of consultancy services is becoming intensely competitive and there are a large number of domestic and foreign companies in the fray. Cost may not remain a key competitive advantage as foreign consultants move in and recruit local talent and use advanced technological tools.

## Recommendations

While considering disinvestment in the company, the following factors need to be taken into account.

RITES has been able to source its skilled manpower requirements and other consultancy manpower not only from the Railways but also from other Government departments.

Its PSU status has helped RITES secure assignments from Governments - both Central and State - and PSUs. This, however, may not be sustainable in the long run.

RITES has received support from the Indian Railways in its operations in terms of business and manpower as also infrastructure. In a sense, RITES provides the cutting edge to the globalization efforts of Indian Railways in terms of exports of materials and rolling stock as also project expertise.

The equity base of RITES is rather low.

**From the above, it is seen that the balance of advantage is in favour of RITES continuing as a public sector undertaking for some time to come. The uncertainty surrounding the Iraqi dues would also preclude any disinvestment effort till that issue is satisfactorily resolved. There is not likely to be a favourable response from small investors or institutions to a limited offer of shares in the company. The Commission does not, therefore, recommend any disinvestment in RITES.**

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DISINVESTMENT  
COMMISSION

AUGUST  
1997

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# PART A



# 1. GENERAL ISSUES AND RECOMMENDATIONS ON DISINVESTMENT

## Review of Progress in Disinvestment

The Disinvestment Commission submitted its first Report to Government on February 21, 1997. Subsequently, the second and third Reports were submitted in April and May 1997. In these Reports, the Commission has made general recommendations applicable to all PSUs which are intended to promote the long term disinvestment strategy of Government. The Commission has, in addition, evolved detailed guidelines on modalities and procedures of disinvestment. Specific recommendations in regard to 15 PSUs out of the 50 PSUs so far referred to it (Annex A) have been submitted in these three Reports.

According to item 3(IX) of the terms of reference of the Commission (Annex B), it is required to monitor the progress of the disinvestment process. The Commission has taken due note of the progress of the disinvestment process over the past six months. Although there has been no formal communication from Government, based on the information available with the Commission, the action so far taken by Government on the recommendations of the Commission is reflected in the following tables:

Table 1 General Recommendations

Recommendations	Government Action
Establishment of Disinvestment Fund (I 3.1)	Decision awaited
Formation of Standing Empowered Group (I 4.1)	Core Group Empowered
Guidelines on Offer of Sale - Book building for domestic and GDR issues (I 4.2)	Book building for GDR only
Guidelines on selection of Intermediaries (I 4.3)	Decision awaited
Retailing PSU shares to small investors & employees (I 4.4)	Decision awaited
Recommendation on joining NSDL (II 1)	Decision awaited

**Table 2 Corporate Governance: All PSUs**

Recommendations for all PSUs	Government Action
<ul style="list-style-type: none"> <li>• Professionalising the Board by induction of non-executive directors to be chosen by PESB (I.3.4)</li> </ul>	Decision awaited
Provision for Elected Directors (I.3.4) <ul style="list-style-type: none"> <li>• Selection of Top Management (I.3.4)</li> <li>• Salaries and Incentives for Top Management (I.3.4)</li> </ul>	Decision Awaited
<ul style="list-style-type: none"> <li>• Autonomy in Price Fixation (I.3.4)</li> </ul>	Decision awaited
<ul style="list-style-type: none"> <li>• Accountability (I.3.4)</li> </ul>	Decision awaited
<ul style="list-style-type: none"> <li>• Setting up of Pre-Investigation Board (I.3.4)</li> </ul>	Decision awaited
<ul style="list-style-type: none"> <li>• Strengthening the Investor Interface (I.3.4)</li> </ul>	Decision awaited
<u>Moderate Performers</u>	
<ul style="list-style-type: none"> <li>• Powers to dispose of Assets (I.3.4)</li> </ul>	Decision awaited
<ul style="list-style-type: none"> <li>• Freedom of Investment within certain limits (I.3.4)</li> </ul>	Investment Powers of the Board of Directors have been doubled from earlier limits for all PSUs.
<u>Strong Performers</u>	
<ul style="list-style-type: none"> <li>• Powers to form Joint Ventures (I.3.4)</li> </ul>	Decision awaited
<ul style="list-style-type: none"> <li>• Full freedom with regard to Investments (I.3.4)</li> </ul>	

**Table 2A Corporate Governance : For Nine Select PSUs**

Recommendations for Strong Performers	Government Action
<ul style="list-style-type: none"> <li>* Professionalising the Board by induction of non-executive directors to be chosen by PESB (I:3.4)</li> </ul>	<p>At least one third of the BoD to be non executive directors to be chosen by an independent panel comprising Chairman, PESB, Secy, DPE, Secy.-Admin Ministry and some eminent non-officials.</p>
<ul style="list-style-type: none"> <li>* Provision for Elected Directors (I:3.4)</li> <li>* Selection of Top Management (I:3.4)</li> <li>* Salaries and Incentives for Top Management- (I:3.4)</li> </ul>	<p>The nine PSUs have been granted freedom to structure and implement schemes relating to HR management &amp; personnel and required to ensure that employees have a long term stake in the profitability and performance of the corporation</p>
<ul style="list-style-type: none"> <li>* Autonomy in Price Fixation (I:3.4)</li> </ul>	<p>Decision awaited</p>
<ul style="list-style-type: none"> <li>* Accountability (I:3.4)</li> </ul>	<p>High Powered Committees to monitor performance</p>
<ul style="list-style-type: none"> <li>* Setting up of Pre-Investigation Board (I:3.4)</li> </ul>	<p>Decision awaited</p>
<ul style="list-style-type: none"> <li>* Strengthening the Investor Interface (I:3.4)</li> </ul>	<p>Decision awaited</p>
<ul style="list-style-type: none"> <li>* Freedom of Investment (I:3.4)</li> <li>* Powers to dispose of assets (I:3.4)</li> <li>* Powers to form Joint Ventures (I:3.4)</li> </ul>	<p>Full freedom to incur capital expenditure without any monetary ceiling. In addition, the nine PSUs have been allowed to set up financial joint ventures and wholly owned subsidiaries in India or abroad subject to (1) an equity limit of Rs. 200 crores in any one project, (2) 5 percent of the networth of the PSU in any one project and (3) 15 percent of the networth of the PSU in all joint ventures/ subsidiaries together. However, for entering into technology joint ventures and strategic alliances, the PSUs have to adhere to guidelines to be issued by Government from time to time.</p>

**Table 3 Specific Recommendations for 15 PSUs**

<b>Recommendations</b>	<b>Government Action</b>
Strategic Sale in respect of ITI, HTL, KIOCL, BALCO, ITDC, MFIL, BRPL	Decision awaited
GAIL (I.5.2) -25% disinvestment through GDR Autonomy under Strong Performer Criterion Implement TL Sankar Committee Recommendations	24.84% (210 million shares disinvestment through GDR Decision awaited Decision awaited
CONCOR (III.2.1) -10 million shares offer to institutional investors and public and at a later stage the company could go in for fresh issue of 12.5 million shares thereby reducing the Govt's share to 51%	Disinvestment of 6 million shares approved along with fresh issue of 12.5 million shares - Sequencing of issues not indicated
MTNL (III.2.3) - 60 million shares in GDR market and 28.3 million shares in domestic market through book building Financially restructure - by formation of a new company for raising funds for DoT Grant of Autonomy under Strong Performer Criteria	Disinvestment 47 million shares along with fresh issue of 60 million shares in the international markets Decision awaited Decision awaited
Madras Fertilisers Limited (II.2.5) - Review the terms of agreement with the National Iranian Oil Company	Decision awaited
Manganese Ore India Limited (II.2.6) - No immediate disinvestment	No Action needed
Oil India Limited (III.2.4) - Disinvestment after policy decisions on pricing	Decision on APM awaited
Oil and Natural Gas Commission (III.2.5) - Disinvestment after policy decisions on pricing	Decision on APM awaited
RITES (III.2.6) - no disinvestment	No Action needed

In respect of 15 PSUs covered in the first three reports, the Commission has recommended different modalities of disinvestment as follows:

Table 4 Disinvestment Modalities Recommended in Reports I, II & III

Modality of Disinvestment	No.	Name of PSU
Trade Sale	2	ITDC <sup>a</sup> , MFIL
Strategic Sale	5	HTL, ITI, BALCO, BRPL, KIOCL, MFL*
Offer of Shares	3	GAIL, CONCOR, MTNL, MOIL*
No disinvestment	1	BITES
Disinvestment deferred	2	OIL, ONGC
Total	15	

<sup>a</sup> Lease-cum-management contracts for hotels in prime locations like Delhi and Bangalore.

\* At a later date

It is seen that Government has accepted the recommendations of the Commission in respect of GAIL, CONCOR and MTNL where offer of shares has been the suggested modality of disinvestment. In respect of the other PSUs where either trade sale or strategic sale has been recommended, Government has not taken any decision so far. The Commission would like to quote from its First Report:

“Viewed in this scenario, disinvestment has larger implications than just selling equity at the best price in profitable enterprises, as this alone may not provide long term budgetary benefit unless the question of recurring budgetary support to loss making PSUs is also addressed. The essence of a long term disinvestment strategy should therefore be not only to enhance budgetary receipts, but also minimise budgetary support towards loss making units while ensuring their long term viability and sustainable levels of employment in them”.

(I: 2.1)

The Finance Minister, in his Budget Speech in February, 97, also endorsed this view of the Commission. **The decisions announced so far on the Commission's recommendations suggest that Government's present approach seems to be oriented towards getting budgetary receipts by offer of shares in profit-making PSUs and will not solve any of the issues relating to reducing the budgetary dependence of PSUs or achieve the larger objectives of disinvestment. The credibility of the disinvestment process as a whole will suffer and the impression of disinvestment as a short-term budgetary measure intended mainly to raise resources to cover fiscal deficit would be difficult to avoid.**

While strategic sales recommended by the Commission have not been acted upon. Government is reportedly going ahead with strategic sales leading to joint ventures in some PSUs not referred to the Commission. **Transfer of a sizeable proportion of Government shares along with management control to a joint venture partner is no different from disinvestment through the mode of strategic sale as set out by the Commission in its First Report.** In the strategic sales mode as recommended by the Commission, a strategic partner is inducted into the management of the PSU with a transfer of share-holding up to 50% to him. At that time there will be also an agreement with such strategic partner that at a later date within a stipulated period when share values go up, Government will disinvest its balance holding. The Commission has also recommended a transparent and competitive bidding process for the selection of the strategic partner in the PSUs referred to it. **The reported move of converting some PSUs into joint ventures with private capital and management will be no different from the strategic sale recommended by the Commission.** Moreover, the Commission, while recommending disinvestment in any of the PSUs referred to it, considers all the modalities of disinvestment such as offer of share, strategic sale or trade sale, weighs their relative advantages and disadvantages from the standpoint of the company's future performance, receipts to Government through disinvestment, employee interests etc. and then recommends a particular modality to be carried out in a transparent and competitive manner. **By not referring the PSUs to the Commission, duly set up for this very purpose by Government, the benefits of such a detailed consideration by an independent body are being denied to all the interested parties.**

The terms of reference of the Disinvestment Commission state that the Commission will examine PSUs referred to it. The inference of the Commission was that Government would not undertake any disinvestment without reference to the Commission. This was later confirmed by Government. However, it would now appear that Government is taking a different approach in some selected cases. In any event, disinvestment in PSUs not referred to the Commission, while not acting on the recommendations already submitted by the Commission in respect of PSUs referred to it, puts the Commission in an anomalous position. Two parallel and uncoordinated channels of disinvestment are bound to impact adversely the credibility of the disinvestment process. **The Commission, therefore, would urge Government to review the position and decide whether such cases as mentioned above should be kept outside the purview of the Commission.**

Another aspect which the Commission has been stressing in its successive Reports is the need for improving corporate governance in the PSUs and the



granting of greater autonomy to the PSU Boards of Management to enable them to run the undertakings commercially in an increasingly competitive environment. While the Commission is happy to note that Government has come out with a package of measures conferring autonomy to nine selected PSUs, action on the recommendations of the Commission in its earlier Reports on the extension of graded autonomy to all PSUs according to performance criteria is still awaited. **Moreover, even in the case of MTNL and GAIL, two other large PSUs, which are strong performers and where disinvestment is contemplated by Government, no such autonomy has yet been conferred.** The Commission, on the basis of its study of experiences across the world, has underlined the value-enhancing effect of better corporate governance on PSU shares. **The Commission would like to reiterate that undertaking disinvestment without implementing the general recommendations of the Commission, - in particular those relating to corporate governance, managerial autonomy, remuneration, incentives, professionalising the Board of Management and restructuring where necessary - would result in undervaluation of Government shares and cause loss to the national exchequer.**

Furthermore, continued good performance in a competitive environment by PSUs in which Government has made disinvestment, and visible improvement in their corporate governance are crucial for ensuring ongoing support of institutional and retail investors to future disinvestment in PSUs. From this angle too the value-enhancing effect of improved corporate governance has much significance.

Apart from the general recommendations contained in the Commission's Reports, the specific recommendations in respect of particular PSUs have also highlighted certain areas of organisational and general policy measures which would need to be addressed before Government undertakes disinvestment. **The Commission would once again urge Government to address the recommendations of the Commission fully and in a co-ordinated manner so as to establish the credibility of the disinvestment process and maximise the receipts from it.**

With regard to the offer of sale of Government shares in the PSUs, the Commission has already stressed the importance of sales to domestic investors - institutional as well as small shareholders and employees. It is true that in some cases, particularly the larger PSUs, the domestic capital market would not be able to absorb the entire offer of shares and sale of shares in the overseas market will be necessary. **However, one of the important objectives of disinvestment should be the broad-based dispersal of shares, especially in the profit-making PSUs, among Indian investors. The Commission hopes this important recommendation will be duly taken note of by Government.** The Commission has also suggested that disinvestment through the National

Securities Depository Ltd. (NSDL) in the dematerialised form would facilitate easier participation besides offering other benefits to the small investors in the process, especially in regard to high-value PSU shares like those of GAIL, MTNL, VSNL, IOC and CONCOR. This recommendation also requires urgent attention by Government in the interest of broadbasing the ownership of PSUs in the process of disinvestment.

### **Voluntary Retirement Scheme (VRS)**

The studies carried out by the Commission of the PSUs covered in its Reports reveal that several PSUs including the profit-making ones have staffing levels well in excess of the comparable competing units in the domestic and international markets. Given the need to remain competitive in a globalised business environment it is important and necessary that all PSUs continually review their staffing levels and take appropriate measures to balance the size of their workforce. This process will be facilitated if a stable VRS policy providing meaningful financial and other benefits is put in place.

In its Second Report the Commission has recommended that Government announce a stable VRS policy with reference to its terms and conditions and provide adequate funds for its implementation by different PSUs. In actual fact the Commission has come across instances where PSUs who have implemented the VRS Scheme have not been able to secure funding support from Government.

The Commission would like to elaborate further on this subject as the future of several PSUs and the value of shares sold will change for the better if surplus employees are provided acceptable VRS terms. The following steps are recommended :

- 1. The terms of VRS should be finalised as early as possible on a stable and long-term basis. Individual management may be given a range within which they may deviate from the prescribed terms for different age groups, different categories of employees and different industrial sectors.**
- 2. Prompt funding should be assured to all PSUs which implement the VRS scheme. The Disinvestment Fund can be used for this purpose as recommended by the Commission in its First Report.**
- 3. The terms and benefits of the VRS scheme should be clearly brought to the attention of the employees through suitable publicity measures.**

4. **As there is danger of a one-time lumpsum payment being frittered away by the employees or drained out by unscrupulous middle men, a special scheme may be drawn up through commercial banks, UTI or LIC, wherein the VRS benefits are invested on behalf of individual employees to provide long-term benefits and some measure of social security.** To illustrate, the scheme will be able to provide with an investment of about Rs. 2 to 3 lakhs for 10 to 15 years a monthly income of around Rs.2000 together with annual lump-sum payments for meeting expenses on account of family functions etc. to individual employees. Insurance cover may also be provided to the individuals. This could in fact be structured to become an Employees Pension - cum - Insurance Scheme. Banks and other institutions should be persuaded to open special branches, if necessary, at the locations of the undertakings to service the scheme.

In the absence of an effective VRS particularly in loss-making or marginally profit making undertakings, an unfortunate and inevitable consequence will be an increasing sickness of the PSU with a progressively increasing burden on the budget and eventual closure leading to unemployment of the entire workforce in the process. **An effective VRS scheme can ensure long term productive employment for a substantial number of residual employees in a going concern. It will also fetch better prices for shares sold by Government.**

#### Misconceptions regarding Disinvestment

As mentioned in the First Report of the Commission, the Commission held a series of meetings with a wide cross-section of persons interested in the disinvestment process and organised two seminars to highlight the underlying issues in disinvestment. The Commission also brought out a Discussion Paper on Disinvestment Strategy and Issues. After presentation of three Reports by the Commission, and judging by the reactions of the different groups of persons to the Commission's approach and recommendations, it is seen that there is absence of a clear understanding of the rationale for disinvestment in some quarters.

Even though disinvestment has been going on since 1991, this lack of proper public awareness and consensus has, among other things, definitely hindered the progress of disinvestment. **While there is wide-spread dissatisfaction among the public about the poor performance of a large number of PSUs, there is insufficient recognition that disinvestment could be the corrective action to tackle this problem.** Studies of the experience of disinvestment in the different countries across the globe clearly show that in almost all the countries, the impetus to disinvestment came from the

general perception among large sections of the people that the performance of the public sector, by and large, lacked commercial and market orientation and that there existed need for better utilisation, of and returns from, the public resources invested in the PSUs. In India too, therefore, there has to be a conscious effort towards building up such a consensus among the different sections of the people before disinvestment can really take off with any seriousness of purpose. As has been repeatedly mentioned by the Commission, disinvestment, as a long-term strategy, does not mean mere sale of some proportion of Government shares in blue-chip PSUs but involves concerted action to introduce elements of commercial orientation and market responsiveness into the management of the PSUs to enhance enterprise value. This lack of understanding is not confined to just PSU personnel but it is equally prevalent among some PSU executives, some ministries of Government and the general public. The Commission has stressed that its approach to disinvestment is not ideological but driven by the imperative need for better utilisation of public resources for the good of the economy. **There is therefore a clear need for building awareness and consensus among the general public for the successful pursuit of disinvestment as a long-term strategy for improving public sector performance.**

Common among the *misconceptions* about disinvestment are the following:

**Misconception-1 :** **Disinvestment is a short-term budget balancing measure by disposing of valuable public assets carefully built over the years without demonstrating explicitly the use of the proceeds for priority investment for long-term benefits to the economy.**

The Commission has stressed that it is for Government to dispel this notion by implementing the Commission's recommendations as a package and not confining action just to the sale of a part of equity in profit-making PSUs. The Commission has detailed the procedure to be followed in respect of sale of shares through the book building process. **A transparent and open disinvestment procedure will maximise the realisation by Government on account of sale of PSU shares and in turn will dispel any misgivings the public may have in this regard. The Commission's recommendation for the creation of a Disinvestment Fund is also meant to build the credibility of the disinvestment process and ward off criticism on this account.**

**Misconception-2 : Disinvestment is seen by organised labour and the Trade Unions as a threat to job security.**

The Commission, in its various Reports, has again stressed that mere transfer of ownership from Government to the private sector does not in any way imply closure or total retrenchment. Right-sizing the work-force may be required to improve the viability of a concern in an increasingly competitive environment and this will be inevitable in the long run whether an undertaking continues to be managed and /or owned by Government or not. There is lack of proper appreciation of the fact that over-staffing in an enterprise adversely impacts its commercial viability and makes continuing employment in it unsustainable. In such cases, there arises a crucial choice between providing employment to a somewhat smaller number on a sustainable basis and maintaining a larger workforce in a loss-making enterprise with an eventual prospect of closure and hence permanent loss of all the jobs. Right-sizing of such enterprises, therefore, turns out to be in the longer term interest of employees as a whole. This inevitably means loss of jobs for surplus employees who apart from getting VRS benefits would need to be retrained to take up alternative jobs or self-employment or in other activities. During the period of training as well as afterwards, lump-sum VRS benefits can provide immediate financial support as well as a continuing stream of income by properly investing the lump-sum amount provided. Where right-sizing of the work-force is inevitable in the interest of competitiveness and viability, the Commission has in the earlier part of this Report recommended the formulation of an attractive VRS which also provides long-term pensionary and insurance benefits to the workforce. Ministry of Labour is operating a scheme for retraining and redeployment of employees affected by the closure of units. This Scheme needs to be properly revamped to cover the employees who accept voluntary retirement. Till the establishment of the Disinvestment Fund suggested by the Commission, adequate budgetary provision should be made separately to cover the retraining cost of all surplus employees who opt for VRS. There is need for a conscious effort on the part of all concerned to inspire confidence among labour in this regard.

**Misconception-3 : Disinvestment is perceived as a prelude to the withdrawal of State intervention from critical areas of the economy. .**

As already stated, the Commission's approach to disinvestment is not ideological. Disinvestment in specific PSUs is recommended solely on grounds of the relevance or otherwise of public sector presence in that

**sector. Even in the case of currently profit-making PSUs, the decision to disinvest will be based on whether any public purpose is served by continued Government ownership and control in a PSU given the nature of the market in which it is operating. The establishment of the Disinvestment Fund in fact would enable the resources generated by disinvestment to strengthen public sector presence in sectors where it is still perceived as necessary in public interest. Public investment would thus get reallocated from sectors where public purpose is no longer served by such investment to other sectors where there is greater need for it. Disinvestment is not aimed at curtailing state activity for economic growth in important areas but towards channelising it to areas of greater priority and towards ensuring better and more effective utilisation of public resources for the good of the economy and maximisation of the welfare of the people.**

# PART B





## 2. SPECIFIC RECOMMENDATIONS

### 2.1 Hindustan Copper Limited

#### Evolution

Hindustan Copper Limited (HCL) was set up in 1967 to manufacture primary copper products. The company was formed by taking over all copper ores mines located at Khetri and Kolihan in Rajasthan and Rakha Copper Complex in Bihar from the National Mineral Development Corporation. In 1972, Government nationalised the private sector Indian Copper Corporation Limited in Bihar and merged it with HCL. In 1982, the company expanded its operation to Madhya Pradesh by developing the Malanjkhanda copper mine which is the largest open pit mine in India. Further in 1990 as a part of a forward integration move, HCL commissioned a 60,000 tonnes per annum (tpa) continuous cast wire rod plant at Taloja in Maharashtra.

In FY 94, Government of India (GoI) disinvested about 1% of the total equity of Rs. 338.20 crores in favour of financial institutions. The shares are listed on the BSE but are infrequently traded.

#### Industry Analysis

In terms of application, copper is considered as the third most important metal after iron and aluminium. It has high electrical and thermal conductivity, high strength, ductility and corrosion resistant properties.

India has around 205 known deposits of copper with an estimated geological reserves of approximately 588 million tonnes. Nearly 90% of these reserves are located in Rajasthan, Bihar and Madhya Pradesh. However, the quality of copper reserves is relatively poor with only about 1.2% to 1.3% of copper content as against about 2.3% worldwide. Similarly, the quantity of other precious metals such as gold and silver extracted along with copper is low in India when compared with other countries. Thus, the cost of copper mining is high in India.

Prior to liberalisation, imports of copper were restricted and the domestic copper price was administered. During this period, the domestic prices were higher than the landed cost and HCL was the only integrated producer in the country. In March 1992, canalised imports of copper and the system of administered pricing were removed and copper imports were liberalised. Subsequently, domestic prices were directly linked to the prices of copper on the London Metal Exchange (LME).

As part of liberalisation, the customs duty on copper and copper products has been progressively reduced as shown in the table below :

**Table 1 Customs duty on copper**

Products	FY 97	FY 93
Cathodes	30%	65%
Wire Rods & Bars	30%	65%
Copper Concentrates	10%	60%
Copper Scrap	30%	65%

In the budget for 1997-98, there is no change in the customs duty on copper products except in concentrates where duty has been reduced from 10% to 5%. This reduction will help new smelter projects which can import concentrates and convert them into semi/finished products. Due to the decreasing levels of duty differential between copper concentrates and cathodes, manufacture of domestic wire rod / bars on the basis of imported cathodes is unviable.

### Demand

The demand for copper is dependent on the level of economic activities. The total demand grew at a cumulative annual growth rate (CAGR) of 9.2% from 2.1 lakh tonnes in FY 91 to 3.2 lakh tonnes in FY 96. Demand for cathodes grew at a CAGR of 7.9% from 1.6 lakh tonnes in FY 91 to 2.4 lakh tonnes in FY 96.

The demand for copper can be either for cathodes or for scrap. Cathodes are used for high conductor application, while scrap is used for handicrafts and manufacture of utensils. The following table gives the details of consumption in these two segments.

**Table 2 Consumption Pattern**

Year	Total Demand (tonnes)	% demand of refined copper to total demand	% demand of scrap to total demand
1990-91	207170	77.7%	22.3%
1991-92	187890	70.6%	29.4%
1992-93	195710	77.4%	22.6%
1993-94	239400	72.8%	27.2%
1994-95	287330	69.5%	30.5%
1995-96	321000	73.2%	26.8%

Sectorwise usage of copper for FY 95 and the estimated usage in these sectors by FY 2000 and FY 2005 based on the projections made by Indian Copper Development Centre (ICDC) are given below :

**Table 3 Estimated Demand (Tonnes)**

End User Sector	1999-00 (E)	2004-05 (E)
Defence and mint	11200	13500
General engineering	19670	26300
Process industries	22120	29600
Consumer durables	27890	44950
Building and construction	32850	43200
Transport	33640	48400
Handicrafts	57600	92800
Electronics & Telecommunication	81900	116300
Electrical sector	136000	186350
<b>TOTAL</b>	<b>422870</b>	<b>601400</b>

On the supply side, HCL has been the only domestic supplier till date and the balance demand was met out of imports. However, significant capacities are expected to be commissioned in the private sector in the medium term. The supply scenario over the next five years with the new capacities coming upstream are given in the following table.

**Table 4 Supply Scenario**

Quantity in Tonnes	1995-96 (Actual)	1999-2000 (Forecast)	2000-01 (Forecast)
<i>Supply</i>			
<b>Existing</b>			
HCL	41,000	45,000	45,000
<b>Proposed</b>			
HCL (Expansion)		51,750	62,100
Sterlite Industries		85,000	85,000
Indo Gulf		75,000	85,000
SWIL		17,500*	22,500
<b>Total Supply</b>	<b>41,000</b>	<b>274,250</b>	<b>299,600</b>
<b>SURPLUS/(DEFICIT)</b>	<b>(194,100)</b>	<b>(21,750)</b>	<b>(13,865)</b>

\* After considering an export commitment of 20,000 tonnes

As has been mentioned earlier, copper prices in India are linked to international prices on the LME. The LME prices are highly volatile and do not reflect any predictable trend as the pricing is determined on a number of factors like the demand supply gap, inventory build up, etc. The movement of LME copper prices (annual monthly average) for the last past one decade is given below:

**Table 5 LME Prices ( USD/tonne)**

Year	LME Price
FY 87	1373
FY 88	2045
FY 89	2788
FY 90	2652
FY 91	2673
FY 92	2276
FY 93	2291
FY 94	1827
FY 95	2576
FY 96	2844
FY 97	2257

As can be seen from the above table, LME prices of copper decreased and touched a low of USD 1827 per tonne in FY 94 on account of the recession in developed countries and the increased Russian supplies. However, subsequently the prices firmed up to cross an all time high of USD 3076 in July 1995.

Worldwide, the production for FY 96 was slightly higher at 12.27 million tonnes against a consumption of 12.10 million tonnes. Chile is the largest copper producing nation with an annual production of 2.5 million tonnes.

It is expected that the world production would grow at a faster pace when compared to consumption resulting in an inventory pile-up. This is likely to have an adverse impact on pricing and copper prices over the medium term are forecast to move in a price band of around USD 2100 to 2200 per tonne.

### Business Analysis

HCL is the only integrated copper producer in India. At present the company has the following facilities;

**Table 6 HCL Facilities**

Khetri Copper Complex (KCC) - Rajasthan	Under ground mine, concentrator plant, smelter and machining refining capacity of 31000 tpa
India Copper Complex (ICC) - Bihar	Under ground mine concentrator plant, smelter and machining refining capacity of 16500 tpa, and a by-product recovery plant.
Malanjkhand Copper Project, Madhya Pradesh	Open pit mine Concentrator and Leach Copper Plant.
Taloja Copper Project, Maharashtra	Continuous cast wire rod plant with 60000 tpa of wire rod

HCL has 9 underground mines and one open cast mine. The details of mines under HCL and their ore reserves are given in the table below :

**Table 7 HCL's Mines And Ore Reserves**

	No. Of Mines	Million tonnes
KCC	4	71.78
ICC	5	60.76
MCP	1	67.65
TOTAL	10	200.19

HCL operates these mines on leases from the State Governments. Recently the Supreme Court passed an interim order asking the State Governments to ensure that all mining operations either on or under forest land and reserve forest areas be closed down. These orders affected the operations at KCC mines but were restarted within a short period on receipt of interim permission from Central Government. In future it is unlikely that the mines would be completely shut down due to environmental reasons.

The cost of mining from the various mines of HCL vis-à-vis the imported cost of concentrates is shown in the table below:

**Table 8 Cost of Concentrates (Rs./Tonnes)**

Source of Concentrate	Cost of Metal*
Indian Copper Complex	125,648
Khetri Copper Complex	70,080
Malanjkhand Copper Project	67,924
Imported	72,000

\* Excluding the value of Gold, Silver etc.

From the above table it is apparent that it would be profitable for HCL to stop sourcing ores from ICC mines and instead import the requirements of concentrates after utilising the KCC and MCP production. The company has already made a start by applying for closing down the unviable mines at Dariba in Rajasthan and Mosabeni in Bihar. If all the unviable mining operations were to be closed down in a phased manner, it is estimated that the cost of right-sizing the workforce would be about Rs. 100 crores currently.

All mining companies in the copper rich countries get about 25-40% of the total revenue from sale of by products such as Gold, Silver, etc. In the case of HCL, the contents of by-products are low and hence the return from these by-products sale is only 4-5% of the total revenue.

HCL has a total smelting capacity of 47,500 tpa. These smelting plants lack economies of scale as they are relatively small in size when compared with international plants. This acts as a disadvantage and the fixed cost proportion in the overall cost structure is high. The technology used in these smelter plants is also old and inefficient when compared with the latest technology. Presently the recovery of copper from the ore stage to the cathodes stage is low at 81%.

HCL's Taloja plant has a capacity to produce 60,000 tonnes of wire rods annually. HCL's own production of cathodes is presently insufficient to meet the entire production requirements of this unit. The balance requirement of cathodes is imported predominantly from Chile.

The production of various products at HCL for the past three years is as under :

Table 9 Production Of Copper / By Products

	1995-96	1994-95	1993-94	1992-93
Cathodes (tonnes)*	41153	46134	39002	45275
Wire Bar (tonnes)	24161	21351	21239	25264
Wire Rod (tonnes)	37143	29869	18181	19631
Gold (Kg)	375	480	437	291
Silver (Kg)	4146	5585	5580	3185
SSP (tonnes)	43484	24848	15296	47303
Sulphuric Acid (tonnes)	83749	92455	59471	51946

\* Includes cathodes consumed for producing Wire Bars and CC Wire Rods

HCL fixes the prices of copper products on a monthly basis which is based on the average of previous month's copper prices. Currently, HCL is exposed to the volatility in LME prices as only finished products are linked to LME. However, after the expansion of Khetri plant, the company will be insulated from the price volatility to the extent of imported raw materials.

HCL has a total manpower strength of 19,884 as on March 31, 1997. Over the past ten years there has been a manpower reduction of about 6,000 through the VRS. The expenses on this account have been funded through the National Renewal Fund. Further, the company proposes to reduce its employee strength by about 2,500 over the next five years.

## Financial Analysis

The financial performance of HCL for the past five years is indicated in the table below:

Table 10 Financial Performance

(Rs Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	969.8	823.3	610.0	598.4	625.8
Operating Profit	105.5	141.8	-15.5	78.9	147.3
Profit after Tax	75.8	72.3	-69.6	26.4	54.9
Equity Capital	338.2	330.2	305.2	304.2	304.2
Tangible Networth	495.3	416.0	313.5	393.3	365.9
Gross Margin (%)	10.9	17.2	-2.5	13.2	23.5
Net Margin (%)	7.8	8.8	-11.4	4.4	8.8
ROCE (%)	13.6	16.3	-5.1	10.3	16.1
RONW(%)	15.3	17.4	-22.2	6.7	15.0
Earnings per Share (Rs )	2.24	2.19	-2.28	0.87	1.80
Dividend (%)	1.50	0	0	0	0

Despite increased sales, the sales realisation declined in FY 94 as the LME price of copper fell to USD 1827 per tonne from USD 2291 per tonne in FY 93. In addition, the material cost has risen substantially due to increased imports of cathodes. HCL's gross and net margins have been fluctuating over the past five years depending on the changes in the LME price of copper and the changes in the customs duty.

The lowering of import duties has led to the linking of HCL's realisations with the prices of copper on the LME. As a result of the volatility of international copper prices, the company's bottom line has fluctuated considerably. HCL reported losses of about Rs. 70 crores in FY 94 and net profits of more than Rs. 72 crores in the next two financial years. In FY 97, the company has reported losses again, which is estimated to be about Rs. 130 crores. In spite of accruals to reserves, these losses have eroded the networth of the company and as at March 31, 1997 the networth was substantially represented only by the equity capital of about Rs. 338 crores. During 1997-98, the company expects to post losses once again, though at much lower levels than the previous year at the current LME copper prices. If the LME copper prices were to decline substantially, the losses would be much higher.

HCL's long term loans amounting to about Rs. 175 crores were from Government. The company has not serviced these loans and the total interest accrued and due amounted to Rs.141 crores. The total amount outstanding towards Government on account of principal and interest amounted to Rs.316

crores as on March 31, 1997. HCL has not been in a position to service these loans due to the fluctuating level of profits over the past five years.

## Strengths & Areas Of Concern

### Strengths

*Only integrated producer* HCL is the only integrated copper producer in the country. The private sector producers are still in the process of setting up their plants and it will be some time before their plants are commissioned.

*Market share* Currently HCL is the market leader and with its proposed expansion can maintain its market share in the near future.

*Demand prospects bright* The demand projections show a deficit in the medium term. This shortage will enable HCL to implement its proposed expansion.

### Areas Of Concern

*High cost of mining due to low percentage of copper.* The percentage of copper content in the ore in India is relatively low when compared with ore in other parts of the world. This results in higher cost of mining.

*Environmental issue* The recent Supreme Court decision on the mining will affect the performance of all mining companies. Even though HCL has received permission from the Central Government, it is not known whether permission will be forthcoming in the future.

*Lack of economies of sale in smelting operation* The smelting plants of HCL are small when compared with other smelting plant world over. Due to this, the fixed costs in smelting are high.

*Poor recovery and low throughput* The recovery of copper from the ore stage to the cathode stage is relatively low at 81% due to technological factors.

*High employee cost* The employee cost in the mining operations of HCL is high. Further, the company is saddled with an excessive workforce at the ICC plant due to historical reasons. However, it should be mentioned that the company has initiated a VRS programme which has resulted in a reduction of about 6,000 workers over the past five years.

### HCL's Expansion Programme

As already noted, HCL's realisations are linked to the prices of copper on the LME. Fluctuations in LME prices have cast their shadows on HCL's bottomline over the last five years. After posting losses of about Rs.130 crores in FY 97, HCL faces the prospect of losses though lower again in FY 98.

HCL's road to recovery as a profitable company now hinges on the implementation of the proposed expansion plan at the Khetri complex in Rajasthan. The company is planning to expand its smelter and refining capacity



at KCC from the present level of 31,000 tpa to 1,00,000 tpa by using imported concentrates. This will increase the total production capacity of concentrates from 47,500 tpa to 1,16,500 tpa and will result in significant reduction of cost of production of cathodes. The planned expansion is through a brownfield route by modifying the existing furnace thereby increasing the throughput. However, capacity expansion for concentrator dryer, converter, anode furnace and refinery will have to be undertaken for meeting the increased throughput from the smelter. Due to this brownfield expansion, the capital costs are expected to be significantly lower than it would be for a similar sized greenfield project. The project could commence from August 1997 if Government's approvals are obtained. This expansion is currently estimated at about Rs. 530 crores but with approvals still awaited, it is likely that the project cost could increase to about Rs. 600 crores.

The implementation of this project is expected to be beneficial to the company on account of the fact that it is based on imported copper concentrates. Thus, the low cost of production and the prevailing tariff differential between finished copper and copper concentrates would increase profitability and also partly insulate HCL from the wide fluctuations in the LME prices. This, in turn, would reduce the volatility in the company's profits. The timely implementation is equally important as the company is expected to face competition from the private sector in the future.

### Funding Options

The requirements of funds for HCL are two-fold. Firstly, as enumerated above, the company requires funds of about Rs. 600 crores for the expansion at Khetri. Secondly, the closing down of unviable mining operations of the company will require about Rs. 100 crores. Thus the total funding requirements are in the region of Rs. 700 crores.

For this purpose, the company will have to either raise the funds from the capital market on its own or has to depend on its principal shareholder i.e. Government. The company's weak balance sheet as at March 31, 1997 and the depressed nature of the primary markets may preclude the options of tapping the capital markets for these funds.

As the majority share holder, it may be worthwhile for Government to examine various options available for the implementation of the expansion and for restructuring the internal operations. This will involve either budgetary support or disinvestment of a majority stake to a strategic partner to enable the company

to raise funds. These options have to be evaluated in terms of immediate outflows and inflows occurring over a period of time to Government. Figures mentioned in the table below are only indicative and are taken for the purpose of weighing various options. The implications of the above scenarios are elaborated further below:

Table 11 Government Options on HCL

	Scenario	Immediate Government net outflow	Government Inflows	Remarks
1	No action taken by Government due to paucity of funds	Nil	Nil	Company likely to turn sick
2	Restructure ICC fully & implement project through budgetary support and disinvest fully at a later stage	Rs. 700* crores	Rs. 340 crores at 51% disinvestment	Project costs could increase due to financing delays. Further disinvestment would bring in additional revenue
3	Implement project through budgetary support and disinvest fully at a later stage (no restructuring)	Rs. 600* crores	Not Ascertainable	Project costs could increase due to financing delays. Drag on profitability due to large work force will bring down share value.
4	Disinvest upto 51% immediately without restructuring or implementing the project	Nil	Significantly low when compared to option 2	Buyers unlikely to be interested
5	Restructure ICC and disinvest upto 51% immediately to a Strategic partner and disinvest the balance after Implementation	Rs. 100 crores	Rs. 340 crores at 51% disinvestment	Likely to improve the share valuation. Further disinvestment would bring in additional revenue

\* The actual outflow to Government would be Rs. 200 crores in the form of equity/loan support. In addition, there would be a contingent liability in the form of guarantee to the extent of Rs. 400 crores to enable the company to raise the debt for the expansion. Besides, about Rs. 100 crores would be required in the form of a grant for closing down of all unviable mining operations.

#### Scenario 1

If due to budgetary compulsions, funds are not forthcoming from Government or are available only partly, the expansion plans will be jeopardised and the advantages accruing from the implementation of the project will not be available to the company. The company's competitive position could be eroded further, and it is most likely that it could lose more money in the medium term. The uncertainties facing the company would increase and it is likely that HCL could turn sick within one or two years. While there would be no outflow in the short term, any inflows on account of loan servicing, dividends or disinvestment proceeds may have to be ruled out. If disinvestment is not undertaken immediately and no action is taken by Government, it is likely that the company

would require an increasing level of budgetary support to meet potential future losses.

#### Scenario 2

The second option involves the closing down of the unviable mining operations which is estimated to cost about Rs. 100 crores and implementing the Rs. 600 crores project on the basis of Government support. Thus, the total commitment would be about Rs. 700 crores. However it may be noted that any delay in project financing could lead to a further escalation of costs. At present HCL is not seeking budgetary support for the project implementation. This level of support has to be weighed against the likely inflows to Government on account of disinvestment proceeds. It is estimated that disinvestment of shares upto 51% after the project implementation and the restructuring will fetch about Rs. 340 crores due to enhanced share value. Further disinvestment beyond 51% will add to the initial disinvestment proceeds.

#### Scenario 3

As explained earlier, it is doubtful whether the company can raise funds from the markets for project implementation. If Government is intent on turning the company around without any disinvestment at this stage, then immediate Government support to the extent of Rs. 600 crores will be required to implement the proposed expansion. However without restructuring, HCL will continue to have excess manpower and fixed costs will continue to be high. Thus, the break-even LME price for HCL will be much higher than USD 2350 per tonne. Given the bearish outlook on LME prices of copper over the medium term, it is likely that implementing the project alone may not yield desired results as the company's future profitability will be determined by the extent to which cost reduction can be implemented. While there would be outflows to the extent of Rs. 600 crores in the short term, corresponding inflows over a period of time cannot be accurately assessed at this stage. However, on an overall basis, it is expected that there would be net outflows from Government.

#### Scenario 4

In the fourth option, Government could disinvest a majority stake of 51% without closing down the unviable mining operations or implementing the project at Khetri. On the basis of the current financial strength and the likely future cash flows, the value realisable by Government will be significantly low. However it has to be noted that if sale is attempted on an as-is-where-is basis without restructuring, the sales realisation could be much lower on account of possible discounts which could be attached by the buyer.

#### Scenario 5

In the last option, Government could close down the unviable mining operations in Bihar and disinvest 51% immediately to a strategic partner on the basis of an internationally competitive bidding process. This level of disinvestment will fetch about Rs. 340 crores. After meeting the expenditure towards the closing down of the unviable mining operations in Bihar of Rs. 100 crores, it would still result in a net inflow of Rs. 240 crores. If further proceeds from disinvestment are added, the above figure would be higher.

#### Recommendation

While HCL continues to be the only integrated copper producer in the country, significant capacities based on imported concentrates are expected to be added in the medium term in the private sector. In addition, import duties on copper products have been lowered and copper imports decanalised since 1992. Thus, the markets are expected to become fully contestable. Therefore the Commission reiterates HCL's classification as non-core as recommended in its First Report.

In addition, the Commission is of the view that there is an urgent need to cut operational costs in HCL. The company is already in the process of closing down some of its unviable mines. The Commission suggests that this matter should be expedited and the company should take the earliest possible decision in this regard. This will reduce the fixed costs and in turn lower the break-even level of LME copper prices for the company. However, the smelting operations at ICC in Bihar which employs about 1000 people could continue its operation on the basis of either imported concentrates or sourcing additional concentrate from the Malanjkhand mines.

In order to enable the mines closure, it is proposed that the company formulate an imaginative VRS on the lines suggested in Part A of this Report. The Commission estimates the overall cost of this closure to be around Rs. 240 crores. However, if the closure is done in a phased manner, the immediate costs of closure of a few mines is estimated to be in the region of Rs. 100 crores. The funds required for this purpose could be temporarily funded from the proposed Disinvestment Fund as recommended by the Commission in its First Report.

In the past, HCL's long term borrowings have been mostly funded by Government by way of budgetary support. In spite of concessional rates, HCL has deferred payment of interest although it has been making a provision in its books. As at March 31, 1997 the loans amounted to about Rs. 175 crores while the interest arrears were about Rs. 141 crores. The company has submitted a financial restructuring proposal to Government.

It is therefore, clear that it is extremely vital for the medium term viability of the company that the expansion project at Khetri should be taken up and completed immediately. The company has been making efforts to raise the resources required from the market. However, the rather dismal financial performance during FY 97 would make raising funds from the market rather difficult. Since the company cannot afford any delay in the implementation of the project, the other alternative would be for the company to look to Government for these resources and raise a part of it also from the market backed by Government guarantee. As of now, this contingency has not been dealt with by the company. From the above analysis, it emerges that the options before Government are:

1. HCL may implement the Khetri smelter expansion and Malanjkhand mine expansion projects as also restructure the ICC mining operations by closing down unviable mines along with VRS to the affected employees. After the completion of these projects, which may take about two years, Government may select a strategic partner for the company through an open and competitive bidding process after suitable pre-qualification of bidders offering him 51% of the equity of the company, Government may also disinvest 23% of the equity through an offer of shares in the domestic market to institutions, small investors and employees. Government may retain 26% equity in the company, keeping in view the importance of the copper mining operations in Malanjkhand and some of the ICC mines. The implications of this option however are that in view of the poor financial performance of HCL in the last two years, Government may have to contribute to the extent of nearly Rs. 200 crores as additional equity/loan besides extending guarantee to the company's market borrowings to the extent of Rs.400 crores for implementing the khetri and Malanjkhand projects.
2. The other option for Government would be to select a strategic partner straightaway and offer him 51% of the equity. The restructuring of the mining operations in the ICC may however be finalised, including the VRS to the affected employees, before such partnership, as this would facilitate better response from prospective partners besides enhancing the value of Government shareholding. After the completion of the expansion projects, Government may disinvest further 23% of the equity in the domestic market to institutions, small investors and employees Government may retain 26% equity in the company for the reasons already mentioned above. In this option, the budgetary demands

on Government are totally eliminated, except support to the VRS as applicable to all PSUs.

The Commission recommends that Government should consider these options and take a decision with the least possible delay. The future of the company is dependent vitally on the immediate implementation of the expansion project and any delay will lead to the company turning sick over the next two years, especially in view of the current depressed copper prices in the LME.

In order to conduct the strategic sale, the Commission recommends that the Standing Empowered Group appoint Financial Advisers/Consultants in order to value the company for fixing a reserve price. The procedure for appointing Financial Advisers for strategic sales and conducting the sale has been outlined in Part B of the First Report of the Commission (pp 38-40). The Financial Advisor may also consider the financial restructuring package submitted by the company and suggest alternatives.

## 2.2 Pawan Hans Helicopters Limited

### Evolution

Pawan Hans Helicopters Limited (PHL) was incorporated in 1985 for providing helicopter services primarily to meet the requirements of Oil & Natural Gas Commission Ltd. (ONGC). In India, the primary requirement of helicopter service for commercial purposes came from the oil sector. Before PHL was set up, ONGC's requirements were met by foreign companies which resulted in large outflows of foreign exchange.

PHL was set up as a joint venture, Government and ONGC contributing 51% and 49% of the total capital respectively. However, due to conversion of unsecured loans in FY 94 and further infusion of equity by Government, its holding went up to 78.5%. The shares of PHL are not listed on any stock exchanges.

### Industry Analysis

Commercial helicopter service is relatively unique as this is normally used where other modes of transport are not economically viable or the nature of service is urgent. Globally, helicopters are used commercially for emergency medical services, fire fighting, corporate charters, tour operations, information gathering, traffic watch, agriculture, construction, oil & gas pipeline industries etc.

In India, helicopters are primarily used for oil exploration and agrospraying unlike the wide usage of helicopters globally. The oil sector is the biggest user in India accounting for more than 80% of the total demand as shown in the table below:

Table 1 Usage pattern (%)

Service	Share in Global demand	Share in Indian demand
Charters	25	7
Public Services/Safety/fire fighting	15	0
Emergency Medical Service	9	0
Oil & Gas support	8	80
Agriculture	6	8
Others	37	5
Total	100	100

In the Indian market currently 79 helicopters are operational. Depending upon their seating capacity, these helicopters can be classified as light and ultra light (2-7 seats) medium (10-15 seater) and heavy category ( greater than 24 seats). Out of the total helicopters in operation, 65% are in the light and ultra light category while 33% are in the medium category with only 2% in the heavy category. The charter operators own 44 helicopters while the balance 35 are owned by Corporates and State Governments.

The demand from the private sector exploration companies is difficult to estimate at this point of time because private investment in this sector is still in the nascent stage. Similarly, the demand for helicopters in the tourism sector has not yet built up as the sector needs market development. In the corporate charter segment, the helicopters are owned by the corporates themselves. However, there are some sectors like the Mumbai region, Calcutta-Haldia region where there is potential for such services. Overall, it is expected that around 15-20 helicopters will be added in the light category in the next five years to cater to these sectors.

Apart from PHL, the other major company in India is Mesco Airlines which operates 8 helicopters. It is also understood that Mesco Airlines and another private company, Sahara Airlines are planning to expand the fleet strength over the next 5 years.

The key success factors in this industry are the availability of skilled manpower for flying and maintenance, infrastructure facilities for maintenance and high standards in service quality. There are no major entry barriers in the industry. The capital costs of the smaller helicopters are not high. But full utilisation or availability of long term charters are crucial for profitable operations. Helicopter import which was on the restricted list till FY 91 was subsequently moved to special import licences and has been put under OGL from FY 95.

The pricing in the industry operates on two structures viz. long term contracts, through fixed monthly rentals and hourly revenue. The fixed rental covers the fixed expenditure, while the hourly revenue covers variable costs. Secondly in the case of corporates and tourists charters, single hourly tariff is charged which is expected to cover both fixed and variable costs.

#### **Business Analysis**

PHL derives about 85% of its operating revenue from the services provided to ONGC. Apart from this, PHL also provides services to State Governments,



PSUs, Customs Department, and also operates on charters for corporates and tourists. The company a fleet of 27 helicopters as below: °

Table 2 Details of fleet and their current deployment

Helicopter	Type	No. of Helicopters	Deployment
Dauphin	Medium (11-14 seater)	20	11 with ONGC 1 each with Punjab state, Arunachal state, Lakshadweep, Min. of Home Affairs & Vaalco Energy 4 maintenance reserve
Bell	Light (4-5 seater)	3	2 with customs deptt. 1 tourist charter
Robinson	Light (4-5 seater)	2	1 with Oil India 1 with ONGC
M1 172	Heavy (24+ seater)	2	Both idle at present
Total		27	

Apart from its own fleet, PHL operates and maintains 5 helicopters belonging to State Governments, Gas Authority of India Limited, Border Security Force and Punj Llyod. PHL has set up maintenance facilities at Delhi and Mumbai for servicing its own fleet as well as other helicopters.

The details of PHL's operations for ONGC are given below:

Table 3 Total Flying hours of PHL and ONGC's share

Year	Total Flying Hours	ONGC's Share
FY 92	18,012	88.7%
FY 93	16,998	90.9%
FY 94	18,812	86.4%
FY 95	19,242	85.4%
FY 96	19,213	85.5%

Since inception, PHL has been getting the ONGC business on a captive basis. Even ONGC's requirements of heavy helicopters were catered to by PHL through contracting from private operators. In FY 97, there was a change in ONGC's chartering policy. The company invited global tenders for deployment of heavy duty helicopters (M1 172) instead of routing it through PHL. PHL on the other hand, had purchased these machines for meeting ONGC's requirements. The bid was won by Mesco Airlines which resulted in PHL's machines lying idle. The company is presently looking for alternative

deployment of these helicopters. Similarly, in the medium range, the PHL fleet is deployed with ONGC but the situation may undergo a change if the latter were to float a global tender for this category also.

Between FY 87 and FY 89, PHL acquired 21 Westland helicopters from the UK which developed a series of operational defects over a period of time. Following this, the entire fleet was grounded. They were re-introduced in FY 91 after modifications. However at this point of time, it was found that the operating costs of these helicopters had gone up significantly. Moreover it was also felt that the operations of the Westland fleet were still unsafe. Efforts made to sell these machines have not been fruitful so far. Though the funds for the purchase of these helicopters were received by Government as a grant from the Overseas Development Authority (ODA), Government on lent this amount to PHL in the form of a loan. As on March 31, 1996, PHL has a loan outstanding to Government to the extent of Rs.130.9 crores towards this purchase and an interest liability of Rs.220 crores. Based on this, PHL has claimed tax deduction on this interest liability. In case the company gets a waiver of both interest and principal, there will be a tax liability of Rs.124 crores.

## Financial Analysis

The financial performance of PHL over the past five years is indicated in the table below:

Table 4 Financial Performance

(Rs. crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	111.8	97.6	93.1	88.9	73.1
Operating Profit	7.6	18.4	19.1	18.8	15.6
Non-Operating Income	44.9	36.6	38.3	32.4	22.5
Profit after Tax	47.8	40.7	32.3	26.0	12.1
Equity Capital	113.8	113.8	113.8	50.0	50.0
Tangible Networth	237.0	207.6	175.6	124.9	137.0
Gross Margin (%)	6.8	18.8	20.5	21.1	21.4
Net Margin (%)	42.8	41.7	34.7	29.2	16.6
ROCE (%)	1.2	2.0	-	-	-
RONW (%)	20.2	19.6	18.4	20.8	8.8
Earnings per share (Rs.)	4.20	3.58	2.84	5.20	2.42
Dividend (%)	7	7	6	5	-

PHL follows the globally accepted accounting practice of creating a maintenance reserve from the profit and loss account every year. The repair and maintenance expenditure is then charged to this account. The appropriation to this reserve is based on the manufacturer's recommendation. Currently, PHL allocates about 45-50% of the cost of sale every year into this reserve. However, the actual expenditure has been lower by 25-30% every year resulting in an accumulation of Rs.90 crores in the maintenance reserve.

Employment costs are the next important element in the total costs which accounted for 10-15% of cost of sales over the past five years. This has gone up substantially during FY 96 due to the revision in salaries of employees and the consequent payment of arrears and gross margins have consequently substantially declined.

PHL has made significant investments in unsecured inter-corporate loans. The company has advanced loans to Instrumentation Ltd and to Hindustan Photofilms Ltd. which were later referred to BIFR. As a prudent accounting measures, PHL has been providing for these loans and these are expected to be fully provided by FY 97.

PHL's non-operational income is significantly high due to investments in public sector bonds which was Rs.102 crores as at March 31, 1996. This has

resulted in substantially higher net margins when compared with the gross margins from operations.

## Strengths and Areas of Concern

### Strengths

*Largest helicopter fleet operator* PHL is the largest helicopter fleet operator in India. There is only one other private company operating helicopters. PHL is therefore well positioned to capitalise on the emerging opportunities. The company is planning to enter into areas other than oil exploration like tourism, corporate charter etc.

*Own maintenance infrastructure* PHL has maintenance infrastructure in Delhi and Mumbai and can maintain all types of helicopters. These facilities help the company to provide improved service qualities.

### Areas of Concern

*Over dependence on one customer* 85% of its total operating revenue is linked to one customer, viz. ONGC. With ONGC inviting tenders for the helicopter services, PHL's status as the sole provider is under threat.

*Ageing Fleet* The PHL fleet is relatively old. Replacement of these helicopters will involve huge capital expenditure.

*Competition* As the entry barriers are low, a number of private operators are expected to enter this business. The industry is expected to become fragmented.

*Skilled manpower* A key success factor is the availability of skilled manpower for operations and maintenance. With the current pay scales in PHL, the company will find it difficult to retain the skilled manpower.

### Recommendation

As has been mentioned earlier, PHL was set up as a joint venture company between Government and ONGC for meeting the latter's requirements. The operations and profitability of PHL are directly linked with the business contracts with ONGC. Due to various reasons, ONGC has started inviting global tenders for the deployment of helicopters against the earlier policy of depending on PHL. The operations of PHL may come under further strain if ONGC plans to extend its tendering process for all its requirements.

**The Commission reiterates the classification of PHL as non-core as the company operates in competitive markets in which the private sector has a presence.**

An important factor which may affect the financial strength of the company is the amount due to Government on account of Westland helicopters. However it may be noted that the funds advanced to PHL for purchase of the Westland helicopters by Government were in the form of loan while the same was received by Government from ODA as a grant. As the whole transaction was undertaken by PHL at the behest of Government, the Commission recommends writing off the Westland loans together with the accrued interest appearing in the books of PHL. Upon writing off the loan with interest, Government could realise Rs. 124 crores in the form of tax as the company had claimed the interest payable on the loan amount to Government as tax deductible.

As PHL derives 85% of its operating revenues from serving the oil exploration activities of ONGC, the Commission recommends that Government should first offer its shareholding to ONGC so that PHL could become its subsidiary. This transfer of shares is expected to be mutually beneficial. In the event that ONGC is not interested, the Commission recommends that the Government sells its entire holding of 78.5% to an investor. In order to conduct the sale, the Commission recommends that the Standing Empowered Group appoint Financial advisors/Consultants in order to value the company for fixing a reserve price. The procedure for appointing financial advisors for the sale and conducting the sale has been outlined in Part B of the First Report of the Commission (pp 38-40).

## 2.3 Power Grid Corporation of India Limited

### Evolution

The Power Grid Corporation of India Limited (POWERGRID) was set up in 1989 for the purpose of construction of Extra High Voltage AC and High Voltage Direct Current Transmission Lines, Sub-stations, Load Dispatch Centres and Communication Facilities in a co-ordinated and efficient manner to move large blocks of power from central generating agencies and surplus if any, from State Electricity Boards (SEBs), to load centres within and across the geographical Regions with reliability, security and economy.

The basic need for setting up such a centralised system arose on account of the multiplicity of central and joint venture power generation companies such as National Thermal Power Corporation (NTPC), National Hydro Power Corporation (NHPC), North Eastern Electric Power Corporation (NEEPCO), Neyveli Lignite Corporation (NLC), Nuclear Power Corporation (NPC), Damodar Valley Corporation (DVC), Bhakra Beas Management Board (BBMB) etc and for meeting other requirements relating to the planning, construction, operation and maintenance of transmission lines and sub stations for the evacuation of power in a centralised and co-ordinated manner. The multiplicity of organisations and ownership resulted in numerous operational and commercial problems in actual operations of the regional grids. In order to eliminate the operational and commercial problems and ensure better integrated operations of Regional Grid Systems, it was considered necessary to have a centralised pooling of all transmission lines and substations.

The share capital of POWERGRID as at 31st March, 1996 was Rs.2992.24 crores and the entire equity capital is held by Government.

### Industry Analysis

The power sector in India is principally regulated by the Indian Electricity Act of 1910 and the Electricity Supply Act of 1948 which recognises generation and distribution as distinct activities and not transmission. There has been efforts by the Government to correct this anomaly by issuing an ordinance recognising transmission as a distinct activity. However, till date transmission is still bundled with generation and distribution.

The Indian power sector is organised at three levels - the States, the five regions and the Centre. At the State level, the SEBs are the main entities which undertake power generation, transmission and distribution.

At the regional level, the main organisations are:

1. Regional Electricity Boards (REBs) whose principal function is to act as the forum for regional planning; and
2. Regional System Co-ordinating Centres (RSCCs) which provide a dispatch function at the regional level by issuing instructions to the central generating stations and to the State Load Dispatch Centres (SLDC) and Communication Centres.

At the Centre, the principal agency is the Ministry of Power (MoP) which governs the power sector in India. MoP has an advisory arm namely Central Electricity Authority (CEA) which generally carries out technical analysis on matters on which MoP has to issue formal notifications.

The Electricity (Supply) Act, 1948 gives statutory powers to CEA, the central generating companies and SEBs. Some of the important statutory powers/roles vested in these agencies are as follows:

- All investments above a notified level, in the electricity sector have to be approved by the CEA
- Tariff setting powers for Central generating companies are vested with MoP
- Central and State Governments have wide powers to issue directives in their respective jurisdictions
- REBs and RSCCs have powers to issue instructions on system operation and require licensees and generating companies to follow these instructions
- CEA acts as an appellate authority for the resolution of disputes.

Most organisations in the power sector are either owned by the central or state Governments or a combination of the two. The terms of agreement between the companies have normally been not on commercial considerations. The price determination responsibility rests with CEA and based on its advice, the MoP issues notification. The Electricity (Supply) Act, 1948 places regulatory powers in the MoP/CEA at the Central level and in the SEBs at the State level. Even though CEA has been armed with statutory powers, given its role as advisor to MoP, it is difficult to enforce compliance on the issue of tariff fixation. Thus, this system of tariff fixation has not enabled the healthy development of the industry as a whole.

## Role of POWERGRID

POWERGRID is the only organisation which has been assigned with the task of transmission of power in the country. The role of POWERGRID as it stands today is still fluid and has to evolve over a period of time. In its present form, the roles could be three-fold viz. providing transmission lines, ensuring the reliability of the system and dispatching power from central generating units.

*Role as a transmission service provider* The primary function of the regional transmission service is to provide a high voltage network connecting the major generating stations and main load centres. The extent of POWERGRID's role depends on:

- The degree to which POWERGRID takes on responsibility for planning and operating the network as opposed to just constructing and maintaining assets in accordance with contractual obligation and
- Where POWERGRID takes a decision making role, the scope of the regional network for which it has this responsibility.

*Role as a dispatcher* In the role as a economic dispatch agent, the range of roles POWERGRID could take up as the operator of RSCC are:

- POWERGRID acts as the dispatcher for the whole region and it has the dispatch authority on all plants operating in the region
- POWERGRID is responsible only for the dispatch of the plants of the Central generating companies and the SLDC are responsible for the dispatch of the individual generating units in the State.

*Role as an agency ensuring System reliability* Ensuring System reliability would involve a multitude of tasks which would include:

- Deciding on operational reserves and on emergency procedures
- Operation of transmission network
- System monitoring
- Operational planning, including scheduling of planned maintenance and operation policy.

## Business Analysis

The company's current operations primarily involve development and construction of transmission assets and operating and maintaining them. POWERGRID has completed the consolidation process of taking over of transmission systems from central and Centre-State joint venture organisations viz. NTPC, NHPC, NEEPCO, NLC, NPC etc. alongwith related manpower. The company is in the process of augmenting the power systems for improved co-



ordination in the operation of regional grids. As a part of total integrated system operation, POWERGRID will establish power pools to facilitate the exchange of power between States and Regions, thus leading to the formation of the National Power Grid. In this regard, POWERGRID started by taking over the Southern Region RSCC on 1st January, 1994 and all other Regional RSCCs were taken over by January, 1996.

The planning and construction of the new transmission lines are included in the five year plans and are undertaken by several entities at the Centre and State level. Typically before making any large investments, POWERGRID would have to obtain two streams of clearances viz. techno-economic clearance from CEA and PIB/CCEA clearance like any other PSU, which are complex and time consuming. The details of the total transmission system under operation and under construction by POWERGRID are given in the following table:

**Table 1 Transmission System**

Transmission Lines (Circuit Kms)		
	Under Operation	Under Construction
HVDC	1630	580
400 KV	16575	8390
220 KV	4495	1270
132 KV	700	400
Total	23400	10640
Sub-stations		
Nos.	47	14
MVA	15334	4410

The operating performance of a transmission company is measured on the basis of availability of the transmission system and the number of trippings per line which are attributable to the transmission company. The following table gives the operating performance of POWERGRID over the past three years:

**Table 2 Operational Performance**

	FY 94	FY 95	FY 96
Availability of Transmission System			
Target (%)	97.8	97.8	97.8
Actual (%)	97.6	98.0	98.3
No. of Trippings			
Standard	8.4	7.0	5.5
Actual	6.2	4.3	4.4

When compared with international utilities such as National Grid Company of U.K, Bonneville Power Admn. USA, Eskom of South Africa etc., the operating performance of POWERGRID has been quite satisfactory.

### Financial Analysis

The financial performance of POWERGRID for the past five years is indicated in the table below:

**Table 3 Financial Performance**

(Rs Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	976.3	804.8	645.1	631.2	21.3
Operating Profit	788.1	666.2	542.0	538.8	-19.4
Profit after Tax	276.0	225.4	202.6	236.5	-1.8
Equity Capital	2992.2	2972.2	2889.1	1849.2	61.1
Tangible Networth	4158.8	3734.9	3378.8	2068.5	41.5
Gross Margin (%)	80.7	82.8	84.0	85.4	-9.1
Net Margin (%)	28.3	28.0	31.4	37.5	-8.5
ROCE (%)	5.7	5.4	6.2	8.4	-0.7
RONW (%)	6.6	6.0	6.0	11.4	-4.4
Earnings per Share (Rs.)	0.92	0.76	0.70	1.28	-
Dividend (%)	0.33	0.17	0.17	0	0

The company was incorporated in FY 90, and the operations commenced in FY 93. FY 94 was thus the first full year of operation and hence the figures in the above table are strictly not comparable across the years.

POWERGRID earns its revenue through transmission charges. These charges are calculated so as to earn a 12% return on equity (ROE) based on normative parameters. The computation of the tariff takes into account a number of factors such as depreciation, interest on loan capital, O& M expenditure etc. In the computation of the tariff, the debt to equity ratio is taken as 1:1 regardless of the actual debt to equity ratio of the project. However, over the last three years, the company's actual rate of ROE remained low at 9.2% for FY 96, 7.6% for FY 95 and 7% for FY 94. The principal reason for the same is due to non inclusion of capital work-in-progress in the pricing formula for the purpose of calculating ROE. It may be noted that as on March 31, 1996, the capital work-in-progress of POWERGRID amounted to about 56% of the total gross block of Rs. 5500 crores.

The main elements of operating costs for POWERGRID are employee costs, power costs and administrative expenses which have remained steady over the

last three years. As a result, the operating margins have also been at a steady level at about 80% during the same period. However, due to high interest costs and depreciation (about 20% and 33% respectively of the total income in FY 96) the net margins of POWERGRID have generally been low.

Even though the levels of receivables has declined from 236 days in FY 94 to 212 days in FY 96, the absolute amount increased from Rs. 421 crores to Rs. 564 crores. All these amounts are due from SEBs and more than 56% of the same is due for over six months. Keeping in view the mounting receivables, Government of India has instructed all SEBs to open Letters of Credit for receivables of all Central sector power utilities. This is expected to bring down the level of receivables for POWERGRID. Similarly, an appropriation of the Central Plan Appropriation (CPA) amounts due to the SEBs towards the receivables of the Central sector power utilities was agreed to by Government in FY 94. This has resulted in reduction of receivables of POWERGRID to some extent.

## **Areas of Strengths and Concern**

### **Strengths**

*Predictable Revenue Stream* As the tariff stream of the company is a cost plus tariff, the risks associated with the variability in this revenue is low. The tariff and the returns associated with each project can be predicted virtually at the time of commissioning the assets.

*High level of operating efficiency* The operating efficiency of POWERGRID is comparable with other international transmission companies. Even though, currently the returns are not linked with the operating efficiency, there is an inherent strength in the company to improve its future earnings as and when the tariffs are linked with the operating efficiency.

*Professional expertise* POWERGRID was formed by taking over all transmission assets alongwith the trained manpower from the central power generating companies. This has resulted in pooling of expertise in the field of power transmission.

### **Areas of Concern**

*Regulatory Risks* The tariff for the company would be set by the MoP. Thus under the administered price regime, power being an important input in the development of the economy, there is a tendency to keep down the tariff in order to make it available at low cost to the consumers. Under the current industry structure, any increase in tariff mandated by MoP is being resisted by the SEBs, owing to their inability to pass it on to their consumers, even if they are statutorily required to accept this tariff.

*Low levels of return* The tariff structure and the return levels applicable to POWERGRID do not allow it to earn returns commensurate with the risks faced.

*High levels of receivables* The poor financial condition of most of the SEBs is a source of concern as they are the sole purchasers of the services of the company. However over a period of time there has been an improvement in the level of receivables due to action initiated by the MoP.

### Recommendation

POWERGRID has suffered in the past due to heavy locking up of funds on account of works in progress. These relate to transmission lines constructed and kept in readiness by POWERGRID but not used commercially on account of delays in completion of generation projects, particularly in the hydro-electric sector. This mismatch between completion of transmission projects and generation projects would need to be eliminated through better co-ordination among all the concerned agencies. There are also some instances of transmission lines remaining unutilised or underutilised because of the poor distribution infrastructure at the end of the State Electricity Boards. This is particularly true of sectors like the North East where POWERGRID has not realised transmission revenues in proportion to the capital expenditure incurred on account of the lower volumes of power actually transmitted over these lines.

In view of the uniformly poor financial health of the State Electricity Boards, POWERGRID has had problems of realising its dues. This is a problem which is likely to continue for some time and would adversely impact POWERGRID's profitability.

POWERGRID has been pressing for a revision of the formula for fixing transmission charges. In particular it has been pressing for an upward revision of ROE from the current 12% to 16%. An early decision from Government on this new tariff fixation formula will have a bearing on POWERGRID's profitability and its attractiveness to potential investors.

Huge investments are called for to strengthen the transmission infrastructure in the country. This has been estimated at Rs. 56,000 crores. POWERGRID would need to raise such resources from the market either through debt instruments or through equity issue. In view of Government's inability to pump in additional equity to meet such requirements, the alternative would seem to be to identify sectors wherein transmission lines could be established by private parties through a Build, Own Operate, Transfer (BOOT) arrangement.

From the above analysis, it would emerge that POWERGRID operates in an extremely strategic area of infrastructural activity and, therefore, it is a core PSU. The entire sector is also in need of considerable reform covering a wide gamut including *inter-alia* co-ordinated action among all the players, establishment of proper systems and effective implementation thereof and finally commercial orientation of all the players in the system. While Government is seized of these problems, it may take a few years before all the reforms are put in place and the system is given proper commercial and market orientation. The Commission is of the view that until this is achieved, POWERGRID may not be able to attract the right kind of response from institutional or other investors to consider disinvestment. The Commission is also of the view that the long-term potential of the company once the entire electricity sector is fully restructured is high and any premature disinvestment might result in considerable undervaluation of the shares of the Company. The Commission, therefore, recommends that disinvestment in POWERGRID need not be considered for the time being. The requirements of the transmission sector in the short to medium term could be taken care of by commercial borrowings by POWERGRID to the extent required and implementation of select transmission projects through BOOT arrangements.

## 2.4 Shipping Corporation of India

### Evolution

The Shipping Corporation of India (SCI) was incorporated on October 2, 1961 by the merger of the Eastern and Western Shipping Corporations through an Act promulgated in that year. At that time, SCI had a fleet predominantly of liners with an aggregate capacity of 0.19 million dead weight tonnage (dwt). Currently, it owns 122 vessels aggregating 5.44 million dwt and operates practically in all areas of the shipping industry. It also operates cargo and passenger vessels owned by other Government agencies.

SCI operates under the administrative control of the Ministry of Surface Transport. Earlier, Government had disinvested in two tranches in FY 92 and FY 94 aggregating 19.88% of the equity of Rs. 282.3 crores. The share holding pattern as at March 31, 1997 is given below:

Table 1 Shareholding Pattern

Shareholder category	% holding
Unit Trust of India	11.74
Other MFs GIC, LIC	5.83
FII's and Retail Investors	2.31
Government	80.12
TOTAL	100.00

SCI's shares were listed on the Bombay Stock Exchange in 1993 after the first tranche of disinvestment. However, trading has generally been infrequent and volumes quite low as the free float available in the market is quite limited. On a par value of Rs. 10, the closing share price of SCI was Rs. 51 on July 31 1997.

### Industry Analysis - International scenario

The global shipping industry can be segmented on the type of cargo being transported. As on January 1, 1996, the total tonnage deployed was estimated at 718 million dwt. Out of this, 72% of the tonnage was deployed in bulk carriage of goods (crude oil, coal, iron ore, grains, etc.) and 18% of the tonnage was deployed in the liner trade including the break bulk (small packages) segment. The balance was deployed in specific segments such as passenger ships, gas carriers, and other specialised vessels. In terms of freight revenues, container and general cargo vessels generate a much larger quantum of freight than bulk carriers as most of the high value items are shipped through the former category of ships.

Globally, the shipping industry is fragmented and most shipping companies are relatively small. Many ships owned by the same owners are legally owned by a single purpose company set up with the specific objective of owning the vessel. Over one third of the world fleet is beneficially owned by the developed countries but are registered in "flags of convenience" countries like Panama, Liberia, etc. for tax advantages and considerable flexibility in manning the vessels.

Globally, the demand for shipping services is dependent on the level of economic activities, trade linkages between various regions, the availability of tonnage and the vagaries of the climate. Given the cyclical nature of these factors, the shipping industry is in turn, cyclical. Typically, each cycle lasts about five to six years. However within the shipping industry, some segments such as the crude tanker segment are relatively less volatile when compared with the dry bulk carriage.

### **Indian Shipping Industry**

As on 30th June 1996, the Indian fleet comprised 477 vessels aggregating 11.57 million dwt. When compared with the global pattern of ownership, Indian shipping companies generally own all the ships within the fold of the same company. Among the important ship owning nations India ranks 17th in the world. The Indian merchant fleet constitutes about 1% of the world's total fleet in terms of numbers and 1.5% of the cargo carrying capacity.

In terms of dwt, the SCI fleet is the largest and accounted for about 47% of the total tonnage the balance 53% being distributed among 79 companies in the private sector. In the private sector, four large shipping companies i.e. Great Eastern Shipping, South India Shipping, Essar Shipping and Chowgule Shipping own about 24% of the Indian fleet. Thus, nearly three-fourths of the Indian fleet are owned by these five companies.

A little over 95% of India's foreign trade, in terms of volume and 77% in terms of value, are transported through ships. While the volume of overseas trade has shown a steady increase, the share of Indian ships in the carriage of national trade has been declining mostly due to the inability of the Indian shipping companies to acquire tonnage to match the volume of overseas trade. This trend is expected to continue in the future mainly on account of the inability of Indian shipping companies to access the foreign debt market in accordance with the norms specified by Government.

Most countries in the world provide incentives to their shipping industry by way of tax relief, low interest loans, and cargo support, as shipping is seen to be of strategic importance for safeguarding national trade interests as well as providing a second line of defence for the country. In India, Government had been extending soft loans through the Shipping Development Fund in the eighties and also provided other incentives by way of investment allowance, incentive to investors, etc. Increasing budget deficits in the nineties have compelled Government to withdraw these incentives. In addition, the Minimum Alternative Tax has been made applicable to shipping companies also. However, as far as dry bulk cargo is concerned, Indian shipping companies have cargo preference, provided the Indian operator matches the lowest bid offered by a foreign operator. In the case of crude oil imports, the public sector SCI is preferred over private sector and foreign lines.

### Business Analysis

On the basis of the type of vessels operated, SCI has three operating divisions: the Bulk and Tanker (B&T) division, the Liner and Passenger Services (L&PS) and the Technical & Off-shore Services (T&OS). The division wise performance as at March 31, 1996 is shown in the table below:

Table 2 Division wise Performance in FY 96

Division	Vessels	Tonnage	Revenue		Op. profit	
	(Number)	%	(Rs crores)	% Share	(Rs crores)	% Share
B&T	77	88	1504.3	71	249.7	98
L&PS	35	10	587.3	27	-3.3	-1
T&OS	10	2	37.3	2	8.5	3
Total	122	100	2128.9	100	254.9	100

As can be seen from the above table, the B&T division is the main stay of SCI's operations with a contribution of about 98% of the operating profits in FY 96. Within this division, crude oil carriage contributed nearly 50% of the operating profits and about 37% of the operating profits for the company as a whole. The crude oil fleet of SCI is mainly engaged by the Oil Co-ordination Committee (OCC) on a Contract of Affreightment (CoA) on a cost-plus basis. Under the CoA, SCI is responsible for transporting a specified quantity of crude between a specified sources and destination over an agreed period of time. Almost three-fourths of India's imports are made on FoB basis and the carriage from the port of export to India has to be arranged by the importer. Thus, SCI acts as the captive fleet of the Indian oil industry and carries a predominant share of crude for the country.



Under the cost-plus method, the charges for crude oil transportation are fixed by Government on the basis of a formula which takes into account the return on the capital invested on the ship. This method of computation of the freight charges have generally been advantageous to the company when compared with the method of computing time charter rates. These arrangements have ensured returns and have, in addition, minimised the volatility of the company's earnings which is a characteristic in the shipping industry.

However, the dismantling of the administered pricing mechanism in the oil sector could lead to the withdrawal of the cost plus arrangements of SCI with the OCC. SCI's monopoly in the transport of crude could be thus open to competition. In such an event, the oil industry will charter vessels on a globally competitive basis, but the charter rates are expected to be higher than the international prevailing rates due to infrastructural bottlenecks in the Indian ports. Hence, while competition would reduce the deployment advantage of SCI, the dependence of the oil industry on SCI is expected to continue in the long term.

### Financial Analysis

The financial performance of the company is presented in the table below:

Table 3 Financial Performance

(Rs.Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	2177.0	1773.6	1555.9	1477.3	1358.3
Operating Profit	655.0	481.3	388.1	347.1	309.2
Profit after Tax	323.3	201.3	167.4	143.1	109.1
Equity Capital	282.3	282.3	282.3	282.3	282.3
Tangible Networth	1273.1	1012.0	841.7	719.6	617.0
Gross Margin (%)	30.1	27.1	25.0	23.5	22.8
Net Margin (%)	14.8	11.4	10.8	9.7	8.0
ROCE (%)	15.2	11.4	10.8	10.9	10.5
RONW(%)	28.3	21.7	21.4	21.4	19.0
Earnings per Share (Rs.)	11.45	7.13	5.93	5.07	3.86
Dividend (%)	20	15	15	10	6

Despite the cyclical nature of the industry, income from operations have exhibited consistent growth partly due to the deployment of a substantial part of SCI's new fleet on a cost plus basis. Further, the diversity of the fleet has helped SCI to withstand changes in business cycles in individual segments. In addition, SCI was able to control direct operating costs. These measures have helped to improve profitability at both the gross and net levels.

Shipping companies generally maintain a high level of cash in order to play on the asset markets. In order buy ships at the right time, SCI has maintained about Rs. 560 crores in deposits with Financial Institutions and about Rs. 200 crores in bank deposits. Interest on these funds account for about 20% to 25% of the total income.

In spite of these cash assets, the gearing of SCI is high at 1.80 when compared with other major Indian Shipping companies. With the proposed expansion / replacement of the fleet in the ninth five year plan to be funded through predominantly debt sources, the gearing is likely to go up further.

## Areas of Strength & Concerns

### Strengths

*Assured Returns on Crude Transport* India's imports of crude oil are carried by SCI through a Government policy which favours the company over other operators. In addition, the cost plus pricing mechanism under the APM assures returns to the company.

*Diversified Fleet* The company has expanded its operations to practically all areas of shipping. This diversified fleet will enable the company to withstand the proposed deregulation of the oil sector wherein the monopoly position of SCI is likely to be open to competition.

*Ability to borrow in the International Markets* SCI has been able to successfully tap the international markets for its borrowing requirements. The company has been able to secure these funds at competitive rates.

### Areas of Concern

*Large Capital Expenditure Outlays* The average age of SCI ships is about 14 years and considering the economic life of these ships, they are due for replacement over the next five years. Consequently, SCI is planning a massive replacement programme of its existing fleet. This is proposed to be funded through a combination of debt and equity funds amounting to Rs. 5600 crores.

*Overmanning of Vessels* As per SCI's own estimates, the current crew strength is about 65% more than its requirements. However, at the current levels of attrition and negligible additions, SCI expects the crew strengths to fall to optimum levels in the next few years.

### Recommendation

SCI's crude tanker tonnage constitutes about 60% of the total tonnage of the Company's fleet and currently transports about 70% of the domestic imports of crude to the country. The operations are of strategic importance as India will continue to import crude in the future too. With the commissioning of refinery

capacities in the private sector over the next two-three years, the total level of imports of crude is expected to increase. Unless the company adds substantially to its fleet of crude tankers in the same period, it is expected that the share of SCI in crude transport will come down in the future.

SCI's dry bulk and specialised carrier tonnage constitutes about 30% of the total tonnage of 57.6 million tonnes. In FY 95, foreign vessels had a dominant share of 82% of the total trade in this segment, while Indian vessels accounted for the balance 18%. Within the share of Indian vessels, SCI's market share was 44% with the balance accounted by the other major Indian shipping companies. With the relative inability of the Indian shipping companies to expand their fleet to take advantage of the increased trade in the coming years, the share of foreign vessels in this segment is likely to increase further. In line with this trend, SCI's share is also expected to come down in the future.

**Excepting the crude carriage operations, where the company has been enjoying a preference, SCI operates in competitive markets both locally as well as internationally. Also, the oil sector is expected to be de-regulated, over a period of time. The preferential treatment for SCI in crude carriage is likely to be replaced by competition from both Indian and foreign vessels. Increased presence of other shipping companies will, in turn make this segment more competitive and a majority share holding directly by Government may thus not be required.**

At this stage, the issue of the long term ownership of the company needs to be addressed. Government has already disinvested about 20% of the equity, mostly to UTI, LIC, GIC, Mutual Funds and others.

However, SCI's crude carriage operations are important for the country's refinery companies both in the public and private sector. **The Commission is of the view the refinery companies could constitute a core group of stable shareholders in SCI who would benefit from equity linkages with a vital supplier of services.** This will be in line with the international practice wherein almost all major oil companies own sizeable tanker fleet to cater to their requirements.

The Commission has noted that the company has a fairly large capital expenditure programme of about Rs. 5600 crores over the 9th Five Year Plan which is aimed at part replacement of the existing fleet as well as adding new ships. The company plans to raise about Rs. 550 crores from the equity markets and borrow about Rs. 3800 crores from the international markets. The balance is proposed to be funded through internal accruals.

While considering disinvestment in SCI, therefore, three important issues need to be kept in mind.

- Government receipts from disinvestment need to be maximised both in respect of extent of disinvestment and the price to be realised for the shares.
- The strategic role of SCI in the transport of vital supplies of crude and other petroleum products would need to be sustained.
- SCI would need to tap the equity market for raising resources for its fleet replacement and expansion plans and Government disinvestment should not constrain this in any manner.

The disinvestment strategy in SCI would need to harmonise all these objectives.

The Commission recommends that Government should disinvest in SCI in favour of the Oil Refinery Companies. 30% of the equity of SCI may be offered to IOC, HPCL, BPCL, CRL and MRL in proportion to their net profits. In addition, 10% could be offered to the private sector and joint-sector refineries. In the event that this offer is not accepted by the private sector refineries it may be offered to the public sector refineries in the manner already indicated. The prices at which the SCI shares are to be transferred to the refineries may be determined through a valuation exercise to be undertaken by a specially appointed Financial Adviser. The provisions of the Substantial Acquisitions and Take-over Regulations of SEBI will have to be complied with, if applicable. Through this transaction, Government share holding will come down from the current level of 80% to about 40%.

By following the above course of action, Government receipts on disinvestment would be quite significant. Even though Government's direct holding in the company falls below 50%, the oil PSUs and others would be holding 30% and constitute a group of stable shareholders. At the same time, thanks to the reduction of Government holding and the induction of representatives of the user PSUs, the Board of Directors of the Company will acquire a more professional character and the company could be managed more commercially and professionally. The investor perception of the company would improve considerably and the share value of the company would be enhanced significantly.

With this proposed transfer of Government shares to the oil refineries, the direct Government holding will fall below 51% and SCI will be run as a Board managed company. **As a first step, the Commission recommends that the Board of SCI be broad-based by inducting a few non-executive Directors from the relevant disciplines. At the same time, the composition of the Board should also reflect the shareholding of the company and all refinery companies who hold a part of the equity should be represented on the Board.**

After the disinvestment, SCI could tap the equity market to raise about Rs. 550 crores. SCI should in the first instance make an equity offer in the Indian market to the institutional investors through a domestic book building process. In the next stage shares may be offered to the small investors and employees in the domestic market at a discount of 10% over the institutional price. Thereafter, SCI may make an offer in the overseas market through a global book building process. The quantum and timing of these issues may be determined by the Board of Directors taking into account the industry conditions and the requirement of funds for the expansion project. Even at current share prices, the combined holding of Government and the oil refineries will be considerably above 51% after this public issue.

*First List - September, 1996*

<u>Sl. No.</u>	<u>Name of the PSU</u>	
1	Air India	AI
2	Bharat Aluminium Co. Limited	BALCO
3	Bharat Earth Movers Limited	BEML
4	Bharat Electronics Limited	BEL
5	Bongaigaon Refineries & Petrochemicals Limited	BRPL
6	Container Corporation of India Limited	CONCOR
7	Engineers India Limited	EIL
8	Fertiliser & Chemicals (Travancore) Limited	FACT
9	Garden Reach Shipbuilders & Engineers Limited	GRSEL
10	Gas Authority of India Limited	GAIL
11	Hindustan Aeronautics Limited	HAL
12	Hindustan Copper Limited	HCL
13	Hindustan Latex Limited	HLL
14	Hindustan Zinc Limited	HZL
15	Hotel Corporation of India Limited	HCIL
16	HTL Limited	HTL
17	IBP Co. Limited	IBP
18	India Tourism Development Corporation	ITDC
19	Indian Petrochemical Corporation Limited	IPCL
20	ITI Limited	ITI
21	Kudremukh Iron Ore Co. Limited	KIOCL
22	Madras Fertilisers Limited	MFL
23	Mahanagar Telephone Nigam Limited	MTNL
24	Manganese Ore (India) Limited	MOIL
25	Modern Food Industries (India) Limited	MFIL
26	National Aluminium Co. Limited	NALCO
27	National Fertilisers Limited	NFL
28	National Hydro Power Corporation	NHPC
29	National Thermal Power Corporation Limited	NTPC
30	Neyveli Lignite Corporation Limited	NLC
31	Northern Coal Fields Limited	NCF
32	Oil India Limited	OIL
33	Oil & Natural Gas Corporation	ONGC
34	Pawan Hans Helicopters Limited	PHL
35	Power Grid Corporation of India Limited	POWERGRID
36	Rail India Technical & Economic Services Limited	RITES
37	Shipping Corporation of India Limited	SCI

38	South Eastern Coal Fields Limited	SECF
39	Steel Authority of India Limited	SAIL
40	Western Coal Fields Limited	WCF

*Second List - March, 1997*

1	Hindustan Vegetable Oil Corporation Limited	HVOC
2	Nepa Limited	NEPA
3	Electronic Technology & Trade Dev. Corpn. Limited	ET&TDC
4	Hindustan Prefab Limited	HPL
5	Ranchi Ashok Bihar Hotel Corporation Limited	RANCHI-ASHOK
6	Pyrites, Phosphates & Chemicals Limited	PPCL
7	Central Electronics Limited	CEL
8	Engineering Projects (India) Limited	EPIL
9	Utkal Ashok Hotel Corporation Limited	UTKAL-ASHOK
10	Rehabilitation Industries Corporation Limited	RICL

**MINISTRY OF INDUSTRY**  
(Department of Public Enterprises)  
**RESOLUTION**

New Delhi, the 23rd August, 1996

**No. 11013/3/96-Admn.**—In pursuance of the Common Minimum Programme of the United Front, Government hereby constitutes a Public Sector Disinvestment Commission, initially for a period of three years.

2. The composition of the Commission will be as follows :—

1. Shri G.V. Ramakrishna, Full-time Chairman
2. Shri Dipankar Basu, Part-time Member
3. Shri M.R.R. Nair, Part-time Member
4. Dr. Suresh Tendulkar, Part-time Member
5. Dr. D.M. Nanjundappa, Part-time Member

The Commission will have a full-time Secretary who will be appointed separately. Shri P. Shankar appointed Member Secretary vide Government of India Notification No. 13/20/96-EO(SMI) dated 13th November, 1996.

3. The broad terms of reference of the Commission are as follows :—

- I. To draw a comprehensive overall long term disinvestment programme within 5-10 years for the PSUs referred to it by the Core Group.
- II. To determine the extent of disinvestment (total/partial indicating percentage) in each of the PSU.
- III. To prioritise the PSUs referred to it by the Core Group in terms of the overall disinvestment programme.
- IV. To recommend the preferred mode(s) of disinvestment (domestic capital markets/international capital markets/auction/private sale to identified investors/any other) for each of the identified PSUs. Also to suggest an appropriate mix of the various alternatives taking into account the market conditions.
- V. To recommend a mix between primary and secondary disinvestments taking into account Government's objective, the relevant PSU's funding requirement and the market conditions.
- VI. To supervise the overall sale process and take decisions on instrument, pricing, timing, etc. as appropriate.
- VII. To select the financial advisers for the specified PSUs to facilitate the disinvestment process.
- VIII. To ensure that appropriate measures are taken during the disinvestment process to protect the interests of the affected employees including encouraging employees' participation in the sale process.
- IX. To monitor the progress of disinvestment process and take necessary measures and report periodically to the Government on such progress.
- X. To assist the Government to create public awareness of the Government's disinvestment policies and programmes with a view to developing a commitment by the people.
- XI. To give wide publicity to the disinvestment proposals so as to ensure larger public participation in the shareholding of the enterprises; and
- XII. To advise the Government on possible capital restructuring of enterprises by marginal investments, if required, so as to ensure enhanced realisation through disinvestment.

4. The Disinvestment Commission will be advisory body and the Government will take a final decision on the companies to be disinvested and mode of disinvestment on the basis of advice given by the Disinvestment Commission. The PSUs would implement the decision of the Government under the overall supervision of the Disinvestment Commission.

5. The Commission while advising the Government on the above matters will also take into consideration the interests of stakeholders, workers, consumers and others having a stake in the relevant public sector undertakings.

**S. TALWAR**  
Joint Secretary



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# DISINVESTMENT COMMISSION

SEPTEMBER  
1998



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# DISINVESTMENT COMMISSION

NOVEMBER

1997

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अवर सचिव Under Secy to Govt  
निस्विक्रम विभाग Disinvestment  
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# DISINVESTMENT COMMISSION

NOVEMBER  
1997

Disinvestment Commission  
Room No. 165, North Block,  
New Delhi-110001 INDIA



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*Note : The Tables contained in this Report are based on information received from Management of the PSUs and other sources.*





# PART A



# 1. GENERAL ISSUES AND RECOMMENDATIONS ON DISINVESTMENT

## Review of Progress in Disinvestment

In its Fourth Report, the Commission had indicated, in the form of a Statement, the action taken by Government on its recommendations contained in its first three Reports. Since then, some more decisions have been announced by Government on the specific recommendations of the Commission as well as in continuation of ongoing public sector reforms. The Commission has taken note of the progress so far in implementing the recommendations of the Commission in its four Reports and once again it is presented in the form of a Statement.

Table 1 General Recommendations

Recommendations	Government Action
Establishment of Disinvestment Fund (I:3.1)	According to Government communication Fund set up in September, 1996. Details as regards scope or purpose not available.
Formation of Standing Empowered Group (I:4.1)	Core Group Empowered as recommended
Guidelines on-Offer of Sale-Book building for domestic and GDR issues (I:4.2)	Book building followed in GDR issues
Guidelines on selection of Intermediaries (I:4:3)	Accepted
Retailing PSU shares to small investors & employees (I:4.4)	Accepted
Recommendation on joining NSDL (II:1)	Accepted
Revamped Voluntary Retirement Scheme-Employee Pension cum Insurance Scheme (II:1) & (IV:1)	Decision Awaited

**Table 2 Corporate Governance : All PSUs (Other than Navratna Category)**

Recommendations for all PSUs	Government Action
<p>* Professionalising the Board by induction of non-executive directors to be chosen by PESB (I:3.4)</p>	<p>Govt. to broadbase Boards of 97 PSUs by inducting at least three non-official part-time Directors and the number of such Directors should be at least one-third of the total strength of the Board. These Directors would be selected by Search Committee comprising of Chairman, PESB; Secretary, DPE; Secretary of the Administrative Ministry; and some eminent non-official(s).</p>
<p>Provision for Elected Directors (I:3.4)                      * Selection of Top Management (I:3.4)                      * Salaries and Incentives for Top Management (I:3.4)</p>	<p>Decision Awaited                      Decision Awaited                      Decision Awaited</p>
<p>* Autonomy in Price Fixation (I:3.4)</p>	<p>Decision Awaited</p>
<p>* Accountability (I:3.4)</p>	<p>Accepted</p>
<p>* Setting up of Pre-Investigation Board (I:3.4)</p>	<p>Decision Awaited</p>
<p>* Strengthening the Investor Interface (I:3.4)</p>	<p>Decision Awaited</p>
<p><u>Moderate Performers</u>                      * Powers to dispose of Assets (I:3.4)                      * Freedom of Investment within certain limits (I:3.4)</p>	<p>Decision Awaited                      To incur capital expenditure on new projects, modernisation, purchase of equipment etc. upto Rs.300 crores or equal to their network whichever is lower for category I PSUs# and Rs. 150 crores or upto 50% of their network whichever is lower for Category II PSUs#.</p>
<p><u>Strong Performers</u>                      * Powers to form Joint Ventures (JVs) (I:3.4)</p> <div style="border: 1px solid black; padding: 5px; margin: 5px 0;"> <p>[# <i>Category I PSUs</i> - PSUs who have made a profit in the last three years continuously and pre-tax profits should have been more than Rs.30 crores or more in at least on of the three years and should have a positive net worth. <i>Category II PSUs</i> - PSUs who have made profit for the last three years continuously and should have a positive net worth]</p> </div> <p>* Full freedom with regard to Investments (I:3.4)</p>	<p>To establish JVs and subsidiaries in India - Should be limited to Rs. 100 crores in any one project, should not exceed 5% of the network of the PSU in any one project or 15% of the network of the PSU in all JVs/subsidiaries put together for Category I PSUs and Rs. 50 Crores in any one project, should not exceed 5% of the network of the PSU in any one project or 15% of the network of the PSU in all JVs/subsidiaries put together for Category II PSUs.                      To incur capital expenditure on new projects, modernisation, purchase of equipment etc. upto Rs.300 crores or equal to their network whichever is lower for category I PSUs, and Rs. 150 crores or upto 50% of their network whichever is lower for Category II PSUs.</p>

**Table 2A Corporate Governance : Eleven Select PSUs (Navratana Category)**

Recommendations for Strong Performers	Government Action
<ul style="list-style-type: none"> <li>* Professionalising the Board by induction of non-executive directors to be chosen by PESB (I:3.4)</li> </ul>	<p>Govt. to broadbase Boards by inducting in the first instance at least four non-official part-time Directors and the number of such Directors should reach at least one-third of the total strength of the Board within six months. These Directors would be selected by Search Committee comprising of Chairman, PESB; Secretary, DPE; Secretary of the Administrative Ministry; and some eminent non-official(s).</p>
<ul style="list-style-type: none"> <li>* Provision for Elected Directors (I:3.4)</li> <li>* Selection of Top Management (I:3.4)</li> <li>* Salaries and Incentives for Top Management (I:3.4)</li> </ul>	<p>Decision Awaited Decision Awaited Decision Awaited</p>
<ul style="list-style-type: none"> <li>* Autonomy in Price Fixation (I:3.4)</li> </ul>	<p>Decision Awaited</p>
<ul style="list-style-type: none"> <li>* Accountability (I:3.4)</li> </ul>	<p>Accepted</p>
<ul style="list-style-type: none"> <li>* Setting up of Pre-Investigation Board (I:3.4)</li> </ul>	<p>Decision Awaited</p>
<ul style="list-style-type: none"> <li>* Strengthening the Investor Interface (I:3.4)</li> </ul>	<p>Decision Awaited</p>
<ul style="list-style-type: none"> <li>* Freedom of Investment (I:3.4)</li> <li>* Powers to dispose of assets (I:3.4)</li> <li>* Powers to form Joint Ventures (I:3.4)</li> </ul>	<p>Accepted Decision Awaited The PSUs have been allowed to set up financial joint ventures and wholly owned subsidiaries in India or abroad subject to (1) an equity limit of Rs. 200 crores in any one project, (2) 5 percent of the networth of the PSU in any one project and (3) 15 percent of the networth of the PSU in all joint ventures/subsidiaries together. However, for entering into technology joint ventures and strategic alliances, the PSUs have to adhere to guidelines to be issued by Government from time to time.</p>

**Table 3 Specific Recommendations for 19 PSUs**

Recommendation	Government Action
<p><b>Modern Food Industries India Limited (MFIL) (I:5.1)</b>                      Sale of entire Government shareholding on an as-is-where-is basis</p>	<p>Decided to reduce Government shareholding in Modern Foods from present 100% to 50% in Phase I</p>
<p><b>Gas Authority of India Limited (GAIL) (I:5.2) -25% disinvestment through GDR</b>                      Autonomy under Strong Performer Criterion                      Implement TL Sankar Committee Recommendations</p>	<p>24.84% (210 million) shares disinvestment through GDR                      Granted Autonomy under "Navaratna Status"                      Implemented</p>
<p><b>Indian Tourism Development Corporation (ITDC) (I:5.3)</b> Handing over the hotels located in prime locations to established hotel chains to run on long term structured contract on lease cum management basis. The hotels in other locations may be demerged into separate companies and Government to sell 100% of its equity in those new companies.</p>	<p>Decided to appoint global adviser to evaluate four options as identified by Core Group</p> <ul style="list-style-type: none"> <li>• Acceptance of the Disinvestment Commission's recommendations</li> <li>• Acceptance of the view of the Ministry of Tourism (limiting disinvestment upto 49%)</li> <li>• Reduction of Government shareholding to 50% in favour of strategic partner</li> <li>• Reduction of Government shareholding to less than 50% in favour of strategic partner</li> </ul>
<p><b>Bharat Aluminium Company Limited (BALCO) (II:2.1)</b> Immediate disinvestment of 40% of the equity to a strategic partner with an agreement to dilute Government holding to 26% through public issue within 2 years. The Government to disinvest its balance holding of 26% in full at an appropriate time in future</p>	<p>Accepted</p>
<p><b>Bongaigaon Refineries and Petrochemicals Limited (BRPL) (II:2.2)</b> Strategic sale of 50% of Government holding with an agreement to further dilute to 26% or below through public offer at a later date.</p>	<p>Decided to appoint global adviser to evaluate two options</p> <ul style="list-style-type: none"> <li>• Disinvestment Commission's recommendations for a strategic sale</li> <li>• Ministry of Petroleum's suggestion of merger of Oil India and BRPL to make it an integrated oil company and disinvest Government holding to 50% or below in the merged entity</li> </ul>
<p><b>HTL Limited (HTL) (II:2.3)</b> 3 options for disinvestment -</p> <ul style="list-style-type: none"> <li>• Sale of 100% shares in HTL alongwith ITI in the process of Strategic Sale</li> <li>• 50% of shares of HTL may be offered to a strategic partner through a global competitive bidding</li> <li>• if none of the above options is feasible, straight sale of assets of the company through competitive bidding</li> </ul>	<p>Core Group broadly endorsed the recommendations, however waiting for the views of the Telecom Commission.</p>

**Table 3 Specific Recommendations for 19 PSUs (Continued)**

<p>ITI Limited (ITI) (II:2.4) Immediate reduction of manpower through VRS and hiving off the Defence Division in Bangalore and merge with Bharat Electronics Limited followed by strategic sale of 50% of the shares with an agreement to reduce the Government holding to 26% through public offer to Indian institutions, small investors and employees later</p>	<p>Core Group broadly endorsed the recommendations, however waiting for the views of the Telecom Commission.</p>
<p>Madras Fertilisers Ltd (MFL) (II:2.5) Recommended to initiate negotiations with National Iranian Oil Company (NIOC) to change the terms of agreement which would permit sale of 50% of the shares in the company to a strategic partner</p>	<p>Approval for negotiations with NIOC along the lines suggested by the Commission</p>
<p>Manganese Ore India Limited (MOIL) (II:2.6) - No immediate disinvestment</p>	<p>Accepted</p>
<p>Container Corporation of India Limited (CONCOR) (III:2.1) -10 million shares offer to institutional investors and public and at a later stage the company could go in for fresh issue of 12.5 million shares thereby reducing the Govt's share to 51%</p>	<p>Disinvestment of 6 million shares approved along with fresh issue of 12.5 million shares - Distribution of issue between domestic and international market to be based on the market conditions</p>
<p>Kudremukh Iron Ore Company Limited (KIOCL) (III:2.2) Strategic sale of 30% and induction of the strategic partner in the management. There should be an agreement with the strategic partner for further dilution of Government equity to strategic partner and public offering within 2 years.</p>	<p>Decided to appoint global adviser to advise the Ministry of Steel and KIOCL on disinvestment and strategic sale.</p>
<p>Mahanagar Telephone Nigam Limited (MTNL) (III:2.3) - 60 million shares in GDR market and 28.3 million shares in domestic market through book building Financially restructure - by formation of a new company for raising funds for DoT Grant of Autonomy under Strong Performer Criteria</p>	<p>Disinvestment of 47 million shares along with fresh issue of 60 million shares - Distribution of issue between domestic and international market to be based on the market conditions Decision Awaited Granted Autonomy under "Navaratna Status"</p>
<p>Oil India Limited (OIL) (III 2.4) - Disinvestment and Company's IPO only after company's prospects are clearly established through the outcome of exploration activities in the North Bramhaputra area and Government's policy on APM</p>	<p>Accepted</p>
<p>Oil and Natural Gas Commission Ltd. (ONGC) (III:2.5) -Disinvestment after the organisational changes are in position and Government's policy on APM</p>	<p>Accepted</p>

**Table 3 Specific Recommendations for 19 PSUs (Continued)**

Rail India Technical & Economic Services Ltd (RITES) (III:2.6) - No disinvestment	Accepted
Hindustan Copper Limited (HCL) (IV:2.1) - Two options suggested : <ul style="list-style-type: none"> <li>• HCL to implement the expansion programme and also restructure the ICC mining operations by closing down mines through VRS. Afterwards, Government to divest 51% of its holding through a strategic sale. The balance 22% to be disinvested through offer of sale to domestic institutions, small investors and employees</li> <li>• Immediately disinvest 51% through a strategic sale and after restructuring and expansion, disinvest balance 22% through offer of sale to domestic institutions, small investors and employees</li> </ul>	Decision Awaited
Pawan Hans Helicopters Limited (PHL) (IV:2.2) - Recommends writing off the Westland loans together with interest. Offer the entire Government holding to ONGC. If ONGC not interested, sell the entire holding of Government to an investor.	Decision Awaited
Power Grid Corporation of India Limited (POWERGRID) (IV:2.3) Disinvestment only after entire electricity sector is fully restructured.	Decision Awaited
Shipping Corporation of India Ltd (SCI) (IV:2.4) Government to disinvest 40% of its holding to oil refineries, (30% to public sector and 10% to private sector refineries). This can be followed by the company's own equity raising.	Decision Awaited

Arising out of this, the Commission would like to make the following general observations :

**Firstly, the Commission considers the establishment of the Disinvestment Fund to be extremely vital to the credibility and social acceptability of the disinvestment process and hence towards building a general consensus in the country in its favour. Government has communicated that a Disinvestment Fund was set up in September,**



**1996 - prior to the Commission's recommendation.** However, in the view of the Commission, what is currently sought to be done is merely to earmark a small portion of disinvestment proceeds towards restructuring schemes of PSUs and specific VRS proposals. **The Commission would reiterate that there is urgent need for Government to consider the Commission's recommendations fully, keeping in mind the objectives to be achieved through the establishment of the Disinvestment Fund.** Later in this Report, the Commission has made some further remarks on the Disinvestment Fund.

Secondly, while Government has processed the recommendations of the Commission with regard to strategic sale of some PSUs and taken certain decisions, **there is some concern that the implementation of those decisions could be delayed if time-limits are not laid down for the Ministries concerned to implement the decision.**

Thirdly, while the Commission welcomes the further initiative taken by Government towards conferring autonomy to a large number of PSUs with a view to improving corporate governance therein, it hopes that this process will be carried forward in a comprehensive and co-ordinated manner, taking into account the Commission's recommendations made in its First Report. In particular, the Commission would like to emphasise the following:

- (i) The Commission has recommended autonomy for all PSUs categorised according to their performance (I:3.4).**
- (ii) The Commission's recommendations also include the setting up of Pre-Investigation Board, proper incentivisation of the top management personnel, strengthening investor interface (I:3.4) and need for change in the perspective of audit by the C&AG and examination by Parliamentary Committees taking into account the changes in the commercial environment in which PSUs are now operating (I:3.3). These need to be considered urgently by Government, both for improving the investor perception of PSUs as also for creating the necessary climate for the Boards of Management of PSUs to exercise the greater powers now proposed to be conferred on them, without hesitation or fear.**

- (iii) Providing representation to minority shareholders in the PSUs where disinvestment has already taken place needs to be stressed. To start with, Government may consider providing such representation in PSUs where disinvestment has exceeded 25%. This step will greatly improve investor confidence in PSUs and will help the process of future disinvestment.**

## **Terms of Reference**

The terms of reference of the Commission, as notified in the Government Resolution No. 11013/3/96-Admn. dated 23 August, 1996, of the Department of Public Enterprises inter-alia include the following:

- VI. To supervise the overall sale process and take decisions on instrument, pricing, timing etc. as appropriate.
- VII. To select the financial advisers for the specified PSUs to facilitate the disinvestment process.
- IX. To monitor the progress of disinvestment process and take necessary measures and report periodically to the Government on such progress.

Para 4 of the Government Resolution reads :

“The Disinvestment Commission will be (an) advisory body and the Government will take a final decision on the companies to be disinvested and mode of disinvestment on the basis of advice given by the Disinvestment Commission. The PSUs would implement the decision of the Government under the overall supervision of the Disinvestment Commission.”

The Commission has considered the terms of reference and is of the view that, in the light of para 4 quoted above, it will not be possible for it to act on items VI and VII of the terms of reference. In its First Report, the Commission, therefore, while recommending the establishment of the Standing Empowered Group (SEG) recommended that the selection of Financial Advisers, supervision of the overall sale process and decisions on instrument, pricing, timing, etc. as per terms of reference,

items VI and VII may also be entrusted to the SEG. **Government has since taken decisions on the specific recommendations of the Commission relating to some PSUs and entrusted implementation to official groups. This would indicate that the Commission's interpretation of the terms of reference as above has been accepted by Government. In other words, the Commission will function as an advisory body and will not involve itself, as originally envisaged by items VI and VII of the terms of reference, in the actual disinvestment process itself.**

The Commission in the First Report had also mentioned that "in order to enable the Commission to monitor the progress of the disinvestment process as per terms of reference IX, it is proposed that the SEG should keep the Disinvestment Commission informed of the various steps undertaken from time to time." According to the Government decision communicated to the Commission, "the recommendations of the Commission will be processed by the Ministry of Finance through the Core Group chaired by the Cabinet Secretary for obtaining the decision of the Cabinet thereon. The Core Group will also monitor the actual process of disinvestment in each case." **According to item IX of the terms of reference, the Commission is required to monitor the progress of disinvestment process and take necessary measures and report periodically to the Government of such progress. The Commission will, therefore, continue to take note of the Government decisions and monitor the progress of the disinvestment process with regard to the implementation of the Government decision with a view to maximising the benefits to the Government and the economy in general, accruing out of the disinvestment process.**

Government referred 40 PSUs to the Commission in September, 96, and ten more PSUs in March, 1997 (vide Appendix I). The Commission has arranged to have diagnostic studies of all these companies through professional consultancy firms prior to the consideration of disinvestment in them.

However, some of the administrative Ministries have raised objections to disinvestment in the PSUs under their purview, well after the PSUs

were referred to the Commission by Government. For instance, the Department of Defence Production & Supplies in the Ministry of Defence has written to the Commission that the PSUs under its administrative control, namely, Bharat Earth Movers Ltd., Bharat Electronics Ltd., Garden Reach Ship Builders & Engineers Ltd., and Hindustan Aeronautics Ltd. need not be considered by the Commission. Government have since accepted this view and withdrawn these four PSUs from the Commission. Again, recently, the Ministry of Coal has expressed similar views regarding PSUs coming under its administrative control, namely, Northern Coal Fields Ltd., South Eastern Coal Fields Ltd. and Western Coal Fields Ltd. In respect of Air India, the Commission understands that separate studies have been initiated by the Ministry of Civil Aviation for restructuring the company including merger of Indian Airlines with it.

**The matter whether a PSU should be considered by the Commission for disinvestment or not should be sorted out between the administrative Ministry and the Core Group (SEG) before referring it to the Commission. Government should have the prima facie intention to consider disinvestment in a PSU before referring it to the Commission. The Commission would then examine the PSU and recommend to Government whether there should be disinvestment, and if so, the timing and the modalities thereof. Once a PSU is referred to the Commission, the concerned PSU and the administrative Ministry concerned should be directed to co-operate fully with the Commission. In the absence of such clear understanding on these issues, the Commission's time and effort and Government resources, will be needlessly wasted as has happened in the case of the seven PSUs referred to earlier. Pending clarifications by Government, the Commission is unable to proceed further with the examination of the three PSUs under the Ministry of Coal.**

Among the 50 PSUs so far referred to the Commission, there are some which are subsidiaries of PSUs. These are :

Table 4 Holding companies

Name of the Subsidiary	Holding Company
● Hotel Corporation of India Ltd	Air India
● Northern Coal Fields Ltd. ● South Eastern Coal Fields Ltd. ● Western Coal Fields Ltd.	Coal India Ltd.
● Ranchi Ashok Bihar Hotel Corporation Ltd. ● Utkal Ashok Hotel Corporation	ITDC

The shares in such subsidiaries are held by the PSUs and not directly by Government. Disinvestment per se would relate to sale of shares held directly by Government. The case of subsidiaries, therefore, should not normally come under the purview of the Disinvestment Commission. Government have also recently clarified that the off loading of shares in such subsidiaries would be decided by the Boards of Management of the concerned Public Sector holding company and in future would not be referred to the Commission. In so far as some of the subsidiaries have already been referred to the Commission and the Commission has also completed the studies with a view to examining them for the purpose of disinvestment, the Commission would be making recommendations in those cases even if proceeds from disinvestment of shares by the holding companies may not accrue directly to Government.

### Disinvestment Fund

In its First Report, while recommending the offer of sale in GAIL, the Commission had mentioned that the price and the exact timing may be decided by the SEG depending on market conditions. In its recommendations for offer of sale in MTNL made in the Third Report, the Commission also reiterated among other things that the appropriate timing of the sale of shares will be decided by SEG keeping in view the market conditions.

These recommendations relating to market conditions have to be read along with that for setting up a Disinvestment Fund made in the First Report. It was pointed out that the separation of disinvestment proceeds from the other non-debt capital receipts in the Budget will prevent the short-term budgetary compulsions from obscuring the long-term benefits of disinvestment in loss making PSUs; and will help in highlighting the seriousness of the fiscal and revenue deficits and can compel actions to deal with them in the context of raising current revenues, and/or curtailing current expenditure.

**The essence of the Commission's recommendation is the delinking of disinvestment from the annual Budgetary exercise. Budget-driven disinvestment will have to be made under compulsion of the budgetary time-frame and may not allow the sales to be timed to suit favourable market conditions. Selling under the compulsion of the budgetary time-frame would encourage investors to bid lower prices particularly when market conditions turn unfavourable. The setting up of the Disinvestment Fund into which proceeds can be put in as and when disinvestment takes place would enable Government to undertake disinvestment at the most opportune moment in the market.**

The Commission would, therefore, suggest that in the light of the foregoing considerations, it is important to take an early and clear decision on the structure and utilisation of the Disinvestment Fund on the lines recommended in the First Report of the Commission.

### Strategic Sales - Some Issues

Strategic sale is one of the modalities recommended by the Commission to achieve disinvestment of Government shares in non-core PSUs. A strategic sale would involve selling a substantial stake in a PSU along with management control to a bidder who would complement the existing strengths of a PSU with a view to imparting long-term viability. The Commission has favoured an initial transfer of shares to the selected strategic buyer to the extent of 30 to 50% of equity and within an agreed time-frame, further dilution of Government equity through a combination of public offer and offer to the joint venture partner to enable him to acquire controlling interest in the company. The

Commission has proposed that Financial Advisers be appointed to draw up the terms and conditions for inviting bids from potential strategic buyers with appropriate prequalifications. In its first four Reports, the Commission has recommended strategic sales as a mode of disinvestment in the following Companies : ITI, HTL, KIOCL, BALCO, ITDC, MFIL, BRPL, HCL & PHL. Government have since accepted either wholly or in part the recommendations of the Commission in respect of BALCO, BRPL and KIOCL and indicated that Financial Advisers would be appointed to pursue action therefor. It is important at this juncture to further elaborate on some aspects relating to strategic sales.

- (1) It is essential to clarify the role of Financial Advisers in this context. The appointment of Financial Advisers has been recommended for arriving at a proper valuation of the assets of the PSU and fix a realistic value of the shares to be offered to the strategic buyers; to finalise the terms and conditions of the bid to be invited from prospective strategic buyers; to arrive at norms for prequalification of bidders; and finally to advise the Government on the evaluation of bids received. The Commission while making recommendations takes due account of all the relevant factors specific to the PSU as well as general market conditions in the industry in which it is operating. Its PSU specific recommendations are given after careful deliberations, consultations and a close examination of the different options before the PSU in the light of its past performance and future prospects. **The Financial Advisers therefore are expected to advise and assist in the implementation of the decisions of Government on the recommendations of the Commission on strategic sale of select PSUs. Their role is not to evaluate the disinvestment options as recommended by the Commission. This needs to be clarified while appointing Financial Advisers and settling their terms of reference.**
- (2) The essence of the strategic sale modality is the identification of a suitable strategic buyer who would contribute the required strengths to the PSU for its future viability and sustained operation in an increasingly competitive industrial environment. Such strengths could be in the areas of Finance, Marketing or Technology. **The importance of prequalification of bidders, as**

**stressed in the Second Report, arises from the need to select a suitable strategic buyer who could add to the existing or potential strengths of the PSU in any one or more of the areas identified as vital to the PSU's future and to avoid entry of others who may have intentions of merely reaping short-term gains.**

- (3) After the strategic buyer has been identified, there is need for entering into an agreement with him spelling out the manner in which the control of the PSU would pass from Government to him. Initially, there would be an offer of a substantial stake in the PSU, to the extent of 30 to 50% as recommended by the Commission at the price determined on the basis of the competitive bidding. In order to assure the strategic buyer that eventually Government would withdraw from the PSU, it is necessary that the agreement should spell out the details, including the time-frame, for further dilution of Government share holding. However, even at the time of the initial induction of the strategic buyer, Government should entrust management control to him as already recommended. The agreement should also spell out clearly the medium-term and long-term strategy of the strategic buyer to strengthen and improve the viability of the PSU.**
- (4) Continued Government presence in the PSU with significant share holding exceeding the holding of the strategic buyer even as a transitional arrangement would deter prospective bidders. The Commission, therefore, recommends that Government may keep its direct share holding below the level of the investment being offered to the strategic bidder by divesting some portion of its equity to institutions such as multilateral financing institutions, private Equity Funds, Mutual Funds and a few select PSUs who have business interest in the particular PSU being disinvested. Such sales would be at the same price as that paid by the strategic bidder. This will improve the response to Government's invitation for strategic partnership.**

**As already recommended by the Commission, 5% to 10% of the equity should also be earmarked for allotment to employees**



**under the existing SEBI guidelines as also to a trust under an appropriate Employee Stock Option Scheme (ESOP).**

- (5) The response to strategic sales will also improve if Government takes some immediate action towards restructuring the PSU concerned. Immediate financial restructuring including waiver of past long standing loans, arrears of interest and penal interest, if warranted under particular circumstances of a PSU, should be undertaken. Also where ever the PSU has a problem of an unviable workforce size, it would be useful for Government to undertake essential rightsizing through VRS before inviting the offer for such strategic sales. The Commission, in its earlier Reports, has already given its suggestions for making VRS effective and attractive. Among other things, Government needs to announce a suitable long-term VRS with stable terms so that workers concerned have a clear idea of the compensation they would receive. Secondly, the Commission has also proposed that the VRS should be reformulated to combine the features of a monthly payment, an annual payment and insurance in the long-term interests of the employees opting for the scheme. Thirdly, the PSU concerned needs to be assured of the funds required for implementing VRS. The Disinvestment Fund proposed by the Commission will take care of such assistance to the PSUs. Fourthly, for those employees who may not opt for the pension scheme but would like to set up a commercial venture with the lumpsum VRS payment, the management of the PSUs in collaboration with organisations like the Industrial and Technical Consultancy Organisation in the State should organise a counselling service so that they may be properly guided as regards alternative investment options like establishing a small business venture or retraining to seek alternate employment. Both these measures, namely, financial restructuring and implementing the revamped VRS would maximise the returns to Government through strategic sales. If financial restructuring and VRS were to be left to the new strategic buyer, it is likely that he would discount the value of the shares being sold to him to take care of these measures and such discount could actually be higher than the cost to Government in undertaking them prior to sales.**

## **Audit of Disinvestment Transactions**

Disinvestment in PSUs by Government over the last five years has attracted considerable public attention, especially after reports of audit of such transactions were completed by the C&AG and submitted to the Parliament. Experience world wide has shown that in spite of all the conceivable procedural safeguards, in retrospect it is possible to conclude in some cases that some of the disinvestment procedures could have been improved. **In order that disinvestment is implemented ultimately in the best interests of the public, while at the same time establishing a proper environment for decision making, it is essential that audit of each disinvestment by the C&AG is conducted thoroughly, expeditiously and with the involvement of professionals familiar with the working of the industry and the capital markets.**

The need for expeditious completion of audit cannot be exaggerated. Disinvestment is a continuous process of learning as it has been observed in other countries. Delayed audit of performance would not serve this useful purpose of improving the disinvestment process and maximising the gains therefrom to the public exchequer. **It would be desirable that such audit should be carried out within six months of the completion of the disinvestment transaction. This would ensure that, the people involved in the transaction would be available for examination at a time when their memory would be fresh with regard to the action taken and decisions arrived at soon after the disinvestment transaction under audit. Also an early availability of audit reports on past transactions would provide opportunities for improving the quality of processing subsequent disinvestment transactions. Similarly, involvement of professionals with full knowledge of the working of the industry and the capital market in the process of audit is extremely vital. This would enable the process of audit to identify any deficiencies in decision making and in implementation of these decisions while, at the same time, protecting the officials concerned against action for bonafide decisions under conditions prevalent at that time. This would improve the confidence of all concerned and enable the right kind of approach, attitude and commitment for implementing the disinvestment decision objectively and expeditiously in the ultimate interest of maximising the gains from disinvestment.**

# PART B



## 2. SPECIFIC RECOMMENDATIONS

### 2.1 Engineers India Limited

#### Evolution

Engineers India Limited (EIL) was established in 1965 in collaboration with M/s Bechtel Corporation, USA mainly to establish consultancy capabilities in India with respect to petroleum projects such as refineries, oil field development and oil and gas pipelines.

Over the last three decades, the growth of EIL can be divided into four stages. In the first stage, EIL responded to the needs of the market by diversifying into new areas of business such as offshore exploration structures, oil/gas production systems, fertilisers, etc. In the second stage, the company set up its own technology development and research facilities in order to provide specialised skills in the areas of project engineering design, tendering, procurement. In the third stage of growth, EIL entered new markets by forming subsidiaries and joint ventures abroad. In the last stage - during the nineties - the company has focused on improving internal systems which has enabled it to obtain ISO 9001

The company operates under the administrative control of the Ministry of Petroleum and Natural Gas. In FY'94, the Government disinvested 6% of the equity of Rs. 18 crores in favour of financial institutions, mutual funds and private parties at an average price of Rs. 585. EIL's shares are listed on the Delhi Stock Exchange. As on July 22, 1997 the share price was quoted at Rs. 650. Due to the limited public shareholding, the stock is illiquid with low trading volumes.

#### Industry & Business Analysis

#### Project Services & Role

EIL's services range from pre-feasibility studies to commissioning support for projects across a wide range of process industries (Table 1). EIL's competency across a range of process industries stem from the synergy available across industries in terms of designing and engineering practices, similarity of equipment and materials applicability of codes.

However, EIL's presence in a sector is based on commercial considerations.

An analysis of the turnover of the past three years indicates that the sectoral share of business is dominated by Refineries, Petrochemicals and allied businesses which together constituted about 70% of the total turnover. EIL's role in projects may vary from that of a prime management contractor (PMC) to that of an engineering, procurement, construction (EPC) contractor.

Table 1 EIL's Project Services & Role

Project Services	Project Role	Industries
<ul style="list-style-type: none"> <li>• Project feasibility</li> <li>• Basic engineering design</li> <li>• Detailed engineering design</li> <li>• Procurement</li> <li>• Construction supervision</li> <li>• Project management services</li> <li>• Commissioning support</li> </ul>	<p><b>PMC</b></p> <ul style="list-style-type: none"> <li>• Consultants involved from the feasibility stage (to basic design, award of contracts and subsequent monitoring of the project), operating on behalf of client.</li> <li>• In some instances consultant also undertakes (rather than award to another contractor) specific packages like detailed designing, construction supervision etc. (Strictly termed as EPCM - i.e. engineering, procurement and construction management)</li> </ul> <p><b>EPC</b></p> <ul style="list-style-type: none"> <li>• Consultant undertakes all aspects (including engineering, procurement &amp; construction) of the project (or a specific module of the project) right from design to procurement to construction (on a turnkey basis)</li> </ul> <p>Consultant would assist in project funding (through its linkages with FIs)</p>	<ul style="list-style-type: none"> <li>• Refineries</li> <li>• Oil &amp; Gas</li> <li>• Petrochemicals</li> <li>• Fertilisers</li> </ul>

The financial terms on which projects are awarded vary from the cost-plus method to the Lumpsum Turnkey method as shown below:

**Table 2 Financial Terms of Projects**

Method	Description
Cost plus or (Time plus & Material plus)	Consultant is re-imbursed for the actual effort based on a man-hour rate which has in-built margins
Lump sum fee	The entire consultancy effort is estimated and quoted for as one figure
Lumpsum Turnkey (LSTK)	Consultant is responsible for engineering, design, procurement, construction & commissioning within overall financial limits

In the past, most of the projects executed by EIL were on a cost-plus or a lumpsum basis which had limited emphasis on time and costs and therefore had low financial risks. As a consequence, margins, though limited were protected.

On the other hand, the trend abroad is that a significant number of projects are undertaken on a lumpsum turnkey basis (either the whole project or the project divided into two-three modules each of which is executed on a turnkey basis). Domestically too, it is expected that LSTK would be increasingly preferred over the other methods as the customer will benefit by way of reduced costs and on-time implementation.

As far as the consulting companies are concerned, project execution on LSTK basis will involve the ability to conceptualise, monitor and implement projects by adhering to time and cost schedules. If the project has not been properly estimated in terms of organisational effort and time, the consulting company could face penalties. Thus, taking on large projects on LSTK basis may be riskier for a consultancy company. In addition, the consultant may be required to provide funds for temporary periods during project implementation. Also the ability to arrange long-term finance for execution of the projects assumes importance.

In addition, strong bidding skills and strong linkages with suppliers/sub-contractors /technology licensors will also be important. Presently, EIL's capability to take on projects on a LSTK basis is relatively limited. The company is in the process of improving internal systems in order to progressively switch over to this method.

## Competition

The ongoing liberalisation programme of the Government has led to a redefinition of the client base in EIL's traditional areas of operation with a resultant impact on business. The refinery sector which was hitherto reserved for the public sector has been opened up for private sector participation. Unlike public sector refineries, private sector refineries are free to choose engineering consultants other than EIL. Recently, the Government has proposed substantial autonomy to nine large PSUs; four of these are in the Oil sector and are important clients for EIL. With the delegation of autonomy, the driving factor in consultant selection for these PSUs would be commercial. Thus, EIL may no longer expect preferential treatment.

The industry has seen the entry of foreign companies such as Kvaerner Powergas, Betchel, Flour Daniel, Chemtex, etc. in the large and mega projects segment. Foreign consultants have been preferred in cases where the projects have to access overseas funds.

However, EIL's experience in handling large projects and the depth of technical expertise is expected to help the company to face competition. In fact, EIL currently has a good-mix of clients in the public and private sector. The average client-wise and sector-wise break-up for the past three years indicates that the public sector accounted for 56%, private sector 24% with the balance 20% coming from overseas clients. Within the public sector, the Oil sector companies comprising refining, oil and gas, petrochemicals dominated with more than 80% of EIL's turnover.

EIL's acceptance with its customers - both in the public and private sector - is quite high given its credibility, range of experience and



expertise in handling mega projects. Industry feedback indicates that EIL has a good standing in the industry in terms of project management capabilities, high quality of manpower and technical services. In the hydrocarbon sector, the track record and the brand equity of the company is particularly high.

A number of significant investments are likely to take place in the Ninth Five Year Plan in the refineries, pipelines, petrochemicals sectors both by the public sector as well as the private sector. These investments present attractive growth opportunities for EIL as well as its competitors. If EIL has to cash in on these emerging opportunities, it is imperative that the company should prepare itself for taking on new projects on a LSTK basis.

### Access to Technology

In the majority of down stream secondary and tertiary processes (e.g. Naphtha crackers) where technology is largely licensed, EIL has worked with most of the major technology suppliers in the world. Typically, EIL evaluates and recommends technologies to the client who takes the final decision. In general, EIL's acceptability to technology licensors has been quite high in the past in terms of detailed design capabilities.

A new trend which seems to be emerging is that global engineering consulting companies have started acquiring specific technologies in order to create entry barriers. Therefore it is perceived that access to technology will become increasingly important in future. Anticipating these changes, EIL has already entered into strategic alliances with specific suppliers for specific technologies. These would allow EIL to enhance its business through access to new markets and exposure to latest technologies. However, it is more likely to be available along with equity participation.

## Financial Analysis

The financial performance of the company over the past five years is presented in the table below :

Table 3 Financial Performance

(Rs.Crores)

	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	260	235	224	157	105
Other Income	31	24	20	17	13
Total Income	291	259	244	174	118
Operating Profit	83	86	85	41	25
Profit after Tax	68	60	60	29	26
Equity Capital	18	18	2	2	1
Tangible Networth	320	256	200	142	115
Gross Margin (%)	32.0	36.5	37.8	25.9	24.0
Net Margin (%)	26.3	25.5	26.9	18.7	24.7
ROCE (%)	33.9	40.7	49.7	37.5	29.7
RONW(%)	21.3	23.3	30.1	20.7	22.6
Earnings per Share (Rs.)	38(*)	32(*)	302	147	259
Dividend (%)	25.0	20.0	100.0	100.0	100.0

(\*) on enhanced equity

EIL's income from services has shown a consistent increase in the past five years with a sharp increase in FY'93 and FY'94. This was primarily due to large increases in domestic income, large increases in overseas income and a higher contribution on foreign businesses. EIL's expenditure essentially comprises of salaries and wages paid to employees. With most of the premises owned by the company, rental outgo is relatively low. As a result, gross margins have also been quite healthy and are above 30%. Since EIL has no borrowings, the net margins of the company are equally high in the region of 25%. EIL's ROCE compares very favourably due to high level of internal accruals. The EPS have been impressive in the past five years.

## Strengths and Areas of Concern

Based on the above business and financial analysis, the strengths and areas of concern for EIL are as below :

### Strengths

*Strong Business Position* EIL is the only Indian consultancy organisation which is capable of taking up large and mega projects in a wide range of process industries for execution. In addition, it is the only company to have undertaken all aspects of refinery projects including basic design. The company has thus built up an unparalleled track record and has a high brand equity with both technology suppliers and end users.

*Flexibility to work Across Areas* EIL possess expertise in a wide range of industries by availing of the synergy available across a wide range of industries in terms of designing and engineering practices, similarity of equipment and materials and applicability of codes. This has helped EIL to diversify business risk so that downturns in any one industry would not unduly affect EIL's income.

*Human Resources* EIL's main capital is intellectual in nature. Among all companies including foreign MNC consultants, EIL has the largest manpower base which is rated quite high in terms of capability.

*Strong Financial Position* EIL has demonstrated consistent profitability since inception which have contributed to a high level of internal accruals. As on date, the company has no borrowings. The reserves as at March 31, 1997 are substantial at around Rs. 385 crores against an equity capital of Rs. 18 crores.

*Bright Growth Prospects* The Indian hydrocarbon sector has been opened up to private sector participation. This is expected to increase the level of investments thus opening new growth opportunities for EIL.

### Areas of Concern

*Changing Business Scenario* In the past, EIL had a near monopoly position due to various reasons. The liberalisation measures initiated by

the Government have brought about a change from cost plus method of bidding to the LSTK method of project management. EIL currently does not have enough experience in terms of bidding for projects on a LSTK basis.

*Increased Competition* The entry of private sector participants in the Refinery sector coupled with the liberalisation measures initiated by the Government have seen the entry of a number of established multi-national companies into India. These companies are expected to increase the competition levels for EIL.

*Access to Technology* Increasingly, global engineering consulting companies have started acquiring specific technologies in order to create entry barriers. Therefore it is perceived that access to technology will become increasingly important in future. In such a scenario, EIL ability to source technology will become important.

## Recommendation

As can be seen from the above analysis, EIL is a profitable enterprise and has been a consistent performer with a healthy ROCE. The Company has played a major role in providing engineering consultancy support to the growth of refinery and petro-chemical industries in the country. However, the recent changes in the economy requires a long-term business strategy that would enable it to build on its current business strengths and complement them through strategic partnership, with other capabilities to cover areas of weakness, so that it could benefit from emerging opportunities and combat the competition of global consultancy companies. It has also the potential to become a global consultancy firm through such partnerships. This effort would be necessary not merely for EIL to expand the scope of its operations in global terms but also to sustain its position in the domestic sector. The opening of the hydrocarbon sector for private investment will see a large number of private sector and joint sector refinery companies coming up and EIL will have to compete with international players to secure the contracts on the basis of competitive bidding. Two other developments which need to be addressed by EIL are the change in business preference from EPC contracts to LSTK contracts and the consequent need to access cost effective funds for project management from domestic

or international agencies and multilateral funding agencies. EIL would need to take urgent action to consolidate its own internal strengths and forge a strategic partnership to sustain its presence in this fast changing business environment.

Another dimension of EIL that has emerged from the analysis is its strong manpower base. It has a large pool of qualified technical manpower. This pool is likely to be the target of new players, particularly the international consultancy companies and EIL has to address HRD with positive measures, building up employee loyalty and commitment.

The field of consultancy services over the years has become increasingly competitive. There is also entry of a large number of international companies. Viewed from this angle, a consultancy company could be said to belong to the non-core sector. Disinvestment in EIL, however, is not viewed from the standpoint of budgetary resource-raising or Government exiting from a sector where its presence no longer serves a public purpose. Disinvestment in EIL is aimed at strengthening EIL as an important domestic consultancy company which has played a prominent role in the industrial growth of the country and is seen to have a similar role in the vital infrastructural sectors in the future. The Commission, therefore, recommends a mix of disinvestment modalities which would enable EIL to continue to function as a major consultancy company in the field of hydrocarbons, petrochemicals and fertilisers as also in the new emerging sectors of power and natural gas.

1. EIL may scan the market for a suitable strategic partner who may be offered upto 30% equity stake in the Company alongwith appropriate role in the management. Such a partner should be able to add to EIL's strengths in terms of project management particularly LSTK capabilities, global acceptance and access to international funds, without, at the same time, eroding its strong domestic brand equity.
2. EIL may also establish an Employee Stock Option Plan (ESOP) and assign 10% equity towards this purpose. The available models of ESOP would need to be closely studied and modified to suit EIL's own HRD requirements, particularly the need for

**providing incentive and motivation to the middle and top level technical personnel.**

- 3. 10% of EIL's equity may be offered to public sector oil companies, as also to SAIL, GAIL and NTPC in view of EIL's expertise in providing services to these companies.**
- 4. Already 6% of EIL's equity is with the public and this may be increased to 24% through an offer to domestic investors, at an appropriate time, after the strategic partner is inducted.**

**Through this process, Government may reduce its equity holding to 26% and maintain it at that level with a view to ensuring that EIL retains its main character as an Indian Consultancy Company in strategic areas.**

**Government may appoint a Financial Adviser to effect the strategic sale as recommended above. The Adviser would also need to identify strategic requirements of EIL which will form the basis of the pre-qualification norms for the selection of the strategic partner.**

## 2.2 Engineering Projects (India) Limited

### Evolution

Engineering Projects (India) Limited (EPIL) was established in 1970 as “Indian Consortium for Engineering Projects” by seven Public Sector Undertakings under the Ministry of Heavy Industry viz., Instrumentation Limited, Heavy Engineering Corporation, Hindustan Steel Construction Limited, Bharat Heavy Plates and Vessels Limited, Bharat Heavy Electrical Limited, Mining and Allied Machinery Corporation Limited and Triveni Structurals Limited. Subsequently, it became a PSU under the same Ministry.

The company’s main line of activities include preparation of project reports, feasibility studies, detailed engineering, supply of plants and equipment, civil and structural work, erection, trial runs and commissioning of operations etc. in the areas of civil and structural work, material handling systems, metallurgical sector, chemical process plant, environment and pollution control etc. EPIL undertakes turnkey implementation of major industrial and infrastructural projects both in India and abroad.

The paid up capital of EPIL is Rs. 8 crores and Government of India (GoI) owns 98% of the total share capital with the balance being held by the 7 PSUs.

### Industry Analysis

An analysis of the income of the past three years indicates that EPIL mainly operates in the engineering contract and civil construction sector. Engineering contracts are driven by the level of investments in the steel and non-ferrous metals. These industries are experiencing a slow down in investments over the past few years. Most of these industries are now in a consolidation phase and new investments or investments in modernisation and upgradation are not forthcoming. The market for contracts is thus shrinking.

In addition, EPIL also faces tough competition from peer PSUs such as Metallurgical & Engg. Consultants (India) Limited (MECON), DCPL

etc. apart from units in the private sector. Many foreign companies have also set up their operations in India and are bidding for domestic contracts. Thus, the level of competition in the engineering contracts segment, is quite high. In the civil construction sector, EPIL faces competition from peer PSUs like National Building Construction Corporation Limited (NBCC), NPGC etc. apart from a host of medium sized companies in the private sector.

## Business Analysis

EPIL has long experience in implementing multi-disciplinary projects on turnkey basis in India and abroad with expertise in detailed design and engineering, quality control, project construction management etc. EPIL's business activities and their percentage share in the total turnover for FY 97 is as under.

Table 1 Break-up of Business Activities

Sl.No.	Sector	% share
1	Civil Construction	27.8
2	Engineering Contracts	
	• Material Handling	36.8
	• Metallurgical sector	25.0
	• Water Supply & Miscellaneous	10.4
	Total	100.0

The major works under civil construction handled by EPIL are integrated townships, large public building/high rise Reinforced Concrete Cement (RCC) structures etc. EPIL has work experience in the material handling systems for coal, ore, food grain, fertiliser etc. EPIL has specialised in the metallurgical sector in the areas of Reheating & Heat Treatment Furnaces, Electric Arc Furnaces, Processing & Finishing Lines, Lime Kilns, Foundries etc. EPIL has also set up sugar/chemical plants, ore beneficiation plants etc. In the field of pollution control and environment management system, EPIL has set up water supply & sewage treatment plants, effluent treatment plants etc. for their clients.



In order to gain a competitive edge, EPIL had from time to time, entered into term specific and project specific collaborations with foreign technology suppliers such as Mannesmann Demag of Germany, Stein Heurtey of France etc. Through these collaborations, EPIL could successfully implement a number of projects involving state of the art technology for integrated steel plants of SAIL, TISCO, Essar Steels apart from integrated aluminium producers such as NALCO, BALCO etc. However, most of the technological tie-ups have expired and only two collaborations viz., one in the field of industrial lime & dolo Calcination plants, and other in the field of setting up Nitric Acid plant and Sulphuric Acid plant are currently valid.

The Engineering Contracts division is the only division of EPIL which is currently profitable. This was because of all the major steel plants and non-ferrous units have undertaken massive modernisation and expansion programmes in the eighties. However, the business from this segment is on the decline.

Apart from the domestic assignments, EPIL had undertaken various project works in Iraq and Kuwait. However, due to the Iran-Iraq war, EPIL suffered heavy losses as many of its projects which were in the midst of completion got delayed. Payments on these contracts have not materialised. Even though the company had completed all the projects, there are still outstanding dues receivable from the Iraqi clients. Some claims have already been settled against which EPIL had received bonds issued by the RBI amounting to Rs.75 crores. Similarly, EPIL had lost about Rs. 55 crores due to Kuwait war.

The total manpower strength of EPIL as at 31st August, 1997 was 643. EPIL has 209 engineers, while its finance wing has 92 employees and other services like personnel, administration have 342 support staff. The proportion of non-technical staff to the total employee strength appears to be on the higher side for a project consultancy organisation.

## Financial Analysis

The financial performance of EPIL for the past five years is given below:

Table 2 Financial performance

(Rs. Crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Operating Income	155.0	125.0	130.9	135.0	101.4
Operating Profit	4.8	-3.7	-8.6	-2.7	-17.2
Profit after Tax	-48.8	-61.2	-66.8	-61.6	-59.8
Equity Capital	8.0	8.0	8.0	8.0	8.0
Tangible Net Worth	-708.2	-655.8	-591.1	-569.7	-508.2

*Note : The ratios have not been presented as they are all negative*

The company's operating income has remained more or less constant over the past five years. At the operating level, the company's performance in FY'97 improved and showed profits unlike the previous years. However, due to increased burden of interest costs, the net losses remained in the range of Rs. 50 crores. The Government loans to EPIL as at 31st March, 1997 amounted to Rs. 225 crores and the interest accrued on the same amounted to Rs. 621 crores resulting in a total outstanding payable to Gol amounting to Rs. 846 crores. Due to the poor financial position, EPIL has not been in a position to pay interest on the Government loans. Due to the above, the company has a negative networth of Rs. 708 crores as at 31st March, 1997.

The margins in civil construction contracts has been very low because of strong competition from both private and public sector companies. EPIL was making better margins on its engineering contracts but this business is cyclical in nature. The company made consistent profits from this sector of business during the past decade except in FY 96. However, at the overall operating level, the company still made losses.

### Strengths and Areas of Concern

Based on the above business and financial analysis, the strengths and areas of concern for EPIL are as below :

## **Strengths**

***All India presence*** EPIL has offices in all project sites which is spread across the country. Its operations are controlled from four zonal offices. This wide geographical presence has helped the company to address a large number of clients.

***Own Construction Equipment*** EPIL has its own construction equipment which are depreciated fully.

***Extensive network of vendors and contractors*** Over a period of time, EPIL has been able to develop its own network of suppliers and sub-contractors.

***Specialised professionals*** Due to various technological tie-ups in the past, the EPIL professionals have acquired experience and expertise in various disciplines.

## **Areas of Concern**

***Surplus manpower*** As mentioned above, the large component of non-technical staff has resulted in higher employee cost.

***Unattractive Balance Sheet*** The unpaid loans together with accumulated interest makes the balance sheet of EPIL unattractive and will limit the ability of EPIL to raise funds from the market for new investments.

***Competition*** EPIL is mainly in the business of construction contracts where the company has to face competition from both private sector and public sector. Moreover, multi national companies have already started their operations in India.

***Technical collaborations*** In the past, EPIL executed all projects with the technical collaborations from world class licence holders with state-of-the-art technologies. However all such agreements have expired. Currently EPIL has only two technology agreements. Given the nature of the sector in which it operates, technology agreements with world class licence holders is a must for sustaining future business.

## **EPIL - Current Position**

**EPIL as it stands today does not have any significant strengths in the area of civil construction. It has to face competition from other PSUs. In spite of having an early presence in the Middle East region, the company had to withdraw from these projects as a result it had to incur substantial losses. Due to this adverse financial performance, Government had to step in and provide budgetary support periodically.**

**In the other main areas of its operations, i.e. engineering contracts, EPIL had some strengths in the form of technical collaborations. However, new investments in these sectors are unlikely to materialise and EPIL may not also be able to bid for projects given its poor financial strength.**

## **Recommendation**

**EPIL was set-up at a time when major investments were being planned by the Government in metallurgical industries such as steel and non-ferrous metals. Its primary role was to provide engineering and construction support to its seven promoter PSUs over a period of time, the Government set-up other PSUs such as MECON with similar lines of activities.**

**Currently, EPIL operates in the civil construction and engineering contracts sector. This business is characterised by low entry barriers in the form of low initial investments and the lack of any proprietary knowledge or skill base. As a result, the number of companies operating in the segment - both from private and the public sector - is quite high. This high level of competition has made the market fully contestable. On these grounds, the Commission classifies EPIL as non-core.**

**The poor financial position of the company is a major cause of concern. It is understood that the company does not come under the purview of the Sick Industries (Companies) Act, 1985 despite erosion of its networth many times over. The company is currently in a deep financial crisis and given the current competitive situation, a**

**complete turnaround under Government management and ownership seems uncertain.**

The commission has noted that the Department of Heavy Industry has already obtained approval of the Government for the sale of equity upto 74% in the company to a strategic buyer. Not much headway has been done, however, in the matter of identifying a suitable buyer. **The Commission recommends that the Government should pursue the decision already taken. In the absence of a satisfactory response from prospective bidders, the Commission recommends closure and sale of the assets of the company, after proper valuation through a transparent competitive bidding process, and after giving fair and equitable compensation to the employees.** For this purpose, the Commission recommends that Government should appoint a Financial Advisor immediately. The procedure for appointing Financial Advisers for strategic sales and conducting the sale has been outlined in Part B of the First Report of the Commission (pp 38-40).

## 2.3 Hindustan Prefab Limited

### Evolution

Hindustan Prefab Limited (HPL) was set up in 1950 as Hindustan Housing Factory and was taken over by Government in 1955. The company's name was changed in 1978. The company was set up primarily to provide cheap houses using light weight concrete panels for the displaced persons from West Pakistan. However, due to various reasons, the initial objectives could not be achieved and the company diversified its activities. It started manufacturing prestressed concrete (PC) railway sleepers, PC electric poles, PC fence poles, pavement slabs etc. Since the early nineties, company started site construction work which has currently become the principal activity.

HPL is a 100% Government owned company with an equity capital of Rs. 6.97 crores.

### Industry Analysis

The construction sector plays a vital role in the growth of any economy. In India, it represents about 6% of the GDP. However, the companies in this sector are highly fragmented as the entry barriers are low. Secondly, the construction sector generates considerable employment.

The pre-fab segment of the construction industry in India is still in a nascent stage of evolution. Large construction companies have traditionally concentrated on the higher end of the pre-fab segment where the products are used for building bridges etc. In the lower end, such as PC railway sleepers, PC electric poles, the industry is again heavily fragmented due to low entry barriers. The existing companies are mostly set up in the unorganised sector. The current government policies are also not favourable for the development of pre-fab industry in the organised sector. As such, majority of the work of this nature is done at the construction site itself.

## Business Analysis

The principal activities of HPL and their share in the total business for FY 96 are as follows :

Table 1 Principal activities (Rs. in lakh)

S.I. No.	Products/Activities	Sales Value	% age to total
1	PC Electric Poles	142	5
2	PC Railway Sleepers	503	17
3	RCC & Vayutan	295	10
4	Site work	1888	65
5	Land Development	86	3
	Total	2914	100

The business operations of HPL can be divided into two segments viz., manufacturing of pre-fab products and managing turnkey construction projects. Even though, HPL started its operations with manufacturing, currently the construction segment has over taken the manufacturing activities as is evident from the above table. However, the contribution margins from the construction segment is low when compared to the pre-fab segment mainly because of the fact that HPL uses sub-contracting.

The product segment such as PC electric poles and PC railway sleepers, PC slabs are low value, low tech items. The principal buyers of these products are State Electricity Boards, Railways etc. The market growth rates are static; moreover, the competition from the unorganised sector, the cost impact due to duty structure have contributed the poor profitability of HPL.

The technology in use in HPL is called the "long line" method which is more costly than the cost effective method of "stress bench" which is used by many of the competitors of HPL. This together with the duty structure has put HPL in a disadvantageous position when compared to its competitors. However, the company has plans to upgrade its technology and diversify its product mix.

Apart from these activities, HPL has an integrated wood processing plant including that for seasoning and termite treatment. The plant is lying idle

for the past several years due to the ban of use of timber in construction of government buildings. The company is making efforts to revive this plant by taking up the work for furniture industry.

The company currently employs 699 people. The total salary and wages bill account for 50% of the total fixed cost. The company received Rs. 6.42 crores from the National Renewal Fund for payment of voluntary retirement (VR) benefits and during April' 94 to March' 96 369 employees accepted VRS. The company intends to bring down the surplus manpower in future.

### Future plans

In the circumstances mentioned above, the company is in the process of shifting its business focus and is planning to take up the manufacture of prefab products for the construction sector and undertake such construction projects which predominantly use prefab building blocks. In order to enable this project, the company requires investments in plant and machinery.

The company is located in an area of around 30 acres in Delhi. The factory alongwith a developed township occupies part of the area. The company intends to develop a part of this land into commercial complexes and realise money for meeting the liabilities and future investment. For this purpose, the company has already initiated the process of getting approvals from the competent authorities.

### Financial Analysis

The financial performance of HPL for the past five years is given below:

Table 2 Financial performance (Rs. Crores)

	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	32.86	30.62	31.82	32.43	26.09
Operating Profit	-2.42	-0.49	0.67	2.20	0.74
Profit after Tax	-4.35	-1.98	-1.57	0.62	0.46
Equity Capital	6.97	6.97	6.97	6.96	6.96
Tangible Net Worth	-9.20	-4.84	-2.87	-1.30	-1.93

*Note : The ratios have not been presented as they are all negative*



Even though the company's operating income remained almost constant during the past four years, the operating profit has gone down substantially. This has resulted in erosion of networth and as at 31st March, 1997 the company's networth stood at Rs.13.96 crores (Provisional). The Government has given a loan of Rs.11.13 crores to HPL and on the same interest accrued and due till 31st March, 1996 amounted to Rs. 18.37 crores. The annual interest liability on the loan exceeds Rs. 2 crores and the same is expected to go up keeping in view the poor financial position of the company. There are no signs of improvement in the performance of HPL.

## Strengths and Areas of Concern

Based on the above business and financial analysis, the strengths and areas of concern for HPL are as below :

### Strengths

*Government Departments as Client* The major clients for HPL products are railways, Electricity Boards etc. Moreover, HPL is taking up construction activities for Government. HPL can, at best expect some preferential treatment by virtue of being a Government owned company.

*Diversified Business Activities* HPL has diversified into small site based construction management activities. The anticipated investments in infrastructure will benefit HPL.

### Areas of Concern

*Competition* HPL operates in those segments where the industry is fragmented and is in the unorganised sector. HPL has to face competition from the small local pre-fab manufacturers who normally meet the demand of the customer at the site.

*Limited Customer Base* HPL's main customers are only Railways and a few State Electricity Boards. The company never tried to expand their business beyond these two agencies.

*Technology* The technology used by the competitors of HPL in the manufacture of pre-fab products are cost effective. This has put HPL at a disadvantageous position vis-a-vis its competitors.

***Differential Duty*** Conventional building products as well as prefab building components, if made at site of construction, do not attract excise duty, whereas if made at a factory premise attracts excise duty. This has discouraged increased use of factory produced prefab building blocks.

***Surplus Manpower*** The current manpower strength of the company is 699. It is estimated that for similar sized operations, only half of the existing strength is required.

***Lack of project management expertise*** HPL uses sub-contracting for the site construction work and as such does not have expertise in the project management area due which there are cost and time overruns. This sub-contracting results in reduced contribution also.

## **Recommendation**

HPL was set up with a view to providing cheap housing for displaced persons during the partition. However, due to various reasons, it could not achieve its initial objective and diversified into other business of construction, manufacturing of concrete railway sleepers, concrete electric poles etc. These businesses have low entry barriers and are highly competitive; consequently the returns are also low. Moreover, the unorganised sector has the advantage of lower fixed overheads and the exemption from paying excise duty. As a result, the competitive scenario is getting increasingly tougher for HPL in its business activities.

Since the lower end of the construction sector is competitive and highly fragmented, there is no public purpose served by Government's presence in these sectors. On these considerations, the Commission classifies HPL as non-core.

Due to the increased competitive pressures, HPL currently is working at a loss. Till date, Government has supported the operations of HPL by providing budgetary support in the form of loans. As on March 31, 1997, the loan and the accumulated interest amounted to Rs. 29.50 crores. As of the same date, the company had a accumulated losses of Rs. 21 crores on an equity base of Rs. 7 crores. It is understood that the company does not come under the purview of BIFR inspite of the complete erosion of its networth.

The company's operations are located in the heart of Delhi and are spread over an area of 30 acres. The Commission is of the view that some of the land held by the company could be used for developing commercial/residential complexes. If the commercial complexes are developed by HPL, the company's financial position would improve substantially which will enable the company to venture into new value added products such as pre-fab building blocks. These products have bright industrial and construction demand. In fact, a number of companies in the private sector are contemplating entry into this product line.

In this regard, HPL has already submitted a turnaround plan to the Ministry of Urban Affairs and Employment. According to this plan, the company has proposed the manufacture of value added items. In order to finance these plans, the company proposes to develop a part of its land holding into commercial complexes. The company is in the process of getting the requisite approvals from the competent authorities.

In view of the indifferent financial health of the company, the Commission is of the view that the turnaround plan may not be effectively implemented by the company itself. Hence in order to take up the turnaround plan and also induct new technologies, the induction of a strategic buyer is desirable.

The Commission therefore recommends that the Government may offer upto 74% of the shares of the company in HPL to a strategic buyer. The choice of the strategic buyer should be done carefully so that the project of development of commercial sites as well as the diversification of the company's operations into higher value added products are both undertaken. However, this can only be possible if Government approval for the change of land use for a part of HPL land holdings is granted before the sale.

Prior to the strategic sale, it is recommended that the Government announce a stable VRS policy along the lines indicated by the Commission in its Fourth Report which will help the company to rightsize the workforce.

As already recommended by the Commission, the Government should appoint a Financial Adviser to effect disinvestment through a strategic sale. The modalities for strategic sale have already been indicated by the Commission in its First Report and further elaborated in this Report.

## 2.4 IBP Company Limited

### Evolution

IBP Company Limited (IBP) was first incorporated in Burma in 1909 and later in India in 1942. The company was taken over by Government in 1970 and was made a subsidiary of Indian Oil Corporation. In 1972, IBP was demerged and established with its own identity under the Ministry of Petroleum and Natural Gas.

Traditionally, the principal business of the company has been marketing of petroleum products. Since the early sixties, the company diversified into engineering activities such as cryogenic and industrial containers, etc. The company later diversified into the manufacture of industrial explosives.

As a backward integration move, IBP set up a plant for lube blending which was later transferred to a joint venture company formed with Caltex Oil Corporation. As part of the same backward integration move, the company is also in the process of setting up the Numaligarh Refinery Limited jointly with Bharat Petroleum Corporation Limited and Government of Assam. IBP is also in the process of setting up a joint venture for the provision of terminalling services within the country.

Balmer Lawrie and Co. Ltd. (BLCL) which is 61.8% owned by IBP, is in the business of industrial packaging, grease and lubricant manufacturing, leather and oleo chemicals, marine freight containers, tea exports and travel and tour business.

The equity capital of IBP as at 31st March, 1997 was Rs. 22.14 crores. This has gone up from Rs. 14.76 crores as at 31st March, 1996 due to a bonus issue of 1:2 in FY' 97. The shareholding pattern of IBP as at 31st March, 1997 was as follows:

Table 1 Shareholding pattern

Shareholder	% holding
Government of India	59.6
Fin. Institutions & Banks	23.0
Employees	1.0
Non-residents	0.4
Others	16.0
Total	100.0

The shares of IBP are listed on all major stock exchanges. As on 7th November, 1997, the stock was quoted at Rs. 117/25 on the Bombay Stock Exchange.

## Industry Analysis

IBP's three main lines of business are: marketing of petroleum products, manufacture of industrial explosives and manufacture of cryogenic and industrial containers.

### Petroleum Products Marketing

The petroleum sector in India can broadly be segmented as follows :

- Crude oil exploration and production (ONGC & OIL)
- Integrated refining cum marketing companies (IOC, HPCL & BPCL)
- Exclusive refining companies (MRL, CRL & BRPL)
- Exclusive product marketing companies (IBP)

Currently, the petroleum sector continues to be regulated although the Government has announced a phased decontrol. The production and marketing of petroleum products are controlled by the Oil Co-ordination Committee (OCC). Under the current administrative regime, the oil refining companies are not allowed to sell their products freely. The market shares of oil companies are controlled by the Sales Plan Entitlement (SPE). Until FY' 89, SPE allocation varied with each year. Subsequently it was pegged to the market share of each company at the FY 90 level. As such, all marketing companies are allowed a uniform growth of sales so as to share the incremental trade on the basis of the prevailing market share. The market share as per SPE of the product marketing companies are as follows:

Table 2 Market Share

Company	% share
Indian Oil Corporation	55
BPCL	20
HPCL	19
IBP	5
Others	1
Total	100

Every month, the OCC makes an industry supply plan for ensuring supplies to all refining companies. These companies are allowed to sell their products throughout the country as they are not bound by any territorial restrictions. The cost of products made available to the marketing companies at various supply locations is the same, irrespective of the source, ownership and mode of transportation upto the destination.

The Product Exchange Agreement (PEA) allows the oil companies to sell products of other companies by matching regional demand with their storage and distribution facilities. Under this agreement, one company can sell products directly to another oil company. This arrangement has been devised to avoid cross haulage of products, minimise transportation costs and optimise usage of facilities.

The petroleum products are normally sold through distribution networks. The Oil Selection Board appoints retail outlet dealers and distributors. Currently more than 60% of the outlets are dealer owned and dealer operated. The balance outlets are company owned but dealer operated. In case of LPG and Kerosene Oil, the entire sales are made through dealer operated outlets. The company wise retail sales infrastructure is as follows :

Table 3 Share of Retail Outlets and Tankages

Company	Outlets (No.)	Share (%)	Tankage (Mill.KL)	Share (%)
IOC	6723	40	7.25	52
HPCL	4310	26	2.44	18
BPCL	4363	26	2.61	19
IBP	1439	9	0.2	1
Others			1.34	10
Total	16835	100	13.84	100

The dealer commission is fixed by the Government and in the case of petrol and kerosene, dealers are allowed a slab based commission. For kerosene sales, commission is based on the volume sold.

The prices of petroleum products are administered by the Government. There is substantial variance between the international and domestic prices of petroleum products due to the system of cross subsidy used for balancing the under recoveries on subsidised products.

## Industrial Explosives

The mining industry has seen a gradual shift from underground mining to open cast mining, as is the trend globally which has resulted in bulk explosives becoming increasingly popular. There has also been a gradual phasing out of harmful nitro-glycerine explosives in favour of site mixed slurry (SMS). As a result, the explosives industry can broadly be divided into two categories viz., bulk and cartidged explosives. The market for both types of explosives is fragmented with about 32 manufacturers in operation. As at March 31, 1997 the total licensed and installed capacity of SMS and cartidged explosives in the industry was 523 tonnes and 498 tonnes respectively

The two major manufacturers in this industry are ICI Ltd. and IBP who together account for 24% of the licensed capacity of the industry. Competition for explosives is expected to remain high as the total installed capacity is much higher than current demand and future demand projections.

As Coal India is the single largest buyer, the prices are determined by the price paid by CIL to its suppliers.

## Engineering Products

The major customers for the cryogenic containers produced by IBP are State Governments. The other users are scientific and biological laboratories and research establishments. The industrial containers are used for storage and transportation of liquefied oxygen, argon and nitrogen.

IBP dominated the cryocan industry till FY' 96 when Indian Oxygen Limited entered the market and has gained a 14% market share. In case of industrial container industry, there are four major manufacturers and IBP's market share is only 6%. Competition for industrial containers

is expected to remain high as the total installed capacity is much higher than current demand.

## **Business Analysis**

*Petroleum Products Marketing* IBP has a market share of around 4.5% and correspondingly, its scale of operations is much smaller when compared to Indian Oil Corporation, Hindustan Petroleum Corporation Limited and Bharat Petroleum Corporation Limited. The company has traditionally been a marketer of HSD, motor spirit and Superior Kerosene Oil, which together constitute around 94.5% of its total petroleum product sales, and are sold through the company's retail outlets (ROs) spread across the country. Under the present regulated environment, development of the retail marketing network is also decided by the Ministry of Petroleum & Natural Gas (MoPNG) through annual marketing plans. In the past, the company had been affected by a lack of storage facilities for IBP has been focusing on development of retail network and storage and distribution facilities and investments on account of these are being funded by loans from Oil Industries Development Board (OIDB) and internal accruals. During 1994-95, it commissioned its major marketing terminal in Tamil Nadu viz. the Cauvery Basin Marketing Terminal (CBMT) and additional storage facilities at Wadala, near Bombay. These would enable the company to increase sales and improve its market position leading to improved profitability in the future.

*Industrial Explosives* IBP is a dominant player in the industrial explosives market and in 1996-97, the group attained market leadership with a 23.5% market share. This was achieved by an increase in its production on the one hand, and the closure of Nitro glycerine (NG) based explosives by ICI Limited, IBP's main competitor, on the other. Currently, there is an over supply situation in the industrial explosives industry with Coal India and its subsidiaries being the only major consumer. This does not enable the company to pass on cost increase to the desired extent. In view of this, the performance of this business group has remained unsatisfactory in the past. However, the company is strategically changing its product-mix, by shifting to the production of site mixed slurry explosives and the more environment friendly emulsion explosives, which are likely to yield higher margins.



*Engineering* The products of this business group, excepting for cryo-containers, do not find a favourable market currently. The sales performance of this group is dependent upon the budgetary allocation by the various state governments, since the major customers are the animal husbandry departments of the various states. This business group would continue to contribute marginally to the turnover of the company and consequently would not have any significant impact on the overall financial performance of the company.

## Financial Analysis

The financial performance of IBP for the past five years is indicated in the table below :

Table 5 Financial Performance (Rs.Crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Operating Income	3884.2	3243.1	2929.6	2517.6	2139.7
Operating Profit	94.5	91.8	76.7	59.0	54.0
Profit after Tax	25.5	33.9	31.7	18.9	17.4
Equity Capital	22.2**	14.8	14.8*	7.4	7.4
Tangible Networth	259.8	239.5	220.2	112.1	95.4
Gross Margin (%)	2.4	2.8	2.6	2.3	2.5
Net Margin (%)	1.2	1.9	2.0	1.4	1.5
ROCE (%)	3.6	6.1	6.7	4.7	5.3
RONW(%)	9.8	14.1	14.4	16.8	18.2
Earnings per Share (Rs.)	11.53	22.93	21.45	25.67	23.66
Dividend (%)	30.0	35.0	32.0	30.0	27.0

\* Conversion of fully convertible debenture

\*\* Bonus Issue

IBP's operating margins have been traditionally low on account of its primary business being marketing of petroleum products. Since, the purchase price, sale price and margins are fixed by the Oil Co-ordination

Committee (OCC), an improvement in the profitability of the company is invariably dependent on the revision in the fixed prices and margin by OCC, which is done once in three years. Also, IBP is required to surrender its margins on sales made over and above its Sales Plan Entitlement. The improvement in IBP's operating margin in 1995-96 over 1994-95 is partly due to the updation in the margins by the OCC and partly due to the improvement in profitability of the chemicals and engineering business. During FY '97, the company's margins were under pressure because of increased costs, specially those of storage and distribution.

With an increase in OADB loans, which were availed of by the company for funding its APT programmes and investments in JVs, IBP's gearing, as defined by Total Debt/ Total Networth, has increased from 1.10 as at March 31, 1994 to 1.72 as at March 31, 1997

The share capital of the company has doubled from Rs. 7.4 crores to Rs.14.8 crores in FY 95 on account of conversion of fully convertible debentures at a premium of Rs.110 per share of Rs.10. This has resulted in a substantial increase in reserves of the company. Later during FY 97 the company issued bonus shares on a 1:2 basis further increasing the equity of the company.

In addition, the company has invested in projects which have not yet started yielding returns. The investments of the company have increased from Rs.18.59 crores in FY 94 to Rs. 61.75 crores in FY 95 due to its investments in subsidiary companies and joint venture companies viz., BLCL, NRL, ICL.

## Strengths and Areas of Concern

Based on the above business and financial analysis, the strengths and areas of concern for IBP are as below :

### Strengths

*Strong presence in North India* IBP has a strong retail presence in North India. Almost 50% of its total retail outlets are located in this region.

*Joint Venture tie-up* IBP has recently tied up with Caltex Oil Company which is a multi-national oil major with a global presence. This will enable IBP to capitalise on opportunities when the sector gets liberalised.

*Quality customer service* The retail outlets are perceived to deliver better service and good quality products when compared with other retail outlets of other oil companies. This is largely because of the fact that the company is focused on marketing only.

## Areas of Concern

*Insignificant market share* The market share of IBP is only 5% as against 55% of IOC. In a market determined pricing mechanism scenario, the market share could shrink further due to the entry of new entrants.

*Lack of adequate infrastructural facilities* IBP lacks certain marketing related infrastructural facilities when compared to other oil marketing companies. It does not have exclusive control over pipelines/port facilities. At present, these facilities are availed from other PSUs. In a decontrolled scenario, these may not be available to the company.

*Large investments Ahead* In order to meet the future requirements under the market determined pricing mechanism era, the company will need significant funds to expand the existing retail outlets and for setting up additional storage and terminalling facilities.

*Not an integrated oil company* Since IBP is not an integrated oil company, the company may have to face the risk of supply side problems such as high input costs and competition for domestic products under the market determined pricing mechanism.

## Recommendation

The key points which emerge from the above analysis are :

- New private sector investments in the petroleum sector which will reduce the erstwhile dominance of the public sector;
- The phasing out of the Administered Price Mechanism over a two-three year period as announced by Government will considerably enhance the contestability in the oil industry as a whole;
- IBP's principal business activity is marketing of petroleum products which contributed to more than 90% of its turnover and net profits

in the past. This is expected to continue in the future too. When compared with other oil-sector PSUs, IBP's share in the marketing of petroleum products is relatively low at 5% and its operations are not currently backward integrated. In terms of number of retail outlets, IBP is also relatively smaller.

**On the basis of the above, the Commission recommends that Government's disinvestment could exceed 51%. However, considering IBP's existing linkages with other oil-sector PSUs and the relative importance of the oil sector as a whole, the Commission recommends that Government should continue to hold a minimum of 26% in the equity of the company.**

The Commission has evaluated various modalities of disinvestment in case of IBP. Given IBP's current competitive position vis-à-vis other companies in the oil sector and considering its competitive position in a de-controlled scenario, the need to induct a strategic partner who could bring in new strengths is clearly evident. This is especially needed in a situation when the annual requirements of petroleum products will not be available on an assured basis as is currently the case under the SPE arrangement. IBP needs to make arrangements for assured access to products in such a scenario. In addition, the ability to raise resources and invest in new projects to meet the challenges of competition will also be an important factor.

However, the induction of a strategic partner will depend on the extent of shares available for disinvestment.

In the light of the above, the Commission finds it difficult to understand the recent reported decision of Government to permit IBP to go for a public issue to raise about Rs. 60 crores and consequently bring down Government's direct holding to 51%.

The Commission regrets that in spite of Government having referred IBP to the Commission to examine the possibility of disinvestment, a decision on the public issue has been taken without waiting for its recommendations. According to the terms of reference of the Commission (Item V), the Commission is "to recommend a mix between primary and

secondary disinvestments taking into account Government's objective, the relevant PSU's funding requirement and the market conditions". The Commission has already expressed its views in this regard in its Third Report where it had stressed on a co-ordinated view being taken on public offer of shares by PSUs and disinvestment of current holding by Government.

The analysis of the Commission shows that the immediate need of funds can be met by encashing Units - 64 to the extent of about Rs. 90 crores, cash receipts from the Oil Pool Account and additional borrowings if necessary, from the OIDB. **By the process, not only can the company's own need for funds be met but Government could realise substantial amount even upto Rs. 400 - Rs. 500 crores by a strategic sale of 33.9% of shares while still retaining 26% share holding. This would be possible only if Government's present holding is maintained at 59% without dilution through the proposed public offer.** If Government share is reduced to 51% as a result of the public issue, it would not be feasible to offer 25% to a strategic buyer with Government retaining 26%. As mentioned earlier, retaining 26% may be desirable for the present in view of IBP's various activities and its commitment in the Numaligarh Refinery.

Further, the postponement of the IPO could lead to significant advantages for both the company as well as Government. Firstly, Government could offer about 33.9% of the equity to a strategic partner instead of 25%. This increase of 8.9% together with the promise of management control will help substantially improve Government realisation as mentioned above. Secondly, the induction of a strategic partner at this stage itself will strengthen IBP to face increased competition and prepare the company for the impending oil sector reforms. Given the current poor capital structure of IBP and the fairly large requirements of funds over the medium term, it is essential to induct a strategic partner who could pump in equity funds and help the company to raise additional debt funds.

In any case, the present condition of the primary markets may not provide the opportunity to IBP to get the expected premium. This is especially the case after the recent turbulence in the international stock market has percolated to the Indian stock markets as well.

**The Commission would therefore recommend that the decision on the proposed public offer by IBP be reviewed and 33.9% of company's equity be offered to a strategic buyer while retaining 26% by the Government. This stake of 33.9% may be offered to an Indian oil company or joint sector oil company or foreign oil companies through an international global bidding process.**

The disinvestment through strategic sale may be undertaken on the following lines :

- **Government may offer to the strategic buyer upto 33.9% of the company's equity out of Government holding of 59%.**
- **In accordance with SEBI's take over code, the strategic buyer has to acquire shares from the public also. He can, if he so desires, acquire the Government offer of 33.9% in addition to what he may take from the public offer.**
- **In case the strategic buyer wants to acquire less than 33.9% of Government shares after acquiring the public shares, he may do so. In such a case, Government may sell the remaining shares out of the 33.9% of the initial offer to equity funds, multilateral institutions and others at the accepted bid price for the strategic sale as suggested in Part-A of this Report so that Government's holding falls to the stipulated level of 26%.**

IBP has substantial investments in a number of ventures and has also an subsidiary in Balmer Lawrie which would be an added attraction for strategic buyers. The Commission would, at this stage not recommend any restructuring of the company to improve valuation. However, the financial advisers appointed for this sale will have to value these investments in joint ventures and subsidiaries before fixing a reserve price. The procedure for appointing financial advisers as well as inducting strategic partners has been outlined in the Commission's First Report.

## 2.5 National Thermal Power Corporation

### Evolution

National Thermal Power Corporation (NTPC) was set up by the Government in 1975 as a central power generating company with the objective of developing the planning, design, construction and operations of thermal power plants in the country. As of date, NTPC has 11 coal based power stations and 5 gas based power stations spread across the country. Apart from its own power plants, the company manages the captive thermal power plant of Bharat Aluminium Co. Ltd. and the Badarpur Thermal Power Plant for the Delhi Viduyt Board.

The company has an equity share capital of Rs. 7335 crores and currently the entire share capital is held by Government.

### Industry Analysis

Power plays a vital input in the infrastructural development of any economy; India is no exception. The country's power position has improved substantially over the past five decades from an installed capacity of 1,362 MW in the pre-independence era to 83,288 MW as on March 31, 1996. The current installed generating capacities from all the three modes viz., hydro, thermal and nuclear are given below:

Table 1 Installed Generating capacities in Utilities as on 31.3.96

	Hydro		Thermal		Nuclear		Total	
	MW	% Share	MW	% Share	MW	% Share	MW	% Share
State	18603	88.7	34917	58.1	-	-	53520	64.25
Centre	1929	9.2	22069	36.7	2225	100	26223	31.50
Private	444	2.1	3101	5.2	-	-	3545	4.25
Total	20976	100	60087	100	2225	100	83288	100

From the above table, it is clear that out of the total capacity available in the country, State Governments owns 64% while the Central Utilities own 32% leaving a small share to private sector utilities. The State

Electricity Boards (SEBs) are responsible for generation, transmission and distribution of electricity within the State. The Central power generating utilities generates the power which is then sold to the SEBs.

Even though the State Government's share in the capacity is substantial, the actual generation is quite low. The performance of power plants owned by these three entities viz., State, Central and private sector can be analysed from the following table:

Table 2 Sectoral comparison for PLF for FY 96

Particulars	Private Sector Generators					Central Sector		State
	GIPCL	TEC	BSES	CESE	AEC	NLC	NTPC	SEBs
Installed capacity (MW)	145	1624	500	565	550	2070	16795	34917
Generation (MU)	1113	10010	1219	3833	2928	10970	93155	NA
Fuel Used	Gas	Hydel/ Coal & Gas	Multifuel	Coal/ Gas	Coal/ Gas	Lignite	Coal/ Gas	Coal/ Gas
PLF (%)	87.4	83.9	NA	77.0	70.5	70.4	78.8	55

GIPCL - Gujrat Industrial Power Corporation Limited; TEC - Tata Electric Companies; BSES - BSES Ltd.; CESE - CESE Ltd., AEC - Ahmedabad Electric Company Limited; NLC - Neyveli Lignite Corporation

From the above table, it is clear that SEB owned plants are performing much below the capacity utilisation when compared with the central sector power plants.

The following table illustrates the demand supply position.

Table 3 Demand Supply Position (in MU)

	FY 93	FY 94	FY 95	FY 96
Demand	305266	323252	352260	389721
Supply	279824	299494	327281	354045
Shortage	25442	23758	24979	35676
Shortage (%)	8.3	7.3	7.1	9.2



Currently the demand outpaces supply. The peak shortage is estimated at 18.3% in FY 96 while the overall shortage was 9.2% in FY 96. The energy demand supply position for the past four years indicates that the shortage has varied from a level of 7% to 9% while the peaking shortage ranged from 16% - 20%.

The Government in the Eighth plan envisaged a total addition to capacity of 30,538 MW against which the actual capacity added was only about 18,000 MW. This has further aggravated the demand supply imbalance with the peaking shortage reaching well over 20%. Going forward, the Government in the Ninth Plan has projected an additional capacity requirement of about 57,000 MW. In order to set up this kind of capacity, the investment required are enormous. In this context, the Government initiated liberalisation of the power sector and it is hoped that the current policy on power sector will bring in necessary investments by allowing private sector power generating companies to set up power plants. As on 31st March, 1996, Government has received proposals for setting up of 124 power projects for a total capacity of 67,281 MW which will involve a total investment of approx Rs. 2,46,472 crores.

## Business Analysis

As mentioned above, NTPC generates power through both coal as well as gas. The company currently operates 11 coal based plants and 5 gas based plants with a total installed capacity of 16,795 MW. In the country's total power generation, NTPC's share is 20% while the share in thermal power generation is 28%. The total country wide power generation from various sources vis-à-vis that of NTPC's is as follows:

Table 4 Share of NTPC in Country's Capacity

(In MW)	All India	NTPC	Capacity of NTPC
Thermal	60087	16795	28%
Hydro	20976	-	-
Nuclear	2225	-	-
Total	83288	16795	20%

In order to manage its operations, NTPC has grouped its operations into five regions as under:

- Northern region - Singrauli Super Thermal Power Station (STPS), Rihand STPS and Feroze Gandhi Unchahar Thermal Power Station (TPS)
- Southern region - Ramagundam STPS
- Western region - Korba STPS, Vindychal STPS, Kawas Gas Power Plant (GPP), Jhanor-Gandhar GPP
- Eastern region - Farakka STPS, Kahalgaon STPS, Talcher STPS, Talcher TPS
- National Capital Region - Dadri coal based plant, Anta GPP, Auraiya GPP and Badarpur TPS (management contract only)

NTPC's capacity utilisation has shown a constant improvement in the recent past. The average all India Plant Load Factor (PLF) has increased from 55% in FY 92 to 63% in FY 96 while NTPC's PLF has risen from 70% to 79% during the same period. The PLF of the coal based plants are more than that of gas based plants. The main reason for this low PLF of gas-based plants are due to non-availability of gas and grid restrictions.

Out of NTPC's total installed capacity of 16,795 MW, 13,620 MW is from coal based plants. The availability factor was 85% for FY 96 as against 83% for FY 87. The PLF from these plants are also showing a consistent improvement. Among the NTPC's coal based power plants, Rihand STPS achieved the highest PLF of 87% in FY 96 while the Talcher STPS recorded the lowest of 16%. NTPC's coal based power plants also achieved an increase of 15% in power generation in FY 96 over FY 95. The coal required for NTPC is supplied by two Government companies, namely, Coal India Limited and Singareni Collieries Company Limited. In FY 96, NTPC received 56.6 million tonnes of coal which was 15% higher than the previous year consumption. Even then, the company lost generation to the extent of 3642 million units due to non-availability of coal.

The capacity of the five gas based stations of NTPC is 3,175 MW. The availability factor, however, has come down to 65% in FY 96 as against 68% in FY 90. The PLF, which was 66% in FY 90 has come down to 53% in FY 96. The main reason for the lower availability and PLF are inadequate gas supply. During FY 96, only 8.54 Million Standard Cubic Metres Per Day (MMSCMD) of gas was received against a linkage of 10.75 MMSCMD. The total loss of generation on account of non-availability of gas was 4,512 MU during FY 96 as against 6,520 MU in the previous year. This shows that there was a marginal improvement of gas availability during FY 96. In order to overcome the problem of non-availability of gas, NTPC is currently taking steps to augment the liquid fuel arrangements at Anta, Auraiya and Dadri. At Kawas GPP, NTPC is in the process of creating dual fuel facility for regular operation on liquid fuel.

Similarly an analysis of the performance of NTPC plants on the regional basis shows that the Southern region's PLF is the highest and the Eastern region's PLF is the lowest. The following table illustrates NTPC's region-wise market share in the total power generation.

Table 5 NTPC's Region Wise Market Share

	Capacity (MW)	PLF (%)	Generation (MU)	NTPC share as % of all India Availability
Northern (including NCR)	6142	77	41103	39
Southern	2100	85	15351	17
Eastern	3900	43	14482	34
Western	4653	73	29219	25
All India	16795	70	100155	28

From the above table, it can be seen that the Northern and southern regions are performing well above the all India average PLF. NTPC accounts for only 17% of the total power generated in the Southern region. Since there is a shortage of power in this region, this provides NTPC with an opportunity to expand its operations. The eastern region's performance is hampered by grid restrictions and lack of stabilisation of Talcher STPS, Kahalgaon and Farakka Plants. Moreover, Talcher TPS is a recently acquired plant from the Orissa State Electricity Board and is operating at a PLF of 19%. The performance of the Eastern Region plants will improve after

completion of the transmission lines projects by Power Grid. In the interim, NTPC has entered into contracts with southern SEBs to enable the Eastern region plants to perform to their maximum as power can be evacuated to southern states.

## Future Plans

NTPC is undertaking a major expansion programme during Ninth Plan period. The company is planning to expand capacity by 4,500 MW from FY 98 to FY 2002 apart from the existing approved ongoing projects of 1,770 MW. The Ninth Plan expansion will be more on gas-based projects (3,000 MW) than on coal based projects (1,500 MW). The total investment planned by NTPC for this expansion is about Rs. 19,800 crores. For meeting these investments, NTPC is projecting an amount of Rs. 4,200 crores through internal accruals and the balance would be met out of market borrowings.

## Financial Performance

The financial performance of NTPC for the past five years is given below:

Table 6 Financial Performance (Rs. Crores)

	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	8494	6420	5937	4627	3954
Operating Profit	3463	2585	2326	1961	1934
Profit after Tax	1353	1125	1058	887	1007
Equity Capital	7335*	8668	8000	7550	7022
Tangible Net Worth	14827	14990	13327	11885	10470
Gross Margin (%)	40.8	40.3	39.2	42.4	48.9
Net Margin (%)	15.9	17.5	17.8	19.2	25.5
ROCE (%)	11.0	8.0	8.0	8.0	9.0
RONW (%)	9.1	7.5	7.9	7.5	6.3
Earnings per Share(**) (Rs.)	184	130	132	117	143
Dividend (%)	2.4	1.6	0.8	-	-

(\*) Reduction in share capital is due to handing over of transmission assets to Power Grid Corporation Limited (\*\*) on a share of Rs.1000

The unaudited results for FY 97 indicates energy sales of Rs.10,210 crores with a profit after tax of Rs.1,648 crores. Analysing the five year financial performance, it may be noted that the company's sales have more than doubled. Similarly, the operating profits rose by 79% while the net profit rose by 35% during the past five years. However, the gross margins showed a decline from a level of 49% in FY 92 to 41% in FY 96 largely due to increase in fuel costs and employee costs. The net margins also showed a decline from the levels of 26% in FY 92 to 15% in FY 96 largely due to higher depreciation and interest & finance charges. ROCE and RONW showed steady improved during the past five years.

One of the major financial concerns of NTPC is the outstanding receivables from their principal buyers, namely, SEBs. At the end of FY 97, the outstanding dues to NTPC from SEBs stood at around Rs.3,600 crores. This is almost two times the existing norms for debtors as per the tariff guidelines. Currently, the company is selling power to SEBs through Letter of Credit. This has resulted in lower level of receivables on the current sales. However, the past dues are a matter of concern for the company. Similarly, the inventory levels of stores and spares are also significantly high at Rs. 1,131 as at March, 1996 which is equivalent to more than three year's cost of repair & maintenance. This high levels of receivables and inventory has increased the interest on working capital substantially.

## Strengths and Areas of Concern

Based on the above business and financial analysis, the strengths and areas of concern for NTPC are as below :

### Strengths

*Dominant market share* NTPC is the single largest power generating company in India with 28% of the total thermal power generating capacity with a presence through out the country. In addition, NTPC has a diversified fuel base for operating plants in various regions.

*High operational efficiency* NTPC's overall average operating efficiencies are high when compared with national average. The average PLF of NTPC run plants is 70% while the national average is significantly lower. Some of its units have higher PLF than private sector power plants.

*Skilled manpower* Since NTPC was set up with the objective to develop thermal power plants from the design stage to its operations. Thus, the company has developed expertise in all related fields over a period of time.

*Major expansion programmes and ability to withstand competition* NTPC is in the midst of a major capacity expansion programme. The company is planning to add around 4,500 MW additional capacity during the Ninth Plan period. Given the demand supply gap of 9.2% and the projected growth of demand at 9% annually in the Ninth Plan period, NTPC is well positioned to face up competition from the private sector power generating companies. In addition, NTPC can foster strategic alliances to ensure competitive edge such as by forming joint ventures with fuel suppliers etc. to set up additional generating capacities.

*Strong Balance Sheet* The company is having a strong balance sheet which will enable the company to raise resources in future with ease. The debt equity ratio as at FY 96 was only 0.70.

## Areas of Concern

*Huge Outstanding Receivables* NTPC still has a high level of outstanding receivables from SEBs. Due to the weak financial health of SEBs which is the sole buyer, the receivables have been on the increase. The outstanding dues from SEBs at the end of FY 97 amounted to approx. Rs.3,600 crores. Even though the company realises the current billings through letters of credit, the past accumulated receivables is still a matter of concern.

*Inadequate Fuel Supply* Out of the total generating capacity of 16,795 MW, almost 20% capacity is through gas based power plants. The company in the past has suffered heavily due to non-availability of gas. Even though the company has a gas linkage of 10.75 MMSCMD, it has received only 8.54 MMSCMD of gas during FY 96. This has resulted in low PLF for the gas based power plants. Similarly the coal supplied to NTPC is also of poor quality which results in higher costs.

*Grid Restriction in the Eastern Region* NTPC has a strong presence in the Eastern region. However, the PLF for the eastern region was low at 43%. This was largely due to the grid restrictions which has resulted in forced breakdown on regular basis.

*High levels of Inventory* NTPC's stores and spares inventory at the end of FY 96 was Rs.1,131 crores which is more than three times of annual repairs and maintenance cost.

*High cost of renovation and modernisation* NTPC will require funds for renovation and modernisation as many of its plants are due for such capital expenditure. NTPC will require substantial funds for maintaining the current operational efficiencies.

*Relatively lower Tariff* NTPC, under the current tariff norms is allowed a return of 12% on its networth for old projects while it is allowed 16% return for the new projects. In spite of this increase, the tariff is relatively lower when compared with the tariff negotiated by Independent Power Producers with SEBs. The overall figures of return on networth for the company for the previous five years is low in the region of 7 - 9%.

## **Recommendation**

NTPC was set up in 1975 as part of Government initiatives to step up installed capacities across the country in order to meet the power requirements for industrial and agricultural development. The company currently enjoys a prime position in the sector being the single largest power producer with an installed capacity of 16, 795 MW as at end FY'97. At present, it contributes to over 28% of the total thermal power generated and around 20% of the total power generated in the country.

Till recently, the development of the power sector was mainly in the public sector. However, due to the burgeoning demand -supply gap, the Government initiated reforms in 1991 which allowed the private sector entry into the hitherto reserved sector. Some of the key features of the reforms are the entry of the private sector into generation, the removal of foreign equity restrictions for funding the projects and assurance of speedy approvals for clearance of proposals. In spite of these initiatives, till date no major capacities have been added in the private sector mainly due to two reasons: the delay in evolving rational tariff package and in developing assured fuel linkages. As a result, the Government (both at the State and the Centre) continues to supply as much as 96% of the total power supplied in the country.

The process of improving the market contestability in the Indian power sector hinges on a number of crucial issues. Firstly, in view of the poor credit rating of most SEB's the private sector producers are hesitant to supply power on a non-recourse basis. Secondly, tariff reforms which will enable SEBs to generate power on a profitable basis. Thirdly, the SEBs in most states are unviable and need structural reforms in terms of unbundling generation, distribution and transmission.

Thus, till the time that the above reforms are in place, NTPC will continue to play a dominant role in the sector. Further, with NTPC's demonstrated capability to execute and operate power projects at high efficiency levels, the company will continue to be an important player in the power sector in the future. The commission is of the view that till the time the sectoral reforms in the power sector are complete and the markets are fully contestable, it may be desirable for the public sector to continue to play an important role in the power generating segment. **On these grounds, the Commission reiterates the classification of NTPC as Core.**

There is scope for considerable enhancement of NTPC share values once the reforms are put in place and the new parameters are settled for tariff fixation. All these are under the active consideration of the Government. Due to the low tariff structure and hence relatively poor rates of return on networth, any disinvestment at present will lead to an undervaluation of the Government holding and result in poor realisation to the exchequer. **The Commission therefore recommends that there should be no disinvestment in NTPC presently.**

**At the same time, the Commission recommends that NTPC should seriously engage itself in the assessment of performance of its different units under the present monolithic structure of the company. It may be useful to study alternatives for restructuring the organisation either in terms of regions, individual plants or based on input fuels used by the plants. It is expected that such an exercise combined with managerial restructuring would be completed within an year or two by which time most of the power sector reforms may be expected to be in place. Disinvestment in NTPC and the modalities thereof will be considered at that stage by the Commission and appropriate recommendation will be made to Government.**



## 2.6 NEPA Limited

### Evolution

NEPA Limited (NEPA) commenced operations in 1947 in the private sector. Immediately thereafter, the company was taken over by the then State Government. In 1959, the Central Government acquired a controlling interest by the conversion of the existing loans into equity. Originally called "The National Newsprint & Paper Mills Ltd." the name was changed to the present form in 1989.

NEPA is a single product company engaged in the manufacture of newsprint. Newsprint is a special type of paper used for printing newspapers and magazines. Generally, newsprint is coarse and light but strong to prevent tearing. There are two types of newsprint: standard newsprint which is used for ordinary newspapers and magazines and glazed newsprint which is used for glossy colour sections of newspapers and magazines. Glazed newsprint is expensive and requires superior coating and finishing.

The company's manufacturing facilities and offices are situated in Nepanagar in Madhya Pradesh. The present paid-up equity share capital of the company of Rs. 64.8 crores is held as shown in the table below. NEPA's shares are not listed on any stock exchange.

Table 1 Share Holding Pattern

Share Holder	Percentage
Government of India	96
Government of Madhya Pradesh	3
Public	1
TOTAL	100

### Industry Analysis

Newsprint is a globally traded commodity. The main trade flows are from North America to Asia and Europe and more recently from Europe to Asia. North America is by far, the largest producing region with about 47% of the world's installed capacity. Asia is the largest importer of newsprint taking 43% of its total consumption from outside the region.

## Demand

The main users of newsprint and their share (of total consumption) are as given below :

- Large Newspapers (65 percent)
- Medium and small newspapers (15 percent)
- Magazines and government publications (20 percent)

Demand for newsprint depends on the literacy rate and the number of magazines published. In India the number of newspapers and magazines being published has shown a dramatic increase since the early nineties. Newsprint demand therefore is expected to grow at a higher rate of 6% - 8% as compared to 5% - 6% in the recent past.

## Supply

Till recently, the structure of the Indian newsprint industry was largely regulated by Government policies. For nearly 25 years till 1981, NEPA was the only newsprint mill in the country, In the mid-eighties, Tamil Nadu Newsprint and Hindustan Newsprint were started in the public sector to augment the need for additional requirements. Currently, there are about 22 mills manufacturing newsprint with the public sector accounting for 63% of the total capacity of 600,000 tpa.

Until 1991, the production, supply and pricing of newsprint was controlled through the Newsprint Control Order, 1962 (NCO). Since then, the Government has opened up the industry to private sector participation. It has also allowed imports on a decanalised basis and has removed all quantitative restrictions on imports. Newspapers are now allowed to import their entire requirements of newsprint.

## Pricing

Till 1991, the sale price of imported newsprint was decided by the Newsprint Price Fixation Committee on a quarterly basis in accordance with the NCO. This pricing mechanism gave a certain level of protection to the domestic manufacturers of newsprint. After decanalisation of newsprint imports in 1992, newsprint manufacturers price their products so as to match the landed cost of imports.

Internationally, newsprint prices have tended to be cyclical. Major producers in Canada and USA virtually dictate prices. Price of newsprint had increased in early nineties but have again shown a declining trend in the recent past. After rising through 1995, and peaking at about USD 1000 per tonne in early 1996, prices had dropped to a low of USD 465 per tonne in the first quarter of 1997. In the near future, prices are expected to decline further due to fresh capacities coming up in the South Asian Region.

### Technology Characteristics

- The process for making paper is fairly simple and the technology is well known and stable. Most of the equipment is available in India and access to technology is not an barrier.
- The process itself is not directly scale sensitive. However, firms with large capacities do benefit from economies of scale in their overall operations.
- The process is highly energy intensive. In India, the two major sources of energy are steam and power.
- Paper manufacture is polluting and the process is water intensive. Hence most of the large manufacturers are located near rivers.

### Business Analysis

The trend in sales and sales realisation is shown in the table below:

Table 2 Trends in Sales and Realisation

Year	Sales (tonnes)	Realsn. (Rs/ton)
FY '93	67475	16724
FY' 94	17394	16482
FY' 95	63418	18779
FY' 96	15719	24825
FY' 97	20348	20008

Sales volumes which have been fluctuating have shown a marked decline in the last couple of years due to the following reasons.

- After decanalisation in 1992, NEPA's newsprint which had quality problems could not withstand free competition. With the progressive reduction in custom duties of newsprint, NEPA lost out to the lower priced, better quality imported newsprint from Russia, China and Canada. NEPA has made some efforts in improving quality; this however has not had much impact on sales.
- NEPA'S production also suffers from technological obsolescence of its plant and machinery, outdated manufacturing process, inadequate power supply and scarcity of forest based raw materials. In particular, the low capacity utilisation in FY 1997 was due to closure of the plant due to non supply of power from Madhya Pradesh State Electricity Board.

## Raw Materials

The major inputs for paper production is fibre. Sources of fibre include softwood, babul, Agro residues and waste paper. In case of NEPA the main source of raw material has traditionally being bamboo. However the depletion of the forest cover around the vicinity of the plant has led NEPA to change over to other sources such as Eucalyptus and Subabul as well as imported pulp. Currently imported pulp and paper cuttings accounts for almost half of the raw material cost. The volatility and higher input costs of imported pulp prices make it necessary for NEPA to control inventories to the optimum level; this has not been the case. As a result, the profitability of NEPA has been adversely affected.

The other main input is energy. NEPA requires about 30 MW of power to work at full rated capacity of 88,000 tpa. It has to depend for about 50% -60% per cent of the total power requirement from the Madhya Pradesh State Electricity Board. Due to frequent to load shedding from MPSEB, the quality of power supplied to NEPA has been quite erratic.

## Financial Analysis

The performance of NEPA over the last five years is shown in the table below:

Table 3 Financial Performance (Rs. Crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Operating Income	40.4	141.9	118.6	115.3	112.7
Operating Profit	-38.5	13.3	-10.2	-12.4	7.2
PAT	-58.4	-3.4	-27.7	-29.3	-7.8
Equity Capital	64.9	64.9	62.4	62.4	62.4
Tangible Networth	-22.9	33.6	30.0	38.4	63.7

*Note : The ratios have not been presented as they are all negative*

- During FY'97, plant operations were closed for a period of almost seven months due to the non-availability of power. The financial indicators, as a result are an aberration from those in the normal working years.
- The old plant & machinery with outdated technology has resulted in higher operating costs for NEPA as compared to industry averages.
- After a sustained downtrend beginning in the early nineties, newsprint prices started firming up in 1995 to peak towards the end of 1995/early 1996. The improved market scenario resulted in NEPA posting positive margins in FY'96.
- NEPA networth as at March 31, 1997 is a negative Rs. 23 crores. The company is in the process of applying to the Board for Industrial and Financial Reconstruction under the SICA.

## Strength and Areas of Concern

Based on the above business and financial analysis, the strengths and areas of concern for NEPA are as below :

## **Strength**

*Long Presence in the Sector* NEPA had a head start of over 25 years over other newsprint manufacturers and has in place all the requisite infrastructural facilities. The company has the potential to earn profits if the raw material linkages are assured and financial inputs are provided at the appropriate time.

## **Areas of Concern**

*Operational Problems* NEPA, as it stands today is beset with a number of operational problems. Firstly, the piecemeal additions to the plant capacity in the eighties and nineties has resulted in imbalances in production capacities. For example while the mill has an overall paper production capacity of 88,000 tpa the captive pulp making capacity is inadequate. As a result, the capacity utilisation of the mill has been affected.

*Raw material linkages* NEPA also faces problems of assured raw material supply. The company was conceived during the pre-independence era, assuming abundant supply of forest based raw materials. With the rapidly depleting source of forest cover, the availability of bamboo - the major raw material for NEPA - has declined significantly. While the mill capacity was expanded from 33,000 tpa to 88,000 tpa between 1950 and 1990 there was no commensurate increase in the availability of raw materials. In view of the above, NEPA has been constrained to resort to imported pulp and alternate source of raw materials which has increased the cost of production.

*Poor quality of Newsprint* The quality of newsprint manufactured by NEPA is lower when compared with other Indian newsprint manufacturers. This is because NEPA has problems of old technology, operational bottle necks and raw material problems. As a result, NEPA realisations have been lower.

*Inadequate and Poor Quality of Power* Unlike other paper producers, NEPA does not have a captive power plant. Due to this, the company has to depend on the inadequate and the erratic power supply from the MPSEB which has resulted in higher input costs and has also been one

of the major constraints for NEPA in achieving optimum capacity utilisation. In the future, the power supply scenario is expected to worsen due to the poor growth in the generating capacity in Madhya Pradesh.

*Manpower* The company is saddled with excess manpower to the extent of 800-1000 out of a total workforce of 3000. In addition, the company has to bear the costs of overheads of Nepanagar - a self contained township - which amounts to about Rs. 3 crores annually. This has increased the overhead costs for NEPA.

## NEPA's Turnaround Plan

Keeping the above operational problems in mind, NEPA has drawn up a turnaround plan which is based on the following:

- To upgrade the mill technology, improve productivity and remove the imbalances prevailing in the various mill capacities;
- To become self-sufficient in captive pulp production and to avoid dependence on imported pulp;
- To provide stable and adequate power supply and
- To diversify into value added products.

It is envisaged that the restructuring plan will take three years to implement and the benefits will thus be available only from FY 2002. With this implementation, the company is expected to recover from its loss making situation and position itself firmly on a growth path. In order to do so, the company will have to raise about Rs 300 crores which will cover projects costs as well as fund working capital requirements till the turnaround is complete. Assuming a debt to equity ratio of 1:1, the plan will have to be funded through equity infusion of about Rs. 150 crores and debt funds to the same extent.

In addition, the company will need about Rs. 20 crores in order to provide a VRS for employees found surplus in labour force restructuring.

## Funding Options

For this purpose, the company will have to either raise the funds from the capital market on its own or has to depend on its principal shareholder i.e. Government. The company's weak balance sheet as at

March 31, 1997 and the depressed nature of the primary markets may preclude the options of tapping these funds from the capital markets.

As the majority shareholder, it may be worthwhile to examine various options available to Government for the implementation of the restructuring plan. This will involve either budgetary support or disinvestment of a majority stake to a strategic buyer to enable the company to raise funds (Table 3).

**Table 4 Government Options on NEPA**

	Scenario	Government outflow	Remarks
1	No action taken by Government due to paucity of funds	Nil	Company renovation will be delayed beyond repair - action on disinvestment will be delayed
2	Restructure fully through budgetary support and disinvest at a later stage	Rs. 150 cr. + guarantee for Rs. 150 cr.	Heavy burden on Government. Project costs could increase due to time and cost overruns.
3	Take up only essential restructuring. Disinvest upto 51% immediately to a Strategic partner and the balance after implementation	Rs. 20 crores for VRS + Rs. 5 crores for capital expenditure + guarantee for Rs. 45 crores	Burden on Government minimal. Application to BIFR can be delayed. Likely to improve investor interest. Further disinvestment would be at higher values thus increasing realisations.

*Scenario 1*

NEPA's accumulated losses of Rs. 95 crores as on March 31, 1997 against a paid-up capital of Rs. 65 crores has resulted in a negative networth of the company. With the adoption of the annual accounts for FY'97 by end November, 1997, the company will be referred to the Board for Industrial and Financial Reconstruction (BIFR). A reference to BIFR at this stage may delay the implementation of the vital renovation and modernisation schemes and may push the company to a stage beyond repair. Any further action on disinvestment cannot also be taken up. Further, the company may also require an increasing level of budgetary support to sustain cash losses as all credit lines have been frozen.



Keeping the above in view, it may be necessary to convert part of Government loans to equity in order to delay the reference of NEPA to BIFR. However, this action alone may not be feasible or sufficient to turnaround the company.

The other options available to Government are to either fully implement the turnaround plan or fund the essential parts before inviting a strategic partner.

### *Scenario 2*

The overall restructuring plan could be implemented by Government fully. In this case, the financial burden on Government is quite substantial both in direct and indirect terms. Apart from initiating steps to prevent the company from a BIFR referral, Government will have to pump in equity funds to the extent of Rs. 150 crores as well as provide guarantees to enable the company to raise debt funds to the same extent. Also, with relatively low levels of morale in the organisation, the effective implementation of the plan is doubtful. In turn, this could lead to further time and cost overruns.

### *Scenario 3*

Government could initiate minimal restructuring before inviting bids for a strategic sale. Government support will be restricted to:

- A grant of Rs. 20 crores for providing VRS for surplus labour force;
- A loan of Rs. 5 crores for carrying out emergency repairs. This would be the minimum investment that would be required to stabilise production and demonstrate its potential viability to prospective strategic buyers.
- A Government guarantee for Rs. 45 crores in order to enable the company to borrow funds from banks for working capital.
- Conversion of loan to equity as determined by the Financial Advisers

These steps will help in commencement of full production which will at least help in meeting a part of the fixed expenses of the company. The conversion of part of Government's loan into equity will help the company to stay outside the purview of BIFR.

The advantages are :

- A significant level of funding will be done by the new successful bidder thus minimising the financial burden on Government;
- The project implementation by the partner will be relatively more cost and time effective than implementation by Government. This will help to enhance the share value of the balance shareholding of Government.
- Implementation of the essential restructuring will improve investor interest as also sales realisation.

## Recommendation

As is evident from the above analysis, the lowering of custom duties on newsprint coupled with the decanalisation of imports have lead to a significant competitive pressures on the domestic newsprint industry. In addition, all quantitative restrictions on imports have been eased and the users are now free to import all their requirements. The markets have thus become fully contestable. In such a scenario, there is no public purpose served by NEPA. **The Commission has thus classified NEPA as non-core.**

**It is also clear that the medium term viability of the company is crucially dependent on the turnaround plan. Options on funding explored earlier indicate that the funding could be done by either Government or by a new partner.**

**In view of its non-core status, the Commission recommends that the Government offer immediately a minimum of 51% which could go up to 100% alongwith the transfer of management to a strategic partner who could bring in the necessary funds to take-up the turnaround plan. In case buyers bid for different levels of**

**shareholding, the decision on the final bidder will necessarily have to be based on the realisation per share rather than the total realisation. This may be clearly brought out in the bid document.**

**As the process of selection of a strategic partner could take time, the Commission recommends that Government initiate the following action immediately:**

- Suitable conversion of loans to equity with retrospective effect to enable the company to stay out of the purview of BIFR .**
- A grant of Rs. 20 crores for providing VRS for surplus labour force. Further, if the scheme is formulated as a pension-cum-insurance scheme on the lines suggested by the Commission in its Fourth Report, the funds required upfront may be lower.**
- A loan of Rs. 5 crores for carrying out emergency repairs;**
- A Government guarantee for Rs. 45 crores in order to enable the company to borrow funds from banks for working capital.**

**The Commission has taken note of the fact that Government had previously approved “in-principle” for private sector participation in rehabilitation and modernisation of NEPA and engagement of a merchant banker to undertake this exercise. As per this decision, SBI Capital Market Ltd. had already initiated action in locating a suitable partner. The process may be carried forward to complete the sale taking into account the recommendation of the Commission.**

**Government may also consider hiving off the township at Neapanagar and organise it into an appropriate local body for future management. A corpus may be created out of the sale proceeds of the company, to support future maintenance of the colony and the civic services.**

**After the completion of the turnaround plan by the Strategic buyer, Government may disinvest the balance of its equity holding if any, to retail investors in the domestic market.**

## **2.7 Ranchi Ashok Bihar Hotel Corporation**

## **2.8 Utkal Ashok Hotel Corporation**

### **Evolution**

Ranchi Ashok Bihar Hotel Corporation (R-Ashok) was set up in 1981 as a 51:49 Joint Venture between India Tourism Development Corporation (ITDC) and Bihar State Tourism Development Corporation (BSTDC). The 30 room hotel located in Ranchi was inaugurated in 1988 predominantly to cater the needs of executives from the Central Government public sector undertakings visiting their offices in Ranchi and other business travellers.

Utkal Ashok Hotel Corporation (U-Ashok) was set up in 1983 as a 51:49% joint venture between India Tourism Development Corporation (ITDC) and Orissa Development Corporation (OTDC). In 1988, a 36 room hotel in the name of Nilachal Ashok Hotel was inaugurated on the beachfront of Puri which is a popular tourist destination on the eastern coast of India.

### **Industry Analysis**

The hotel industry forms the major part of the tourism infrastructure. The first hotel was set up in private sector in 1902 in India. Subsequently, many more hotels came up and currently this is dominated by private sector groups such as the Taj group, Oberois, Welcomegroup etc. The Government of India established its own hotel chain in seventies in order to promote tourism activities in India. Hotel industry being the service sector industry, the private sector had an edge over the public sector hotels. The hotel industry is highly capital intensive with a long gestation period. Apart from the initial investment, the hotel requires high cost of maintenance.

### **Business Analysis**

The hotels stands on lands leased by the respective State Government Tourism Development Corporations to R-Ashok & U-Ashok for a period of 99 years. As per the lease deed, sale or transfer of land or building constructed are prohibited except for leasing or renting of the premises in the normal course of business. Similarly, as per the joint venture agreement, transfer of shares to private parties is also prohibited. The management of the hotels are vested with ITDC through the joint venture agreement.

R-Ashok is having 27 twin bedded, 1 deluxe and 2 executive suites including a restaurant. The hotel is also having a conference room and a board room.

As mentioned above, R-Ashok caters to business travellers visiting local corporates and due to this, the hotel is having low level of occupancy. Room sales contributed approx. 53% of the total revenue while the food sales contributed approx. 34% in FY 97. The location of the hotel attracts low tourist traveller potential. The hotel employs 54 employees and employee cost accounts for approx. 31% of the total turnover.

In case of U-Ashok, the hotel is having 36 twin bedded rooms including a restaurant. The hotel is having a Travel service.

The hotel is located very near to the popular domestic pilgrimage and sea beach on the Eastern coast of India. However, it has to face tough competition from three other private hotels operating in the same area. This hotel is not preferred due to the lack of adequate facilities and poor maintenance. The occupancy rate of the hotel had fluctuated around 30% and in FY 96, due to shutdown of operations, the occupancy had fallen to 19%. Room sales contributed approx. 65% of the total revenue while the food sales contributed approx. 30% in FY 96. The hotel employs 57 employees and employee cost accounts for approx. 30% of the total turnover.

### Financial Analysis

The financial performance of R-Ashok for the past four years is given below :

Table 1 Financial Performance (Rs. Lakhs)

	FY 95	FY 94	FY 93	FY 92
Operating Income	68.45	65.33	57.46	64.25
Operating Profit	-4.85	0.69	5.88	2.66
Loss	-45.27	-38.51	-27.19	-24.73
Equity Capital	71.60	71.60	71.60	71.60
Tangible Net Worth	-102.20	-59.96	-18.47	8.64

*Note : The ratios have not been presented as they are all negative*

The company's annual accounts for the years 1995-96 onwards have not yet been finalised.

Since inception, the average room occupancy has been hovering in the range of 40%-60%. Due to the low occupancy levels, the hotel ran into financial difficulties. The company equity capital including share application money as at 31st March, 1997 was Rs. 71.60 lakhs and its accumulated losses amounted to Rs. 173.73 lakhs. All this has resulted in default of loan repayment to the Bihar Industrial Credit & Investment Corporation (BICIC). Accordingly, BICIC issued an advertisement to auction the assets of the company which the company resisted by approaching the Court. BSTDC, the joint venture partner agreed to transfer its share to ITDC for a token sum in order to pay off the loans of BICIC as an one time settlement. However, the one time settlement could not be adhered to and BICIC issued notices to both joint venture partners and issued advertisements for sale of assets. In response to the advertisement, BICIC received a highest offer of Rs. 2.05 crores. As per the State Financial Corporation Act, BICIC gave the first right to refuse this offer to promoters and the company. ITDC tried to settle the issue in consultation with other partner, BSTDC in the ratio of their share in R-Ashok. Upon non receipt of any response from BSTDC, ITDC, accepted the offer and deposited Rs. 1.03 crores which in turn was accepted by BICIC. However, on March 31, 1997, BICIC Board resolved to handover the property to BSTDC. ITDC moved the Court and obtained the stay order against transfer of property to BSTDC and has deposited the full amount as per the Court directive. The matter is subjudice.

The financial performance of U-Ashok for the past four years is given below:

Table 2 Financial Performance (Rs. Lakhs)

	FY 95	FY 94	FY 93	FY 92
Operating Income	28.87	28.92	28.11	34.99
Operating Profit	-13.73	-11.23	-12.04	-1.61
Loss	-62.44	-49.37	-62.48	-33.96
Equity Capital	100.00	100.00	100.00	100.00
Tangible Net Worth	-160.57	-98.17	-49.07	-1.97

Note : The ratios have not been presented as they are all negative

The company's annual accounts for the years 1995-96 onwards have not yet been finalised.

The financial performance of U-Ashok was dismal mainly due to low occupancy levels of average 30%. The paid up equity capital of the company as at 31st March, 1995 was Rs. 1 crores which was raised subsequently to Rs. 1.3 crores and the accumulated losses as at 31st March, 1995 amounted to Rs. 2.76 crores. The company had defaulted in repayment of loans from the State Financial Institutions. As a one time settlement, ITDC paid Rs. 3.8 crores to these State Financial Institutions. As a part of restructuring, OTDC transferred a part of its shareholding to ITDC thereby changing the shareholding pattern in the ratio of 91.5 : 8.5. Further, the company issued preference shares for Rs. 3.5 crores in favour of ITDC.

## Recommendation

As part of the initiative of the Government to develop tourism infrastructure, the India Tourism Development Corporation in the mid-eighties set-up joint ventures with the State Governments for the development of budget hotels mainly to cater to the lower end of the tourist segment. These hotels were located in up-coming tourist areas such as Ranchi, Puri, Bhopal, etc. Typically, the State Governments had provided land while ITDC provided the expertise to run the hotels. Thus, the share holding pattern was divided between the two. However, in case of Ranchi-Ashok and Utkal-Ashok, the ITDC holds 51% and 91.5% respectively with the balance taken up by the State Governments. Thus, these hotels are subsidiaries of ITDC.

The Commission has already given its recommendations on ITDC in its First Report. To recapitulate, the hospitality services sector has seen the entry of a large number of companies in the private sector some of whom are established global companies. In spite of high entry barriers in the form of high capital requirements, the level of competition in the business travel and luxury segment has been quite high. The market is fully contestable. In addition, it was also pointed out that the public sector is relatively handicapped in matching the level of services provided by its counterpart in the private sector. **On these considerations, the Commission has already classified ITDC as non-core.**

As regards restructuring, the Commission has recommended that hotels located in prime locations like Delhi and Bangalore should be handed over to established hotel chains through a competitive bidding process to be run on long term structured contract on a lease-cum-management basis. As regards hotels located in other locations, the Commission recommended that these could be demerged into separate corporate entities. Following the de-merger, shares could be issued in these companies to the Government and other shareholders, if any, in exchange of ITDC shares. In turn, the Government could disinvest 100% of its holding in these new entities through a competitive bidding process.

The Commission reiterates that the role of the Government in the tourism sector should be re-oriented towards facilitating development of tourism and away from actually providing services. One of the objects of the ITDC has been to promote tourism by disseminating information and providing marketing support wherever necessary. The proposed disinvestment of direct hotel services will provide a much sharper and urgently needed focus to the role of ITDC in the development of the tourism in the country.

As in the case of the non-metro hotels of ITDC, the Commission recommends that in both these companies that ITDC may fully disinvest its share holding in favour of a private entrepreneur through a transparent and competitive bidding process after undertaking a proper valuation exercise through a Financial Adviser. Since the lands have been obtained from the State Governments on certain terms and conditions, ITDC would need to negotiate and settle this issue with them prior to disinvestment.



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# DISINVESTMENT COMMISSION

DECEMBER

1997

Disinvestment Commission  
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# PART A



## 1. Review of Progress in Disinvestment

In the Fifth Report, the Commission had indicated, in the form of a Statement, the action taken by Government on its recommendations contained in its first three Reports and subsequent decision taken by Government on the specific recommendations of the Commission as well as in continuation of ongoing Public Sector Reforms. The Commission has now taken note of the progress so far in implementing the recommendations of the Commission in its five Reports. The Commission is pleased to note that subsequent to its Fifth Report, Government is firming up plans for sale of Government equity in GAIL, CONCOR, and Indian Oil Corporation during the current fiscal year and that decisions have been taken on some of the recommendations of the Commission made in its earlier Reports such as granting greater autonomy to PSUs and induction of non-official directors.

The Commission also notes the decision of Government to dismantle the Administered Price Mechanism (APM) in respect of petroleum products in a phased manner. The Commission had in its Third Report recommended that disinvestment of companies dealing in petroleum products should be preceded by an announcement of dismantling of the APM so that it would enable enhancement of their share values. The Commission therefore hopes that the disinvestment process for the oil companies would now commence.

The Commission would, however, urge that decisions to be expedited on other important areas such as creation of the Disinvestment Fund, offer of shares in domestic market, revamped Voluntary Retirement Scheme, Employee Pension-cum-Insurance Scheme, counselling service to those taking VRS and safeguards to officers and staff for bonafide commercial decisions. The Commission would like a definite time-table to be set up by Government for time bound action to eliminate further delay in implementation of the recommendations of the Commission.



# PART B





## 2. SPECIFIC RECOMMENDATIONS

### 2.1 Electronics Trade & Technology Development Corporation Limited

#### Evolution

Electronics Trade & Technology Development Corporation Limited (ET&T) was set up in 1974 with the main objective of setting of strengthening bilateral trade between India and the East European countries and USSR in the field of electronics. The company was also set up with a view to implementing policies and strategies for facilitating the growth of the electronic industry in India. It acted as the canalising agency for import of various components for computers, consumer electronics and telecommunications under the "ET&T" brand name.

Over a period of time, the product mix of the company has undergone a change and the company is currently engaged in assembling of PCs, software development, marketing of software products and computer education.

The paid up equity share capital of ET&T is Rs. 5 crores which is wholly held by Government of India and the accumulated losses as at 31st March, 1997 amounted to Rs. 56.8 crores.

#### Industry Analysis

As has been mentioned above, ET&T is primarily engaged in a variety of activities in information technology (IT) industry. The IT industry is currently the fastest growing industry in the economy. The industry has grown from a turnover level of about Rs. 2,700 crores in FY 92 to about Rs. 13,400 crores during FY 97 resulting in a CAGR of 38%. The major segments in the IT industry which contributed to this growth were hardware sales, development of software for domestic and export and computer maintenance. Even though the domestic growth rates have been substantial, India's share in the global IT industry is only 0.7% of the world market as it has to face tough competition from other Asian, European and Latin American countries.

*Hardware Segment* The share of the sales value of the domestic hardware segment in the total IT industry has declined from 65% in FY 91 to about

30% in FY 97. This segment which was earlier dominated by Indian companies has now seen an increasing market presence of transnational companies with access to state-of-the-art technology. Most of the Indian companies have closed down manufacturing operations and have switched to value-added sales and service.

*Software Segment* Computer software for domestic use and exports has been a major contributor to the Indian IT industry. Exports from this segment have grown at a compounded annual growth rate (CAGR) of 53% over the past six years i.e., FY 91 to FY 97. The computerisation projects undertaken by various sectors of the economy such as Banking, Insurance, Stock Market etc. has resulted in the rapid growth of the domestic segment. Moreover, due to the year 2000 date conversion project (Y2K), the Indian software segment is expected to grow significantly over the next few years.

*Maintenance Segment* As the level of computerisation has grown rapidly, the related service segment also has also grown faster. Computer maintenance is emerging as a major area of operation in the IT industry. Maintenance can be either undertaken by the manufacturers themselves or by third party maintenance. The latter is expected to become popular as has been the case abroad.

*Training and Education Segment* Another service segment which is growing faster in the IT industry is the training and education segment. Currently the software industry employs approximately 150,000 people and with India emerging as a strong base for the Y2K projects, the requirement of manpower training would increase substantially in the near future. This segment is dominated by two companies, i.e. NIIT and Aptech who together account for 65% share of the market. Tie-ups with leading international companies that are engaged in this business are expected to enhance the value of the training programme. Even many of the international software developing companies are planning to set up their own training and education centres in India.

## Business Analysis

ET&T's operations can be organised under six major divisions and the income composition from these divisions for FY 97 is as follows :

**Table 1 Composition of Income in ET&T's operation - FY 97**

<b>Division</b>	<b>% of Total Income</b>
<b>Equipment Imports &amp; Project Consultancy</b>	<b>44</b>
<b>Information Technology</b>	<b>36</b>
<b>Consumer Electronics</b>	<b>12</b>
<b>Computer Education and Training &amp; Instructional Video</b>	<b>8</b>
<b>TOTAL</b>	<b>100</b>

ET&T derives more than 40% of its total income from the business of importing electronic equipments and project consultancy. The company imports equipments are used in the defence & paramilitary sector, research laboratories apart from equipments used by educational institutions and various Government departments. The company undertakes total service package for the import of equipments.

In the area of project consultancy, ET&T undertakes consultancy in the following :

- Providing consultancy services for cable televisions, closed circuit TV, surveillance systems, video projection system and EPABX systems for defence and Government organisations;
- Marketing security systems like bomb detection and disposal equipment for Police departments and Indian Army; and
- Marketing communication equipments like pagers to the Police and different ministries.

The second contributor in the total income of ET&T is from various IT businesses. The company undertakes assembling of personal computers (PC), marketing computer hardware and its maintenance, software development and marketing of branded software products etc.

ET&T assembles PC at its facility at Bhiwadi, Rajasthan. This unit was initially set up by the Rajasthan Financial Corporation and was acquired by ET&T in 1993. The company assembles PCs with 386, 486 and Pentium chips. However, the number of PCs assembled in this unit has declined sharply due to low level of orders received.

The company's software development activities is located in Gandhinagar in Gujarat. The segment is dominated by large number of players and the share of ET&T is insignificant.

In the consumer electronics division, ET&T assembles colour TVs (CTV) and black & white TVs (B&W TV) from kits and sells them in domestic and overseas markets. The company's production of various types of televisions has been on a decline over a period of time as shown below:

Table 2 Details of Production of Television (Nos)

TV Models	FY 97	FY 96	FY 95	FY 94
14" CTVs	835	4170	8425	17350
14" B&W TVs	247	459	0	0
20"/21" CTVs	83	73	0	0

ET&T is also engaged in computer education and training. ET&T has around 65 franchisees, at different locations in the country, offering short term and long term courses for beginners as well as customised courses for professionals. The company's share when compared with the total size of the segment is insignificant.

The employee strength as at 31st March, 1997 was 333 and about half of the total manpower are clerical. The company has announced a voluntary retirement scheme in May 96, but so far only 6 employees availed this facility.

## Financial Analysis

The financial performance of ET&T for the past five years is given below:

Table 3 Financial Performance (Rs. Crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Operating Income	45.6	30.1	49.6	63.5	74.0
Operating Profit	-3.2	-3.2	-1.8	0.7	0.5
Profit after Tax	-16.1	-15.0	-12.9	-6.5	-5.8
Equity Capital	5.0	5.0	5.0	5.0	5.0
Tangible Net Worth	-56.8	-40.6	-25.7	-13.5	-6.8

*Note : The ratios have not been presented as they are all negative.*

The company's operating income has been declining due to its inability to withstand the severe competition. However, with a renewed thrust towards information technology and computer education, the company was able to achieve a growth in turnover in FY 97.

While both sales and margins have declined, the company's establishment expenses continued to remain high resulting in increasing operating losses. With funds locked up in inventories and debtors, and cash credit facilities frozen by banks due to defaults, the company borrowed short term loans for working capital purposes, resulting in increasing interest burden. Interest cost as a percentage of total income was 23% in FY 97. Increasing interest burden has resulted in an increasing level of losses during the last three years.

The inventory value as on 31st March, 1997 was Rs. 9 crores while the company had provided about Rs. 4.7 crores for obsolescence and diminution in value. The overdue position of debtors as at 31st March, 1997 was Rs. 11.9 crores while the company has made a provision of Rs. 4.4 crores for doubtful debts.

To cover up the deficit in current operations, ET&T borrowed from a number of sources including banks. The total external liabilities as on March 31, 1997 were Rs. 67 crores. Some of these banks have already started the process of recovery through the Debt Recovery Tribunal.

## Strength and Areas of Concern

### Strength

*Professional Staff* . The quality of human resources is a key factor in the IT industry. ET&T has, inspite of its problems, been able to retain qualified professional staff on its rolls.

### Areas of Concern

*Poor Business Position* : The poor business position of ET&T can be attributed to a number of external as well as company related reasons. The decanalisation of imports of electronic equipments by Government in the late eighties and early nineties made ET&T redundant to a large extent. At the same time, the lack of timely steps to adapt to the changing

environment caused a sharp decline in the company's turnover. The company's entry into highly competitive areas such as trading, assembling of PCs, and computer education without any sustainable competitive advantage have seen a rapid erosion in the business position of the company.

*Poor Financial Position* : With a view to meeting the deficit in current operations, the company resorted to short term borrowings from PSUs and banks without a clear assessment of its own repayment capacity. The short term borrowings were used for financing manufacturing facilities which, due to low capacity utilisation, turned out to be unviable. With increasing interest burden, the company has become irregular in the payment of dues. The problem has been compounded due to the freezing of working capital loans from banks and financial institutions.

In addition, poor recovery systems have caused accumulation of debtors, major part of which turned bad and have bleak prospects of recovery.

*Excess manpower* : ET&T's sales turnover has declined substantially and, at the current level of operations, the manpower strength especially on the non-technical side is on the higher side. The company's efforts to reduce manpower levels through a VRS has not been successful.

### ET&T's Turnaround Plan

Given the above areas of concern, the company has submitted a restructuring plan for turn around to its Administrative Ministry. The plan comprises of the following:

- One time settlement with the existing banks, PSU lenders to be provided by Government;
- Waiver by Government of its outstanding loans and continuation of ways and means support;
- Reduction of non-technical manpower by 50 and induction of a corresponding number of technical persons;
- Fresh cash infusion of Rs. 10 crores by Government;
- Sale of part of fixed assets and

- Refocus business on education and training, software development, IT solutions and Trading. In particular, the focus would be on the lower end of the educational and training segment in smaller cities.

According to the company's estimates, if the above plan is implemented, the company would turn around in two years time and would be self sustaining without the need for any budgetary support

## Recommendation

The areas of operations of the company viz., consumer electronics and information technology are extremely competitive. The opening up of the consumer electronics industry to imports has led to this increased competitiveness. Domestic as well as international companies are making considerable investments in these segments. Further, in order to retain their competitive advantage, these companies are making continuous efforts at product innovation and are offering attractive packages to draw customers.

India is among the few countries in the world which are globally competitive in the IT industry. As a consequence, the IT industry has matured in terms of investment as well as technological capabilities.

The markets in which ET&T operates are thus fully contestable. ET&T's development objectives as envisaged in the seventies may no longer be as vital in the above scenario. **The Commission has therefore classified ET&T as non-core.**

Given its precarious position, the company has formulated a turnaround plan for financial restructuring which would require waiver of both principal and interest from banks as well as Government. **The Commission has examined the above plan in detail and is of the view that the turnaround prospects have a high element of risk since ET&T faces stiff domestic as well as international competition in its areas of operations. Even if the turnaround is complete, the profits of the company would remain at low levels because of the low margins from its product-mix of operations and high burden of overheads. In such a scenario, it is difficult to envisage investor interest in the operations of the company.**

As a prudent investor, the best option available to Government would be to discontinue all operations. **The Commission therefore recommends that**

**ET&T should discontinue all its operations with immediate effect. However, existing contracts taken on by the company should be completed and no new contracts should be entered into by the company.**

In order to facilitate the discontinuation of operations, the Commission recommends that Government announce a package of measures comprising:

- **A pension-cum-insurance scheme as an alternative to a one-time payment for the employees who are not professionally qualified. An outline of the scheme has already been given by the Commission in its Fourth Report.**
- **Career counselling on alternative available options for employees who are professionally qualified. In such cases, the company should formulate a scheme by which the professional staff could take advantage of other opportunities in the fast growing IT industry.**
- **If some of the employees have entrepreneurial aptitudes, Government should encourage them by providing assistance as suggested by the Commission in its Fifth Report. ET&T has 65 franchisees at different locations in the country which offer short term as well as long term courses for beginners as well as customised courses. If some of the employees are interested in running these franchisee units jointly by forming a corporate enterprise, Government should encourage handing them over after suitable pre-qualifications. In such cases, the lumpsum amounts payable on account of VRS could be adjusted against the value of the assets. Government could, in the initial years, provide some external assistance till the time that business stabilizes.**

At a later point and if required, Government may also appoint Financial Advisers who could assist in the sale of the assets of the company. The procedure for appointing Financial Advisers has been outlined in the Commission's First Report.



## 2.2 Hindustan Vegetable Oils Corporation Limited

### Evolution

Hindustan Vegetable Oils Corporation Limited (HVOCL) was incorporated on March 31, 1984 with the merger of two private sick enterprises i.e. Ganesh Flour Mills Limited (GFM) and Amritsar Oil Works (AOW).

Prior to the nationalisation, Government had taken over the management of these companies under the Industries (Development & Regulation) Act. The performance of the companies even after management intervention was not healthy and subsequently the assets of the company were taken over and merged to create Hindustan Vegetable Oils Corporation in its present form. The company is under the administrative control of the Ministry of Civil Supplies, Consumer Affairs and Public Distribution. The shares of the company are wholly held by Government.

### Industry Analysis

The production of vanaspati was HVOCL's primary business in the early 1990s which contributed to more than 50% of the turnover at that point of time. However, due to the general decline in the vanaspati and refining oils industry, Palmolein packaging for the public distribution system and breakfast foods have become the primary activities of the company and account for more than 75% of the total turnover since the last two years.

### PDS Packing

Packing of imported refined oils for PDS distribution was started by Government during the late 1970s initially to refine and pack the imported rape seeds and mustard oil. This was done to tide over the edible oil shortage faced by the country during that period. Later, when the country became self-sufficient in rape-seed and mustard oilseed production, Palmolien became the major imported oil during the last decade.

The allocation of oil for PDS packing is done state-wise by the Ministry of Civil Supplies based on demand from states and funds allocated for oil imports. The packing allocation for HVOCL is on the basis of the presence of HVOCL in a state and the extent of its installed capacity.

The company gets a fixed net margin of 3-4% from Government. Since all costs are reimbursed, the company has no incentive to improve production efficiency. Subsequent to the easing of availability of edible oils in the country and the shift to liberalisation of imports, Government has taken a conscious decision to reduce the edible oil imports on its own. As a result, the trend of packing allocation to HVOCL has been volatile during the past five years. Also with the shift of edible oil imports to OGL, oil imports by government are likely to decline further.

In summary, HVOCL faces considerable uncertainty in the scale of its operations due to the variations in allocations by Government from year to year in the PDS packing business.

## Breakfast Foods

The breakfast foods industry in India comprises of products like corn flakes, oats and museli. All these products are ready-to-eat and are normally consumed with milk. The breakfast foods are consumed more in urban areas where the disposable income is higher and awareness about the benefits is high.

*Cornflakes* The market size is presently estimated at 4,000 tpa which has quadrupled after the entry of multi-nationals since the early nineties. The three major players in this segment are Kelloggs, Mohan Meakins and HVOCL. Although there is a large market potential due to low penetration and low per capita consumption, the markets have to be built up in terms of brands and distribution networks.

*Oats* In the oats segment the demand is largely supply driven with demand presently being higher than supply. HVOCL has been so far the dominant player in this segment due to the absence of any large player. When compared with developed markets, the market penetration is again quite low. However, the entry of Quaker Oats (the world's largest oats producer) and the tie-up of ITC-Agro Tech with ConAgra (which is a popular brand in South Asia) is expected to intensify competition and could adversely affect HVOCL's position.

HVOCL markets its cornflakes and oats under a common brand name "Champion" which has been fairly popular because of its long existence.

However, given the poor financial position of the company, HVOCL has not made any investment in developing its brand or strengthening the sales network. In fact, the company relies on the Mysore Sales International Limited (a Karnataka State Government Agency) for nation-wide distribution.

The Breakfast foods business of HVOCL is likely to be under threat against the onslaught of MNCs. Even though the company enjoys a fairly good brand equity, it lacks the marketing, distribution and financial resources to compete against players like Kelloggs and Quaker Oats.

## Business Analysis

The company has manufacturing facilities at 8 locations spread all over India with vanaspati manufacturing mainly in Delhi, Kanpur and Amritsar. The packing capacities are located in those states where the allocation of PDS is high. The present status of units is indicated in the following table :

Table 1 Status of Units

Unit	Major Operations	Current Status	Employees
Delhi - V	Vanaspati	Shutdown due to Supreme Court Order	265
Delhi -BF	Breakfast foods and PDS packing	Operational	191
Amritsar	Vanaspati and PDS packing	Vanaspati shut down due to technological obsolescence	282
Kanpur	Vanaspati and PDS packing	Vanaspati shut down due to technological obsolescence	332
Mumbai	Oil refining and PDS packing	Refining shut down due to technological obsolescence	346
Calcutta	Oil refining and PDS Packing	Operational	31
Chennai	PDS packing	Operational	31
Bangalore	PDS packing	Operational	24

The company has large capacities with obsolete technology in vanaspati and refining. Production at two vanaspati units (Amritsar, Kanpur) and oil refining units (Mumbai, Amritsar and Kanpur) has been stopped due to obsolete technology leading to high cost of production and poor product quality. Manufacturing operations at Delhi (vanaspati) and Calcutta (refining) units have been stopped as per court orders.

Old plant and machinery is primarily responsible for the low capacity utilisation in the breakfast foods division. The company has stopped the production of wheat-flakes due to poor market response. Corn-flakes production has been curtailed due to strong competition from Kelloggs, Mohan Meakins, and Gold Crunch. Oats production has not increased despite market demand due to operational problems in the pneumatic machines which were installed after a fire destroyed the oats production line in 1991.

In the case of PDS packing, the utilisation of packing capacities is dependent upon the packing allocation by Government to HVOCL and hence it has no control over the capacity utilisation in this segment.

The oil refining and vanaspati production are economically unviable as the sales realisations do not cover even the variable costs. While the material costs are higher due to the absence of efficient procurement systems, the power and fuel costs are higher due to lower efficiency as compared to industry norms.

The primary raw materials in the manufacture of vanaspati are crude edible oils like soyabean oil, cottonseed oil, sunflower oil, mustard oil (solvent extracted), rice bran oil, sesame oil, etc. The vanaspati units of Amritsar and Kanpur are located in the oil seed growing areas of Punjab (cottonseed) and Uttar Pradesh (mustard). Besides, oil seeds like soyabean and mustard are also crushed in neighbouring states of Madhya Pradesh and Rajasthan. Since the prices of oils vary on a day-to-day basis, it is extremely important for a company to have proper systems to monitor oil prices on a daily basis so as to buy oil when prices are low and monitor quantum of oil requirements. In this respect, HVOCL is placed at a disadvantageous position, as the company is not always able to take quick decisions due to its PSU character.

HVOCL lacks logistical abilities and qualified man power required for efficient sales and marketing functions.

## Financial Analysis

The financial performance of the company for the last five years is shown in the table below :

Table 2 Financial Performance

(Rs.Crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Operating Income	113.0	98.3	93.5	87.8	146.3
Operating Profit	-2.5	-3.9	-6.0	-7.4	-2.3
Profit after Tax	-2.5	-3.8	-7.1	-10.3	-3.8
Equity Capital	7.7	7.7	7.7	7.7	7.7
Tangible Networth	22.5	24.3	29.9	38.4	49.7

*Note : Ratios have not been presented as they are all negative*

The operating income decreased by 40% in FY 94 mainly due to decline in vanaspati and packing business but has since increased due to increased packing allocation.

The company has been incurring continuous losses for the last six years which has eroded its net worth from the level of Rs. 50.22 crores in FY 91 to Rs. 22.5 crores as on March 31, 1997. The losses are mainly due to closure of its main businesses while the fixed expenses have remained more or less constant. In addition, the company has incurred an expenditure of Rs. 9.5 crores (out of which of Rs. 7.11 crores was received from NRF) on account of VRS started in FY 91. It is likely to incur expenditure on this account in future also.

The company has an unsecured loan of Rs. 3.5 crores from Government, on which interest has been due for the last six years. The principal cum interest liability has grown to a high of Rs. 8.07 crores as on March 31, 1997.

## Strengths and Areas of Concern

### Strengths

*Hidden Assets* The company's operations in Delhi and other metro cities are located in the heart of the cities. The land on which factories exist have significant real estate potential.

*Good Brand Equity* HVOCL has brands such as “Champion” which have been in the market for a fairly long time. As a result, the brand equity of some of the products is fairly high.

## Areas of Concern

*Low Margin Businesses* The existing businesses of HVOCL which is PDS packing and breakfast foods have inherently low margins. As a result, the company has not been able to build a strong financial position.

*Obsolete Technology* The company's vanaspati units have been closed down due to obsolete technology. As a result, the staff at these units have become idle which has added to the operational costs.

*Commodity Nature of Business* HVOCL operates in agro-based commodities for inputs which require strong procurement skills to maximise profits. Being a PSU, it is difficult for the company to take quick business decisions.

*Poor Marketing* The processed foods business world wide is brand driven. Companies with financial resources who can build up brands in the initial years have built sustainable competitive advantages in the long term. In this respect, the poor financial position of HVOCL has placed the marketing of the company's products at a disadvantage. The company has not been able to match the marketing strategies of multi-nationals who have entered India.

## Recommendation

**The Commission classifies HVOCL as non-core due to two reasons :**

- The reasons for HVOCL's nationalisation - Government control of the vanaspati industry - is no longer relevant in today's context of free edible oil imports and alternative availability of edible oils. In addition, the segment is highly competitive due to the presence of a large number of players.
- The breakfast foods business has seen the entry of a number of multi-national companies which has increased the level of competition in the industry.

The markets in all the business segments in which HVOCL operates are thus highly contestable and no public purpose will be served by sustaining a loss making public sector company in the processed foods business requiring quick decisions for viability.

As far as the vanaspati business is concerned, the Commission has noted that two of the units located in Delhi and Calcutta have been closed down by a Supreme Court order. The relocation of the plant and machinery and subsequent revival is unlikely given the fact that the plant and machinery have remained idle for more than five years. As far as these units are concerned, the Commission recommends that Government should implement the Hon'ble Court's decision in toto and compensation paid as per the Court directives.

In respect of vanaspati and refining units in other locations, revival is highly doubtful given the obsolete technology and the dilapidated condition of plant and machinery. Besides, with HVOCL's networth already eroded by about 60% over the last five years, the company is in effect on the verge of becoming sick.

As far as the packing business for PDS is concerned, the Commission has noted that the net margins provided by Government is in fact an indirect subsidy which has sustained the expenses in the other unviable operations. This business has an uncertain future as the allocations by Government - which have been volatile in the past - are likely to decline significantly in the future.

**In such a scenario, the Commission recommends that the company's operations in vanaspati and packaging of refined oils be discontinued with immediate effect.**

**Prior to such discontinuation, the Commission recommends that Government should announce a package for the employees. The scheme should cover the following :**

- **A pension-cum-insurance scheme in lieu of a one-time payment for voluntary separation for the employees based on the last salary drawn. An outline of the scheme has already been given by the Commission in its Fourth Report and is reproduced in**

**Annexure 1. The employees covered under the Supreme Court order should be excluded from this scheme.**

- **Career counselling on alternative available options. If the level of skills developed by an employee is high, Government should actively assist the employee in finding alternate jobs in the private sector.**
- **Those employees having entrepreneurial skills should be encouraged by providing assistance as suggested by the Commission in its Fifth Report such as making available counselling services in collaboration with organisations like the Industrial and Technical Consultancy Organisations in each State and regarding alternative investment options like establishing small business ventures or retraining for alternate employment.**

The breakfast foods business has been running with a well established brandname especially in the oatmeal segment. All over the world, the processed foods is brand driven and requires a strong level of financial support to develop and create new markets. With increasing globalisation of the Indian economy, the markets in India are unlikely to be different. In such a scenario, the strengthening of the business will require significant funds as well as managerial inputs which is lacking in HVOCL. **The Commission therefore recommends hiving off the breakfast food business into a new company and subsequent sale of 100% holding through a competitive bidding process.**

**The estimated value of the other freehold real estates owned by HVOCL units (as per the valuation performed by Central Bureau of Direct Taxes (CBDT) in November, 1996) is quite substantial. Hence the net inflow to Government by closing down all the units by liquidating their assets and selling the breakfast foods unit after settling all the claims and retirement benefits would still be high.**

At a later point in time, Government may also appoint Financial Advisers who could assist in the sale of the demerged assets of the company. The procedure for appointing Financial Advisers has been outlined in the Commission's First Report.



## 2.3 Hindustan Zinc Limited

### Evolution

Zinc mining and purification has been carried out in India for several centuries with the mining industry preceding the smelting industry. The zinc industry was consolidated into Hindustan Zinc Limited (HZL) after the nationalisation of various zinc mines. HZL is engaged in the business of mining and smelting zinc and lead. While the mining reserves are located in Rajasthan, the smelting capacities are located in Rajasthan, Andhra Pradesh and Bihar.

The equity capital of the company as at 31st March, 1997 was Rs. 423 crores. The Government of India has so far disinvested 24% of its holding. The current shareholding pattern of HZL is as follows :

Table 1 Share Holding Pattern

Name of share holder	Percentage
Government of India	76
Financial Institutions	21
Public	3
TOTAL	100

The shares of HZL are listed at Bombay Stock Exchange and is currently trading at Rs. 15.25 as on December 26, 1997.

### Industry Analysis - Zinc

Zinc is an ancient metal which co-exists with a number of other metals like copper, lead, silver and cadmium. The industry can be divided into two distinct components - mining and smelting. The mining industry excavates the ore from surface or underground deposits (which contain metal content typically between 2% to 15%) and beneficiates the ore to produce concentrates with 50-55% metal content. The smelting industry converts the concentrate into high purity zinc metal. The smelting operation for zinc can be based on either an electrolytic or a pyrometallurgical process.

Globally, the known reserves of zinc metal are around 330 million tonnes with annual consumption being around 7.3 million tonnes. The Indian reserves are estimated at 20 million tonnes with annual domestic consumption being about 200,000 tonnes. The global geographical dispersion of the industry in terms of major mining, smelting and consumption countries is given below:

**Table 2 Global Zinc production, consumption (Million tonnes)**

Name of the Country	Ore Production	Smelting	Consumption
Canada	1.00	0.69	0.14
Australia	0.97	0.32	0.16
China	0.75	0.97	0.57
Peru	0.67	0.15	0.54
USA	0.58	0.35	1.17
Japan	0.10	0.66	0.73
CIS countries	0.35	0.37	0.29
Germany	—	0.36	0.51

From the above table, it can be seen that Canada, Australia and China account for approximately 41% of the world ore production while China, Canada, Japan and Germany account for 40% of the smelting capacity. In terms of consumption, USA, Japan, Germany and China account for around 45%. Asia has become a principal consumption market accounting for approximately 37% in FY 96 as against only 6% in FY 60.

Historically, India has been self-sufficient in zinc. Currently however, India is a net importer of both zinc metal and concentrate. The latter is primarily imported by Binani Zinc, a private sector producer which is located near a port.

The Indian zinc industry comprises one integrated producer (HZL) and one smelting company (Binani Zinc) with several other secondary zinc producers through the scrap recovery route. The consumption of primary zinc during FY 97 was about 216,000 tonnes as against production of about 140,000 tonnes, with the balance being met out of imports. Apart from the primary zinc, about 30,000 tonnes of secondary zinc was also consumed during FY

97. The domestic production of secondary zinc was almost equivalent to the domestic consumption.

Zinc is primarily used in galvanisation which accounts for 49% of the total world's consumption. Construction and transport sectors are the major end user segments for the zinc accounting for 48% and 23% of the total consumption respectively. The application of zinc could vary from country to country as seen in the following table :

Table 3 Major Consumption Sectors

Region	Application Area	Consumption Sectors
Global	Galvanisation - 46% Die Casting and alloys - 39%	Construction Transport
India	Galvanisation - 70% Die Casting and alloys - 10%	Construction Transport

Since galvanisation is the core application; zinc consumption centres tend to be co-located with steel product manufacturing locations. While globally, the traditional application area for housing has been experiencing low growth rates, in emerging economies like India and China, steady growth in consumption is expected. However, zinc consumption is threatened by substitutes like plastic coatings etc.

### Industry Analysis - Lead

The lead industry co-exists with the zinc industry for the following reasons :

- Several ores contain lead in significant proportion with zinc;
- In the pyro-metallurgical route, zinc and lead can be produced simultaneously and
- London Metal Exchange (LME) is the nodal agency for trade in both the metals

Lead metal production world wide is around 5.2 million tonnes per year with the consumption fluctuating significantly. The major consumption areas for lead is the storage battery industry which traditionally accounts for about two thirds of the consumption.

In India, HZL in the public sector and India Lead Limited (ILL) in the private sector are the two main producers who produce lead through the primary route with capacities of 65,000 tonnes per annum and 24,000 tonnes per annum respectively. Apart from these two producers, there are many small companies who operate through the secondary route.

The lead production in FY 97 was 43,433 tonnes while consumption was 84,000 tonnes. This increase in consumption has been driven by a corresponding increase in the market for automotive and industrial batteries. India is a net importer of lead, even though a substantial part of the requirement is met by the secondary sector.

LME is the nodal exchange for international trade in metal and concentrates. The prices of both zinc and lead are determined on the basis of LME prices. As mentioned above, Asia is emerging as a major production and consumption centre for zinc. China, being the dominant player on the LME, influences LME zinc prices. HZL is not registered on the LME and India is represented through Binani Zinc and India Lead.

## Business Analysis

HZL has a dominant position in the zinc and lead mining industry in India. The total ore reserves in HZL's leasehold area are estimated to be 122.7 million tonnes. In addition, the company has rights to about 40 million tonnes of possible reserves. The details of HZL's reserves are given below :

Table 4 Details of HZL's Zinc Lead reserves (Million Tonnes)

Sl.No	State/Mine	Reserve(*)	% Lead	% zinc
<b>Rajasthan</b>				
1	Zawar Group	36.51	2.02	4.66
2	Rajpura Dariba Group	29.07	2.39	7.31
3	Rampura Agucha	48.25	1.98	13.53
4	Ghughra	5.52	1.88	3.35
<b>Orissa</b>				
5	Sarigapalli	1.48	5.49	0
<b>Andhra Pradesh</b>				
6	Agnigundala	1.85	5.46	0
<b>Total (**)</b>		122.67	2.19	8.59

(\*) Reserves include developed probable

(\*\*) In addition to total reserves indicated, additional 40 million tonnes of possible ore reserves exist in HZL lease hold areas

The Rampura Agucha mine is an open cast mine and has the highest quality of ore among all HZL mines. This mine operates at internationally comparable norms and at competitive costs. The cost of mining and milling concentrate varies considerably in HZL's mines. The average cost of mining and milling of concentrate for HZL mines is around Rs.7,003 per tonne.

HZL owns 4 smelters with metal processing capacity of 214,000 tonnes per annum. It has a zinc smelting capacity of 149,000 tonnes per annum and lead smelting capacity of 65,000 tonnes per annum. HZL's smelters - located at three locations - employ different technologies and the efficiencies of these smelters varied differently. The performance of different smelters are as follows :

Table 5 Performance comparison of HZL smelters (FY 96)

Particulars	Debari	Vizag	Chandaria
Year of Commissioning	1968	1977	1991
Technology	Electrolytic	Electrolytic	ISP*
Zinc Recovery (%) - Actual	93	88	83
- Possible	95	95	91
Installed Capacity - Zinc (Tonnes)	49000	30000	70000
Capacity Utilisation (%)	105	93	51
Installed Capacity - lead (Tonnes)	Nil	35000	22000
Manpower	1655	1642	843

(\*) Imperial Smelting Process

Debari is the oldest zinc smelter of HZL and is the best among the smelters of HZL in terms of recovery percentage and capacity utilisation. The Vizag smelter, being a port based smelter, was set up with an objective to process imported concentrate. However, after the development of Rampura Agucha mines, this smelter started using the concentrate from the captive sources. The transportation cost of concentrate from Rajasthan to Vizag makes the conversion cost per tonne of metal from this smelter significantly higher.

HZL set up its third smelter at Chandaria using Imperial Smelting Process (ISP) technology which was a new technology. In terms of manpower, this

smelter uses lower levels of manpower even for a higher capacity. The smelter operates with 83% zinc recovery and about 51% capacity utilisation. The smelter has high expenditure on stores, spares, components and consumables. The ISP technology used in the plant has been used only in 14 plants worldover and only two plants in Japan are operating satisfactorily after modification. HZL is hopeful that the capacity utilisation of the smelter would improve substantially over next two years and would result in improved profitability.

The average conversion cost of HZL is Rs.25,190 per tonne which is significantly higher than international conversion cost of Rs.13,500 to Rs. 15,500 per tonne. One of the reasons for this higher cost is the size of smelters of HZL. Worldover, smelters have capacities much greater than the Chanderia smelter.

### **Future Plans**

HZL has entered into an agreement with BHP Ltd, an Australian based mining company, to undertake aerial survey and exploration over a stretch of 15,000 sq.kms in Rajasthan. Apart from this, the company has plans to incur about Rs. 1350 crores on various capital expenditure schemes during Ninth Five Year Plan period :

- Plan to expand the Rampura-Agucha mine at a cost of Rs. 60 crores
- Plan to invest in a new zinc smelter at a cost of Rs.475 crores and Rs.80 crores for expansion of capacity at Debari and Vizag
- Plan to invest Rs. 430 crores in a power plant for captive consumption
- Rs.40 crores to be invested in joint ventures
- Rs. 70 crores to be spent on diversification into other metals etc.
- Rs. 145 crores towards replacement of plant and machinery

### **Financial Analysis**

The financial performance of HZL for the past five years is indicated in the following table :

Table 6 Financial Performance

(Rs.Crores)

	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	823.3	972.7	759.8	777.8	702.2
Operating Profit	175	181	126	210	199
Profit after Tax	42.4	76.4	4.6	62.9	93.4
Equity Capital	422.5	422.5	422.5	412.5	403.7
Tangible Networth	821.7	777.9	643.4	669.7	636.3
Gross Margin (%)	21.3	18.6	16.6	27.0	28.3
Net Margin (%)	5.1	7.8	0.7	8.1	13.2
ROCE (%)	10.6	11.6	6.7	10.9	13.0
RONW(%)	5.1	9.8	0.8	9.4	14.6
Earnings per Share (Rs.)	1.0	1.80	0.11	1.52	2.30
Dividend (%)	2.0	—	—	6.0	6.0

Sales value increased from Rs.700 crores in FY 92 to Rs. 973 crores during FY 95 primarily due to increased sales volume as the prices of zinc concentrate and metal fluctuated during the period. HZL's realisation came down as a result of sales price rationalisation in line with international prices. The gross margins showed wide fluctuations from a level of 28% in FY 92 to 21% in FY 96. One of the reasons for the fall in margins can be attributed to the lower operational efficiency of Chanderia smelter. Net margins have shown significant fluctuation and the fall in margins is due to lower realisation and increase in interest outflow.

Power is an important element in the total cost of production. The cost of power is significantly high when compared with smelters in other countries which results in higher cost of production. The company is planning to meet its power requirement by setting up a captive power plant.

## Strengths and Areas of Concern

### Strengths

*Dominant producer* HZL is the only integrated producer of both zinc and lead in the country with 55 - 60% market share. The company enjoys a

dominant status both in the mining and the smelter segment. This has enabled them to influence prices in Indian market to some extent even though the company is not a member of LME.

*High quality ore* The company reserves of international grade ore in the Rampura-Agucha mines are among the best in the world in terms of average metal content.

*Bright Growth Prospects* The widening demand supply gap and increasing demand scenario will enable HZL to grow in the medium term. It is estimated that the consumption of zinc will grow at a CAGR of 6-8% while the lead consumption is expected to grow at a CAGR of 6-7%. The demand supply gap for zinc is expected to be 50% by year 2000.

## Areas of Concern

*High cost of production* The average conversion cost for HZL is higher when compared with the international norms. This puts HZL in a disadvantageous position. Similarly, the average metal production cost of HZL (excluding head office overheads and sales overheads) is almost close to the landed price of imported Zinc, thus leaving no margin for HZL.

*Reduction in import duty* Existing level of import duty provides substantial protection to HZL. However, a further reduction in the custom duties together with a fall in LME prices can put further pressures on HZL's margins.

*Power cost and availability* Rajasthan is a net power deficit state and has to depend on power from other States. Because of this, the cost of purchased power for HZL is high and the availability is also at times difficult.

*Water Shortage* The smelting process of HZL requires extensive water and Rajasthan is also a water deficit state. HZL has to incur expenditure to meet the water requirement by setting up dams.

*Smelter capacity and utilisation* The installed capacity as well as the capacity utilisation for the existing smelting plants is relatively low when compared with global smelters. This has led to increased cost.



## Recommendation

While the company has been categorised as a “non-core” PSU by the Commission, having regard to its dominant market share in the Zinc industry and also its considerable ore reserves, the Commission would not recommend disinvestment in the company beyond 49% at present. Also taking into account the reserves of high grade Zinc ores in the country, continued Government control over this company may be desirable to conserve this exhaustible material for the downstream industry and safeguard against indiscriminate “slaughter mining” for short-term financial gains. **No public purpose will be served by converting a near public monopoly to a private monopoly and therefore disinvestment beyond 49% is not considered desirable at present. This issue can be reviewed once the situation changes in the future.**

**The Commission, therefore, recommends that the Board of the company be given managerial autonomy (on the lines of the Strong Performer as categorised by the Commission in its First Report) with due regard to its successful track record of profitability and dividend pay-out to enable it to implement its projects of diversification relating to :**

- **establishing joint ventures for exploration of further reserves;**
- **establishing captive power plant and**
- **expanding and developing mines for production of high grade zinc ore.**

**HZL may scan the market for a suitable strategic partner who may be offered upto 25% of the equity stake in the Company alongwith appropriate role in the management. Such a partner should be able to add to HZL's strengths in terms of mining and production management, technology and access to international funds and markets. A strategic partner in HZL will also be willing to pay higher price for a stake in the company and Government proceeds could thus be maximised.**

**If this option is not feasible, Government could consider disinvestment upto 25% in one or more trenches in the domestic market with preferential allotment to small investors and the employees, as set out in the Commission's First Report.**

## 2.4 Hotel Corporation of India Limited

### Evolution

Hotel Corporation of India Limited (HCIL) was set up as a 100% subsidiary of Air India (AI) in 1971 with the objective of catering to the requirements of AI in respect of hotel rooms for its transit passengers and crew. The flight catering division of AI was merged with HCIL. In 1975, HCIL set up the Centaur Hotel in Mumbai. The Centaur Delhi was set up in 1982, while the Centaur Lake View Hotel in Srinagar was established in 1983. Later in 1986, to meet the growing tourist traffic demand, the Centaur, Juhu was set up.

There has been no disinvestment in HCIL and the entire equity of Rs. 40.6 Crores are held by AI.

### Industry Analysis

The hotel industry is the second largest foreign exchange earner in the country and is one of the most important elements of infrastructure for tourism. The hotel industry can be divided into various segments for meeting the requirements of different classes of tourists. The five star hotel industry (Elite segment) can be further categorised into business hotels located in metropolitan cities and business cities and tourist hotels located in places of tourist interest.

The total room capacity in five star and five star deluxe category in India is 18,025 out of which about 62% are located in four metropolitan cities. Out of the total rooms available, 51% are in Delhi and Mumbai, which makes these two cities the largest business centres. This segment of hotel industry is dominated by private sector companies. East India Hotels Ltd. (Oberoi group) manages 10 hotels throughout the country while Indian Hotel Co.Ltd.(Taj group) manages 14 hotels. In Mumbai, 70% of the room capacity is accounted by Taj group, Oberoi group and Hotel Leela Kempenski. In Delhi, this is more evenly distributed across different players such as ITC group, Taj group, Oberoi group, Asian Hotels Ltd, Bharat Hotels Ltd. etc.

The opening up of the economy has resulted in an annualised growth rate of 18% in business traveller traffic between FY 93 and FY 96. The

conservative estimate of growth of business travel over the next three years is 12-14%. The supply demand position of rooms in the two major cities shows that no capacity addition has taken place since FY 94. This has resulted in increased tariff by 30-40% between FY 93 and FY 96, while maintaining a high occupancy level of 70-80%. The room availability and demand forecast for rooms in the two metros for the next four years are as follows :

Table 1 Demand Forecast in Mumbai and Delhi

<b>Mumbai</b>	FY 97	FY 98	FY 99	FY 2000
Room Availability (nos.)	2452	2452	2452	2762
Demand	1716	1922	2153	2584
Av.Occupancy Levels	70%	78%	88%	94%
<b>Delhi</b>				
Room Availability (nos.)	4329	4529	5029	5029
Demand	2814	3151	3530	3954
Av.Occupancy Levels	65%	70%	70%	79%

The key success factors for hotel industry are the proximity to business centres, airports and the range of facilities offered. The expected industry growth in business travel segment is 12-14% over the next three years while the expected tariff increase during the same period is only 15-18%.

### Flight Catering

This service industry is relatively small in size when compared with the hotel industry and is dominated by the flight catering unit of HCIL in the public sector and the Taj Air Caterers, Oberoi Flight Catering and Ambassador Sky Chef in the private sector. The quality of supplies and reliability of delivery schedule are critical for the success in the industry. The first in the industry to start operations was HCIL. The other three players entered the field in the mid-eighties. The strong bargaining power of the airlines and the smaller size of the market resulted in undercutting of prices which, in turn, culminated in losses. The entry of private airlines has additionally intensified the competition among the four players. In the

last three years, some of the catering operators have also entered into alliances with international airlines in order to improve their bargaining powers and to ensure guaranteed offtake levels.

## Business Analysis

The location of HCIL's hotels are shown in the table below :

Table 2 Principal businesses and their locations (FY 97)

Hotels	Location	Category	Rooms
Centaur Airport	Mumbai	5 star	288
Centaur Juhu	Mumbai	5 star Deluxe	372
Centaur Delhi	Delhi	5 star	376
Centaur Lake View	Srinagar	5 star	249
Indo Hokke (Subsidiary)	Bihar	Budget	26
The flight catering services consisting of Chefair and Dining Services are located in Delhi and Mumbai.			

In spite of poor standards of hotels facilities relative to the industry, the supply shortfall in Mumbai and Delhi has enabled the units to increase tariffs while maintaining high occupancies.

The proximity to the domestic airports ensures high level of occupancies from the airline segment in Centaur Mumbai. It is the only unit of HCIL to show consistent profits since inception. Out of 288 rooms, 100 rooms are reserved for AI's transit passengers. The average room occupancy from airlines business contributed 51% while its contribution to total income is only 35%. This is because of the nature of this segment which is highly discounted. The two most remunerative segments are Foreign Free Individual Traveller (FFIT) and Domestic Free Individual Traveller (DFIT). FFIT contributes only 18% to the occupancy while its contribution to total income is 28%. Similarly, DFIT's share in occupancy is only 18% while its share in total income is 24%.

The Centaur Juhu Beach is ideally located in a popular tourist spot. It is the only unit of HCIL which is located on free hold land while all other

hotels are on leasehold lands from Airport Authority of India. In the case of Srinagar, the land belongs to J& K Government. Centaur Juhu was incurring losses till FY 93 and has improved its operating performance since then, like the Centaur Airport Mumbai. The Centaur Juhu also having a higher room occupancy rate from airlines. The business from airlines contributes 46% of the room occupancy, while its contribution to total income is only 32%. The most lucrative segment's (both FFIT & DFIT) contribution in the occupancy rate is 31% with their share in income of 44%.

Centaur Delhi is located close to airport. However, its location is not as advantageous as the Mumbai hotels of HCIL. In Delhi, the airlines business contributes 73% of the total occupancy while the travel segment contributes the balance 27%.

The Centaur Lake View Hotel, Srinagar was set up in 1983. This unit has been incurring operating losses since inception. This unit caters to non regular segments like Border Security Force personnel, officers of banks etc. The tariff charged are significantly low. This is the only big hotel presently operating in Srinagar as all other hotels have been closed down due to political and social instability.

The hotel industry is a highly competitive industry where quality of service is the key success factor. HCIL faces tough competition from the private sector operators. The following table shows the competitive position of HCIL vis-à-vis other private sector companies which are operating in similar locations close to airports.

Table 4 Competitive Position of HCIL (FY 97)

	Occ. %	ARR (Rs.)	F&B/RR (%)	No of Emp./ Room
Centaur Airport, Mumbai	89	2754	24	2.7:1
Centaur Juhu	76	2774	38	2.2:1
Centaur Delhi	65	1888	25	2.1:1
Leela Kempinski, Mumbai	84	5783	46	2.8:1
Taj Palace	74	4771	64	3.0:1

ARR: Average Room Rent; F&B: Food & Beverages; RR: Room Rent

The poor condition of facilities has adversely affected the brand image of Centaur and forced the hotels to compete in terms of price rather than quality. Also a comparison of employee to room ratio indicates that overstaffing does not exist. However, HCIL compares poorly in terms of cost of repairs per room, selling expenses per room, etc.

As mentioned above, the flight catering industry is small with only 4 operators. The private sector operators have already turned around their business while HCIL's units at Mumbai and Delhi are still incurring losses. More than 95% of the meals made by HCIL's catering units are catered to passengers of AI/IA. Due to poor quality and unreliable delivery schedules, the offtake from these two units is progressively declining. The capacity utilisation of both units is low, in the region of 20-40%. HCIL also suffers cost disadvantage when compared with their peers from the private sector. The units are highly overstaffed in relation to the size of their operations. Currently, the unit at Mumbai caters to 40% of the requirements of AI and IA whereas the unit at Delhi caters to only 20% of AI/IA's requirements.

## Financial Analysis

The financial performance of HCIL for the past five years is indicated in the table below :

Table 5 Financial Performance

(Rs.Crores)

	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	118.31	83.67	63.04	53.24	45.73
Operating Profit	45.59	23.14	9.58	3.23	3.24
Profit after Tax	33.92	4.53	-7.44	-13.63	-12.11
Equity Capital	40.60	40.60	40.60	40.60	40.60
Tangible Networth	7.19	-39.10	-43.74	-36.01	-21.67
Gross Margin (%)	38.5	27.7	15.2	6.1	7.1
Net Margin (%)	28.7	5.4	-11.8	-25.6	-26.5

*Note : Other Ratios have not been presented as they are negative*

The financial performance of HCIL has improved significantly since FY 94 and the company's networth has been positive as on March 31, 1996. Operating margins showed a significant jump from a level of 15.2% in FY 94 to 38.5% in FY 96.

This improved performance has been mainly due to a sharp increase in the average room rent during the last three years. This coupled with a re-scheduling of loans has helped HCIL to turn around and report profits. In terms of unit wise contributions, the Centaur Mumbai has the highest contribution followed by the Centaur in Delhi and Juhu. The Srinagar hotel has a negative contribution.

In the past, loans on all units with the exception of Centaur Srinagar were renegotiated and financial institutions waived penal interest to the extent of 12 crores. HCIL is presently negotiating with SBI for a waiver of penal interest of approx. Rs.17.6 crores and for a moratorium on loans outstanding against the unit amounting to Rs.10.7 crores.

The liquidity position of the company was affected seriously during FY 97 due to delayed payments from AI. In spite of clearing past dues, the outstanding amount of receivables from AI is high at Rs.25 crores as on March 1997.

## Strengths and Areas of Concern

### Strengths

*Assured Business* As a subsidiary of AI, the transit passengers and crew business is with HCIL. The company has managed to secure business from other airlines also.

*Location* The locations of all the hotels of HCIL are good from the point of view of tourism. The Delhi and Mumbai Centaur hotels are located in close proximity to the airports. The Centaur Juhu is also located on Juhu beach which is a popular tourist spot.

### Areas of Concern

*Poor Brand equity* The poor condition of facilities has adversely affected brand image. As a consequence, the company is not able to charge premium on room rents in spite of premium locations.

*Low Occupancy Rate* When compared with other private sector hotels, the occupancy rates of HCIL hotels are low. Moreover, the occupancy rate is characterised by a high share of business from airlines which operates on substantial discount as compared with the regular tourist traffic.

*No proper upkeep resulting in costly renovation* All the hotels under HCIL require renovations on a large scale. This will involve significant capital expenditure.

## **Recommendation**

The Commission in its Fifth Report had clarified that disinvestment of shares in a subsidiary company of a PSU would be decided by the Board of Management of the concerned PSU and in future, it would not be referred to the Commission. However, where subsidiaries have already been referred to the Commission and where studies have been completed with a view to examining them for the purpose of disinvestment, the Commission would be making recommendation in those cases even if proceeds from disinvestment of shares by the holding companies may not accrue directly to Government. In accordance with this decision, the Commission is giving its recommendations in this case.

HCIL is a subsidiary of Air India and is engaged in two activities viz., managing hotels and flight catering service. Both these businesses requires high quality service and are highly competitive in nature. The private sector presence in both these businesses is significantly high and increasing.

Keeping in view the nature of business in which HCIL is engaged, the Commission recommends that hotels at Mumbai and Delhi may be sold as separate units through a transparent and competitive bidding process after undertaking a proper valuation through a Financial Advisor. In case of the Centaur, Srinagar, the management of AI could initiate dialogue with J & K Government in order to exit from the ownership of the hotel. Since lands on which the airport hotels are located belong to the Airport Authority of India, AI would need to negotiate and settle the terms of transfer with them prior to the sale.

AI would have to decide whether the flight catering service should continue to be provided by HCIL or whether it should be sold of as independent units through a transparent competitive bidding process after undertaking a proper valuation by the Financial Advisor.



## **2.5 National Hydroelectric Power Corporation Limited**

### **Evolution**

National Hydroelectric Power Corporation Limited (NHPC) was incorporated as a Government of India Undertaking on 7th November, 1975 with the main objectives of planning, developing, investigating, constructing and promoting hydroelectric power projects in the Central Sector. After the incorporation of NHPC, three on-going projects, which were being executed by erstwhile Central Hydroelectric Project Control Board (CHPCB) under the then Ministry of Irrigation & Power viz. Loktak Project in Manipur, Baira Siul Project in Himachal Pradesh and Salal Project Stage-I in Jammu & Kashmir, were handed over to NHPC between 1977 and 1978 as there were certain problems in continuing their construction through the Control Board. Along with the projects, the entire manpower was also handed over to NHPC.

To fulfill its mission, NHPC has identified the following corporate objectives:

- to execute hydro power projects and achieve capacity additions expeditiously and economically by adopting modern technology and management techniques and integrated project management systems;
- to generate internal resources to meet requirements of funds for construction, operation and debt servicing to the maximum possible extent;
- to ensure optimum utilisation of installed capacity to achieve maximum generation and machine availability;
- to modernise, renovate and uprate its generation units, as well as of other utilities on request;
- to adopt an environmentally conscious and benign approach in building hydro power projects and assessing the positive and negative impact of hydro development on the environment and ecology;
- to undertake consultancy assignments in all aspects of hydro development including execution of work on a contract or on deposit work basis and
- to attain self reliance and self sufficiency on fiscal and technical matters and achieve all round excellence in execution, operation and engineering.

The paid up share capital of NHPC as at 31st March, 1997 was Rs.2917 crores all of which is held by Government of India.

## Industry Analysis

Power plays a vital role in the development of any economy. The country's power position has improved substantially over the past five decades from an installed capacity of 1,362.MW in the pre-independence era to 83,288 MW as on March 31, 1996. The country currently has all the three modes of power generation viz., hydro, thermal and nuclear. The power generating utilities are mainly owned by Central and State Governments with a small number in the private sector. A major share of the generating capacities is owned by State Governments. State Electricity Boards (SEBs) are responsible for generation, transmission and distribution of electricity within the State. The Central power generating utilities generate power and sell it to the SEBs. The current installed generating capacities from all the three modes are given below :

Table 1 Installed Generating capacities in Utilities as on 31.3.96

	Hydro		Thermal		Nuclear		Total	
	MW	% Share	MW	% Share	MW	% Share	MW	% Share
State	18603	88.7	34917	58.1	—	—	53520	64.25
Centre	1929	9.2	22069	36.7	2225	100	26223	31.50
Private	444	2.1	3101	5.2	—	—	3545	4.25
Total	20976	100	60087	100	2225	100	83288	100

From the above table, it is clear that out of the total capacity available in the country, the power generating capacity through hydel sources is only 25%. Out of this, 89% are owned by State Governments with Central generating companies owning only 9%. Currently, NHPC is one of the major Central hydro generating company in operation. There are two more Central public sector companies which are setting up hydel power generating capacities viz. The Naphtha Jakhri Power Corporation and Tehri Hydro-electric Development Corporation. Apart from these, Tata Electric Company is also generating power from hydel sources.

India has significant potential for hydel power with its wealth of river sources. The Himalayan river systems lend themselves to run-of-the-river development with relatively small storage, although large storage hydro projects are also possible. The peninsular river systems though suffering from wide fluctuations, in seasonal and annual discharges, are still ideal for large storage developments. The regional output potential of hydro projects (at 60% PLF) is yet to be exploited as given below :

Table 2 Regional Potential of Hydro Projects (at 60% PLF) (MW)

Region	Potential Capacities	Developed Capacities	Under Development Capacities	Balance potential capacities	Balance (as a % of potential)
North-Eastern	31857	324	306	31226	98
Northern	30155	4313	2422	23420	78
Southern	10763	5297	1105	4361	40
Western	5679	1814	1531	2333	41
Eastern	5590	7	711	4871	87
All India	84044	12665	6077	65301	78

In countries which have developed power through a thermal and hydel mix, the optimal output ratio between the two has been in the region of 60:40. This ratio is also applicable in India too. It is also suggested that while thermal and nuclear would supply the base load requirement, hydel and gas power would be the source for peak load requirements. This is because hydel and gas based generating plants have the flexibility of instantly increasing/reducing power generation as per the requirements. Despite this, India's hydro power capacity expansion is on slow track. The share of hydro power generation capacity has decreased from 49% in 1950 to about 25% in FY 96. The planned hydro capacity addition during the Eighth Plan period was 9282 MW, but only around 2600 MW was actually added.

The gestation period of a typical hydro electric power plant varies between 6-8 years, while the gestation periods in the case of thermal and gas plants are 4-5 years and around 3 years respectively. Two major reasons for such long gestation periods for a hydro electric project are :

- Uncertainties associated with the geological and topographical constraints
- Socio-economic and environmental problems due to one time submergence and flooding of vast areas and need for rehabilitation of the displaced persons.

Due to the above two constraints, international agencies are more inclined to fund thermal plants than the hydro electric plants. This has resulted in the slow development of hydro electric power plants as Government has had to use its own funds for financing these power projects.

Power position in India is characterised by persistent shortages. Currently the demand outpaces supply. The peak shortage was estimated to be 18.3% in FY 96 while the total demand exceeded supply by 9.2%. The energy demand supply position for the past four years indicates that the shortage varies from a level of 7% to 9% while the peaking shortage ranges from 16% - 20%. The following table illustrates the demand supply position.

Table 3 Demand Supply Position (in MU)

	FY 93	FY 94	FY 95	FY 96
Demand	305266	323252	352260	389721
Supply	279824	299494	327281	354045
Shortage	25442	23758	24979	35676
Shortage (%)	8.3	7.3	7.1	9.2

Government in the Eighth plan envisaged a total addition to capacity of 30,538 MW against which the actual capacity added was only approx. 18,000 MW. This has further aggravated the demand supply imbalance with the peaking shortage reaching well over 20%. Government in the Ninth Plan has projected an additional capacity requirement of approx. 57,000 MW. In order to set up this kind of capacity, the investments required are very high. In this context, the Government's current policy on power sector allows the private sector to set up power plants. As on 31st March, 1996, Government has received proposals for setting up of 124 power projects for a total capacity of 67,281 MW which will involve a total investment of approx. Rs. 2,46,472 crores.

## Business Analysis

NHPC currently operates seven projects with a total installed generation capacity of 2133 MW. It account for 8% of the total hydel capacity and 2% of the total installed power generating capacity of the country. A summary of NHPC's seven operational projects is given below:

Table 4 Summary of Operational Projects (FY 97)

Project Location	Capacity (MW)	Date of Commissioning	Remarks
Baira-Siul (HP)	198	1982-83	Taken over from CHPCB
Loktak, Manipur	105	1983-84	Taken over from CHPCB
Salal-I, (J&K)	345	1987-88	Taken over from CHPCB
Tanakpur (UP)	120	1993-94	Originally planned to be commissioned in 1989-90
Chamera I (HP)	540	1994-95	Originally planned to be commissioned in 1989-90
Salal-II (J&K)	345	1996-97	Extension of Salal-I. Originally planned to be commissioned in 1989-90
Uri (J&K)	480	1997-98	Phased commissioning

The performance of the generation stations of NHPC for the past three years shows a consistent high capacity utilisation. The following table will illustrate the same.

Table 5 Projectwise actual and target generation (Gwh)

Project	1996-97 <sup>(1)</sup>		1995-96			1994-95		
	Target	Actual	Target	Actual	Cap.Ut (%)	Target	Actual	Cap.Ut (%)
Baira-Siul (HP)	750	468.7	750	805	107.3	750	832.9	111.1
Loktak, Manipur	450	331.0	450	486	108.0	450	516.3	114.7
Salal-I, (J&K)	2500	1932.5	2188	2143	97.9 <sup>(2)</sup>	2188	1953.8	89.3 <sup>(2)</sup>
Tanakpur (UP)	460	306.2	460	445	96.7 <sup>(3)</sup>	450	466.9	103.8
Chamera I (HP)	1700	1630.2	1742	2262	129.9	1470	2288	155.6
Total	5860	4668.6	5590	6141	109.8	5308	6057.9	114.1

(1) Actual generation for 1996-97 taken upto November, 1996

(2) Shortfall due to siltation in reservoir and outage of generating units for repairs and maintenance

(3) Shortfall due to accumulation of trash at intake during the monsoon season

Apart from the existing operating projects, NHPC is currently implementing two projects viz. 60 MW Rangit project in Sikkim and 390 MW Dulhasti project in J&K. These two projects are expected to be commissioned during the Ninth Plan (1998-2002). Both these projects have already suffered heavy cost and time overruns. While the project cost for Rangit project estimated was originally estimated to cost Rs. 164 crores and was expected to be commissioned by March 1995, the current revised cost has risen to Rs. 413 crores and is expected to be commissioned by March 1999. The Dulhasti project was planned with bilateral assistance and the work was expected to be completed within 57 months. Due to adverse law and order conditions, the project was stopped in 1992. The original estimated cost was Rs.1263 crores where as the current revised estimate is Rs.3987 crores.

The company has also plans to commission two more projects with a total installed capacity of 990 MW. However, these projects are not expected to be commissioned during the Ninth Plan period.

NHPC has a large workforce of about 13,600 employees. This manpower was inherited by NHPC from CHPCB while taking over the projects undertaken by them. Once the projects were commissioned, over 8500 employees became surplus. Moreover, as and when NHPC takes up new projects, it has to provide employment to one member of every displaced family. This has also resulted in increasing the work force. NHPC had offered VRS in 1992 and about 400 employees opted for the same. Currently, the company is implementing a VRS at an estimated one time cost of Rs.140 crores targeting the currently surplus staff of 5000. This works out to a pay back in 18 months on an annual salary cost of Rs. 90 crores.

## Tariff Calculation

NHPC calculates its tariff on the basis of the extant tariff policy and parameters decided by the Government of India under the Electricity Supply Act. The company has computed its tariffs till FY 97 as per the norms laid down by the KP Rao Committee Report and Tariff Notification of March, 1992. The policy permitted the following expenses to be recoverable from the tariffs chargeable to the beneficiaries:

- Interest on loan;
- Depreciation;

- Operation and Maintenance (O&M) expenses inclusive of insurance expenses;
- Interest on normative working capital;
- Return on equity;
- Tax on income; and
- Other miscellaneous charges.

The salient features of the policy and the issues involved are highlighted below :

- Interest on loans was recoverable from the tariff on the basis of the approved debt to equity ratio of 1:1, irrespective of the actual financing pattern of the project. In case of projects where the debt to equity was higher, the interest over and above the 12% return provided for equity payable on the excess debt had to be borne by NHPC. This additionally liability cut into the return on equity.
- No provision for recovery of cash to meet the loan repayment liabilities were permitted in the tariff computation. In certain cases, where there was delays in execution of projects, repayment started before commencement of commercial operation. The tariff policy took into account repayment as per the approved schedule, irrespective of actual resources generated for repayment. Consequently, loans were taken to meet the repayment obligations. The interest incurred on these loans was also not reimbursable.
- O&M expenses to the extent of 1% of the approved project cost were admissible for hydro electric projects for the purpose of tariff calculations. However, O&M expenses in the case of such projects were higher in view of the nature of the projects, which were not recoverable from the tariff.
- No incentive was offered for generation in excess of the target fixed/ designed energy or higher rate for systems stabilisation.

Keeping in view the drawbacks of the tariff policy, Government of India has amended the old Tariff Policy and liberalised it to include the following

in the new tariff policy which is applicable from 1997-98 onwards:

- An increase in the return on equity to 16% from 12%
- Interest liability on the basis of the actual financing pattern instead of the notional debt equity ratio of 1:1.
- Provision has been made for advance against depreciation to augment the cash resources to meet the loan obligations
- Enhancement of O&M expenses from 1% to 1.5% of the approved project cost
- Incentive for excess generation and increased capacity utilisation.

## Financial Analysis

The financial performance of NHPC for the past five years is indicated in the table below :

Table 6 Financial Performance (Rs.Crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Operating Income	554.2	509.3	480.5	208.7	178.9
Operating Profit	458.6	431.5	408.0	166.4	120.0
Profit after Tax	106.7	77.4	93.7	70.5	41.5
Equity Capital	2917.4	2890.2	2832.7	2832.5	2632.5
Tangible Networth	3568.4	3434.6	3314.6	3230.7	2965.2
Gross Margin (%)	82.7	84.7	84.9	79.8	67.0
Net Margin (%)	19.3	15.2	19.5	33.8	23.2
ROCE (%)	4.0	4.1	5.2	2.2	1.7
RONW(%)	3.0	2.3	2.8	2.2	1.4
Earnings per Share (Rs.)	0.36	0.27	0.33	0.25	0.16

Operating income of the company has grown at a CAGR of 25% from Rs. 178.90 crores in FY 93 to Rs. 554.2 crores in FY 97. This increase is



primarily due to improved capacity utilisation and gradual tariff increases. The operating revenue increased more than 100% in FY 95 due to the commissioning of the Chamera-I and Salal-II units which has resulted in an increase in capacity by 885 MW. Generation of hydel power involves low operating expenditure due to non-requirement of raw materials. The main operating costs are manpower costs and cost related to repairs and maintenance of construction equipments. This results in higher operating margins. The operating margins of NHPC has been consistently above 80% in the last three years.

In spite of the higher operating margins, the net margins of the company is fluctuating at lower levels. This is due to higher depreciation and interest costs. The depreciation charges have shown a substantial increase from Rs. 23 crores in FY 93 to Rs. 111 crores in FY 97. This is due to the commissioning of the Chamera-I and Salal-II projects. Similarly, the interest costs have increased substantially during the period from a level of Rs.60 crores in FY 93 to Rs. 263 crores in FY 97. The company had to borrow heavily for meeting the project costs. The overall debt of the company rose from Rs. 2659 crores in FY 93 to Rs. 5038 crores in FY 97. The company's gross block and capital work-in-progress have increased by 70% over the past five years from Rs. 5248 crores in FY 93 to Rs. 8906 crores in FY 97.

In order to meet the funding requirements for the projects, the company was using various modes of financing. There has been a definite shift from the Government loans to commercial borrowings both in the domestic and international market. Similarly, Government also raised its equity holding in the company from Rs. 2632 crores in FY 93 to Rs. 2917 crores in FY 97. The increasing dependence on debt is also reflected in a decline in the assets being financed out of net worth compared to debt. The gross block/net worth ratio has declined from 56% in FY 93 to 40% in FY 97. The debt service coverage ratio has also shown significant decline from 2.06 times in FY 93 to 1.78 in FY 97.

## Strengths and Areas of Concern

### Strengths

*Large untapped potential* There are still vast untapped potential for hydel power generation capacity in India. Only about 25% of the total potential capacity is exploited so far.

*Premier organisation* NHPC is the premier organisation and nodal agency for the development of hydro electric power in the country. Hydro electric power is a cheap and clean source of energy with low operational cost of generation, steady reduction in the per unit cost of power generation etc.

*Talented work force* NHPC has a talented work force with substantial experience in the entire range of services associated with the planning, investigation, research, design, preparation of preliminary, feasibility and definite project reports, construction, generation, operation and maintenance of large hydro electric power projects.

### Areas of Concern

*Intrinsic risky nature of business* The setting up of hydel generating capacity is fraught with risks such as :

- High initial investigation costs in terms of time and money
- Long gestation ranging from 6-8 years
- High capital intensity. Investment required for a thermal power plant ranges from Rs.3-4 crores/MW vis-à-vis Rs.4.5-5.0 crores/MW for a hydel power project.
- High costs of development of infrastructure and other facilities in and around the area as most of the power projects are located in remote areas.
- High completion risks on account of complexity in design, engineering etc.
- Environmental and social issues.
- Dependence of generation on monsoons.

*Excess Labour* NHPC is saddled with excess labour force. The company has inherited a large labour force from the erstwhile CHPCB. Once the projects were implemented, a large number of the work force became redundant.

*Tariff Policy* The current tariff policy of Government of India does not cover many issues faced by NHPC as described above, though the policy is under revision.

## Recommendation

Inspite of considerable hydro electric potential in India, the development has been on a slow track due to a number of problems faced by NHPC in the implementation of large hydro power projects:

- Large hydroelectric projects have higher levels of implementation risks due to high initial investigation costs. In addition, geological surprises during the investigation phase have necessitated revisions in the project costs and this coupled with high costs of development of infrastructure in remote areas has resulted in higher per capita cost per MW for hydro projects when compared with thermal projects.
- Environmental issues such as land acquisition and submersion, rehabilitation of oustees have increased the level of completion risks.

As a PSU, NHPC had to face additional problems. The company's investment plans in new projects have faced considerable delay at the approval stage. The performance of NHPC's main subcontractor - the PSU National Buildings Construction Corporation Ltd, has been far from satisfactory. The company has also been forced by various state Governments to provide employment to the land oustees as a result of which NHPC has nearly 8,000 excess staff on its rolls adversely affecting performance. The free power that NHPC had to supply to State Governments where its projects are located have not helped improve matters either.

Till recently, the development of the power sector was mainly in the public sector. However, due to the inherent nature of the problems of the hydro-electric sector as detailed above, Government has initiated policy initiatives which clearly recognise the fact that the risks of implementing large projects (which have faced time and cost overruns) need to be shared with a joint venture partner as the Government alone may not be in a position to develop the project fully.

Inspite of these initiatives, till date no major capacities have been added in the private sector mainly due to two reasons: the relative unattractiveness of large hydro projects when compared with equivalent thermal projects and the rationalisation of a tariff package which recognises the inherent higher risks in hydro projects. As a result, the Government (both at the State and

the Centre) continues to supply as much as 98% of the total power supplied in the country.

The process of improving the market contestability in the Indian power sector hinges on a number of crucial issues. Firstly, in view of the poor credit rating of most SEB's, the private sector producers are hesitant to supply power on a non-recourse basis. Secondly, tariff reforms will enable SEBs to generate power on a profitable basis. Thirdly, the SEBs in most states are unviable and need structural reforms in terms of unbundling generation, distribution and transmission.

Thus, till the time that the above reforms are in place, NHPC will continue to play an important role in the development of hydro projects. The Commission is of the view that till the time the sectoral reforms in the power sector are complete and the markets are fully contestable, it may be desirable for the public sector to continue to play an important role in the power generating segment. **On these grounds, the Commission reiterates the classification of NHPC as "Core".**

There is scope for enhancement of NHPC share values once the reforms are put in place and the new parameters are settled for tariff fixation. All these are under the active consideration of Government. Due to the unremunerative tariff structure and hence relatively poor rates of return on networth, any disinvestment at present will lead to an undervaluation of the Government holding and result in poor realisation to the exchequer. **The Commission therefore recommends that there should be no disinvestment in NHPC presently.**

**However, the Commission would like to point out that reforms alone may not be enough to enhance share value to the maximum extent. The NHPC needs to restructure itself along the following lines:**

- **The company should continue to hold its operational projects. The revenue generated from these projects would serve to finance the projects which NHPC has taken up for implementation.**
- **The company should enter into strategic joint ventures with well known reputed international or domestic parties for executing its new projects. This will also help the company to focus on the**

existing projects and thus improve the managerial attention and control.

- Given its track record, the company could aim to provide the entire range of consultancy services related to the development and implementation of the hydro electric power to State Electricity Boards and independent Power Producers.
- The company should take up the issue of workforce restructuring by implementing a VRS for the laid outstees either through an one time payment to employees or a pension-cum-insurance scheme.
- In future, Government would save significantly by adopting a VRS rather than perpetuate employment by providing jobs to outstees till retirement. This is because of the fact that associated overhead costs are cut down which is a medium term saving for the Government. This may be taken into account at the time of formulation of the new hydro policy which, the Commission understands, is on the anvil.

Government has conferred some autonomy on NHPC in its package announcement for medium sized PSUs. While this is a welcome step, given the nature of its problems, this may not be sufficient. The Commission, therefore, recommends that NHPC should be conferred autonomy on the lines suggested by the Commission in its First Report for Moderate Performers.

## 2.6 Pyrites Phosphates & Chemicals Limited

### Evolution

Pyrites Phosphates & Chemicals Limited (PPCL) was set up in 1960 with the objective of exploration and exploitation of import substitute pyrites and rock phosphate ore deposits for the production of fertilisers. The company is currently engaged in mining of pyrites, production of single super phosphate (SSP) and mining and sale of rock phosphate. The company has manufacturing facilities at three locations Amjhore (in Bihar), Saladipura (in Rajasthan) and Dehradun in Uttar Pradesh.

The paid up share capital of the company is Rs. 84.73 crores and the entire equity is held by Government of India.

### Industry Analysis

Fertiliser is an important input in improving the productivity of soil. The fertilisers can be classified on the basis of nutrient contents. Nitrogen (N), Phosphorous (P) and Potassium (K) are the primary nutrients which are required in large quantities. Urea is the main nitrogenous fertiliser while Di-ammonium Phosphate (DAP) supplies both nitrogen and phosphorous. Single Super Phosphate (SSP) supplies phosphorous inputs to the soil and Muriate of Potash (MoP) supplies potassic inputs. As against DAP and Urea which supply primary nutrients, SSP with a phosphorous (P) content of 16% and sulphur (S) content of 12%, supplies a primary and secondary nutrient respectively. It is thus classified as a low analysis fertiliser as per the Fertiliser Control Order, 1985.

The total primary nutrient consumption was about 14 million tonnes in FY 96 out of which P-nutrient consumption accounted for 21%. Within this segment, SSP fertilisers accounts for about 17% (by consumption), DAP for about 55% with the balance consumption being accounted by complex fertilisers.

Rock phosphate and Sulphuric acid are the raw materials used in the manufacture of SSP. In India, rock phosphate deposits are found in Rajasthan and Madhya Pradesh. Most of these deposits are of low grade and requires beneficiation to make the mineral acceptable as feed stock for fertiliser

manufacture. These rock phosphates are suitable for manufacture of SSP while bulk of the requirements of rock phosphate used for DAP fertiliser production is imported. Similarly, sulphur deposits in India are negligible and consequently significant amount of sulphur are imported for use in the fertiliser industry.

The SSP industry is highly fragmented with about 85 units with an installed capacity of 6 million tonnes. Out of this, one-third in number is in the small scale sector. PPCL accounts for about 6% of the total SSP industry capacity with the industry leader Dharamsi Morarjee Chemicals Company Limited (DMCC) accounting for nearly 10% of the industry capacity.

Government of India de-controlled the P & K fertilisers segment in August, 1992. All restrictions on the prices of these fertilisers and on the region of sale for the manufacturers were lifted. Government subsidy was also abolished. The impact of the de-control was as follows :

- Substantial increase in farmgate prices of de-controlled fertilisers and consequent decline in their consumption. The consumption of SSP fell from a level of 3.2 million tonnes in FY 92 to 2 million tonnes in FY 93.
- The fall in the consumption of P&K fertilisers led to a rise in demand for urea. This distorted the consumption pattern of N,K&P fertilisers.

Subsequently, Government announced certain concessions to bring down the cost of production of P & K fertilisers to arrest their decline in consumption. Ad-hoc subsidy was re-introduced on DAP and MoP in October, 1992 and on SSP in June 1993. To begin with, the ad-hoc subsidy on SSP was Rs.340 per tonne which has been increased over the years and is currently at Rs.600 per tonne. Subsidy on DAP and MoP are Rs. 3,750 per tonne and Rs.2,000 per tonne respectively. The retail price of SSP products are generally fixed by State Governments.

The future outlook on SSP are as follows :

- SSP is regarded as a poor man's fertiliser as its cost per bag is lower than DAP. Demand for SSP is expected to grow in the future as production of oil seeds (for which it is mainly used) is increasing.
- As raw material costs accounts for more than 80% of the price, to be viable, SSP units will have to manufacture at 80-90% capacity utilisation.

- As a result of the re-introduction of the subsidy, the consumption has shown improvement and in FY 97, the consumption has risen to pre-control levels. This is expected to be maintained in the future too.

## Business Analysis

The main business activities of PPCL are as follows:

Table 1 Plant Locations of PPCL

Plant Location	Started operations	Capacity ('000 tpa)
Amjhore - SSP Production	October, 1988	264
Amjhore - Acid Production	December, 1989	99
Saladipura - SSP Production	January, 1997	99
Saladipura - Granulation	December, 1997(*)	60
Dehradun Mining of Rock Phosphate	1965	60

(\*) Expected month of Commissioning

Originally the Amjhore unit was set up in 1969 for mining of pyrites solely for supply to the Sulphuric acid plant of Fertiliser Corporation of India (FCI) at Sindri. Consequent to the closure of the pyrite based sulphuric acid plant by FCI at Sindri, in November 1982, due to uneconomical operations, the activities at Amjhore came to a standstill and the entire workforce became idle. In order to deploy the idle workforce, PPCL proposed to set up a phosphatic fertiliser plant. The company received the approval for setting up a SSP unit alongwith the sulphuric acid plant in October, 1986. The SSP unit started operations in October, 1988 with bought out acid. The sulphuric acid plant came on stream only in December, 1989.

The company went for exploration of pyrites in Rajasthan in 1979 and submitted a proposal for setting up of a SSP plant and a pyrite based sulphuric acid plant in 1980. However, the project was found unviable and was abandoned. In order to engage the workforce, the company decided to set up a 300 tpd SSP plant based on bought out acid. The company has tied up for the acid supply from Hindustan Copper Limited which is situated over 100 kms away. Apart from the SSP unit, the 200 tpd granulation plant is expected to be on stream by December, 1997.



In Dehradun, PPCL is engaged in the business of mining rock phosphate deposits. The rock phosphate is ground and sold as a direct application phosphatic fertiliser in acidic soil, mostly in the Southern States and Assam. This product is sold under the brand name "Mussorie Phos" (M-Phos).

The production and sales of products of PPCL for the past five years are as follows :

Table 2 Production and Sales of PPCL (‘000 Tonnes)

	FY 97	FY 96	FY 95	FY 94	FY 93
<b>Amjhore Unit - SSP</b>					
Production	211	183	171	129	177
Sales	187	161	179	161	129
<b>Dehradun Unit - M-Phos</b>					
Production	125	120	121	118	98
Sales	105	107	100	107	103

The performance of SSP production was affected by the de-control of P-fertiliser sector but has subsequently shown improvement. Production and sale of SSP from FY 92 to FY 96 remained in the region of 150000 tonnes. However, the production and sales improved during FY 97 and has crossed the 200000 tonnes level. During FY 96, PPCL had to shut down its plant for two months (October and November) due to inadequate availability of rock phosphate. This has affected its sales in FY 96.

The cost of production of SSP at Amjhore plant is high when compared with competitors due to pyrite route of acid production. Because of this, the operating cost is significantly high.

The employee cost of PPCL is high due to the large workforce engaged in the mining operations. The total manpower strength of PPCL as at March, 1997 was 2426 and almost 1300 employees are engaged in the mining and related activities.

PPCL predominantly caters to the eastern States of Bihar and West Bengal. Madhya Pradesh is the main consumer of SSP. Any producer catering to

this market will have a competitive edge over other producers. Even in the markets where PPCL is having a significant presence, a number of private companies have started operations. They also offer longer credit periods and higher discounts to dealers and customers.

Apart from the mining and manufacturing activities, PPCL is engaged in the trading of fertilisers. It started its trading activity in fertiliser in FY 90 with handling and distribution of urea. PPCL commenced trading in DAP, MoP and other P&K fertilisers after they were de-controlled in 1992. PPCL was one of the co-canalising agencies for urea imports during 1994-96. Trading has accounted for a significant portion of the turnover of the company in all these years. However, the margins in trading operations have been low and insignificant to compensate for the sizeable losses incurred in the manufacturing activities.

### Financial Analysis

The financial performance of PPCL for the past five years is indicated in the table below :

Table 3 Financial Performance

(Rs.Crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Net sales	105	81	78	76	67
Trading Income	274	543	172	180	248
Operating Income	379	624	250	256	315
Operating Profit	10.3	2.8	4.5	2.8	16.3
Profit after Tax	-8.3	-0.7	-5.9	-15.5	-8.3
Equity Capital	84.7	82.7	77.7	74.7	70.7
Tangible Networth	40.0	45.4	40.1	42.1	52.6
Gross Margin (%)	2.6	0.4	1.7	1.0	5.2
ROCE (%)	2.9	10.0	7.4	2.7	11.8

*Note : Other ratios have not been presented as they are all negative*

As can be seen from the above table, trading has contributed significantly (between 69% to 87% of total income) during the last five years to the

turnover of the company. PPCL has been incurring losses in both manufacturing and trading activities. Due to the consistent incurring of losses, the equity of the company has eroded to Rs. 40 crores despite fresh infusion of equity from time to time. The accumulated losses were Rs.35 crores as on 31st March, 1997.

Amjhore unit was showing operating profits due to incentives which the company receives. PPCL is receiving an ad-hoc subsidy of Rs.600 per tonne on SSP and it also receives import substitution incentive payment of Rs. 580 per tonne of SSP production. The total incentive impact for FY 97 for both Amjhore unit and Dehradun Unit works out to be approx. 28 crores.

The Government also granted major reliefs to PPCL without which its financials would have been much worse. The major reliefs granted are as follows :

- Rs.6.92 crores (50% of the plan loan of Rs.13.83 crores as on December, 1994) was converted into non-cumulative redeemable preference shares for a period of 5 years to be redeemed in 3 annual instalments from 2000-01.
- Moratorium has been granted till 31st March, 1996, on the remaining portion of the loan. No repayment schedule has been finalised as yet.

The company has also adjusted accumulated expenditure at Amjhore of Rs.31.95 crores prior to commissioning as follows:

- Rs.11.34 crores, out of the non-plan loan of Rs. 13.9 crores drawn between 1984-89, was converted to grant-in-aid in 92-93. Interest thereon of Rs.5.2 crores was adjusted.
- Remaining Rs. 2.55 crores has been treated as interest free loan with a moratorium till March, 1996.
- Waiver of accumulated interest and penal interest of Rs. 2.44 crores granted.
- Additional amount of Rs. 1.58 crores waived during 1990-92.
- Balance of Rs.13.85 crores being amortised over 18 years.

## Strengths and Areas of Concern

### Strengths

*Production of Cheap Fertiliser* The principal product of PPCL is SSP which is considered as a poor farmer's fertiliser as the cost of SSP is much lower when compared with other fertilisers. Given the price sensitivity of the average Indian farmer, the production of a cheaper alternative of fertiliser is a strength for the company.

### Areas of Concern

*High Raw material Cost* PPCL produces sulphuric acid from pyrites instead of procuring the acid directly or making it from sulphur. As a consequence, this process is almost twice as costly when compared with competitors.

*Locational Disadvantage* PPCL's market is primarily in the eastern region. However, the maximum demand for SSP comes from Madhya Pradesh. This has put PPCL in a disadvantageous position.

*Large labour force* PPCL employs 2426 employees. On the average, the employee cost as a percentage of total operating income for PPCL is almost three times when compared with its competitors. This is primarily due to the mining operations which employs about 1300 employees.

*Dependence on Incentives* PPCL depends on Government to the extent of Rs. 600 per tonne as ad-hoc subsidy. Additionally, PPCL also receives import substitution incentive of Rs. 580 per tonne. Delays in receipt of these incentives would impair liquidity and any removal of these incentives will make operations unviable.

*Poor expertise in trading activity and infrastructure for trading* PPCL does not have a dedicated trading department with the required levels of infrastructure for monitoring demand and marketing. The company also lacks financial flexibility to tide over temporary demand supply imbalance.

### Government Options on PPCL

As brought out in the analysis above, PPCL is currently at a critical stage due to unviable manufacturing operations, high level of competition and dependence on Government for sustaining operations. As the principal

shareholder, the options available to Government at this stage are highlighted in the Table below:

Table 4 Government Options on PPCL

	Scenario	Government outflow	Remarks
1	No action taken by Government due to paucity of funds	Government subsidy of about Rs. 20 cr. p.a.	Losses will continue to mount; likely to be referred to BIFR; Action on disinvestment will be delayed
2	Close down Dehradun operations and sell the Amjhore and Saladipura units on as-is-where-is basis	VRS for Dehradun operations will cost about Rs. 35 crores	Government will save subsidies of Rs. 20 crores as well as conversion costs in the other plant to the extent of Rs. 20 crores; However as buyers are unlikely to be interested the company may be referred to BIFR
3	Close down Dehradun operations. Switch over Sulphur based production at Amjhore; close down mining operations and sell the units after conversion	VRS for Dehradun and Amjhore units will cost about Rs. 79 crore; switch over will cost about Rs. 25 crore	Government support in terms of subsidies during the switchover period of two years would be necessary. The switchover may help increase investor interest as well as realisations.

The options are further elaborated below :

*Scenario 1* The company has been incurring cash losses in the past. The networth of the company has already been eroded from Rs. 53 crores as at 31st March, 1993 to Rs. 40 crores as at 31st March, 1997 despite equity infusion of Rs. 14 crores. Despite receiving direct as well as indirect subsidies, the company has posted increasing level of losses. At present,

the subsidy scheme has been extended by the Ministry of Fertilisers for one more year but the continuance of the incentive scheme in future is uncertain. In this event, Government would have to continue subsidising increasing level of cash losses year after year.

*Scenario 2* Under this option, the Government could close down the unviable operations in Dehradun after paying fair and equitable compensation to the affected employees which is estimated to cost around Rs. 35 crores. The units at Amjhore and Saladipura could be sold off to fertiliser companies who do not have a presence in the phosphatic fertiliser segment. However, while the buyers would have to implement the switchover to sulphur based production of SSP, the Government may have to continue the subsidy till the changeover is complete. However, the large mining workforce may prove to be a deterrent for buyers and may dampen investor interest.

While Government may save by way of stoppage of subsidies, the exit from the business may not prove to be smooth.

*Scenario 3* Under this option, Government assumes responsibilities for both restructuring the mining workforce as well as implementing the switchover plan. The cost of closure of mining operations both at Amjhore and Dehradun would be the cost of VRS for about 1500 employees amounting to approximately Rs. 79 crores. However, it is assumed that the implementation of the change over to sulphur based SSP production would be done by the company without any time or cost overruns. By this action, Government will pave the way for an easy exit from the business.

## Recommendation

**The Commission classifies PPCL as non-core due to the following reasons :**

- PPCL's original objective of making use of locally available pyrites for the manufacture of SSP and thereby conserve foreign exchange for the country is no longer relevant as all import restrictions on phosphates and sulphur have been completely removed.
- Due to low entry barriers, the SSP fertiliser industry is highly fragmented with as many as 85 companies competing with each other. PPCL's market share is currently just 6%. The markets are thus contestable and no public purpose is served by sustaining a loss making public sector.

**The analysis has clearly highlighted the unviability of the Dehradun operations. The Commission recommends that Government should, in the first instance, evaluate the possibility of finding buyers for the Dehradun mines. This will sustain employment at the unit to some extent, besides reducing the funds required for implementing the VRS. If buyers are not available, the Commission recommends that Government sell-off the assets in the Dehradun operations after giving fair and adequate voluntary retirement benefits to the employees engaged in these operations.**

The analysis of the options indicate that the Government - in case of the other units at Amjhore and Saladipura - would have to decide on whether to restructure the operations before disinvestment or sell on an as-is-where-is basis. The Commission recommends the following course of action:

**Government should initiate action to sell the Amjhore and Saladipura units to a strategic buyer who would eventually implement the switchover to sulphur based production of SSP as outlined in Scenario 2. For this purpose, these units will have to be demerged from the Dehradun operations and clubbed together for the purpose of the sale. Government subsidy will have to be continued for two years even if the unit is in the private sector.**

**PPCL should also initiate action to implement a VRS policy on the lines suggested by the Commission in its Fourth Report. This will help the company to rationalise the workforce during the changeover period. The funds required for this purpose could be made available from the Disinvestment Fund as proposed by the Commission in its First Report.**

**Government should also appoint Financial Advisers who could assist in the demerger and subsequent valuation of the units. The Financial Adviser could also help in fixing a reserve price for the sale apart from managing the bidding process. The procedure for appointing Financial Advisors for the sale has been outlined in Part B of the First Report of the Commission.**

**If the bids received by Government are below the reserve price, the Commission recommends that the Government should provide budgetary support to PPCL to enable implementation of the changeover to sulphur based SSP production. At the same time, the Government will also have to continue to provide subsidy as long as the SSP is produced through the pyrite route and continue running the pyrites mines till the change over is complete. After implementation of the changeover, Government could initiate steps to disinvest its entire holding to a strategic buyer.**

## 2.7 REHABILITATION INDUSTRIES CORPORATION LIMITED

### Evolution

The Rehabilitation Industries Corporation Limited (RICL) was set up in 1959 by the Government of India in Calcutta with the primary objective of rehabilitating refugees from Bangladesh, Burma and Sri Lanka. Employment opportunities were sought to be created through the establishment of manufacturing facilities required in low to average skills industries such as industrial estates, taxi co-operative societies, sponsorship of powerlooms co-operative societies and extending loans to private entrepreneurs and co-operative societies. Defence / Government offtake was expected to absorb a major part of RICL's production.

Over the next few decades, RICL commissioned production centres in West Bengal, Madhya Pradesh, Orissa for the manufacturing of light engineering items, ironing casting, textile, food processing, wooden and steel furniture, leather footwear, garments etc. The company also diversified into project engineering in the late seventies.

The share capital of Rs. 47.62 crore is held entirely by Government. Presently, the company is under the administrative control of the Department of Heavy Industries under the Ministry of Industries.

### Industry and Business Analysis

RICL's turnover since inception has been lower than break-even levels resulting in persistent losses and the consequent closure of 21 units by 1991. All the employees of the closed units were absorbed in the 13 operating units resulting in substantial overstaffing.

Since 1992, the production activities have been suspended in all units except the Projects division and Industrial estates further contributing to the overstaffing problem. The snap shot of the various divisions of RICL and unitwise share of turnover and loss figures for the financial year 1995-96 are shown in the table below :



Table 1 Unit wise Turnover of RICL for 1995-96

Division	Units	% turn over	% losses
Engineering	Projects	89%	-1.6%
	Fabrication	0.4%	1.9%
	Cast Iron Foundry	0.3%	0.7%
Textiles	Handlooms	Nil	2.7%
	Powerlooms	Nil	1.2%
Consumer Products	Processed Foods	Nil	1.1%
	Garments	Nil	0.9%
	Leather Footwear	Nil	0.6%
Services	Industrial Estates	9%	-0.1%
	Tours & Travels	Nil	Nil
Head Office		1%	93%
Total		100%	100%

*Note : Negative figure of loss actually represents the profits made in that division*

As seen from the above table, the Projects Division and the Services Division have contributed 98% of the operating income and absorbed about 2% of the losses of the other divisions. As the turnover from the other divisions is nil, the industry analysis is limited to the Engineering segments.

## Engineering

The Engineering industry is characterised by low skill and capital requirements which has led to a proliferation units particularly in the small scale sector. The low technology of the product manufactured implies average product quality and differentiation on the basis of quality is a key success factor. The typical problems confronting the sector are the lack of marketing concept, working capital, appropriate technology and trained manpower.

The demand for products made in the engineering segment are concentrated in geographical regions where industrial projects are set up. Specifically, core sector project like steel and mining and infrastructure projects like bridges and ports drive demand for the engineering/project divisions.

Engineering products are facing a threat from new products made of plastics and composites which are light and cost effective. These are replacing some of the traditional engineering products such as castings.

Finally, the impact of new pollution control standard is likely to affect the production structure of the industry as well as the product mix that is rolled out. Considerable emphasis is likely to be placed on R&D since the pollution control equipments will have to be cost effective and suited to the medium / small scale foundries.

### RICL's Competitive Position

All the engineering products made by RICL are marked by high competition, typically from the small scale sector. The absence of significant differentiation or value addition has resulted in RICL's inability to command a premium in the market. The quality of the products from the cast iron foundry and fabrication units generally meets requirements, but RICL is not able to meet time schedules. As a consequence of the above, the competitive position of the company is weak.

The projects division does not undertake jobs which require high / specialised skills and concentrates on coal handling plants, industrial sheds etc. Vulnerability to competition is high in all areas where RICL operates.

The projects division finance itself through mobilisation of advances and payment received from clients. Delays in receiving payments put an additional strain in meeting completion schedules as RICL's own financial position is precarious. The bidding system employed by customers usually factors in the financial strength of the contractor and RICL is at a disadvantage in this respect.

In addition, the absence of a manufacturing back-up in the project division has adversely affected the company's competitive position. RICL faces competition from large players like L&T, McNally Bharat and TRF Limited. RICL has a severe disadvantage in not having a back-up facility or any long term arrangement with any manufacturer. Though the absence of in-house facility does lower overhead costs, this is offset to a large extent by the lack of effective procurement management systems which is critical to the profitability of this division.

## Financial Analysis

Table 2 Financial Performance

(Rs. Crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Operating Income	51.6	116.9	103.8	108.7	46.7
Operating profit	-72.6	-54.8	-46.7	-43.5	-32.4
Loss	-71.2	-53.77	-46.3	-39.8	-32.0
Equity Capital	47.6	47.6	47.6	47.6	47.6
Tangible Networth	-394.9	-323.4	-269.6	-223.3	-183.4

*Note : Ratios have not been presented as they are all negative.*

As indicated earlier, over 96% of the operating income emanates from the Projects division, as all other divisions have been closed since 1992. The variability in earnings of RICL over the past five years can be completely attributed to the uncertainties associated with this line of business. However, the contracts taken on by this division do not fully cover costs as a result of which the margins are negative.

As seen from the Table 2 above, losses have increased at a steady pace mainly due to increased interest costs. Employee costs have shown a falling trend from between FY 92 to FY 96 due to the introduction of VRS but subsequently increased due to the hike in wage rates in 1996-97. Presently, the company's workforce is sustained on the basis of an annual budgetary support to the extent of about Rs. 10 crores.

As a result of the losses, the networth of the company has been fully eroded and the accumulated losses stood at Rs. 399.44 crores as on March 31, 1997. Due to the erosion of networth, RICL was referred to BIFR in May 1992, but BIFR turned down its registration on the grounds of the company being a conglomeration of number of small scale units. In February 1995, it re-applied for registration with BIFR, but was denied registration due to non-possession of Registration Certificate under Industrial (Development & Regulation) Act.

## Areas of Concern

*Low capacity utilisation* The maximum capacity utilisation attained has been in the region of 50%. All units which were operational till 1991-92 began closing down and currently no manufacturing facility is operational.

*High break even levels* High fixed costs, mainly employee-related, have resulted in high break even levels for the units. This coupled with low utilisation levels has resulted in all the units registering losses even at the operating level. It would appear, therefore, that barring Projects and Industrial Estates, most units are unviable on account of the adverse cost structure.

*Under utilised labour force* Since RICL was set up with the objective of generating employment, the surplus labour exists not only in terms of number but also in terms of higher wages being received in relation to their productivity. This has significantly raised the cost of the company's products and services and made them uncompetitive in the markets.

The extent of surplus labour is illustrated in the table below :

Table 3 Surplus Labour in RICL (FY 97)

Division	% of surplus labour
Head Office	10%
Industry Estate	6%
Consumer Products	8%
Engineering	18%
TOTAL	42%

*Sub optimal resource management* The most critical feature of RICL's manufacturing units is inefficiency in manpower, material and funds management. The management of labour is very poor on account of dominant labour union. This has rendered ineffective any attempt to upgrade productivity levels and rationalise manpower.

## Government Options on RICL

As is evident from the above analysis, RICL has ceased to be operational in most of its business activities and the annual government support is almost fully utilised for the payment of employee costs. The company has an accumulated loss of about Rs. 400 crores, besides a consistent track record of default on loans availed from either Government or banks.

Almost all the commercial units run by the company are in highly contestable areas and will fall in the non-core category. The company was started with the social objective of providing measures of rehabilitation to refugees mainly from Bangladesh. However, the analysis of its business has clearly brought out that none of the ventures of the company has proved to be commercially viable and, in the face of sustained losses over the last several years, the company has been almost exclusively dependent on Government budgetary support for payment of wages. The analysis also shows that none of the units of the company would be of any commercial interest to prospective buyers. A decision on disinvestment of Government equity in the company would, therefore, rest on finding a satisfactory solution to the problem of the employees for whose benefit the company was started. Since all the commercial activities of the company have negative contributions, the budgetary support from Government goes to fund not only the direct cost of labour but overheads involved in providing employment to such labour. Any solution which would limit Government's assistance to the support of labour will be preferable to running the company and incurring losses which are much more than the cost of providing livelihood to refugee beneficiaries. The various options available to Government are analysed in the subsequent paragraphs from this angle :

**Table 4 Government Options on RICL**

	Scenario	Government outflow	Remarks
1	No action taken by Government	Rs. 10 crores p.a. till all the employees retire by the year 2034	The present value of the support (discounted at 13%) is about Rs. 70 crores. In addition, the bank dues of Rs. 30 crores will need to be settled. Terminal value of assets will be negligible.
2	Implement Revival Plan through additional Budgetary Support	A one time grant of Rs. 28 crores for VRS + Rs. 7 crores for working capital.	Revival of the company is unlikely. The plant and machinery has remained idle for more than five years
3	Structure an attractive an attractive VRS for all the employees and close down operations	Rs. 35 crores for the VR compensation + Rs. 30 crores for payment of bank loans	Inspite of an outgo, the Government will save when compared with option 1

**Option 1**

RICL's accumulated losses of Rs. 400 crores as on March 31, 1997 against a paid-up capital of Rs. 47 crores has resulted in a negative networth of the company. The BIFR has already turned down a reference and further, if no action is taken by Government, losses will continue to multiply. Effectively, Government will be funding the employees wage bill till their eventual retirement. The present value of future payments to the employees is estimated to be Rs. 70 crores. This is on the assumption that there is no increase in the salaries of the employees till their retirement. If this is factored in, the figure could be much higher.

Most of the plant and machinery have already been shut down for five years. If they continue to be unutilised over the next five to six years, the terminal value will be close to zero or may be even negative.

It may also be mentioned that RICL owes banks to the extent of Rs. 30 crores. It is likely that these banks may initiate proceedings in a Debt Recovery Tribunal for the recoveries by filing a winding up petition.

### *Option 2*

RICL has drawn up a turnaround plan which is based on the following:

- Modernisation of all units
- Continue with same set of employees and use contract labour if needed
- Additional Government support to the extent of about Rs. 20 crores (one-time) apart from the annual support of about Rs. 10 crores.

It is envisaged that the restructuring plan will take three years to implement and the benefits will thus be available only from FY 2001. With this implementation, the company is expected to recover from its loss making situation and post profits.

The Revival Plan is unlikely to succeed due to the following reasons:

- The company is engaged in businesses which are highly competitive and in which the unorganised private sector has a strong competitive advantage. RICL lacks any competitive advantage in this regard.
- Given the lack of managerial skills and the relatively low levels of morale in the organisation, the effective implementation of the plan is considered very difficult.
- The plant and machinery have remained idle for more than five years and their condition will not allow realisation of turnover to the extent projected.
- The turnaround plan has not been appraised by any financial institution or bank.
- RICL's accumulated losses of Rs. 400 crores against an annual turnover of Rs. 80-100 crores make the possibility of revival in the near future highly unlikely.

### *Option 3*

If the company were to close down all operations and provide an attractive VR scheme, the total outgo on such a scheme would be around Rs. 35

crores (1286 employees @ Rs. 2.5 lakhs per employee). In addition, the retiring of bank loans will account for about Rs. 30 crores. Taken together, this will be still lower than the costs incurred for perpetuation of the company.

Given the company's present financial position, the Government is unlikely to recover its past dues or the principal amount itself. Thus, there may be no option but to waive off entire principal with the accumulated dues.

## **Recommendation**

The analysis of the options before Government indicates that the most prudent course of action would be to discontinue all operations and waive all outstanding Government loans together with interest. In fact, all divisions, excepting the Projects and the Industrial Estates division, have already shut down for more than five years. **A detailed examination of these divisions by the Commission reveals that they are not capable of recovering all costs. Besides, the variability of income from these divisions is high due to the uncertainties associated with this business.**

**The analysis of options also reveal that Government could save significantly by structuring an appropriate labour scheme (either a one-time payment to employees or a pension-cum-insurance scheme) rather than perpetuate employment in the company till all employees retire. This will cut down overhead costs associated with the business resulting in a saving for the Government.**

**The commission therefore recommends that RICL should, with immediate effect, discontinue all operations. However, existing contracts taken on by the company, to the extent unavoidable, should be completed and no new contracts should be entered into by the company.**

Prior to discontinuation of operation, the Commission recommends that Government should announce a package for the employees. The scheme should inter-alia cover the following:

- A pension-cum-insurance scheme in lieu of a one-time payment for the employees based on the last salary drawn. An outline of the scheme has already been given by the Commission in its Fourth Report and is reproduced in Annexure I.



- Career counselling on available alternative options. If the level of skills developed by an employee is high, Government should actively assist the employee in finding alternative jobs.
- **In its Fifth Report, the Commission had pointed that for those employees who may not opt for the pension scheme but would like to set up a commercial venture with the lumpsum VRS payment, the management of the PSUs in collaboration with organisations like the Industrial and Technical Consultancy Organisation in the State should organise a counselling service so that they may be properly guided as regards alternative investment options like establishing a small business venture or retraining to seek alternate employment. RICL is a conglomeration of businesses and if some of the employees are interested in running these units jointly, Government should encourage handing them over after suitable pre-qualifications. In such cases, the lumpsum amounts payable on account of VRS could be adjusted against the value of the assets.**

At a later point in time and if necessary, Government may also appoint Financial Advisers who could assist in the sale of the assets of the company. The procedure for appointing Financial Advisers has been outlined in the Commission's First Report.



## Voluntary Retirement Scheme (VRS)

The Voluntary Retirement Scheme (VRS) has been described in detail in the Commission's Fourth Report. This is reproduced below.

The studies carried out by the Commission of the PSUs covered in its Reports reveal that several PSUs including the profit-making ones have staffing levels well in excess of the comparable competing units in the domestic and international markets. Given the need to remain competitive in a globalised business environment it is important and necessary that all PSUs continually review their staffing levels and take appropriate measures to balance the size of their workforce. This process will be facilitated if a stable VRS policy providing meaningful financial and other benefits is put in place.

In its Second Report, the Commission has recommended that Government announce a stable VRS policy with reference to its terms and conditions and provide adequate funds for its implementation by different PSUs. In actual fact the Commission has come across instances where PSUs who have implemented the VRS Scheme have not been able to secure funding support from Government.

The Commission would like to elaborate further on this subject as the future of several PSUs and the value of shares sold will change for the better if surplus employees are provided acceptable VRS terms. The following steps are recommended :

- 1. The terms of VRS should be finalised as early as possible on a stable and long-term basis. Individual management may be given a range within which they may deviate from the prescribed terms for different age groups, different categories of employees and different industrial sectors.**
- 2. Prompt funding should be assured to all PSUs which implement the VRS scheme. The Disinvestment Fund can be used for this purpose as recommended by the Commission in its First Report.**

3. The terms and benefits of the VRS scheme should be clearly brought to the attention of the employees through suitable publicity measures.
4. **As there is danger of a one-time lumpsum payment being frittered away by the employees or drained out by unscrupulous middle men, a special scheme may be drawn up through commercial banks, UTI or LIC, wherein the VRS benefits are invested on behalf of individual employees to provide long-term benefits and some measure of social security.** To illustrate, the scheme will be able to provide with an investment of about Rs. 2 to 3 lakhs for 10 to 15 years a monthly income of around Rs. 2000 together with annual lump-sum payments for meeting expenses on account of family functions etc. to individual employees. Insurance cover may also be provided to the individuals. This could in fact be structured to become an Employees Pension - cum - Insurance Scheme. Banks and other institutions should be persuaded to open special branches, if necessary, at the locations of the undertakings to service the scheme.

In the absence of an effective VRS particularly in loss-making or marginally profit making undertakings, an unfortunate and inevitable consequence will be an increasing sickness of the PSU with a progressively increasing burden on the budget and eventual closure leading to unemployment of the entire workforce in the process. **An effective VRS scheme can ensure long term productive employment for a substantial number of residual employees in a going concern. It will also fetch better prices for shares sold by Government.**

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# DISINVESTMENT COMMISSION

MARCH  
1998

Trikoot-I, IInd Floor,  
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*PART A*





# 1. Review of General Issues on Disinvestment and Recommendations

The Disinvestment Commission has so far submitted six reports to Government between February 1997 and December 1997 as shown below :

Report 1	February 1997
Report 2	April 1997
Report 3	May 1997
Report 4	August 1997
Report 5	November 1997
Report 6	December 1997

Since the Sixth Report was submitted, there has been a change in the government. Moreover, with this Report, which is the seventh since inception, the Commission has finalised its recommendations in respect of 41 of the 43 PSUs referred to it. The Commission has, therefore, felt it appropriate that, in this report, a review of the origins of the Commission, its approach to disinvestment, its recommendations, both general and specific to PSUs and steps taken by it to monitor the disinvestment process is presented so that the new Government is apprised of the important issues which need to be addressed by it in furtherance of the objectives of setting up of the Commission.

The Disinvestment Commission was set up by a Resolution of Government issued on 23 August 1996 with broad terms of reference as given in Appendix I. The main objectives of setting up of this Commission were to prepare an over-all long term disinvestment programme for public sector undertakings referred to the Commission, determine the extent of disinvestment, select financial advisors to facilitate the disinvestment process, supervise the over-all sale process and take decision on instruments, pricing, timing etc., monitor the progress of the disinvestment process and advise Government on possible capital restructuring to ensure maximum realisation through disinvestment. These comprehensive terms were at variance with Para 4 of the above Resolution, which stated that the Disinvestment Commission would be an Advisory Body and PSUs would implement the decision of Government under the overall supervision of the Disinvestment Commission.

The Commission considered the matter and stated in its First Report that, since it was expected to be an Advisory Body, the selection of Advisers, supervision of overall sale process and decisions on instruments, pricing, timing etc. could be entrusted to a Standing Empowered Group (SEG). This Group would undertake all the activities of the disinvestment process on the lines recommended by the Commission and approved by Government, and in order to enable the Commission to monitor the progress of the disinvestment process, the SEG should keep the Commission informed on the various steps undertaken from time to time.

In pursuance of this understanding, the Commission has been making recommendations to Government, some of which have been accepted and several important ones are awaiting decision. The Commission has also been monitoring the overall progress of disinvestment.

Initially, Government referred 40 Public Sector Undertakings to the Commission and subsequently added 10 more. The list of 50 PSUs is given in Appendix II. Subsequently Government withdrew 7 PSUs from the Commission as indicated in the Appendix III. Of the remaining 43 PSUs, the Commission has so far completed its examination and made its recommendations in respect of 41 PSUs, including those covered in this Report. The Commission is unable to report on Central Electronics Ltd. (CEL), owing to delay on the part of CEL to furnish information. In respect of Air India, the Ministry has appointed a Committee to examine the Undertaking and the report of this Committee is still awaited and the Commission has therefore deferred its examination till the Report of the Committee is available.

In the present Report, recommendations are made in regard to the following 7 PSUs, thus taking the total number of PSUs dealt with by the Commission to 41 out of 43. For the reasons already given, the remaining 2 have not been covered in this Report.

1. Fertilisers and Chemicals (Travancore) Ltd.
2. Indian Petrochemical Corporation Ltd.
3. National Aluminium Co. Ltd.
4. National Fertilisers Ltd.
5. Neyveli Lignite Corporation Ltd.

6. Steel Authority of India Ltd.

7. Hindustan Latex Limited

The Commission started its activities in September 1996 by preparing a paper on "Disinvestment - Strategy and Issues" and circulating it widely for discussion. The Commission also met a number of institutions, market players, trade union leaders and others and elicited their views on the subject. Thereafter two Conferences were held in New Delhi and Mumbai in December 1996 and February 1997 respectively, which attracted wide participation.

On the basis of wide consultations and after taking into account the needs of the public sector in India and other country experiences, the Commission had made a number of general recommendations for improving the performance of the PSUs for enhancing the share value and for protecting employees interests.

The Commission has not taken an ideological approach to disinvestment. The Commission has examined each PSU and classified it as strategic, core and non-core units. Strategic units are those engaged in defence and security-related production. In such units, government holding could be maintained at 100%. The classification of core and non-core has been made not with reference to the industry or sector but with reference to the particular PSU taking into account the structure of the industry, the competitiveness or the market in which it operates, its market share and the public purpose (if any) served by keeping it in the public sector. In the case of units classified as core, the Commission has provided for disinvestment to go up to 49 per cent with the proviso that classification be reviewed from time to time with reference to the above criteria including the public purpose aspect. In regard to units classified as non-core, disinvestment can go up to 100 per cent.

The Commission has examined in detail, with the help of Consultants, each of the PSUs referred to it and also met the top management of the Undertakings and Secretaries of the concerned Ministries. On the basis of expert commercial evaluation of each PSU, taking into account the market structure in the industry and potential commercial viability of the Undertaking, discussions with top management and the concerned Ministries, the various options in respect of the PSUs were considered. Based on this

assessment, the Commission has made specific recommendations in respect of each of the PSUs on the extent of disinvestment and modalities thereof. The manner in which the financial advisers should be selected to facilitate the disinvestment process has also been indicated in the general recommendations. As stated earlier the Commission has made a number of general recommendations in its various Reports. The more important ones are the following: (Report number and the relevant paragraph numbers are indicated in the parenthesis)

### 1. Establishment of Disinvestment Fund (I: 3.1,V:1)

The proceeds from the disinvestment may be placed separately in a 'Disinvestment Fund' and the National Renewal Fund should also be merged with this Fund. The resources of the Fund may be primarily used for temporarily meeting the losses of some PSUs before disinvestment, where required, for a limited period during the process of short term restructuring or closure, for strengthening marginally loss making PSUs in preparation for disinvestment and for providing benefits to workforce found to be surplus during the restructuring or closure. The savings to the budget on account of such recurring budgetary support to loss making PSUs could be diverted for investment in sectors like infrastructure, education and health and retirement of public debt.

### 2. Delink the disinvestment process from the Budgetary Exercise of Government (IV: 1)

Linkage of the implementation of disinvestment with the budgetary exercise may hinder achievement of the larger objective of the disinvestment exercise. The creation of the Fund as stated above would also help the Government in undertaking disinvestment at the most opportune time in the market for maximum realisations.

### 3. Standing Empowered Group (I: 4.1).

Given the advisory nature of the Commission, the Commission recommended the formation of a Standing Empowered Group (SEG) to ensure smooth implementation of its recommendations. SEG was to also be entrusted with the selection of Financial Advisors, supervision of the overall sale process and decisions on instrument, pricing, timing etc. It was recommended that

SEG could comprise the Cabinet Secretary, Secretaries of the Ministry of Finance, Department of Public Enterprises, Administrative Ministry of PSU along with the CEO of the concerned PSU. The SEG was expected to undertake all the activities of the disinvestment process on the lines recommended by the Commission after Government approval. In order to enable the Commission to monitor the progress of the disinvestment process as per terms of reference IX, the SEG was expected to keep the Commission informed of the various steps taken from time to time.

#### 4. Monitoring progress of disinvestment (V: 1).

The Commission will continue to take note of the Government's decisions and monitor the progress of the disinvestment process with regard to the implementation of the Government's decisions with a view to maximising the benefits to Government and the economy in general accruing out of the disinvestment process.

#### 5. Procedures for pre-qualification and selection of strategic buyers (I:4.3, II.1 and V: 1).

Detailed and transparent procedures for the selection of strategic buyers have been recommended by the Commission in order to ensure that the strategic buyer brings in necessary technological and financial inputs which would complement the potential strength of PSU. The selection should be made through a process of global competitive bids from pre-qualified bidders.

#### 6. Procedure for selection of Financial Advisor and Global Co-ordinators (I:4.3)

The Commission has made recommendations for transparent procedures for selection of financial advisors, global co-ordinators and merchant bankers for facilitating disinvestment process.

#### 7. Transfer of Management. (V: 1)

While selling a substantial stake in the Undertaking, management would be transferred to the strategic buyer and a time frame agreed upon with the strategic buyer for further dilution of Government's share holding, where necessary.

## **8. Reduction of Government Equity (V: 1)**

The Commission also recommended that in the interest of establishing credibility with the strategic buyers, the Government may, where necessary, keep its direct share holding below the level of investment being offered to the strategic bidder by divesting some portions of its equity to multilateral financing institutions, private equity funds, mutual funds and a few select PSUs, who have business interest in the particular PSU being disinvested.

## **9. Strategic Sale (V:I)**

The advantages of a strategic sale are many. The induction of a strategic buyer would enable the enterprise to access technology, finance, managerial support and markets and thus make it internationally competitive. This modality of sale will also enable Government to maximise the sale proceeds as the strategic buyer would normally be willing to pay a higher price than retail investor would. Further where shares are sold through strategic sale and management is transferred to a strategic buyer, the valuation of the enterprise would be different as the strategic partner will have control of the management.

## **10. Retailing of PSU shares to Indian small investors and PSU employees (I:4.4)**

Detailed procedure for offer of shares in profit making PSUs to Indian small investors and employees has been recommended by the Commission. The Commission has also recommended on the maximum number of shares and the discount to be offered to small investors and employees. Sale of shares of the PSUs in the profit making PSUs to the small investors would broad base the share holding.

## **11. Audit of Disinvestment Transactions (V:1)**

It would be desirable to conduct an audit of the disinvestment transaction within six months by Comptroller & Auditor General with the involvement of professionals familiar with the working of the industry and capital markets. Such timely Audit provides opportunities for improving the quality of subsequent disinvestment transactions.

## **12. Voluntary Retirement Scheme (II:1) & (IV:1)**

The Commission recommended that the Government should frame a clear cut policy statement on the terms of VRS with stable and attractive terms with long term perspective and make provision of assured and adequate funds for this purpose. The implementation the VRS could be funded from the proposed Disinvestment Fund. A pension cum insurance scheme could be thought of as an alternative to a one-time payment.

## **13. Disinvestment without reference to the Commission (IV:1)**

The Commission had noted that Government had taken decisions in some cases to undertake disinvestment without reference to the Commission. By not referring the PSUs to the Commission, duly set up for this very purpose by Government, the benefits of such a detailed consideration by an independent body are being denied to all interested parties. The Commission, therefore, recommended that, in order to safeguard the credibility of the disinvestment process, there should be no disinvestment by Government in PSUs without reference to the Commission.

## **14. Grant of Autonomy (I:3.4)**

The Commission has recommended the grant of graded autonomy to all PSUs with reference to their financial performance and also enforcement of accountability for commercial and financial performance of the management.

## **15. Pre-Investigation Board (I:3.4)**

In order to encourage the exercise of autonomy in the interest of the Undertaking, the Commission has recommended setting up of a Pre-Investigation Board. It has also been recommended that CAG in the course of its audit and Parliamentary Committees examining the working of the public sector undertaking may keep in view the commercial environment in which PSU have to operate and take quick decisions in the changing market conditions.

## **16. Disinvestment Package (I:3.4, IV:1)**

The Commission reiterates that undertaking disinvestment without implementing the general recommendations of the Commission, - in

particular those relating to corporate governance, managerial autonomy, managerial remuneration, accountability, incentives, professionalising the Board of Management and restructuring where necessary - would result in undervaluation of Government shares and loss to the national exchequer.

A list of all the general recommendations and the action taken thereon by Government so far is annexed in Appendix IV.

The specific recommendations in respect of 41 PSUs examined up to the Report VII are given in Appendix V in a statement showing action taken by Government till now.

### Monitoring of Disinvestment Process

As envisaged in the original terms of reference, the Commission has been monitoring the progress of disinvestment process including the decisions of Government on the general and the specific recommendations as also their subsequent implementation. The Commission has reported this progress to Government in its Reports IV, V, and VI.

**Review :** A review of the decisions taken by Government till date gives no indication as to whether the basic strategy outlined by the Commission and incorporated in its general recommendations has been accepted by Government. While specific recommendations in some cases have been accepted and implemented, Government's approach to disinvestment so far seems to have been to treat it as a budget driven exercise to meet the fiscal deficit. The Commission is concerned that its recommendations of offer of sale of shares in blue-chip companies like MTNL, GAIL and CONCOR are being implemented merely to meet the budgetary gap without implementing the other general recommendations. The Commission would like to reiterate that its recommendations for sale of shares in blue-chip public sector companies should be implemented only after the other important recommendations on the Disinvestment Fund, the Voluntary Retirement Scheme with stable and attractive terms, grant of autonomy and establishment of Pre-Investigation Board are accepted and implemented by Government. These recommendations are intended to provide a mutually reinforcing package for maximising the benefits of disinvestment and for improving the overall performance of the public sector. The Commission would also reiterate that it is necessary to de-link disinvestment transactions from the budgetary



time frame, which would enable realisation of best value when market conditions are favourable.

Out of the 41 PSUs examined so far, the Commission has recommended strategic sale in 18 cases, trade sale in 6 cases, partial sale of equity in 5 cases, no disinvestment in 1 case, disinvestment to be deferred in 7 cases and closure /sale of assets in 4 cases. The units in which these categories of recommendations have been made and action taken by Government are shown in Appendix VI. Out of the 18 cases of strategic sale and 6 cases of trade sale recommended by the Commission, Government have taken decision on 3 cases of Strategic Sale and 1 case of trade sale. Even these decisions except those in the case of BALCO and Modern Foods India Ltd, are tentative in that further advice of Financial Advisors has been sought. The Commission would like to emphasise that where it has made specific recommendations for strategic sale or trade sale in respect of any enterprise, it is very important that a decision be taken thereon by Government as quickly as possible. Otherwise, the concerned enterprise faces considerable uncertainty not only internally but also its relationship with suppliers, buyers, business partners, lending institutions and investors gets affected.

The Government notification issued on 12 January 1998 amending the original terms of reference is given in Appendix VII. The effect of this amendment is to restrict the role of the Commission to purely an Advisory Body without any supervisory or monitoring role. The Commission is of the view that such a restricted scope will not enable it to play an effective role in establishing a credible disinvestment process, as envisaged in the original terms of reference.

### **A Long Term Disinvestment Strategy**

The public sector in India continues to be an important component of the Indian industry even after liberalisation. Therefore, the Commission reiterates that the PSUs, in general, must be managed on sound commercial lines and must generate adequate surpluses and make contribution commensurate with the quantum of public resources invested in them.

The main ingredients of a long term disinvestment strategy would be as follows :

1. Strategic public sector units will be owned wholly by Government.
2. Enterprises categorised as "core" will remain in public sector with majority equity holding by Government. However, these units should be enabled to remain profitable and competitive in the market with requisite managerial autonomy, remuneration structure and other support measures, already recommended by the Commission. Government policies should provide a level playing field for PSUs to compete with the private sector units.
3. In non-core units, Government's withdrawal through strategic sale is indicated on the following considerations :
  - In those PSUs that are loss making, Government cannot afford to support these PSUs without depriving other social sector areas such as education, health, etc. of badly needed Government funding. So in order to revive these PSUs and arrest their losses, induction of strategic partner becomes inevitable.
  - In those PSUs which are profit making but require large funds for their modernisation and expansion programme necessary to enable them to remain competitive, Government has to provide substantial financial support. These resources can be better used for funding social sector areas such as education, health, etc. Complementary support for the enterprise can be provided by the strategic partner who would bring in necessary technology, finance, managerial support and access to markets.
  - In cases where the PSU's market share is low and the market is competitive and there is already significant private sector presence in the market, there is no public purpose served by Government continuing to keep the enterprise in the public sector.
4. The proceeds from the disinvestment either through offer of sale or a strategic sale should be placed in the Disinvestment Fund and should be used for
  - for temporarily meeting the losses of some PSUs before their disinvestment

- for strengthening the marginally loss making PSUs prior to their disinvestment
- for providing benefits to PSU workforce found to be surplus during restructuring or closure
- retiring public debt

The savings to the budget on account of such recurring budgetary support to loss making units could be diverted toward investment in social infrastructure.

5. Disinvestment as a strategy should also aim, wherever possible, at wide dispersal of share holding in the domestic market and broad base ownership in the process. The retail investors should be offered shares both in the offer of sale in "core" units as well as in the sale of the Government's residual share subsequent to strategic sale in the "non-core" units. This will, of course, be subject to the capacity of the domestic capital market to absorb the proposed disinvestment and the private sector's capital requirements. Sale of shares in the foreign markets may, therefore, also become necessary with volume of shares to be sold being determined on a case to case basis depending on the market conditions etc.

**In light of the foregoing review and observations, the Commission would like to make the following further recommendations:**

1. The Commission is of the view that the disinvestment process can be an important instrument for building up a lean and strong public sector and for providing funds for development. The recent amendment dated 12 January 1998 of the terms of reference of the Commission has considerably diluted the role of the Commission in the disinvestment process. It limits even its advisory functions apart from removing overall monitoring and supervisory functions. The role of Commission as an advisory body without powers of monitoring and supervision of the overall disinvestment process renders the Commission ineffective. Therefore, the powers of monitoring and supervision as envisaged in the earlier Government notification dated 23 August 1996 should be restored.

2. The Commission had earlier recommended setting up of a Disinvestment Fund and utilisation of its proceeds. In addition to its earlier recommendations, the Commission would like to suggest that a reasonable percentage of the Disinvestment Fund should be earmarked for funding social infrastructure for promoting rapid growth of the economy.
3. In order to get the best prices for the shares disinvested by Government, particularly in the undertakings that will remain in the public sector, it is essential to time the sale under favourable market conditions. Timely action to select the financial advisers and a close watch on market conditions are necessary to get the best results. The Commission therefore recommends that a full time **implementation machinery** under the Ministry of Finance including public sector merchant bankers be set up under Government with a clear mandate. This machinery will select financial advisers and put through the sale of shares, either through offer of sale or by strategic sale and get the best price for the shares within a reasonable price band, that should be approved in advance by Government.
4. The implementation group should seek the advice of the Commission whenever necessary and be subject to the overall supervision of the Commission.
5. The Commission is not aware if all its recommendations have been taken before Cabinet for decision. The Commission would emphasise that both its general and specific recommendations should not be filtered by official groups but should be placed before the Cabinet in their entirety to enable Government to appreciate the interconnected strategy of the various recommendations and take decisions thereon. The Chairman of the Commission may be invited, wherever necessary, to the meetings of the Cabinet, to offer clarifications on the recommendations of the Commission.

# *Part B*



## 2. SPECIFIC RECOMMENDATIONS

### 2.1 Fertilisers and Chemicals Travancore Limited

#### Evolution

The Fertilisers and Chemicals Travancore Limited (FACT) was one of the first large scale fertiliser plants set up in India. FACT was incorporated on September 22, 1943 by M/s. Seshasayees (of Seshasayee Paper and Boards Ltd.) under the guidance of the Dewan of Travancore, Shri C.P. Ramaswamy Aiyar, with an initial share capital of Rs. 25 lakhs. In 1960, the Seshasayees divested their share in favour of the Government of Kerala. Subsequently, the Government of India became the major shareholder in November 1962. At present, the Government of India holds a 97.38% stake in the company. The equity shares of the company are listed at NSE and are thinly traded.

The brief summary of FACT's operations is as under:

Table 1 Production Facilities (March 1997)

Location	Facility	YOC*	Products	Cap. ('000 tpa.)
Udyogamandal, Cochin	Udyogamandal	1943	Ammonium phosphate	148.50
			Ammonium Sulphate	225.00
			Ammonia	85.80
Sulphuric acid			379.50	
Phosphoric acid			33.00	
	Petrochemical	1990	Caprolactam	50.00
	FEDO**	1966	Engineering consultancy	—
Ambalamedu, Cochin	Cochin Phase 1	1973	Urea	330.00
			Ammonia	198.00
	Cochin Phase 2	1978	Ammonium phosphate	485.00
			Sulphuric acid	330.00
			Phosphoric acid	115.00
Palluruthy, Cochin	FEW***	1966	Fabrication of equipment	—

\* YOC: Year of Commissioning

\*\* FACT Engineering and Design Organisation

\*\*\* FACT Engineering Works

FACT's production facilities are located at Udyogamandal and Ambalamedu, two industrial belts at the outskirts of Cochin. The fertiliser units are located at both Ambalamedu and Udyogamandal and manufacture urea, ammonium phosphate (NP 20:20) and ammonium sulphate in addition to important intermediates like Ammonia, sulphuric acid and phosphoric acid. FACT's petrochemicals division manufactures Caprolactam, the main raw material for Nylon 6.

Commercial production at Udyogamandal commenced in 1947 with a 50,000 tpa installed capacity of Ammonium Sulphate. Subsequently, various expansion and backward integration programmes were carried out between 1960 and 1973. In addition to a plant for Ammonium Phosphate (N:P 20:20), plants for manufacturing Ammonia, phosphoric acid and sulphuric acid were also set up. The Cochin division was FACT's second production facility and is located at Ambalamedu adjoining Cochin Refineries Limited. The first phase of this division, specifically for the manufacture of Ammonia and urea, was commissioned in 1973. The second phase came up between 1973 and 1978 with new plants for the manufacture of sulphuric acid, phosphoric acid and ammonium phosphate (NP 20:20). In 1990, FACT diversified from its traditional business of fertilisers, when it commissioned a 50,000 tpa Caprolactam plant at Udyogamandal. The advantage of the manufacturing process adopted was that it yielded ammonium sulphate as a by-product that could be concentrated and sold as a fertiliser.

FACT has a design and consultancy wing known as FACT Engineering & Design Organisation (FEDO). FEDO received an ISO 9001 accreditation in 1994 for total quality management standards in design of fertiliser, petrochemical and chemical related projects. The company also has a process engineering equipment fabrication division known as FACT Engineering Works (FEW). Both these divisions were set up in mid-sixties.

## Industry Analysis - Fertiliser

Urea, which comprises 46% nitrogen by weight, is the most popular nitrogenous fertiliser in the country and accounts for nearly 94% of the total nitrogenous nutrient consumption. The remaining nitrogen nutrient requirement is met from the low analysis nitrogenous fertilisers like ammonium sulphate, ammonium chloride, calcium ammonium nitrate and from complex fertilisers like DAP, etc.



The demand-supply gap in Urea is met through canalised imports. Until recently, the Minerals and Metal Trading Corporation (MMTC) and the State Trading Corporation (STC) were the canalising agencies. Government has authorised 3 public sector fertiliser companies to import Urea directly. Imported Urea is also sold at the same subsidised rates, as fixed by the Government for indigenous production.

Di-Ammonium Phosphate (DAP), a high analysis NP fertiliser with 18% by weight of nitrogen and 46% by weight of phosphorus, is the most popular complex fertiliser in the country. During the year 1995-96, DAP accounted for about 47% of the total complex fertiliser consumption in the country.

Decontrol has had an adverse impact on the complex fertiliser industry. The high prices of complex and other phosphatic fertilisers subsequent to decontrol, led to a decrease in usage of these fertilisers. As a result, though the recommended N:P:K application ratio for the Indian soil conditions is 4:2:1, the usage of fertilisers during 1995-96 was in the ratio of 8.5:2.5:1. While the compounded annual growth rate of consumption of nitrogenous fertilisers from 1992-93 to 1995-96 was about 5.6%, complex fertilisers grew by only 0.97% during the same period.

Despite significant Government controls, the Indian fertiliser industry is characterised by a fair representation by the private sector. Total investment in the industry is of the order of Rs. 13,000 crore. Of this, the public sector accounts for 41%, the private sector 43% and the co-operative sector 16%. The share in capacities is, however, marginally different: public 40%, private 38% and co-operative 22%. In terms of nutrient break-up, the public sector accounts for 46% of nitrogenous and 30% of complex fertiliser capacity while the private sector accounts for 38% and 55% respectively indicating a significantly higher public sector presence in the still controlled N (Urea) sector.

In terms of numbers, there are about 60 units manufacturing a range of fertilisers and additionally around 80 units (including units in the small-scale sector) manufacturing Single Super Phosphate (SSP). Owing to significant barriers to entry, the industry is characterised by a high concentration ratio. In 1994-95, the top 5 companies in Urea, DAP and complex fertilisers accounted for 62%, 88% and 72% respectively of total production.

Table 2 : Details of Production of Major Producers 1994-95

	<i>Urea</i>	<i>Prodn (Lakh Tons)</i>	<i>DAP</i>	<i>Prodn (Lakh Tons)</i>	<i>Complex</i>	<i>Prodn (Lakh Tons)</i>
1.	NFL	21.71	PPL	7.03	MFL	6.50
2.	IFFCO	18.75	GSFC	5.50	IFFCO	5.93
3.	RCF	17.30	IFFCO	4.23	FACT	5.01
4.	KRIBHCO	14.56	SPIC	4.11	RCF	4.94
5.	INDO GULF	7.84	GODAVARI	3.40	CFL	3.27

The total installed capacity has increased from 8.15 Million Tonnes Per Annum (mtpa) of nitrogenous nutrient in 1990-91 to 9.44 mtpa as at December 1996 (increase in capacity utilisation from 86% to 97%); while phosphatic capacity has risen from 2.77 mtpa to 2.91 mtpa over the same period (capacity utilisation up from 75% to 92%).

### Industry Analysis - Caprolactum

Caprolactam is a benzene-based petrochemical that is the raw material for Nylon 6, used in the nylon tyre cord and the nylon filament yarn industries. New applications for Caprolactam, such as engineering plastics are also being developed.

On the supply side, there are two main manufacturers in India, FACT and the Gujarat State Fertilisers and Chemicals Ltd. (GSFC). GSFC set up the first major capacity in the country of 70,000 tpa. FACT, subsequently in 1991, set up a 50,000 tpa plant. Due to the surplus in the market and a significant import threat, GSFC (to 120,000 tpa) and FACT have not implemented their expansion plans. Annual imports range from 5,000 to 10,000 tpa.

The present estimated demand of 100,000 tpa comes primarily from companies engaged in nylon tyre cord (60,000 tpa) and nylon filament yarn (40,000 tpa) manufacture. Demand drivers include the automobile and synthetic yarn/ fabric sectors.

### Business Analysis

FACT's details of sales of various products for the past four years are as under :

Table 3 Sales of products

(Rs. crore)

	1996-97*		1995-96		1994-95		1993-94	
Factamphos	478.52	45.2%	540.72	46.7%	446.54	44.9%	340.36	40.7%
Urea	169.87	16.0%	165.02	14.2%	177.50	17.8%	170.42	20.4%
Ammo. Sulphate	74.02	7.0%	83.59	7.2%	58.86	5.9%	33.01	4.0%
Traded goods	34.72	3.3%	27.43	2.4%	25.83	2.6%	26.10	3.1%
Total fertiliser	782.86	73.9%	825.81	71.3%	711.91	71.5%	565.44	67.7%
Caprolactam	276.39	26.1%	332.96	28.7%	283.49	28.5%	270.06	32.3%
FEDO/FEW	25.73	2.4%	36.48	3.1%	29.01	2.9%	21.65	2.6%
Net sales	1059.25		1158.77		995.4		835.5	

(\*) Provisional

The Factamphos (Ammonium Phosphate, NP 20:20) product (46% of sales) has a significant presence in the Southern Ammonium Phosphate fertiliser market (73% market share) and is the mainstay of the company's fertiliser operations. Urea is the second largest contributor to fertiliser sales (16% of total) but volumes are marginal relative to those of the competitors.

While FACT has a virtual monopoly in Kerala (over 75% and 60% market shares respectively in terms of N and P nutrient), its presence in Karnataka, Tamil Nadu and Andhra Pradesh is small (typically in the 10-15% range) though growing. Principal competitors include Godavari Fertilisers, Southern Petrochemical Industries Corporation (SPIC), Madras Fertilisers (MFL), Zuari Agrochemicals (ZACL), EID Parry and Coromandel Fertilisers (CFL).

The Caprolactam business, accounting for around 26% of turnover, significantly contributed towards subsidising losses in the fertiliser business in 1995-96. FACT together with GSFC has a duopolistic presence in the domestic manufacture of the product. End user industries include nylon filament yarn and nylon tyre cord. The company also exports a small quantum of Caprolactam to China and South East Asia (around one ton valued at \$3.3 million in 1995-96).

While FACT has a virtual monopoly in Kerala, it is relatively disadvantaged being located in a State where the consumption of nitrogenous and complex fertiliser is limited. In the present context, the domain of individual firms is largely restricted to the home state as

transport costs over long distances by road reduce competitiveness. FACT's competitive position in the other Southern states is average, though marginally improving (particularly in Karnataka). There are a number of established fertiliser companies both in the private and public sector in the Southern states. The increased marketing focus in neighbouring states implies higher freight expenses and necessitates the maintenance of strong distribution infrastructure that the Company has built up over the years.

The deficit of fertilisers is concentrated in specific states like Andhra Pradesh and Karnataka. This has prompted some of the existing companies take on large expansion projects in these regions to strengthen their future market position.

The feedstock for Ammonia manufacture has a strong impact on the profitability of Urea operations. Naphtha is the second most preferred feedstock, next to natural gas, for Ammonia manufacture. In terms of lower plant capital costs, lower energy consumption per ton of Ammonia and ability to achieve higher capacity utilisation, natural gas based plants have a distinct edge over naphtha. Almost 50% of the fertiliser plants in India are gas based. The plants in the South are, however, largely naphtha based.

FACT's Urea manufacturing facilities consist of Ammonia and Urea plant at Cochin. As per the FICC (Fertiliser Industry Co-ordination Committee) norms, Naphtha based 10 year old Urea plants are expected to achieve capacity utilisation of around 80%. In FACT's case, the Urea plant has achieved only between 70% and 80% capacity utilisation over the past 5 years. Shutdowns in the Urea plant have been on account of mechanical and process related downtime mainly in the Ammonia section. This affects Urea capacity utilisation as Ammonia manufacture yields carbon dioxide, a critical raw material for Urea production. A lower than normative (77%) Urea capacity utilisation directly impacts financials in terms of a non-recovery of all fixed expenses.

The Factamphos (NP 20:20) plant has the flexibility to manufacture DAP also. Though the licensed capacity of the plant is 485,000 tpa of complex fertiliser, the plant produces in excess of 500,000 tons of Factamphos in addition to around 20,000 tons of DAP annually. FACT has consistently recorded a high capacity utilisation at this plant.

Availability of key raw materials like Sulphuric acid and Phosphoric acid is important for maintaining high capacity utilisation of the plant. Sulphuric acid is used in the manufacture of Factamphos as well as phosphoric acid. Utilisation of sulphuric acid for Factamphos manufacture takes precedence over phosphoric acid production. Hence, the phosphoric acid capacity at Cochin is under-utilised, necessitating large imports of phosphoric acid.

For every ton of Caprolactam produced, 4.5 tons of ammonium Sulphate is recovered. Udyogamandal has a smaller capacity (148,500 tpa) and older NP 20:20 plant in comparison to Cochin. However, this plant too runs at close to 100% capacity utilisation.

Low capacity utilisation at the 85,800 tpa Ammonia facility (2 plants : 46,200 tpa and 39,600 tpa) at Udyogamandal is primarily due to the age of the plant which is well past its economic life. The larger plant is practically non-operational at present. Material and energy consumption norms per ton of Ammonia are also very unfavourable relative to the Ammonia plant at Cochin.

A downtime analysis of the sulphuric acid and phosphoric acid capacities at Udyogamandal reveals that these plants are under-utilised on account of power shortages, difficulties in gypsum disposal (a by-product of phosphoric acid manufacture) and inadequate storage facilities for phosphoric acid. Any shortfalls in these intermediates are bought out and imported respectively.

FACT imports nearly 75%-85% of its raw material requirements, on a total cost of purchase basis. The import cost depends on the price volatility of key inputs such as Ammonia and phosphoric acid and exchange rate volatility. The price volatility in these commodities is due to demand supply considerations, the oligopolistic nature of the raw material producer industry as well as the availability (or otherwise) of freight vessels for transport from the sources abroad.

If FACT were to produce all its Ammonia requirements in-house, it would require close to 300,000 tons of naphtha annually. Availability of naphtha to the fertiliser industry is not expected to be a cause for concern notwithstanding the increasing demand from the power and transport sectors. However, the removal of subsidy has resulted in an increase in the cost

of Naphtha for fertiliser units. FACT sources its naphtha from BPCL at Cochin itself.

A total Ammonia requirement of nearly 200,000-250,000 tons, over and above the captive production of 191,000 tons (1995-96) is imported from Middle East countries such as Iran, Saudi Arabia, Qatar and Kuwait. Due to limited storage facilities at the Cochin Port, large shipments are not possible. Internationally, prices of Ammonia are very volatile ranging from around \$ 170 to 275 /ton (Cost + Freight) between 1994-1997.

FACT will be entirely self-sufficient in Ammonia once the 300,000 tpa Replacement Ammonia Project (RAP) is commissioned in March 1998. The plant is an outcome of public litigation against the existing Ammonia import storage facility at Wellington Island, Cochin. On a comparative basis, however, the in-house Ammonia production is not expected to be viable in the medium term due to high depreciation, interest cost and decontrolled Naphtha prices.

While most of the Ammonia requirement of the Cochin Urea plant would continue to be met by the existing Ammonia plant at Cochin, the Ammonia produced by RAP would primarily be used by the Caprolactum plant, Udyogmandal complex fertiliser plant and the Cochin complex fertiliser plant.

FACT manufactures as well as imports phosphoric acid. The Fertiliser Association of India (FAI) imports phosphoric acid from Jordan, Tunisia and Morocco on behalf of FACT and other fertiliser manufacturers on a yearly contract basis. The price and the estimated quantity requirements are fixed annually. Though this insulates the company against price volatility of the commodity, the average cost of buying phosphoric acid at Rs. 11,315 / ton in 1995-96 was close to the average variable cost of manufacturing at Cochin (Rs. 11,241/ton) which makes a strong case for domestic manufacture. However power constraints, sulphuric acid capacity constraints and problems associated with disposal of gypsum have resulted in sub optimal utilisation of phosphoric acid capacity. Rock phosphate is also imported from the same set of countries.

FACT employs about 8000 people and a large number of them work in the Udyogamandal Division. Though there is an element of overstaffing,

the personnel pool of FACT is highly qualified by virtue of being in a literate state like Kerala. VRS in the past have not been successful due to negative social connotations. Around 288 employees accepted the VRS plan that was introduced in February 1989

## Financial Analysis

The financial performance of FACT for the past five years is given below:

Table 8 Financial Performance (Rs. Crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Operating Income	1047.8	1202.1	1017.2	798.8	871.3
Operating Profit	96.6	112.8	111.5	72.1	86.0
Profit after Tax	61.8	76.8	79.0	12.3	3.4
Equity Capital	354.8	354.8	350.3	342.8	342.8
Tangible Net Worth	647.6	585.8	526.8	439.8	422.8
Gross Margin (%)	9.2	9.4	11.0	9.0	9.9
Net Margin (%)	5.9	6.4	7.8	1.5	0.4
ROCE (%)	8.7	11.0	14.7	8.2	7.2
RONW (%)	9.5	13.1	15.0	2.8	0.8
Earnings Per Share (Rs.)	1.74	2.17	2.25	0.36	0.10
Dividend (%)	5	5	-	-	-

The overall production process is raw material intensive with raw material costs accounting for nearly 50-53% of the company's operating income. This is inclusive of bought out intermediates such as imported Ammonia and Phosphoric acid and raw materials like benzene, etc. The company's wage bill is 9% of total operating income and compares unfavourably with its peers in the industry. Power and fuel costs account for approximately 8 - 10% of operating income. FACT has captive power plants which can meet approximately 75% of the company's present full capacity requirements. The mix between supply from KSEB and captive power in 1995-96 was 56%:44%, though the erratic power situation in Kerala is increasingly tilting the balance in favour of more expensive captive power.

Gross operating margins have been around 9% after the commissioning of the Caprolactam project. The figure was higher at 11% in 1994-95 as Rs.

32 crore of receipts due under the retention price scheme pertaining to cost increases in earlier periods were received in that year. Net margins have been around 6-8% in the recent past. A division-wise performance analysis in 1995-96, however, reveals that the Caprolactam division has largely been subsidising losses in fertiliser division. Overall margins were low in 1992-93 and the following year on account of high depreciation and interest outgo on the Caprolactam project. Depreciation rates applicable from 1993-94 were comparatively lower than the previous year and this has also contributed to the increase in margins in subsequent years. The relatively poor performance of Caprolactam in 1996-97 has been reflected in the gross and net margins.

## Strengths and Areas of Concern

### Strengths

*Strengths in the NP 20:20 product segment* : The market potential for the Factamphos product in the South is high. FACT is the market leader in this segment.

*Duopolistic Presence in Caprolactam* : The company has a strong presence in Caprolactam and derives benefits from the duopolistic industry structure.

*Brand equity* : The company has invested significant time and resources in farmer education programmes on the use of fertilisers since the 60s. Two seasons after decontrol, FACT was able to continue selling ammonium phosphate outside the ad-hoc subsidy scheme at higher than market rates. The company and its fertiliser products have a recognised brand equity in the southern states.

*Distribution network* : FACT has a 7700 strong dealer network, comprising private as well as co-operatives, in addition to central depots or warehouses. The cumulative warehousing capacity in the four states is 1,55,000 tons.

*Depreciated manufacturing facilities* : FACT's Udyogamandal facilities were established in 1943. The Cochin division phases were commissioned in 1973 and 1978 respectively. This gives FACT a relatively low cost structure.



## Areas of Concern

*Costlier Replacement Ammonia Option* : The Replacement Ammonia Project which is due to be commissioned in March 1998, is a much costlier option than imported Ammonia primarily because of the decontrolled naphtha prices, initial high depreciation and high interest cost.

*Fortunes driven by Government Policy* : Adhoc concessions on NP 20:20 despite having been recently increased, have not kept pace with the increase in cost of production.

*Naphtha based plants* : Naphtha is second to natural gas as a feedstock for fertilisers. This directly places the company at an operational disadvantage in respect of energy consumption and capacity utilisation levels relative to those of gas based competitors.

*Plant Vintage and outdated technology* : FACT's existing Ammonia and Urea plant technology is old. As shown in the table below, FACT's Ammonia plants at Cochin and Udyogamandal do not compare favourably with norms that new technologies can match. The new Replacement Ammonia Project (RAP) would nearly match these efficiency norms.

Table 9 Efficiency Parameters for

Norm	New Plants	FACT - Cochin	FACT - Udyogamandal
Energy (Mn K Cal/ton of Ammonia)	6.8	11.97	12.72
Naphtha (ton/ton of Ammonia)	0.680	0.915	0.856*

\* The efficiency will improve after the commissioning of RAP.

*Balancing Issues* : Currently, the phosphoric acid capacity at Cochin is largely under-utilised on account of limited sulphuric acid availability. This has resulted in exposure to volatility in international phosphoric acid prices. Likewise, problems at the old Udyogamandal Ammonia plant have necessitated imports of Ammonia. This vulnerability will, however, to a large extent be mitigated once the RAP and proposed 900 Tpd Sulphuric acid plants go on stream.

*Deficit Power Situation* : The current power crisis in Kerala has resulted in a 100% power cut to industrial users since April 1997. This strongly influences capacity utilisation as well as manufacturing decisions. Self sufficiency is expected only in 1999-2000 with the commissioning of the new 2X16 MW CPPs.

*Low Financial Flexibility* : FACT is planning more projects to consolidate its position in fertilisers. FACT's contribution from internal sources to these projects is limited on account of lower cash generation expected over the next 3 years. Significant debt financing would tell on interest and repayment commitments.

*Relatively Overmanned Facility* : FACT has a manpower base which is on the higher side for its scale of operations in comparison to other fertiliser plants.

## **Recommendation**

**The Commission reiterates its earlier classification of FACT as “non-core” based on the following :**

- The market structure in the complex fertiliser segment, in which the unit is operating, is competitive as a number of companies have emerged in the private and co-operative sectors due to relatively lower capital requirements when compared with the urea segment. Thus, the market contestability has increased significantly, when compared to the contestability levels at the time when FACT was set-up.
- Given the importance of fertilisers for ensuring food security, Government control on the prices and distribution of this fertiliser will continue in the foreseeable future. If the controls are likely to continue in future, Government ownership of production facilities of the commodity is neither necessary nor justified.
- In addition, Caprolactum business, which contributes about a fourth to the turnover of the company, has seen increasing levels of contestability as the import duties have been brought down in a phased manner, from 80% in FY 91 to 30% currently. Further, Caprolactum, like all other petrochemicals, is subject to international price volatility.

demand risk arising from substitutes as well as risks arising out of Government policies. The market in this business segment is thus fully contestable.

Overall market prospects in the complex fertiliser segment in the South appear to be favourable. The company is seeking to consolidate its business position, but locationally, FACT is at a disadvantage given the saturated Kerala market and freight costs of marketing in other states.

However, the company faces a number of problems after the de-control of complex fertilisers. The company initiated the Replacement Ammonia Project (RAP), even though it was unviable, mainly to conserve foreign exchange. The Kerala High Court order for closure of the ammonia storage facility hastened the commissioning of the project. The depreciation and interest cost for the new plant are substantially high, and coupled with the decontrol of Naphtha prices for the fertiliser sector, have resulted in a high cost of production of ammonia.

Due to the decontrol of complex fertiliser segment and a downtrend in the international prices of ammonia, the company would have to absorb the entire cost increase itself, without being able to pass on any part of it to the end-user. This situation is not expected to change significantly in the near future and the company would incur significant losses in the medium term.

The Government has set-up a committee under the chairmanship of Shri Hanumantha Rao to review fertiliser sector policy. The committee is yet to submit its report.

Currently, FACT is getting compensated for the increase in cost of production, due to Naphtha decontrol, because of the Retention Pricing Mechanism. However, a de-control of the Urea prices could threaten FACT's competitive position vis-à-vis imports.

The analysis of FACT's Caprolactum business reveals that its main strength has been its reputed quality of the product and the consistent demand from large clients such as Century Enka, etc. So far, FACT has managed to do well in the past, aided by a favourable import duty structure. However, this no longer offers much protection. After the commissioning of RAP,

the Caprolactum plant would be using the high cost Ammonia produced by RAP. **The superior returns from the Caprolactum business are thus expected to decline in the future.**

Since Naphtha is a basic raw material used by FACT and its prices are highly volatile, FACT should have an arrangement with its supplier (currently BPCL) for long term availability of Naphtha, while benefiting from any future downtrend in its international prices.

From the above analysis, it is evident that FACT is likely to slip into losses in the current scenario of de-control of complex fertilisers and increased cost of production of Ammonia. One way of strengthening the company's position would be to induct a strategic partner who could bring in necessary business and financial inputs.

The Commission has evaluated the various modalities of disinvestment and is of the view that a public offer of the shares of FACT may not be the most appropriate method. A public issue may not help the company to build upon strengths that will be required to compete in a de-controlled scenario. Neither will it enable Government to get optimal value, as the stock markets in India have traditionally given low price-earnings multiple as far as fertiliser stocks are concerned, since the performance of these companies is dependent on monsoons as well as continuation of Government subsidies.

Keeping the above in mind, the Commission is of the view that the induction of a strategic partner could enable the company to have increased access to funds, markets, as well as technology. The induction of a strategic partner would help FACT to become globally competitive and, thus, be prepared for eventual de-control.

**The Commission therefore recommends that Government should offer a minimum of 51% of the equity to a strategic buyer along with management control on the basis of global competitive bids. A strategic buyer is expected to pay a higher price for management control in the company and Government proceeds could thus be maximised. The selection of the strategic buyer should involve pre-qualification to ascertain capabilities of the potential buyers in the area of feedstock linkage, access to markets and technology.**

After the induction of strategic buyer and completion of on-going modernisation programmes, Government could eventually disinvest its balance holding in FACT, through a public offer of shares to domestic institutions and retail investors. Apart from broadbasing the shareholding, the second tranche of disinvestment will also enable Government to realise higher value on a per share basis.

## 2.2 Hindustan Latex Limited

### Evolution

Hindustan Latex Limited (HLL) was incorporated in 1966, with the main objective of assisting in the population control efforts of the Government of India. The commercial production was started in 1969 with the setting up of a male contraceptive plant with 144 million pieces per annum (mppa) capacity, which was later enhanced upto 608 mppa. Later during 1990's, HLL diversified into the manufacture of various female contraceptives like Intra Uterine Devices (IUDs) and oral contraceptives and healthcare products like blood bags, latex gloves and hydrocephalus shunts. The equity capital of the company as at 31st March, 1996 was Rs.15.5 crores and the Government of India holds 100% of the equity.

### Industry Profile

The industry profile as well as the share of HLL production in various products are given below :

#### Male Contraceptives

The total market size of male contraceptives in India is 1250 million pieces per annum (mppa), out of which 80% is purchased by Government for free supply and social marketing. The balance 20% is marketed commercially. The current capacity in the country is 2000 mppa and HLL's share in the total capacity is about 30%. The other major players are Polar Latex, TTK & London Rubber Company, and JK Chemicals. Since the Government is the major buyer, the fortunes of this industry largely depend on the Government's spending in the areas of family planning and population control. HLL is currently operating at 100% capacity.

#### Female Contraceptives

##### *Oral Contraceptives*

There are two brands of oral female contraceptives that are currently manufactured. Government of India is the sole buyer for these brands. These are mostly distributed free and some are sold at a subsidised rate through

social marketing channels. The raw material for the formulation of this pill is supplied by United Nations Family Planning Association (UNFPA). The three companies tableting these are HLL, IDPL and Eupharma Laboratories Limited. These are marketed through various companies including HLL.

### *Intra-Uterine Device (IUD)*

Another female contraceptive is IUD called Copper-T. The total demand from the Government is 7-8 mppa and the entire product is distributed free of cost by Government under its social welfare schemes. HLL has a capacity of 4 mppa and the other main manufacturers are Famicare Ltd., Contact Devices Ltd., and SMB Corporation Limited.

## **Healthcare Products**

### *Blood Bags*

Blood bags are substitutes for glass bottles and there is a gradual switch-over in the usage from glass bottles to blood bags. The domestic blood bag market is currently having a demand of 6-7 mppa. The dominant player in the industry is Peninsular Polymers Ltd. who has a 80% market share. HLL is a late entrant with a capacity of 2 mppa. The commercial production was started only in September, 1995. The other major players in this field are TTK Pharma Ltd., J.Mitra & Co., Eastern Medikit Ltd., and Core Healthcare Ltd.

### *Hydrocephalus Shunts*

This product is used to drain excess fluid in the cranium. The current demand in India is estimated at 20000 pieces per annum. HLL has set up a unit to manufacture with an installed capacity of 5000 pcs per annum. Currently, the demand in this product is met through imports.

### *Latex Gloves*

There is an over supply situation in this segment. HLL has an installed capacity of 24 mppa and the other domestic manufacturers are from the unorganised sector. The international price of this product was around USD 60 per 1000 pcs in 1991-92 and has declined substantially to USD 25 per 1000 pcs.

## Business Analysis

HLL manufactures a wide variety of products. The production capacities and capacity utilisation for FY 96 is as under :

Table 1 Production capacity and utilisation

Products	Capacity	Cap.Util.
Male Contraceptives	608 mppa	100 (%)
Female Contraceptive - Pills	870 Mn tablets	60 (%)
- Copper-T	4 mppa	75 (%)
Latex Gloves	24 mppa	5 (%)
Blood bags	2 mppa	15 (%)
Hydrocephalus Shunt	5000 pcs	15 (%)

HLL has a diversified product range. But the main component of sales and profitability is from the male contraceptive business. Sales break-up of various products and their contribution towards profit before interest, tax and depreciation (PBIDT) for FY 96 are as follows:

Table 2 Product wise Sale break-up for FY 96

Products	Sales (Rs. Cr.)	% of total	PBIDT (Rs. Cr.)	% of Total Contribution
Male Contraceptives	42.7	81.2	17.6	77.4
Female Contraceptives				
- Mala D/N	3.3	6.3	1.8	7.7
- Copper-T	4.6	8.7	4.1	18.0
- Saheli	0.1	0.3	0.3	1.5
Healthcare Products				
- Latex Gloves	1.1	1.9	-1.2	-5.4
- H.Shunts	0.1	0.1	0.0	0.1
- Blood bags	0.2	0.4	0.0	0.2
Sutures (Trading)	0.6	1.1	0.1	0.5
Total	52.7	100.0	22.7	100.0



## Financial Analysis

Growth in sales has been moderate, but steady, with sales to Government constituting over 80% of the total contraceptive sales. The operations have been profitable in the last few years except in FY 96. The following table gives the details of financial performance of HLL for the past five years.

Table 3 Financial Performance

(Rs. Crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Total Income	85.5	54.5	50.2	43.1	38.0
Operating Profit	16.8	1.6	6.6	7.8	6.6
Profit after Tax	6.48	-6.7	0.8	0.6	0.7
Equity capital	15.5	15.5	13.0	12.6	12.6
Tangible Net worth	27.7	22.6	26.4	24.0	23.8
Gross Margin (%)	19.6	3.0	13.2	18.1	17.5
Net Margin (%)	9.5	-12.4	1.6	1.3	1.9
ROCE (%)	28.1	-5.8	9.7	12.2	7.7
RONW (%)	23.4	-27.4	3.1	2.3	3.1
Earning per Share (Rs.)	4.2	-4.3	0.6	0.4	0.6
Dividend (%)	8.3	-	2.3	0.8	-

The reasons for the declining trend in profitability since 1994 is mainly due to realisation not keeping pace with the increase in raw material cost and high and increasing labour cost. The loss in FY 96 was largely due to the one-time charge on account of wage settlement (Rs.4.7 crores) and low capacity utilisation in the gloves and blood bag units. The company expects to make net profits in FY 97.

### Strengths and Areas of Concern

#### Strengths

*International standards in terms of quality* : HLL has been awarded the ISO 9002 certification and the AFNOR registration of France and the US-510 K certification. Due to this HLL could increase exports and for direct exports to a few countries like France, Brazil and the USA (through tie-ups with foreign agencies), export realisations have been better.

*Entering into New Business areas* : HLL's diversification into blood bag is gaining acceptance in terms of quality. There is a 30% duty on imports on blood bags which will make domestic products price competitive.

Similarly, HLL's hydrocephalus shunt's sales are also picking up. Currently the market is dominated by imports. Once the market accepts the products, there is a good market for this product.

## Areas of Concern

*Over supply in Male Contraceptive market* : The male contraceptive market is currently having a capacity of 2000 mppa while the demand is only 1250 mppa.

*Price & Purchase Preferences* : Till FY 95, HLL was enjoying price preference and HLL used to get 6-10% more than private manufacturers. Likewise, GoI was giving purchase preferences to HLL upto March 31, 1997. This matter is, however, under review.

*Surplus Labour* : The total manpower of HLL is 2160. A study conducted with the help of NPC on Thiruvananthapuram units and Corporate Office has revealed that there is a surplus manpower of 467, which is about 38%. After further discussions with the trade union representatives, surplus manpower of 256 was identified.

*High wage cost* : The wage cost as a percentage of total cost of production is about 32%, which is quite high.

*Delay in getting approvals* : The approval for capital expenditure programmes of the company for the blood bags and the gloves project was delayed, due to which, the company could not enter the market at the opportune time.

*Unviable operations* : HLL's glove manufacturing unit's contribution in profit before interest tax and depreciation is negative. The company with its high wage costs could not compete with the domestic unorganised segment and imports. This has resulted in closure of this unit for most of FY 96.

*Dependence on single buyer* : Government is the principal buyer of HLL's products such as Mala-D/N and Copper-T. If the Government's order fluctuates, the capacity utilisation of the company will be affected resulting in diminishing profits.

## Recommendation

The Hindustan Latex Registered and Corporate Employees union had filed a writ petition in the Kerala High Court, seeking a stay on the reference of HLL to the Disinvestment Commission. The Commission sought legal

opinion, according to which, the Kerala High Court has not passed any stay order in this case and, as such, there is no legal hurdle in the Disinvestment Commission finalising its recommendations.

Disinvestment in HLL, as it is functioning today, cannot have any significant impact, as far as resource generation is concerned. Given its low and inconsistent profitability record and low equity base disinvestment by offer of sale, while keeping it in the public sector, will not generate any interest among investors.

Department of Family Welfare had emphasised before the Commission, the crucial role of HLL in regard to the family welfare programme. It has, however, also to be noted that the Government policy seems to be to phase out preferences to the PSU in the purchase of contraceptive for free distribution as well as social marketing. Price preference has already been discontinued while purchase preference is currently available till 31.3.2000 (except for a brief period from 1 April 1997 to 31 October 1997).

In the absence of a Government undertaking in the field, it could be argued that the cost of contraceptives for free distribution and for social marketing could be pushed up by the private producers. It is, however, to be considered that in this sector, the technology being simple and easily accessible and the capital costs not very high, the entry barriers are quite low.

There is also considerable over capacity in the domestic market, viz. 2000 mppa as against the Government purchase programme of 1000 mppa and the commercial demand of 200 mppa. It is, therefore, difficult to agree totally that Government ownership in the sector is vital or crucial to the implementation of the family welfare programme. In fact with its own costs on the higher side on account of the surplus labour, the usefulness of HLL to keep a check on prices quoted by other private producers for supplies to Government is rather limited. Given the budgetary constraints, in real terms, that the Department is said to be facing, a higher cost public sector producer with purchase preference would, in fact, be counter-productive.

In the long run, HLL has to be enabled to reorient itself to a competitive market scenario. For this purpose, it will have to be given sufficient

autonomy to reorganise its production pattern to improve its market share in the high priced segment of contraceptives, develop a strong marketing network and also push through the diversification projects in areas like blood bags, and shunts, after properly assessing their individual viability. It would also need the necessary freedom to deal with its surplus labour force through an imaginative and acceptable VRS. The company would also need budgetary support for implementing VRS. The Disinvestment Fund, recommended by the Commission, could take care of this requirement. Since it has already established itself as a quality producer of contraceptives and has got not only ISO 9002 certification but also acceptable accreditation in the French and US markets, the company would need to enter the export market aggressively rather than rely only on channels of UNFPA and other international NGO-sponsored sales.

**Keeping in view these challenges facing the company, the Commission feels there is a need for induction of a strong strategic partner. However, the sizeable surplus labour force will be an inhibiting factor.**

**The company should therefore, implement at first, a VRS to bring down the labour cost to a comparable level vis-à-vis its competitors in the private sector. Once this is achieved, the government can offer 51% of its holding to a strategic partner, who would provide further marketing and technological strength to the company to improve its performance in the domestic and export markets. The Government could also go in for further disinvestment in the domestic market, through a public offer to small investors and employees. The Commission recommends that the Government should continue to hold 26% of equity in this company to ensure that the company's role in the production of contraceptives in the lower price segment for free distribution and social marketing is continued even after disinvestment. The Memorandum and Articles of Association should be suitably amended to incorporate necessary safeguards for this purpose.**

## 2.3 Indian Petrochemicals Corporation Limited

### Evolution

The Indian Petrochemicals Corporation Limited (IPCL) was set up in 1969 as a Government company with the objective of establishing a petrochemical sector in India. This was due to the capital intensive nature of the industry and lack of interest shown by the private sector at that time. The facilities were set up for the manufacture of basic petrochemical building blocks (Ethylene/Propylene) and down-stream products. Today, IPCL is the second largest petrochemical company with its focus on polymers. Other products include synthetic fibres, fibre intermediaries, surfactants, industrial chemicals, catalysts and absorbants.

Prior to January 1992, the entire share capital of IPCL was held by Government. The capital structure of the company underwent change in the past five years as under:

Table 1 Disinvestment and IPO details

Period	Disinvestment/IPO	GoI Holding
January, 1992	Disinvestment of 20%	80%
November, 1992	Initial Public Offering	74.86%
July, 1994	Conversion of Rights PCDs (not subscribed by GoI)	64.12%
December, 1994	Issue of GDRs	59.96%
FY 97	Issue of Convertible Bonds	51.2% (**)

(\*\*) Likely in FY 2000

The present equity share capital of IPCL is Rs. 249 crores and the shares of IPCL is listed in all major stock exchanges. The current shareholding pattern is as under :

Table 2 Shareholding Pattern

Name of the Share holder	% Holding
Government of India	59.96
FIs / Corporate Bodies	21.43
GDR holders (Custodian - Citibank)	7.12
Employees	0.50
Gandhar Villages	0.07
Others including Resident individuals	10.92
Total	100.00

## Industry Analysis

The petrochemical industry in India is around 25 year old. Substitutability of traditional materials by polymers and general economic growth led to a healthy growth in demand for polymers. Petrochemical products can be broadly classified into three groups

Table 3 Classification of petrochemical products

<b>Basic Petrochemicals</b>	These are direct products of cracking naphtha or gas. Mainly used to make other petrochemicals, i.e. polymers and manmade fibres. Include ethylene, propylene, butadiene, benzene and toluene
<b>Polymers</b>	Derived mainly from ethylene and propylene. Include polyethylenes, polypropylenes, poly vinyl chloride, polystyrene and synthetic rubber. The key markets for polymers are films (used mainly in packaging), fibres and filament (used mainly in woven sacks to pack cement and fertilisers), pipes and conduits, household products, construction, consumer appliances and containers. Demand pattern, in future, is likely to change with the development and growth of new product applications (driven mainly by automobiles, appliances and household product sectors).
<b>Downstream Petrochemicals</b>	Petrochemicals not falling in the above two categories are broadly groups as downstream petrochemicals. All of them are derived directly or indirectly from naphtha or gas. Include orthoxylene, ethylene oxide, methanol, phenol, LAB etc.

The petrochemical business worldwide is currently dominated by North America, West Europe and Japan. With the developed world's markets nearing saturation, Asia will play a dominant role in future, both in terms of demand growth and capacity. In India, in the past, the domestic capacity growth has not been able to keep pace with demand and hence a large portion of demand was met through imports. Initial plant sizes in India were uneconomical and the industry was protected with high customs duty and relatively low feed stock prices. Post liberalisation polymer plants are of economic size with increasing shift towards integration into ethylene. However, lowering of import tariffs has made the domestic industry vulnerable to competition from imports.

Ethylene and propylene are the main raw materials for production of polymers. These are obtained from cracking naphtha, ethane/propane (C2/

C3), LPG, etc. Both in India and South East Asia, there is expected to be a situation of excess ethylene and propylene capacity by the turn of the century. Build up of capacity in the neighbouring countries will put pressure on Indian producers. This would lead to either lower capacity utilisation to maintain prices or lower prices due to excess supply. IPCL and Reliance Industries Limited are the two dominant players in the polymer market in India. The various polymer product capacity and consumption profile in India is as under:

Table 4 Polymer product capacities and consumption profile

Polymer	Capacity (Tonnes) as on March, 1997	Consumption profile in FY 96 (%)
LDPE (Low Density Polyethylene) /LLDPE (Linear Low Density Polyethylene)	405000	21
HDPE (High Density Polyethylene)	160000	25
PP (Polyethylene)	540000	19
PVC (Poly-Vinyl Chloride)	663000	29
PS (Poly Styrene)	138200	6
Total		100

The driving force in the polymer business is the ability of the industry to come up with new products capable of finding niche applications within a short period. Demand for polymers, in future, is expected to grow at a higher rate than that achieved in the past. In individual segments, demand growth rates are expected to be as under:

Table 5 Demand forecast for polymers (Tonnes)

Polymers	1997 (Estimate)	2002 (Forecast)	Growth in FY 97 (%)	CAGR 97-2002 (%)
HDPE	486000	869000	8.0	12.3
LD/LLDPE	390000	652000	5.5	10.8
PP	412000	768000	*25.0	13.3
PVC	515000	748000	7.0	7.8

(\*) abnormally high due to substitution of HDPE as a result of low PP price

If the planned capacities are commissioned as scheduled, there would be a surplus in all polymers except in LDPE. However, LDPE imports are expected to treble.

Competitiveness of petrochemical companies depends on feedstock availability and pricing. The Ninth Plan working group had estimated a surplus naphtha capacity of 5 million tonnes in FY 2001. However, due to the Government decision to allow naphtha to be used as fuel for power generation, the country may have to import naphtha in future. Similarly, use of natural gas as feedstock by the petrochemical companies will also face uncertainty, due to the expected short supply of domestic natural gas in the medium term.

### Business Analysis

IPCL is predominantly a polymer company. It also produces fibre and fibre intermediaries and industrial chemicals. IPCL's main products are as under:

Table 6 IPCL's main products

Polymers	Fibre and Fibre intermediaries	Chemicals
Low Density Polyethylene (LDPE) Linear Low Density Polyethylene (LLDPE) High Density Polyethylene (HDPE) Poly Vinyl Chloride (PVC) Polypropylene (PP) Poly Butadiene Rubber (PBR)	Acrylic Fibre (AF), Paraxylene (PX), DiMethyl Terephthalate (DMT), Ethylene Oxide (EO), Mono-Ethylene Glycol (MEG)	Linear Alkyl Benzene (LAB) Orthoxylene

The current product mix and its trend in recent years are given below:

Table 7 : Product Mix (%)

Particulars	FY 97		FY 96		FY 95		FY 94		FY 93	
	Qty	Value	Qty	Value	Qty	Value	Qty	Value	Qty	Value
Polymers	65	72	58	66	58	65	54	61	51	55
Fibres	13	13	12	15	13	16	15	17	11	16
Chemicals	21	14	30	18	27	18	30	21	35	25
Others	0	0	1	1	1	1	2	1	3	3
Net Sales	100	100	100	100	100	100	100	100	100	100
'000 tonnes	818		844		774		626		593	
Rs./Crores		2,773		3,088		2,545		1,682		1,697



IPCL operates two petrochemical complexes at Vadodara (1.3 lakh tpa naphtha cracker) and Nagothane (3 lakh tpa gas cracker). A third plant at Gandhar (3 lakh tpa gas cracker) is to be commissioned by December, 1998.

Typically, a petrochemical plant is located close to port facilities for flexibility in accessing raw material and sales. However, both the operational plants of IPCL are located farther from the ports and hence the company has logistical disadvantage.

Feedstocks (naphtha, C2/C3 and FCC/C3) accounted for 74% of IPCL's raw material cost in FY 97. Continuous availability of feedstock, at competitive prices is the key success factor for any petrochemical plant. IPCL sources naphtha from Indian Oil's Koyali refinery located next to IPCL's Vadodara Plant. Naphtha prices were administered by Government till October 1997, when Government fixed domestic naphtha price based on import parity prices. However, a 20% sales tax in Gujarat makes domestic naphtha costlier, whereas no sales tax is applicable on imported naphtha, forcing IPCL to increasingly resort to imports.

C2/C3 is considered to be a more efficient feedstock for producing ethylene. IPCL has a long-term contract for supply of C2/C3 for Nagothane plant from ONGC. Nagothane cracker plant also uses Propane/Propylene (FCC/C3). The company is procuring this from BPCL under a long term contract. Currently, IPCL is not using Natural Gas (NG) as feedstock. However, for the Gandhar Plant, it requires NG. Government has recently revised the prices of NG. The prices would gradually be linked with the international price of a basket of internationally traded fuel oils, with a view to achieve 100% fuel oil parity in future.

IPCL has captive power plants at all the three plants. It faces the problem of availability of lean gas for the power plant because of which it has to use relatively costly imported naphtha.

IPCL has commissioned its captive jetty at Gandhar. It has also commissioned three underground pipelines for transport of propylene, ethylene and naphtha from the jetty to the Vadodara Plant. The commissioning of these facilities has imparted flexibility for IPCL's operations at Vadodara and Gandhar. However, the captive jetty is not operative in monsoons. IPCL plans to construct a Single Buoy facility, near the jetty, which will overcome this problem.

IPCL has a country wide marketing network. It has been instrumental in developing applications in various sectors like automobiles and agriculture. ICPL is a price taker in the market. Pricing is based on the landed prices of imports and the pricing of its domestic competitor. Recently, IPCL has commenced setting prices region-wise, as against its earlier policy of a single price list. This would enable the company to get better prices.

Fibre and fibre intermediaries accounted for 13% of sales volume of IPCL in FY 97. IPCL is the largest producer of acrylic fibre (AF) in the country with a market share of 28%. IPCL is also the second largest producer of MEG and the third largest producer of DMT in the country.

IPCL is the largest producer of orthoxylene and the third largest producer of LAB in the country.

IPCL has around 13,000 employees of which 75% are located in Vadodara.

### Financial Analysis

The financial performance of IPCL for the past five years is given below:

Table 8 Financial performance (Rs. crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Operating Income	2773.5	3088.1	2544.6	1682.1	1697.0
Operating Profit	516.6	920.1	548.3	-31.2	36.9
Profit after Tax	510.2	603.6	562.4	89.2	13.1
Equity Capital	249.0	249.0	248.8	203.5	195.5
Tangible Net Worth	2822.4	2460.9	1958.3	1125.9	942.7
Gross Margin (%)	18.6	29.8	21.6	-1.9	2.2
Net Margin (%)	18.4	19.9	22.2	5.4	7.5
ROCE (%)	18.0	30.4	26.0	12.4	
RONW (%)	19.3	27.8	36.6	8.8	
Earnings per Share (Rs.)	20.5	24.6	22.7	4.5	6.5
Dividend (%)	40	40	30	20	20

As can be seen from the above table, the operating income declined during FY 94 due to lower realisation in all products. Realisations were low because of large-scale imports, at zero import duty, by exporters using the Value Based Advance Licence scheme. This was compounded by low international prices. In that year, IPCL made an operating loss due to lower realisation in all products. However, Profit After Tax was positive due to non-operating income of Rs. 125 crores including Rs. 81 crores on the sale of fixed assets.

However, the operating income showed significant growth in FY 95 and FY 96 due to improved sales volume and realisation. During FY 97, the operating income declined due to lower realisation in major products, as a result of lower international prices and reduced import duties. There was also a decline in production due to non availability of feed stock and unstabilised operations. During FY95 and FY96, profit margins improved significantly due to higher capacity utilisation, higher sales realisation, increased volume of production from Nagothane plant etc. However, the profit margins during FY97 declined, mainly due to drop in prices of major products, non-availability of feedstock, higher raw material cost, selling expenses, interest cost etc.

IPCL has successfully tapped both domestic and international markets through debt and equity issues. The company's debt mix is more in foreign currency. In FY 97, IPCL raised USD 175 million through issue of foreign currency convertible bonds, whose conversion option can be exercised anytime after April, 1997 until maturity in FY 2002. However, at the time of issue of foreign currency convertible bond in FY 97, Government (GoI) had directed IPCL to ensure that GoI holding is not diluted below 51%.

## Future Plans

IPCL is in the midst of a capacity expansion programme at Nagothane plant where it is increasing its cracker size by 100,000 tpa and LLDPE/HDPE capacity by 85,000 tpa. It is also implementing Phase II of Gandhar plant consisting of 300,000 tpa gas cracker and HDPE and MEG/EO Plants. These projects are expected to be completed by September, 1998.

The company is planning to spend approx. Rs.4350 crores during FY 98-2002 on various new projects. This include :

- A new naphtha cracker of 300,000 tpa at Vadodara
- Raising of cracker capacity to 500,000 at Nagothanc
- Expansion of downstream capacities for polymers and chemicals,
- New production lines for ACN and ACB at Gandhar to meet the demands for these products in India, substituting imports.
- Setting up of a Joint venture refinery
- Setting up of power plants through joint venture
- Joint venture for implementation of a chemical port at Dahej.

## Strengths and Areas of Concern

### Strengths

*Major petrochemical company* : IPCL is India's second largest petrochemical company with focus on polymers.

*Wide product portfolio* : IPCL's product range includes polymers, fibre and fibre intermediaries and Chemicals which will help the company in overcoming seasonal cyclicalities in any products.

### Areas of Concern

*Uncertainty in raw material pricing* : Feedstocks (naphtha, C2/C3 and FCC/C3 accounted for 74% of IPCL's raw material cost in FY 97. All the major raw materials, except Naphtha, used by ICPL are currently under the regulated environment. Naphtha prices have already been deregulated, resulting in a price hike. The prices of other raw materials may also undergo drastic change, due to liberalisation of these sectors.

*Locational disadvantage* : Normally petrochemical plants are located closer to ports in order to facilitate movement of raw materials and finished goods. ICPL's both plants are located far off from the ports, which results in higher cost of transportation for both raw materials and finished goods.

*Cracker Inflexibility* : IPCL's crackers are based on single feedstock. This exposes IPCL to the risk of disruptions of feedstock supply. IPCL's competitor has a multi feedstock facility.

## Recommendation

The analysis of the IPCL reveals that the company was promoted in the late sixties with the intention of establishing a vibrant petrochemical sector in India. Since that time, the petrochemical sector in India has matured considerably and today some world-class players have emerged in this sector. In addition, the decreasing levels of import tariffs have, in effect, made the pricing of domestic petrochemical products wholly dependent on the landed price of the imports. Thus, the markets for petrochemical products are fully contestable. **On these grounds, the Commission reiterates its earlier classification of IPCL as non-core.**

The Commission has noted that in such a competitive scenario, IPCL has performed quite well and has reported increased levels of sales as well as profits. This can be primarily attributed to the management of the company, which has demonstrated vision and foresight in building the company.

As far as disinvestment is concerned, the Commission has noted that the current shareholding of Government is about 59%. In addition, the company has issued foreign currency convertible bonds aggregating USD 175 million in FY 97, which could reduce the Government share holding. As per the terms of the bond issue, a conversion option has been given to the holders which is exercisable at USD 13 per bond (1 bond is equivalent to 3 shares). This option can be exercised any time after April, 1997 until maturity in FY 2002. However, the number of investors opting for conversion from FY 1997 to FY 2002 would depend on market conditions. Thus, a clear picture of the percentage of disinvestible shares remaining with Government would emerge only by FY 2002. In the event of conversion, Government's stake would come down to 51%.

IPCL is listed on BSE and NSE and is a part of BSE Sensex with significant weightage. The stock is currently quoting at a relatively low level, as the depreciation of South East Asian currencies would put pressure on IPCL's margins.

With some of IPCL's competitors expected to expand capacities in some product lines and integrate backwards for better control on feed stock supply, IPCL's competitiveness will be challenged in the medium term in spite of capacity expansions and upgradations carried out so far. In addition,

the competition from the Asian region due to new capacities emerging, as well as the threat due to the depreciation in the currencies of the South East Asian countries, pose a serious threat to the petrochemical industry in India and more so to IPCL, in particular, due to its second rung position. It is therefore important to strengthen the company in terms of access to feed stocks, new markets as well as technology.

**The Commission, therefore, recommends that Government, while retaining at least 26% of equity stake in IPCL, should sell 25% to a strategic buyer with the transfer of management control on the basis of global competitive bids. However, care should be taken, while pre-qualifying bidders, to ensure that the strategic sale does not lead to market dominance by any single player. The Government should enter into a shareholder agreement with the strategic buyer to ensure that, in the event of the buyer's exit from IPCL, Government's prior consent is taken, so that the next buyer is also acceptable to Government as a strategic partner who is willing to enter into an appropriate shareholder agreement with it.**

The selection of the strategic buyer should involve pre-qualification to ascertain capabilities of the potential buyers in the area of feed-stock linkage, access to markets and technology. The Government may also appoint Financial Advisers for the company who could advise on suitable financial and business restructuring before effecting the strategic sale. The procedure for appointing Financial Advisors has been outlined in the First Report of the Commission.

## 2.4 National Aluminium Company Limited

### Evolution

The National Aluminium Company Limited (NALCO) was promoted by the Government of India in technical collaboration with Aluminium Pechiney, France, Europe's largest metal products company. The company was incorporated in 1987 with the objective of meeting the domestic demand for aluminium and exporting Alumina. The project included a 2,400,000 tpa bauxite mine at Panchpatmali, Orissa; 800,000 tpa Alumina refinery at Damanjodi, Orissa; 218,000 tpa aluminium smelter at Angul, Orissa; 600 MW coal fired captive thermal power plant at Angul, Orissa and port facilities at Vishakapatnam, Andhra Pradesh. The company has since augmented the power plant capacity by another 120 MW in 1994-95.

NALCO's product mix is limited to Alumina and primary aluminium in ingot, rod and billet form. The company varies the proportion of rod and ingot forms in its total metal production, as per the demand. All the excess Alumina and 40% of the aluminium ingots are exported and the rest is sold in the domestic market.

Government of India, as a part of its disinvestment policy, divested 12.85% of its stake in two tranches in 1992-93 and 1993-94. Now, Government holds 87.15% equity stake in the company.

### Industry Analysis

The aluminium industry in India can be divided into two segments: primary aluminium manufacturers and secondary fabrication units. Primary aluminium can be sold in the form of ingots, billets and slabs. The secondary fabrication units process aluminium metal produced by the primary producers to manufacture three main categories of value added products: redrawn rods, rolled products and extrusions. The secondary product manufacturers have the additional option of using imported aluminium under OGL.

The main primary producers of aluminium in India are National Aluminium Company Ltd. (NALCO) and Bharat Aluminium Company Limited (BALCO) are in the public sector and Hindalco Industries Ltd. (Hindalco) and Indian Aluminium Company Limited (INDAL) in the private sector. NALCO Hindalco and BALCO account for 90% of the total domestic output.

The industry structure in the primary segment is oligopolistic in nature due to high entry barriers such as high capital cost, restricted access to technology and long gestation periods. However, with the lowering of the import duties since 1992, the domestic prices of aluminium are strongly linked to the prices on the London Metal Exchange (LME) and hence the primary market may be considered to be competitive, in spite of a limited number of players.

The industry structure in the secondary value added segment is fragmented, with a large number of secondary producers spread across the country. The threat of substitutes has a bearing on the demand for aluminium products and this, in turn, limits the margins for both primary as well as secondary producers.

Aluminium is manufactured by refining bauxite and then processing the refined intermediary (Alumina) in a smelter to extract aluminium. The process of producing Alumina from bauxite is dependent on the nature of the ore. The reduction of Alumina into aluminium is carried out in electric smelters. Though there has been a shift in technology, it may be noted that the process technology for manufacture is not likely to exhibit significant changes. Improvements if any, will be gradual and can be easily sourced from other countries.

## Demand - Supply

Aluminium's versatile properties make it suitable for diverse applications. The increase in applications and the rationalisation of duties are expected to be the key determinants for demand in the future. The major consuming sectors for aluminium and their expected growth rates in the medium term are as follows:

Table 1 : Segment wise Domestic Demand Growth

Sector	Share FY 96 (%)	Growth Rate* (%)
Electrical	34	8
Transport	22	10
Consumer Durable	11	10
Packaging	11	15
Building & Construction	8	6
Industrial	8	7
Others	6	6
Total	100	9.1

\* Expected growth rates for user industries in the medium term.



Based on the existing capacities of the four major players as well as their on-going and proposed capacity expansions, the demand supply gap is as projected below:

Table 2 Demand Supply Gap (tons)

	FY 96E	FY 97P	FY 98P	FY 99P	FY 2000P
Total Demand	5,60,135	6,10,690	6,66,557	7,27,214	7,93,390
Total Supply	5,29,000	5,49,000	5,90,000	6,25,000	6,45,000
Surplus/(Deficit)	(31,135)	(61,960)	(76,557)	(102,214)	(148,390)

The supply by domestic aluminium producers even at their full capacity will not be enough to meet the total demand and hence secondary producers and other producers would have to import metal.

### Global Scenario

India has 12% of the world's reserves of bauxite but produces only 3% of the aluminium in the world. Despite higher power tariff prevailing in the country, domestic producers measure up to global standards due to captive power plants and low cost of bauxite. The sectoral usage of aluminium is quite different in India when compared with global usage patterns.

Table 3 Usage Pattern of Aluminium (%)

Sector	India	Global
Electrical	34	8
Transport	22	27
Consumer Durable	11	9
Packaging	11	22
Building & Construction	8	20
Industrial	8	8
Others	6	6
TOTAL	100	100

The difference in the usage patterns can be ascribed to the Aluminium Control Order, which stipulated that 50% of the Aluminium produced in the country had to be reserved for the electrical sector. This had led

to a lopsided consumption pattern. With the abolition of the Control Order in 1989, the growth of consumption in other sectors has picked up and the trend is towards replicating the international pattern.

Internationally, prices had fallen in 1996 due to a decline in copper prices, as aluminium prices are strongly linked with the prices of copper. With no fresh additions to smelter capacity, the price of aluminium is likely to be sustained and even witness an upward trend in the medium term.

### Key Success Factors in Aluminium Industry

*Availability of raw materials* The availability of good bauxite ore in close proximity to the smelter will greatly determine the cost of production.

*Captive Power* Since power forms as much as 35% of the manufacturing cost, uninterrupted power supply in the form of captive power is a key success factor.

*Vertically Integrated Operations* Primary Aluminium producing companies, with a presence in the value added segment have a competitive advantage in terms of higher margins. In addition, nearness of the fabrication facilities to the consuming markets will determine freight costs.

### Business Analysis

NALCO's bauxite reserves are located at Panchpatmali hills, Damanjodi in Orissa. These are a part of the East Coast Reserves - which are considered to be the largest bauxite reserve in Asia and the fifth largest bauxite reserve in the world. The fully mechanised open cast bauxite mine, which has been in operation since 1985, has a capacity of 2.4 mn. tpa. The mine has an estimated reserve of 377 mn. tonnes (of which 300 mn. tonnes are mineable) and is sufficient to meet over 100 years of NALCO's bauxite requirements at the current mining rate.

The quality of the ore from NALCO's mines is very good, as it has a high percentage of alumina (45%) and a low percentage of silica (2%

to 4%). The ore deposits are in the form of seams/layers and so the mining operation is fully mechanised. NALCO's bauxite is reputed to be the lowest cost ore in the world.

The refinery uses power generated from its 55 MW (3x18.5) coal fired thermal power plant. The refinery has a capacity of 80,000 tpa of which around 425,000 tons is consumed in-house and the balance is exported.

NALCO uses the Low Pressure - Low Temperature (LPLT) process for refining bauxite into alumina as it uses Gibbistic bauxite. The company's technological advantage coupled with its low cost of ore enables it to be one of the lowest cost manufacturers of alumina in the world.

NALCO's smelter and captive power plant are located near Bhubaneswar at Angul, Orissa about 700 kms from the refinery. The proximity to the Mahanadi coal fields of Coal India Limited determined the choice of the site of the smelter.

The company uses the more advanced pre-baked technology (as against the older and less efficient 'Soderberg process'), which enables the company maintain a high cell amperage leading to lower power cost. On account of the superior quality, NALCO's metal is able to attract a premium to the LME price.

The captive power plant with an installed capacity of 720 MW (6x120 MW) at Angul, is 5 kms from the site of the smelter unit. To ensure uninterrupted coal supply to the captive power plant, Coal India Limited has opened a mine at Talcher, in the government owned Mahanadi Coal fields, with an annual capacity of 3.5 mn. tonnes. The coal is transported to the Angul plant, 15 kms away, by a merry-go-round system.

NALCO enjoys the following logistical advantages :

- Proximity of the refinery to the mines enables transportation of the ore by means of a conveyor belt. This conveyor belt consumes minimal energy as more than half of it is on the downward slope of the hills.
- Though the alumina refining facilities and the smelter is located at a distance of 700 kms, NALCO has its own special wagons (rolling stock

of 9 locomotives and 400 special rail wagons) for transporting the alumina by rail over this distance.

- The coal mines and the power plant are separated by just 15 kms, thus reducing the freight cost. NALCO's captive rail system ensures regular supply of the coal.
- NALCO's captive port facility has mechanised storage and ship handling facilities for export of 375,000 tonnes of alumina and import of caustic soda and other raw materials.

## **Labour**

On account of the highly mechanised operations of the company, the labour force is quite low, which is also reflected in the low employee cost as a percentage of operating income at about 5%, lower than the cost incurred by the other players.

## **Expansion Plans**

The company has commenced de-bottlenecking of the smelter plant which will increase its capacity from 218,000 tons to 230,000 tons and is scheduled to be completed by 1998. The Company plans to expand its manufacturing facilities in two phases. The first phase, which involves expansion of bauxite mines from 2.4 mtpa to 4.8 mtpa and alumina refinery capacity from 0.8 mtpa to 1.57 mtpa would cost about Rs. 1200 crore. The necessary approvals for this phase have been obtained and the work is scheduled to start in the current year. The second phase costing Rs. 2320 crores envisages smelter capacity increase from 230,000 to 345,000 tpa and captive power plant capacity increase from 720 MW to 960 MW is waiting for Ministry's approval.

NALCO's expansion is expected to cost Rs. 5000 crore over a period of 5-7 years. NALCO is expected to implement all its expansion plans through internal accruals and loans. During the next five years, the company is expected to have internal accruals of about Rs. 5000 crore. The company does not rule out Debt/Euro issue also to part finance the project as the internal accruals may not be sufficient to fund the total expansion plan in view of the debt repayments due in future.

## Financial Analysis

The past financial performance of NALCO is shown in the table below:

Table 5 Financial Performance (Rs. crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Operating Income	1635.4	1608.8	1336.0	1062.7	1048
Operating Profit	830.8	885.9	696	480.7	441.7
Profit after Tax	491.8	663.3	360.8	183.3	138.3
Equity Capital	1288.6	1288.6	1288.6	1288.6	1288.6
Tangible Networth	2970.5	2589.2	2005.6	1766.1	1569.9
Gross Margin (%)	51	55	52	45	42
Net Margin (%)	30	41	27	17	13.2
ROCE (%)	15.9	21	14.3	7.6	6.1
RONW(%)	16.6	25.6	17.9	10.3	8.8
Earnings per Share (Rs.)	3.8	5.1	2.8	1.4	1.0
Dividend (%)	8	3.5	3	2	2

NALCO's revenues are closely linked to the international aluminium prices which is evident from the growth in sales revenue in the year 1995-96 despite a decrease in the sales volume from last year. There was a sharp increase in employee costs in 1995-96 due to the payment of arrears for last 3 years as the wage revision of employees came in force.

The company had not been paying income tax in the past due its export income and the high depreciation charge. However, now the company will have to pay at least the Minimum Alternative Tax (MAT), which will result in a drain on company's profits and cash flow.

Net profit margins of NALCO have been growing for the last five years and was 38% for the year 1995-96. The extraordinary items like book exchange gain (Rs. 27.8 crore) and write back of pot relining expenses (Rs. 79.3 crore) have also contributed towards a higher net profit for the year. The company changed the life of its Plant and Machinery from 20 years to 18 years in 1993-94. The company has been providing higher depreciation since then.

As on March 31, 1996, the cumulative depreciation was under provided to the extent of Rs. 959.4 crore which will gradually reduce to zero by the year 2004-05 as a result of higher annual depreciation by the company.

The net margin has increased at a higher rate than the operating margin over the last 5 years mainly due to the reducing interest cost. NALCO's capital structure has consistently improved over the last five years with a reduction in the gearing from 1.83 as at March 31, 1992 to 0.40 as at March 31, 1996 due to the prepayment of its debts.

## Strengths and Areas of Concern

### Strengths

*Access to Rich Ores* : NALCO's bauxite reserves are part of the East Coast Reserves which are considered to be the largest bauxite reserve in Asia and fifth largest bauxite reserve in the world. The mine has an estimated reserve of 377 million tons (of which 300 million tons are mineable) and is sufficient to meet over 100 years of NALCO's bauxite requirements at the current mining rate. The quality of the ore from NALCO's mines is very good as it has a high percentage of Alumina (45%) and a low percentage of silica (2-4%). NALCO's bauxite is reputed to be the lowest cost ore in the world.

*Strong Financial Position* : NALCO has exhibited a strong track record of profit generation and cash accruals over the last five years. NALCO's profitability has been improving over the years as a result of higher realisations,, low cost technology, availability of cheap captive power, and higher capacity utilisation. In the absence of approvals for its expansion plans, the enhanced cash accruals have been utilised by the company to pre-pay its foreign currency loans.

*Strong Business Position* : As the operations are fully integrated, NALCO is one of the cheapest manufacturers of aluminium. The low production cost enables NALCO to enjoy profitability even during a downturn in the aluminium cycle.

### Areas of Concern

*Lack of Autonomy* : The company's expansion plans for de-bottlenecking the smelter and increasing smelter capacities from 230,000 tpa to 345,000

tpa had taken unduly long time for clearances from the central Government. As a result, the strong internal accruals were used to pre pay loans instead of investing in the new projects. The lack of autonomy, considering the impressive track record has adversely affected the expansion plans of the company.

*Limited Product Mix* : NALCO's product mix is limited to alumina and primary aluminium in ingot, rod and billet form. The company's fortunes are thus more prone to changes due to volatility in international prices. In the future, the company has plans to enter the value added segment.

## Recommendation

The Commission had studied the structure of the Indian Aluminium industry in detail in the Third Report as well as in this Report. **Based on this analysis, the Commission has decided to retain NALCO as “core”, for the present, due to the following reasons :**

- NALCO produces about one-third of the primary aluminium produced in the country. The expansion project currently under implementation by the company would further increase its market share in primary Aluminium. Thus NALCO is expected to dominate the primary aluminium market in India for some more time.
- The quality of ore from NALCO mines is among the best in the world. From a regulatory point of view, Government control over the company may be desirable to conserve this exhaustible material for the down stream industry and safe guard against indiscriminate mining for short-term financial gains.

NALCO has exhibited a strong track record of profit generation and cash accruals over the last five years. NALCO's profitability has been improving over the years as a result of higher realisations, low cost technology, availability of cheap captive power, and higher capacity utilisation. The enhanced cash accruals have been utilised by the company to pre-pay its foreign currency loans.

**Given its strong business and financial position, the Commission recommends an offer of sale of upto 30% of the Government's holding of the company to retail as well as institutional investors.**

As the domestic markets may find it difficult to absorb such a large issue, it may be desirable to have to a mix of disinvestment in the GDR as well as domestic markets. **The Commission therefore recommends a GDR issue of 15% of its holding at an appropriate time depending on the market conditions after capital restructuring.** It may be noted that NALCO's shares are already traded on BSE as well as NSE. Soon after the GDR issue, a domestic offer of 10% to the institutional investors and 5% to the small investors could be made. The price for the retail investor could be fixed at a discount over the institutional price.

As mentioned earlier, the prepayment of loans will enable NALCO to be free of debt by FY 99 except debt arising from conversion. The requirement of funds for its expansion projects can be easily met through borrowings. The Commission, therefore, does not envisage any IPO in the medium term from the company to meet its funding requirements.

Proceeds from the GDR issue to the Government would primarily depend on the valuation of NALCO's equity. The company has submitted a proposal to Government for conversion of 50% of equity to interest-bearing loan to improve the valuation of NALCO. An appropriate conversion of equity to debt should be made keeping in view (1) improvement in the valuation of equity shares, (2) availability of adequate shares for Government to disinvest and (3) ability of the company to raise additional equity for funding its expansion projects without diluting Government holding below 51%. This issue needs to be studied in depth prior to the GDR issue by the Financial Advisor. The procedure for appointing Financial Advisors has been outlined in the First Report of the Commission.

The Commission is of the view that the following strategies could also additionally help in improving investor perception and thereby enhance value :

- Corporate image building exercise aimed at reinforcing the premier position occupied by NALCO;
- Follow internationally accepted accounting as well as disclosure practices. Regular interaction with investors by NALCO's management would help in improving investor perception.
- Provide representation to the investors holding 12.85% of the historically disinvested portion of NALCO's equity.



However, preparatory to disinvestment, the Commission recommends that Government should address certain issues relating to corporate governance, and autonomy to NALCO. The policy of lowering import tariffs and the entry of new players in the aluminium industry has posed a challenge to NALCO. In particular, the delay in according clearance to its expansion and de-bottlenecking projects have increased the project costs substantially and have affected the competitiveness of the company.

**Considering its impressive track record over the past five years, the Commission considers it to be a “Strong Performer” and recommends full autonomy to the Board of Directors to enable it to conduct its operations successfully in the increasingly competitive environment.**

## 2.5 National Fertilisers Limited

### Evolution

National Fertilisers Limited (NFL) was incorporated on August 23, 1974 for the manufacture and sale of Urea, Calcium Ammonium Nitrate, and other industrial chemicals. The company was set up with the initial objective of setting up of identical Urea plants at Panipat (Haryana) and Bhatinda (Punjab). While these plants were being set up, the Fertiliser Corporation of India was reorganised into three entities. Consequently, the Nangal plant of FCI came into the fold of NFL. The company also operates a gas-based plant in Madhya Pradesh. Currently, NFL operates four plants, located in three states, with a total installed capacity of 2.81 million tonnes per annum. It is country's largest Urea producer with 12% of the industry capacity.

The share holding pattern of NFL is as follows :

Table I Share holding Pattern

Shareholder	%
Government of India	97.6
Financial Institutions	2.3
Employees & Private Companies	0.1
Total	100.00

Over the past five years, NFL's equity has been disinvested in three tranches in 1992, 1993 and 1995 at an average price of Rs. 8.45, Rs. 24 and Rs. 42.50 respectively. The stock is listed on the Bombay, Delhi, Calcutta and Madras stock exchanges. The floating stock of NFL is relatively low and hence trading volumes are thin.

### Industry Analysis

India predominantly consumes two kinds of fertilisers : Urea (Nitrogenous) and Di-Ammonium Phosphate (Phosphatic). The country is not self sufficient in Urea and hence depends on imports. The imports are canalised through two main trading units (MMTC & STC) and three fertilisers unit in the public sector. The importance of Urea as a fertiliser can be gauged from the fact that wheat and paddy, which currently account for as much as 77%

of the total foodgrain production in India, require large doses of Urea, as the nitrogen depletion rates are higher when compared with other crops. Hence, Urea usage is vital to be country's food security.

Urea accounts for approximately 60% of the India's fertiliser market estimated at Rs. 10,000 crores and accounts for as much as 80% of the total fertiliser subsidy of Rs. 7,800 crores. There are over 15 players in the private, public and co-operative sector, of which the private sector plants are most efficient.

The three key characteristics of this industry are :

- *High capital intensity* : The cost of setting up a green field plant for manufacture of Urea is around Rs. 18,000 to 24,000 per tonne. The industry is highly capital intensive, which has led to high levels of concentration. In India, the top 4 producers account for 47% of the production.
- *Highly working capital intensive* : Subsidy from government constitutes nearly 46% of the income of the industry. Delays in subsidies often stretch working capital requirements.
- *Feed Stock* : Gas based plants are more efficient with respect to capacity utilisation and energy consumption than Naphtha and Fuel oil based plants.

## Demand-Supply Scenario

Due to inadequate levels of production, the import of Urea in the past has ranged between 12%-15% of consumption. The increase in consumption levels has been partly due to shift in the consumption pattern from other fertilisers to Urea. Past demand- supply trend in the industry is shown in the table below:

Table 2 Production - Consumption Gap over the past five years ('000 tons)

Factor	FY 96	FY 95	FY 94	FY 93	FY 92
Production	15,806	14,137	13,150	13,125	12,831
Consumption	17,908	17,112	15,811	14,905	14,003
Deficit	2,103	2,975	2,661	1,780	1,172
Imports	3,782	2,884	2,840	1,857	391

## Regulatory Framework and its Impact

Urea along with other fertilisers, came under the purview of the Retention Pricing Mechanism (RPM) in the late 70s. The basic aim of the policy was threefold : self-sufficiency, rational movement of fertilisers across different consumption centres and timely availability and affordability of all types of fertilisers to farmers.

**Retention Pricing Scheme (RPS) Mechanism:** Under RPS, the fair ex-factory realisation (retention price) of each unit is fixed on the basis of the normative cost of production besides equated freight being fixed for each unit. The difference between the net realisation (Consumer price - Distribution margin) on the one hand and retention plus equated freight on the other hand is paid to (or mopped up from) each unit by Government. The main parameters in fixing the retention price are:

- All raw material cost and increases are covered on an actual basis. Escalation in the input costs are covered by quarterly revisions in the RPS.
- The other costs covered include the conversions costs, selling expenses, depreciation and interest. The normative costs are calculated on the basis of the normative capacity utilisation levels specified at 90% for gas based plants, 80% for liquid fuel plants and 60% for coal based plants.
- A 12% post tax return on networth is assured to the companies.

This mechanism has resulted in payment of subsidy to all fertiliser units in the private and public sector. With addition to capacities, higher capacity utilisation and rising feedstock prices, the Government subsidy bill has kept increasing over the years.

Due to the increased level of subsidies, the decontrol of prices has been suggested as a way of reducing the burden on Government. Decontrol of Urea prices is dependent on (1) possible impact on food security, (2) farmers ability to bear the increase prices and (3) political will to face the resistance to the price increases.

If the Urea price were to rise by 30%, the demand growth would still be about 7% pa over the medium term. Hence, there is sufficient scope for raising prices without affecting food security.

However, complete decontrol of Urea prices is unlikely, at least in the medium term.

## Business Analysis

The fertiliser plants are capital intensive and technology dependent. The key determinants of operating performance are:

- capacity utilisation
- energy efficiency, which is a function of the technology
- maintenance expenses, which is dictated by the vintage level of the plant
- control on overheads.

## Capacity Utilisation

The overall capacity utilisation has improved significantly over the last five financial years, mainly due to process modifications, installation of captive power plants and improved instrumentation.

## Technology

The three plants of NFL, based on the fuel oil, are more than 16 years old and the gas based plant at Vijaipur (other than the newly commissioned unit) is 10 years old. The technologies employed at the three liquid fuel plants are dated (late seventies). The three fuel oil plants are at the fag end of their working life. 50% of NFL's current capacity is more than 16 years old and is a cause for future concern.

The management has taken steps to revamp and modernise the older plants over the last 5-7 years. This is likely to cost Rs. 1,000 crores and is expected to be financed mainly from internal accruals. The Nangal unit underwent revamp to substitute the electrolyzers plant with the naphtha based plant for manufacture of ammonia. Various sections have been replaced and modernised at the other plants, in stages, which has resulted in improvement in operating efficiency.

## Raw Material Supply

Gas accounted for 32% of raw material (RM) costs in FY96. Despite the proposed expansion of the HBJ pipeline, availability of future gas supplies is uncertain. Liquid fuel (LSHS and fuel oil) accounts for 67% of RM costs in the same year. Though the projected demand exceeds supply in the future, this gap could be compensated by imports.

## Consumption Ratios

The plant efficiency is measured by the energy consumption per ton of ammonia and ammonia consumed per ton of Urea. Table 3 gives the details with respect to various plants:

Table 3 Energy Consumption per ton of Ammonia (Kcal per ton)

Plants	95-96	94-95	93-94	92-93	91-92	90-91
Nangal	13.1	13.5	13.29	13.57	13.76	15.96
Bhatinda	12.3	12.1	12.2	12.7	12.6	15.6
Panipat	12.3	12.2	12.3	12.2	12.2	15.30
Vijaipur	8.2	8.2	8.3	8.2	8.02	8.09

The reduction in consumption ratios is reflected in the falling energy levels in the Nangal, Bhatinda and the Panipat plants. The ammonia consumption at Nangal units is higher than the industry average, while in the remaining units, the norm is just above average, leaving room for improvement.

## Manpower

The total staff strength in the company is 6,721, with the officers to staff ratio of 1.15:1. Overstaffing at Nangal is, to a certain extent, accounted for by the multiple product streams and vintage technologies. Vijaipur's staffing levels are comparable to private sector plants. There has been an increase in manpower from 6,081 in 1993 to 6,721 in 1996, despite a freeze on filling up vacancies. This is mainly due to commissioning of new capacities. Only 500 persons were recruited for 1997 Vijaipur expansion. Overall, NFL's manpower costs are higher than other comparable companies.

## Marketing

In the controlled scenario, NFL is protected due to firm allocation of markets. The advantages of the markets allocated to the company are:

- high irrigation intensity
- net importers of Urea
- major contributors to wheat and paddy output
- hinterland location

The company is weak in certain areas of marketing.

- NFL's brand image is relatively weak due to poor prill quality. Its brand "KISAN" faces competition from Chambal, KRIBHCO and IFFCO in its key markets.
- There is no concept of umbrella branding as NFL does not supply the whole range of farming inputs like seeds, pesticides etc.
- Hold on the private trade is weak. The company sells only 20% through private channels, as against the all India average of 31%. Past company policy has not encouraged sale through private channels owing to risks in defaults and compulsory trade through co-operatives in some states.
- Lack of aggressive marketing policies attributable to the PSU environment.

These weaknesses would place it at a disadvantage against nimble private sector players in a free market. However, the price competitiveness of NFL in the newer plants would ensure that it does not lose market share in the medium term. With increase in the capital outlay on the older plants, this advantage would get eroded.

NFL undertakes trading in DAP and Urea and has been a handling agent at the Bhavnagar port for the various Indian canalising agencies. In the third quarter of 1995, NFL was made a canalising agent for the import of Urea. As a consequence, NFL entered into an agreement with M/s Karsan for the supply of Urea without adhering to prescribed systems and procedures. As a result, the company has still not received any shipment

till date, despite having made an advance of Rs. 133 crores. An international arbitration case is pending between NFL and M/s Karsan to resolve the dispute.

## Financial Analysis

The financial performance of the company over the last five years is shown in the table below :

Table 5 Financial Performance (Rs. crores)

	FY 97*	FY 96	FY 95	FY 94	FY 93
Operating Income	1435.5	1515.6	1440.5	1355	1219.5
Operating Profit	145.1	202.5	280.5	245.7	231.3
Profit after Tax	111.9	54.0	121.9	389.1	111.4
Equity Capital	490.6	490.6	490.6	490.6	490.6
Tangible Networth	1205.9	1325.9	1272.1	1199.2	859.2
Gross Margin (%)	10.1	13.36	19.47	18.14	18.97
Net Margin (%)	7.78	3.57	8.46	28.72	9.14
ROCE (%)	3.19	7.00	15.2	14.2	15.6
RONW(%)	9.28	2.85	9.19	30.79	11.06
Earnings per Share (Rs.)	2.28	1.1	2.5	7.9	2.3
Dividend (%)	-	-	10	10	5

\* Provisional

In the period FY 92 - FY 96, factors driving growth in revenue were increases in capacity utilisation, price increases under RPS and the extent of ECA allocation. The low growth in the operating income on a year-to-year basis during the last five years has been in line with industry trends.

The material, power and employees account for approximately 75% of the total costs. While the increase in the material costs has been adequately covered by the RPS, the rise in power, employee and selling costs have not been fully covered. High levels of staffing at the Nangal plant and regular annual wage increases beyond the 5% norm have adversely affected the profitability. Selling costs and secondary freight are higher than the freight subsidy under RPS, again affecting profitability. As a consequence,



profitability as measured by gross and net margins have shown a decline over the past five years.

The other profitability indicators, RoCE and RoNW, do not compare favourably due to poor operating profitability and large sums blocked in capital work-in progress (Vijaipur expansion). These are expected to improve in the future as the new expansion goes on stream and enhance profitability.

The operating profitability of NFL is significantly lower than the comparable producers, since more than 50% of its capacity based on vintage liquid fuel plants.

Due to a large equity base, the Earnings Per Share have been quite low.

## Strengths and Areas of Concern

### Areas of Strength

*Strong Business Position* : NFL's plants have been set up in the seventies and are well depreciated. As a consequence, NFL is competitive even compared to gas based fuel plants. In the event of decontrol, the company would not face any major threats, from imports as the location of consumers deep in the hinterland would result in high freight costs, thus giving a degree of protection.

*Access to Markets* : The primary markets of NFL are Punjab, Harayana, and Madhya Pradesh, whose size is nearly Rs. 2800 crores, which is roughly about half of the total Urea market in the country. The area under food grains as a percentage of total cropped area is high (60-73%) in NFL's key markets. In relative terms, these crops tend to consume higher levels of Urea. In addition, a third of NFL's markets are not exposed to the vagaries of the Indian monsoon. The food grains are produced in irrigated lands and this provides some degree of stability to the consumption patterns of Urea.

*Bright Demand Prospects* : Urea is a crucial input in replenishing the nitrogen content in the soil. As per the Ninth Plan Working Group, even if Urea prices were to rise by 30%, the demand growth would still be in the region of 7% p.a.

## Areas of Concern

*Vintage Plants* : The three plants of NFL at Panipat, Nangal and Bhatinda are based on fuel oils and employs technologies which are dated (late seventies). These plants are at the fag end of the their working life and this is a cause for concern.

*Weak Marketing* : Inspite of assured access to key markets, the company is weak in certain areas of marketing. NFL's brand "Kisan" is relatively weak due to its poor prill quality and faces competition from Chambal, KRIBHCO and IFFCO. There is no concept of "umbrella branding" as NFL does not supply the entire range of farming inputs like seeds and pesticides.

*Karsan Deal* : Though the company has already made provisions, the outcome of the international arbitration case pending between NFL and M/s Karsan would have substantial bearing on NFL's valuation.

## Recommendation

The Commission, in its First Report, had classified NFL as non-core according to which Government disinvestment could exceed 51%. The classification was again reviewed in the course of the study of NFL for disinvestment and the majority of members felt that NFL should continue to be classified as non-core. Dr. Nanjundappa, one of the members of the Commission, however, held a different view for reasons given in his note of dissent, which is appended to this Report (*Appendix A, Page 71*). The other members of the Commission thereupon discussed the matter, in the light of Dr. Nanjundappa's observations. While fully agreeing with Dr. Nanjundappa's views regarding the importance of the agricultural sector for the Indian economy, they wre of the view that NFL should continue to be classified as non-core for the following reasons :

Transfer of ownership and management to a strategic buyer in NFL will not adversely affect the supply of Urea to agriculture; it would, in fact, enhance its availability to the agricultural sector and hence would better serve the interest of the farmers.

A point has been made in the Note of Dissent that there should be confidence among the Indian farmers that there is a giant fertiliser producer

like NFL in the public sector. The majority of members, however, felt that the confidence of the farmers would be sustained by Government ensuring adequate availability of fertilisers produced, both in the public and private sectors, and making it available at suitable prices.

The Urea industry in the country is dominated by the private and co-operative sector as can be seen from the table below.

Table 6 Share of Various Players in Supply of Urea (1996-97)

	Capacity (mtpa)*	Production (mn ton)	Share in Prodn.	Share in Supply
<b>Public Sector - of which</b>	<b>7.53</b>	<b>4.73</b>	<b>30.3%</b>	<b>26.4%</b>
NFL	2.81	2.02	13.0%	11.3%
RCFL	1.91	1.48	9.5%	8.3%
FCI	1.28	0.47	3.0%	2.6%
HFC	0.88	0.32	2.0%	1.8%
FACT	0.33	0.24	1.5%	1.3%
NLC	0.15	0.12	0.8%	0.7%
MFL	0.18	0.08	0.5%	0.5%
<b>Co-operative Sector-of which</b>	<b>3.80</b>	<b>3.46</b>	<b>22.2%</b>	<b>19.3%</b>
IFFCO	2.34	1.92	12.3%	10.7%
KRIBHCO	1.45	1.54	9.9%	8.6%
<b>Private/Joint sector-of which</b>	<b>6.53</b>	<b>7.43</b>	<b>47.6%</b>	<b>41.4%</b>
Indo Gulf	0.73	0.67	4.3%	3.7%
Tata Fertiliser	0.74	0.95	6.1%	5.3%
Chambal Fertiliser	0.74	0.87	5.6%	4.9%
Duncans Industries	0.68	0.72	4.6%	4.0%
Nagarjuna Fertilisers	0.50	0.72	4.6%	4.0%
GNFC	0.59	0.65	4.2%	3.6%
SPIC	0.51	0.62	3.9%	3.4%
Zuari Agro	0.28	0.34	2.2%	1.9%
SFC	0.33	0.40	2.6%	2.2%
GSFC	0.37	0.35	2.2%	1.9%
MCF	0.34	0.34	2.2%	1.9%
OCF	0.73	0.80	5.1%	4.4%
<b>TOTAL PRODUCTION</b>	<b>17.86</b>	<b>15.62</b>	<b>100.0%</b>	<b>87.0%</b>
Imports		2.33		13.0%
<b>TOTAL SUPPLY</b>		<b>17.95</b>		<b>100.0%</b>

\* Million Tonnes Per Annum

- The market structure in the urea segment is competitive, as a number of companies have emerged in the private and co-operative sectors in addition to the existing capacities of the public sector. NFL's share is only 13.0% in the Urea production in India and 11.3% of total supply of Urea. Thus the market contestability has increased significantly when compared to the contestability levels at the time when NFL was set-up.
- In addition, urea is a well-traded commodity in the international markets. In the event of any shortage in the domestic supplies, Urea can be imported by the canalising agencies and this acts as a stabilising factor on the price factor of urea.

As can be seen from the above table, 13.0% of the total supply is met through imports. Current international Urea prices, at below US\$ 100 per ton, are substantially low as compared to the domestic retention prices.

The country is expected to remain a net importer of Urea in the foreseeable future, as per the estimates of the Ninth Working Group on Fertilisers, which is given below.

Table 7 Projected Demand-Supply of Urea in India (Million Tons)

Year	Demand	Production	(Deficit)/Surplus
1997-98	23.0	17.5	(5.5)
1998-99	24.9	18.8	(6.1)
1999-2000	27.3	20.7	(6.5)
2000-01	29.9	25.4	(4.5)
2001-02	32.6	26.1	(6.5)

- The Government has set-up a committee under the chairmanship of Shri Hanumantha Rao to review fertiliser sector policy. The committee is yet to submit its report. However, given the importance of urea, Government control on the prices and distribution of this fertiliser, whether produced domestically or imported, could be expected to continue in the foreseeable future. If these controls are likely to continue, Government ownership of production facilities of the commodity is neither necessary nor justified.
- Currently, under the retention pricing mechanism for urea, there is no distinction made between public sector and private sector. Retention

price for urea is fixed for each unit separately on the basis of normative cost of production of that unit besides equated freight being fixed for each unit. All raw material cost and increases are covered on an actual basis. Hence the transfer of ownership in NFL does not have any adverse impact on supply of Urea in the agricultural sector so long as the Government fixes the output prices.

Thus viewed from the production, supply and price angles, no public purpose will be served by NFL continuing in the public sector.

An analysis of NFL also reveals that the access to right technology is a key success factor, especially in a decontrolled scenario. In three of its plants, NFL's operations are based on fuel oils and employs technologies that are quite out-dated. This has affected the capacity utilisation as well as consumption ratios, which in turn have affected profitability. In fact, the operating profitability of NFL is significantly lower as compared to its competitors, since more than 50% of its capacities are based on vintage fuel plants. The company has initiated measures to revamp its technologies for which it has internal resources. For expansion programmes, estimated to cost Rs. 1,300 crores, sources of funds are yet to be identified. Given its fiscal constraints, Government would be hard put to provide these resources.

The Commission has evaluated the various modalities of disinvestment and is of the view that a public offer of the shares of NFL upto 49% may not enable Government to get optimal value. In general, the stock markets in India have traditionally given a low price-earnings multiple as far as fertiliser stocks are concerned, as the performance of these companies is dependent on monsoons as well as continuation of Government subsidies. On the other hand, the induction of a strategic partner with management control would not only get better value for Government shareholding but would also enable the company to have increased access to funds, markets as well as technology.

**The Commission therefore recommends, by majority view, that Government should sell a minimum of 51% of the its current holding to a strategic buyer with transfer of management control. A strategic buyer is expected to pay higher price for management control of the company and Government proceeds could thus be maximised. In order**

**to enhance investor interest in the company, Government should spell out a long-term strategy on the retention pricing mechanism to be followed by Government. Such an announcement will also help to maximise proceeds from disinvestment.**

**The strategic sale should take place after the Karsan dispute is resolved. The Government should take steps for quick resolution of the arbitration case pending between NFL and M/s Karsan to avoid any delay in the strategic sale.**

**After the induction of a strategic buyer and completion of on-going modernisation programmes, Government could eventually disinvest its balance holding in NFL through a public offer of shares to domestic institutions and retail investors. Apart from broadbasing the shareholding, the second tranche of disinvestment will also enable Government to realise higher value on a per share basis.**

**The procedure for appointing Financial Advisors for the strategic sale is outlined in the First Report of the Commission. This restructuring should be also be done prior to the strategic sale in order to enhance share value as well as investor interest in the company.**

## *Appendix A to National Fertilisers Limited*

*Minute of Dissent Recorded by Prof. D M Nanjundappa, Part-time member*

In the course of the discussions based on a draft report on National Fertilizers Limited (NFL) on 05 March 1998 a proposal to disinvest not less than 51 per cent of the equity of the NFL to a strategic buyer was made to make this major public sector undertaking more efficient and competitive in the fertilizer market. It was in need of both additional funds for both financial and technological restructuring. Of the four members including the Chairman and myself, three (excluding me) were of the view that Government of India need not own more than 49 per cent or in the alternative the disinvestment may begin with 20 or 30 per cent and then depending upon the development, which in the ultimate analysis can lead to a minority share for Government of India. I was, however, unable to persuade myself to agree with this majority view. I am, therefore, recording my minute of dissent as follows:

2. NFL is a major public sector undertaking in agriculture-related sector. Agricultural foundation of the Indian economy is not strong. Investment in agriculture is on the decline and there is deceleration of capital formation in agriculture. More over, agriculture was neglected in the earlier plans and the recently released Draft IX Plan seems to have accorded high priority to agriculture, realising its importance both for food security and employment generation for the increasing work force. The potassic and phosphoric fertilisers have been decontrolled and urea is not yet decontrolled. The retention price mechanism is helping the domestic private sector fertilizer units to get a subsidy to meet the gap between its production cost and sale price fixed by Governments. Likewise, NFL the major fertiliser producer in the public sector is getting the benefit of subsidy. Imported fertilisers are also subsidised to keep the price at a reasonable level.

3. Fertiliser consumption per hectare is still very low in several States compared to the national average of around 120 kgs. And the higher like 165 kg. or so per hectare. Higher prices of P & K have already led to lower offtake and a further reduction of their use. Consequently, consumption of N has increased resulting in a totally imbalanced and destructive fertiliser mix. For maintaining productivity, fertilizer is an important input and the farmers cannot be expected to buy fertilizers of an ideal mix like 4:2:1 when

agricultural markets are highly imperfect. This apart, the farmers produce more only to get less or lose more money in the absence of appropriate market arrangements for storage or export. In recent years, the price cash has hit the farmers most in several commodities, like sugarcane, onion, potato, tomato, groundnut, etc.

4. India, being a predominantly an agricultural economy, cannot depend upon import of fertilisers or production of fertilisers in the private undertakings which may have an important share in the Indian market. It is also noted that there are some fertiliser units in the co-operative sector. However, what is very crucial is that an agriculturally predominant economy must have a strong and assured supply of fertilizers at prices commensurate with low prices of foodgrains and other farm output. This is all the more imperative when the public distribution system meant for vulnerable sections and low inflation depends upon the procurement of foodgrains from the farmers at more or less half the market price. As stated earlier, agricultural markets are the most imperfect ones and an important key input like fertilizer cannot countenance uncertainty and vigorous competition from private sector units either in the domestic market or overseas units which are functioning in a totally different type of an economy where agricultural sector contributes hardly 3-5 per cent of the GDP. In contrast, in India, agriculture accounts for nearly 33 per cent of GDP and yet supports nearly 65-68 per cent of the population. The future scenario could be that while agricultural sector's contribution to GDP may decline to about 18 or 20 per cent, the population/work force depending upon it would certainly not decline in that proportion. On the contrary, it would continue to be the source of livelihood / employment for still 60 or higher per cent of the population.

5. Industry has enjoyed high protection until very recently and this has discriminated against agriculture which is yet to be given the status of an industry from the view point of resources, concessions, costing, pricing and exports. While a large number of financial and other institutions of national scale have been set up in this country to promote industrial development, similar institutions did not exist in adequate numbers in the past for agriculture and it continues to be so even now. Even NABARD came into existence rather very late and is still wanting in comprehensiveness. Karnataka gave the lead in its agricultural policy announced in 1995, which gave set up, inter alia, a separate Agricultural Finance Corporation. This has since been accepted by the Government of India and NABARD has



sponsored such special financial institution for agriculture exclusively in two or three States. Further, on the supply side, fertilizer, seeds, credit and the like have still been creating problems for the Indian farmers. Either the quality of the seed is poor or the quality of fertilizer is poor or both are in short supply more often than not. In such a scenario, in my view, an agriculture-related public sector major undertaking like NFL should be allowed to fully develop and play even a global role like any one of the other Navarathnas. What is most needed is that NFL should have professional management, and full autonomy as recommended by the Disinvestment Commission in its earlier report and also its capital and technological base must be restructured. As budgetary support of the order needed would not be possible, resources can be mobilised by selling upto 49 per cent of equity to domestic or foreign investors including small investors and employees. The holding of a majority share like not less than 51 per cent would give a 'commanding' position for this undertaking to support the agricultural foundation which should be made stronger to achieve a higher growth rate of the Indian economy. If the Government has a majority stake, the confidence of the farming community can be sustained and equity of NFL can be expected to be absorbed widely by them also. A new and much needed instrument of tapping rural savings is likely to become very attractive to agricultural community. In so far as NFL has established itself already, it should be possible for it to grow further. Government of India should treat this as a strategic sector undertaking in so far as agriculture is the backbone of the Indian economy. Unlike some other PSUs, NFL has both production and distribution linkages. At any point of time, there should be confidence among the Indian farmers that there is a giant fertilizer producer like NFL in the public sector in India to meet their fertilizer needs and the farmers need not be fear any threat of manipulations generally attributed to the private sector as its aim is profit maximisation only, rejecting social responsibility and social justice to the poor farming sections of society. It is logical and necessary corollary that Indian Agriculture must have a strong companion, a supplier of fertilisers, in the public sector. Together with some revamping of NABARD, NFL's development as a National undertaking will complement the institutional agricultural framework.

6. A point was also made during the discussions that agriculture is in the private sector and, therefore, logically NFL should be in the private sector by reducing Government of India's equity share to a low level like 26 per

cent. This argument is somewhat fallacious. Because, private sector in agriculture is totally different from the type of private sector structure noticed in industry and other related service areas. The small and the marginal farmers and landless agricultural labourers cannot be exposed to vagaries and merciless moves under imperfect competitive market conditions. The majority of the farmers who are poor and constitute the weaker sections of society have already been further marginalised in the post 1991 liberalisation era.

7. Resources required can certainly be mobilised by disinvesting upto 49 per cent, the proceeds being remitted to the Disinvestment Fund, as recommended by the Disinvestment Commission in its earlier report. This can support the strengthening of NFL. Government both Central and States, should meet a portion of extra budgeting needs of NFL. In short, I strongly feel that there should be a major public sector undertaking producing fertilizers and in an export-led economy with a strong agricultural foundation, NFL can and should become a global player and an exporter of fertilizers, which aspect is presently of least interest either to the domestic private sector or to the foreign fertilizer producing companies. Their eyes are all glued to the tremendous and assured market available in India.

8. NFL should be treated as 'core' enterprise and be retained and fully developed in the public sector. It has exhibited its potential in the past few years and given the autonomy, professional management and funds, there is no reason why NFL should fail to earn and retain a prominent place in the national and global fertiliser market, notwithstanding its integration into the global economy. I would, therefore, conclude that NFL may disinvest upto 49 per cent and not less than 51 per cent of equity should be continued to be owned by the Government of India, thereby having an absolute majority interest in ownership and management.

D.M. Nanjundappa

New Delhi  
09 March 1998

## 2.6 Neyveli Lignite Corporation Limited

### Evolution

The Neyveli Lignite Corporation Limited (NLC) was set up as a private limited company in November 1956, when the Government of Madras invited the Government of India to set up the project, due to the high investment requirements. It was converted into a public limited company in March, 1986. NLC is an integrated complex located in Neyveli comprising two lignite mines, two thermal power stations, a fertiliser plant based on oil / Low Sulphur Heavy Stock (LSHS) and a Briquetting & Carbonisation plant. NLC has the first lignite based thermal power station in South East Asia and also the first pit head thermal power station in India.

The equity capital of NLC as at 31st March, 1996 was Rs. 1,797 crores. The Government holds 94% of the equity and the balance is held by Financial Institutions/ Mutual funds/ Banks and employees.

### Industry Analysis - Lignite Mining

Lignite is a fossil fuel formed over a long period of time from the breakdown of organic materials, primarily plants. Vegetable matter undergoes bio-chemical decay to the stage of peat and then metamorphoses to lignite due to high pressure of the soil above, high temperature, floods, movements of the earth's crust and dehydration. The subsequent stages are sub-bituminous, bituminous and anthracite. When the pressure on lignite increases further, it becomes denser and less volumetric, thereafter transforming into coal.

The total lignite reserves in the country, as of 1996, are estimated to be 26 billion tonnes as shown in the table below:

Table 1 Estimated Geological Lignite Reserves in 1995-96 (Mn Tonnes)

Sl.No.	State	Area	Reserves
1.	Tamil Nadu	Neyveli	3,300
		Jayakonda Cholapuram	1,150
		Mannargudi	18,200
		East of Veeranam	1,340
2.	Pondicherry & TN Bahur		585
3.	Rajasthan		1,020
4.	Gujarat		465
5.	Jammu & Kashmir		90

As evident from the above, the lignite reserves are mainly concentrated in Tamil Nadu and Pondicherry, accounting for 94% of the total reserves.

The occurrence of lignite reserves in Neyveli first came in 1934. The 3300 million tonnes of proven reserves are spread over an area of about 480 sq. kms. Out of this, about 2 billion tons are considered mineable. Lignite found in Neyveli possesses a calorific value of 2500 - 2800 kilo calories/kg, moisture content of 45-55% with 2-9% ash content.

In India, lignite mining was started by NLC. Gujarat Minerals Development Corporation (GMDC) is the only other organisation involved in lignite mining in India.

Coal and lignite mining is, presently, open to private enterprises for captive consumption, but not for free sale in the market. Government has invited bids for lignite mining at Jayakondam, with an estimated reserves of 1.15 billion tons for captive consumption. A total of 27 parties have shown interest in this project. Gujarat Industries Power Corporation is implementing a 420 MW lignite based power plant in Surat District. Barsinger (Rajasthan) lignite mining cum power generation project has been awarded to Hindustan Development Corporation.

### Industry Analysis - Power

Power is one of the most vital infrastructure inputs for the economic development of an economy. Even though the power generation capacity

has grown substantially from 1,362 MW in FY 97 to 83,288 MW in FY 96, India still faces acute energy shortage of about 9% and peak power shortage of 17%. The generation of power from various sources as at March, 1996 are as under:

Table 3 : Installed Power Generating Capacity by Source

Source	Generation (MW)	% Age Share
Thermal	60,087	72
Hydel	20,976	25
Nuclear	2,225	3
Total	83,288	100

Out of the total generating capacities, 64% are owned by the State Governments while 32% are owned by Central Government. The private sector's share is minuscule with only 4%.

Increasing the generating capacity has primarily been the responsibility of Government, with a relatively small contribution from the private sector. The actual capacity addition during the Eighth Plan has been approximately 17,375 MW as against the approval for a capacity addition programme of 30,538 MW. The Central Electricity Authority (CEA) has projected an additional capacity requirement of about 57,000 MW for 1997-2002, given the 9% percent estimated annual growth rate in demand. Against this, the current annual addition is only about 3,500-4,000 MW.

Till 1991, the only five private utilities originally licensed under the 1910 Electricity Act were Bombay Sub-urban Electric Supply Company Limited (BSES), Tata Electric Companies (TEC), Ahmedabad Electricity Company Limited (AEC), Surat Electricity Company Limited (SEC) and Calcutta Electric Supply Company (CESC). However, in FY 92, the Electricity Supply Act was amended to allow entry of private sector generating companies. Since then a large number of private sector power companies are implementing generation projects.

### Business Analysis

NLC is currently operating two lignite mines. Mine-I has a capacity of 6.5 million tonnes of lignite production and is spread over an area of 16.69

sq. kms, with reserves of about 287 million tonnes. The first mining block is being expanded to include additional reserves of about 100 million tonnes covering an area of 9 sq. kms. The capacity utilisation of Mine-I has been more than 100% and expansion of the mine capacity from 6.5 million tonnes to 10.5 million tonnes is underway. In case of Mine-II, project Stage-I of 4.7 million tonnes of lignite was commissioned in 1985. The second stage of Mine-II was commissioned during FY 93. The current installed capacities and production of both mines are as under :

Table 4 Capacity utilisation and Production of Mine-I and Mine-II

	FY 97	FY 96	FY 95	FY 94	FY 93	FY 92
<b>Mine-I</b>						
Installed Capacity (Mn tons)	6.50	6.50	6.50	6.50	6.50	6.50
Production (Mn tons)	7.28	7.27	6.71	6.14	6.50	8.11
Cap. Utilisation (%)	112	111	103	94	100	125
<b>Mine-II</b>						
Installed Capacity (Mn tons)	10.5	10.5	10.5	10.5	6.80	4.70
Production (Mn tons)	10.7	9.94	8.70	8.00	6.80	4.43
Cap. Utilisation (%)	102	95	83	76	100	94

Almost 85% of the lignite mined by NLC is used in power generation. Only about 1 million tonne of lignite mined is used in Briquetting & Carbonisation (B&C) plant. The lignite, after meeting the internal requirements of power and B&C plant is sold to cement, paper and other industries.

Table 5 Lignite Consumption in 1995-96 (million tons)

Production	17.2
Consumption	
Power Plant	14.9
B & C Unit	1.0
Open Market Sale	1.3

NLC has two thermal power stations viz. Thermal Power Station-I (TPS-I) and Thermal Power Station-II (TPS-II). TPS-I consists of 6 units of 50 MW each and 3 units of 100 MW each, aggregating a total capacity

of 600 MW. These were commissioned between 1962 and 1970. The entire power from TPS-I, after meeting NLC's requirements, is fed to Tamil Nadu State Electricity Board, which is the sole beneficiary. Expansion of TPS-I capacity from the present 600 MW to 1,020 MW by adding two units of 210 MW each, at a capital cost of about 1,600 crores, was sanctioned in FY 96. The expansion is scheduled to be complete by FY 2002.

TPS-II was implemented in two stages. Under Stage-I, three units of 210 MW each were commissioned between 1986 and 1988. Under Stage-II, four units of 210 units each were commissioned between March, 1991 and June 1993. The total installed capacity of TPS-II is 1470 MW. Initially, the plant load factor was low due to stabilisation phase and the presence of ferrous sulphide in lignite from the second mine cut area. After meeting the internal requirements of NLC, TPS-II supplies power to the Southern States of Andhra Pradesh, Tamil Nadu, Karnataka, Kerala and the Union Territory of Pondicherry.

The pricing mechanism followed for lignite at NLC is tied up with the pricing of power. The transfer price of lignite to power division is based on fixed return of 12% on mining investment at normative (85%) capacity utilisation of the mines.

The fertiliser plant of NLC was commissioned in 1966 with an installed capacity of 1.52 lakh tonnes of urea. The plant was designed to utilise raw lignite for production of synthesis gas but the feedstock was converted from lignite to fuel oil in 1979, as the plant could not reach the capacity due to operational technological constraints. The capacity of the plant was derated to 1.24 lakh tonnes. The fertiliser plant's cost of production is exorbitantly high when compared with the retention price fixed by the Government. The retention price fixed for the company is Rs. 6540 per tonne of urea while the cost of production is Rs. 9363 per tonne. The company is planning for the modernisation and revamp of the fertiliser plant. The total cost of revamping of ammonia and urea plant is estimated at Rs. 60 crores.

The B&C plant was commissioned in 1966 with an installed capacity of 3.27 lakh tonnes of coke per annum. It finds application in electro-chemical and electro-metallurgical industries, in the tea sector as a fuel

for drying and in cement and paper industries as a substitute for coal, furnace oil, coke and charcoal. The B&C plant is currently a loss making division and during FY 97, the divisional loss was Rs. 10 crores. Currently, lignite is transferred at Rs. 302 per tonne. On assuming transfer at market price (currently about Rs. 600 per tonne), sales realisation of coke will barely cover lignite cost and losses will then go up to Rs. 40 crores.

NLC has a total workforce of 21,369 as on April, 1997 (25,014 as on March 1992). Out of these, 12,955 number of employees are engaged in direct operations while 8,414 number of employees are engaged in central and common services.

### Future Plan

The company is currently pursuing Mine-I expansion of 4 million tonnes and TPS-I expansion of 420 MW. During Ninth Plan, the company plans to invest about Rs. 4,230 crores in various modernisation and expansion programmes. The details of capital expenditure programme for the next five years are as follows:

Table 6 Capital Expenditure Programme 1998- 2002 (Rs. crores)

	FY 98	FY 99	FY 2000	FY 2001	FY 2002
TPS-I Exp.	152	870	472	282	152
Mine-I Exp.	263	708	322	214	195
TPS-I LEP	100	50	-	-	-
Others	75	75	100	100	100
Total	590	1703	894	596	447

The company has arranged two foreign currency loans for meeting part of its capital expenditure programme.

### Financial Analysis

The financial performance of NLC for the past five years is indicated in the table below :



Table 7 Financial Performance

(Rs. crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Operating Income	1377	1311	1113	834	680
Operating Profit	665	659	550	420	360
Profit after Tax	317	293	193	134	93
Equity Capital	1797	1797	1797	1713	1617
Tangible Networth	3347	3021	2736	2575	2361
Gross Margin (%)	48.3	50.3	49.4	50.4	52.9
Net Margin (%)	23.0	22.3	17.3	16.1	13.7
ROCE (%)	8.2	9.9	7.8	6.2	6.1
RONW(%)	9.5	9.7	7.0	5.2	3.9
Earnings per Share (Rs.)	1.76	1.63	1.07	0.78	0.58
Dividend (%)	-	-	-	-	-

The sales and profits have increased from Rs. 545 crores and Rs. 102 crores respectively in FY 92 to Rs. 1,311 crores and Rs. 293 crores respectively in FY 96. The company has reinvested the surplus generated in business in working capital and in retiring loans. The gross margin remained in the region of 50% while the net margins improved from 18.7 in FY 92 to 22.3 in FY 96.

As mentioned above, NLC's fertiliser and B&C divisions are incurring losses, while the profits are generated by power division. The division-wise profitability of NLC in FY 96 is as follows:

Table 8 Division-wise financial performance

(Rs. Crores)

	Power	Lignite Trading	Fertiliser	B&C	NLC Total
Sales	1093	83	68	69	1313
Operating Profit/(Loss)	615	47	(10)	(28)	624
Profit/(Loss)	265	47	(10)	(29)	272

The company has huge receivables from the State Electricity Boards (SEBs). The outstanding dues receivables from SEBs as at 31st March, 1997 stood at Rs. 976 crores out of which about Rs. 100 crores is outstanding for more than three years. The company's turnover to debtors ratio is also high and as at 31st March, 1997, the sales to debtors ratio was 75%.

## Strengths and Areas of Concern

### Strengths

*Fully integrated operations* NLC is the only power generating company which also produces the fuel for power generation. The company is self sufficient in terms of all the resources required for the generation of power.

*Generating cost of power* With the pit-head supply of lignite, the cost of generating power is fairly low. Its capital related charges are low as it has the advantage of depreciated plant and machinery. The tariff for sale of power from TPS-I was 80.25 paise/kwh for FY 96. The power tariff for FY 96 for TPS-II was 78.35 paise/kWh and 132.37 paise/kWh for Stage-I and Stage-II respectively.

*Efficient plant operation* In FY 95, the average all-India PLF was 60%. In NLC's case, however, TPS-I, despite being over 30 years old, achieved a PLF of 70% in FY 96. TPS-II is over a decade old and achieved a PLF of 70% for the same period.

*Process and Technology* NLC employs continuous mining system bucket wheel-excavator-conveyor-spreader. It has a high degree of mechanisation and employs specialised mining equipment.

*Position in Industry* NLC enjoys a status equivalent to a one-man industry as far as lignite mining is concerned. It is the pioneer, leader and virtually a monopoly player in lignite mining-cum-power generation.

### Areas of Concern

*Dues from SEBs* The arrears pending from various SEBs were 761.32 crores as on 31.3.96 and rose to Rs. 976 crores by 31.3.97. NLC is only able to realise approximately 85 percent of sales.

*Dividend Record* NLC has not paid any dividend since inception. It will be difficult to attract investors to the company due to the òno dividendö track record. The dividend policy has not been reconsidered after the first round of disinvestment.

*Equity Base* NLC has an equity of Rs. 1,796.78 crores as of 31st March 1996 against a profit of Rs. 287 crores for 1996-97. The equity is too high to enable servicing in line with market expectations.

*Loss making Units* The B & C plant also made loss of Rs. 10 crores in 1996-97. The fertiliser plant made losses of almost Rs. 30 crores in 1996-97. These plants suffer from high input consumption and poor energy efficiency. The fertiliser plant size is uneconomic as compared to most other fertiliser plants and this leads to losses.

*Land Acquisition* Acquisition from local inhabitants for mining is a major operational problem.

*Pollution control* In developed countries like Germany, all plants like NLC's B&C plant, have been closed due to stringent pollution norms. In light of the ageing plant and obsolete technology, stringent pollution norms would have an adverse bearing on NLC's B&C plant viability.

### Options on B & C

As brought out in the above analysis, B & C plant is a loss making unit due to the old technology and low operating efficiency. The options available to the government regarding B & C unit of NLC can be summarised as :

Table 9 Options on the B &C Unit of NLC

Option	Course of Action	Financial Impact	Remarks
1	Continued operations as a division of NLC	<ul style="list-style-type: none"> <li>Continued annual losses (Rs. 10 cr for 1996-97, on the basis of present transfer pricing)</li> </ul>	The losses are expected to increase in future due to increased cost of mining.
2	Strategic sale after revival	<ul style="list-style-type: none"> <li>Sale proceeds net of the cost of revival</li> <li>Saving of the annual losses</li> </ul>	Finding a buyer for the unit may prove to be difficult due to the environmental and efficiency issues.
3	Closure	<ul style="list-style-type: none"> <li>One time payment on account of VRS</li> <li>Benefit due to lignite supply being diverted to ST-CMS</li> <li>Saving of the annual losses</li> </ul>	A well conceived VRS could receive good response.

## Recommendation

Earlier, the Commission has dealt with, in detail, the Power Sector scenario in India in its Recommendations on NTPC and NHPC in the Fifth and Sixth Reports respectively. The Commission had pointed out that power tariff reforms were crucial in increasing market contestability as well as improving balance sheet and enhancing share value of NTPC, NHPC and POWERGRID which had been proposed for disinvestment. These reforms should be primarily aimed at improving the rates of return of projects in the public sector when compared with the new projects in the private sector and should precede disinvestment. The Commission had highlighted that till tariff reforms are completely in place, it may be desirable for the public sector to play an important role in the power generating segment.

While the Commission reiterates classification of NLC as "Core", it is also evident that there is scope for value enhancement of NLC shares by tariff reforms and by resolving the matter of outstanding dues from the state electricity boards. Any disinvestment at this stage will lead to poorer realisation to the exchequer due to undervaluation of NLC. The company has a relatively unfavourable receivables profile (when compared with other power generating companies) with past dues from SEBs accounting for as much as 75% of the annual sales of the company.

On the above grounds, the Commission recommends that there should be no disinvestment in NLC, presently. The matter could be taken up in the future, as and when the power tariff reforms take firm shape.

Since any disinvestment in the short term can be ruled out, the Commission recommends that the company could use this interregnum to restructure and initiate steps for eventual disinvestment which would also enhance share value.

In spite of NLC being an integrated producer of power - unlike other thermal companies which source coal externally - the backward linkages have not really conferred any significant operating advantages primarily due to a lack of focus in the operations of the company.

NLC's Briquetting and Carbonisation (B&C) plant was conceived to exploit lignite as a feedstock in the sixties and currently employs about 1000 people.

This plant suffers from high input costs and poor energy efficiency. The B&C plant has adverse environmental problems as the unit was designed to the environmental standards of the sixties. The revival of the plant requires significant investments. Given the resource requirements of the core business of NLC, the Commission is of the view that the upgradation of the technology could be handled by a strategic buyer. **After studying the various options for Government regarding B & C unit, the Commission recommends that the B&C plant be hived off into an independent company and offered to strategic buyers. In case the new buyer of the B&C unit wishes to continue the operations with lignite as a feedstock, NLC could enter into arrangements with the buyer for supply on a long-term basis. In case the buyer is provided the lignite at the present transfer price, there may be more investor interest in the B&C unit.**

**However, if there is no investor interest in the B&C division, Government as a prudent investor may have no option but to dispose off the assets and close down the operations of this unit.** In such a case, NLC would be able to reduce its losses on account of the transfer price to B&C unit. This would be partially offset by a one-time cost of VRS to the B&C employees.

The analysis of the manpower staffing reveals that a significant number of employees in this division are aged above 45 years and a well conceived VRS could receive good response. The funds required for this purpose could be provided from the proposed Disinvestment Fund. Alternatively, NLC could set-up a sinking fund for this purpose which could be funded by internal accruals.

NLC's fertiliser plant was also conceived to exploit lignite as a feedstock in the sixties. It currently employs about 1,300 people. This plant suffers from high input costs and poor energy efficiency. Consequently, the feedstock was changed from lignite to fuel oil. The fertiliser plant is incurring losses, even under the RPS mechanism for urea. The urea plant has uneconomic size and requires substantial investments to match the capacities of the modern plants, which are being set up currently. Given the resource requirements of the core business of NLC, the Commission is of the view that the upgradation of the economic size of the plant could be handled by a strategic buyer. **In order to enable modernisation, the Commission recommends that the urea plant be hived off into an independent company and offered to strategic buyers.**

**However, if there is no investor interest in the fertiliser plant, Government as a prudent investor may have no option but to dispose off the assets and close down its operation. The analysis of the manpower staffing reveals that a significant number of employees in these divisions are aged above 45 years and a well conceived VRS could receive good response. The funds required for this purpose could be provided from the proposed Disinvestment Fund. Alternatively, NLC could set-up a sinking fund for this purpose which could be funded by internal accruals.**

Apart from these two divisions, NLC has surplus manpower when compared with its peers. The Commission recommends that NLC should initiate labour restructuring exercise in its core business of lignite mining and power generation along the following lines:

- **A pension-cum-insurance scheme as an option to a one-time payment should be given to the employees who are not professionally qualified. An outline of the scheme has already been given by the Commission in its Fourth Report.**
- **In case of land oustees who are proposed to be employed by NLC on a compassionate basis, Government would save significantly by adopting a lumpsum payment scheme rather than perpetuating unproductive employment.**
- **Career counselling should be provided on alternate options available for employees who are professionally qualified.**

The Commission has also studied the administrative reporting arrangements of NLC. Currently, NLC is under the administrative control of the Ministry of Coal. The company is engaged in mining lignite, apart from a small portion used by B&C plant and direct sale to nearby industries, solely for generating power. Even after selling 1.5 million MT lignite to ST-CMS in future, more than 80% of lignite would be used in-house for power generation. Hence power generation would continue to be the company's core business with SEBs being the major customers.

**The Commission, therefore, recommends that Government should transfer the administrative control of the company to the Ministry of Power with immediate effect.**

**Government has conferred some autonomy on NLC in its package announcement for medium sized PSUs. While this is a welcome step, given the nature of its problems, this may not be sufficient. The Commission therefore recommends that NLC should be conferred autonomy on the lines suggested by the Commission in its First Report for Moderate Performers.**

## 2.7 Steel Authority of India Limited

### Evolution

Steel Authority of India Limited (SAIL) was established in 1973 as a holding company for managing the following six companies which were engaged in the business of minerals and metals

- Hindustan Steel Limited (comprising Bhilai, Durgapur, Rourkela and Alloy Steel Plants)
- Bokaro Steels Limited
- Salem Steels Limited
- Hindustan Steelworks Construction Limited (HSCL), Bharat Coking Coal Limited (BCCL), National Mineral Development Corporation Limited (NMDC).

In 1978, the steel making subsidiaries were dissolved and merged into SAIL while others were spun off as independent companies. Thus, SAIL became a fully integrated, iron and steel maker, producing both basic and speciality steels. The company's products are used by the domestic construction, engineering, power, railway, automotive and defence industries, and for sale in the export market. The company accounted for 45% of the domestic production of crude steel in India and ranked 9th largest globally in 1996.

In 1992, SAIL was one of the first PSUs Government took up for disinvestment. SAIL stocks were listed on major Indian Stock Exchanges after the first round of disinvestment. In March 1996, the company completed a USD 125 million GDR offering and got listed on the London Stock Exchange. The equity base of the company as on March 31, 1997 stood at Rs. 4130.44 crores. The Current share holding pattern of SAIL is as under :



Table 1 Share holding Pattern as on 31 December 1997

Category	No. of Holders	% Holding
Government of India	1	85.82
Financial Institutions	7	5.17
NSDL ( Dematerialised)	1	3.60
GDR Holders	1	3.30
FII's	44	0.95
Individuals	151825	0.71
Banks/ Mutual Funds	42	0.37
Domestic Companies	619	0.08
Total	152540	100.00

### Industry Analysis

As in most countries, the steel industry in India is divided into two principal categories: the integrated steel plants of which presently there are seven; the midi and mini-mills, which include among other types of manufacturing units, approximately 180 electric arc furnace units producing a variety of steel products using scrap metal and sponge iron. Older mini-mills in India are generally smaller and produce mostly generic steel products, while the newer and more modern mini-mills are generally larger and their product mix is generally weighed towards higher value added steel products. Currently, with the exception of TISCO, all integrated steel plants are Government owned entities. In FY 97, approximately 70% of the total domestic crude steel production came from the integrated steel plants and the midi and mini- mills collectively accounted for approximately 30% of total domestic crude steel production.

Historically, Indian iron and steel industry was heavily regulated through pricing and distribution controls. However, as a part of the New Economic Policy of the Government in 1991, steel industry was one of the first to be deregulated. Following deregulation, private sector capacities were permitted into the sector and pricing and distribution controls were removed.

The production and consumption of steel in the country has gone up significantly in the past few years. Even though much of the domestic demand is met out of domestic production, India imports around 5-7% of

its total consumption. Similarly, the indigenous producers are also exporting small quantities of steel produced. The following table gives the production and consumption of steel in the past five years.

Table 2 Production, Consumption of Finished Steel (Mn tons)

	FY 97	FY 96	FY 95	FY 94	FY 93
Production	22.7	21.40	17.82	15.20	15.20
Imports	1.70	1.54	1.63	1.01	1.04
Exports	1.60	1.28	0.92	1.02	0.74
Consumption	22.80	21.66	18.53	15.19	15.50
Growth in consumption over last year	5.3%	16.9%	22.0%	(2.0)%	

Aggregate consumption of steel in India has increased substantially, but in terms of per capita consumption, the current level at 26 kg is very low, when compared with the world average of 150 kg.

Two major product segments for steel products are long and flat. Long products are used primarily in construction industry and for infrastructure whereas flat products are principally used in the manufacture of capital goods and consumer durables.

### Flat Product Segment

In the overall flats segment, SAIL had a dominant position in the early 90's. In FY95, Hot Rolled (HR) coils, sheets and skelp were the largest amongst SAIL's product category, both in terms of sales volume and revenue. Later due to increased competition from both domestic as well as imports, the sales realisations have declined.

Table 3 Overall Flats Production Statistics

('000 Tons)

Year	Integrated Steel Plants					Secondary		Total Production	Apparent Consumption
	SAIL		TISCO		Total	Sector			
	Vol.	%	Vol.	%	Vol.	Vol.	%	Vol.	Vol.
FY 97	4,780	43%	1,342	12%	6,122	5,084	45%	11,206	11,553
FY 96	5,250	50%	1,203	12%	6,453	3,956	38%	10,409	11,024
FY 95	5,016	63%	751	9%	5,767	2,227	28%	7,994	9,190
FY 94	4,979	71%	405	6%	5,384	1,621	23%	7,005	7,479

The competition in the flats segment is presently intense. HR coils/sheets are either sold directly or further processed to Cold Rolled (CR) coils/sheets. At present SAIL, TISCO, Essar Steel and Lloyds Steel together manufacture around 9.65 MT. of HR coils. Imports account for another 1 million tons. In the CR segment, which is a downstream facility, though SAIL accounted for about 60% of the domestic capacity in 1994-95, its estimated market share was in the range of 43%. By 1996-97 the estimated market share reduced significantly to 32%. Further, due to commissioning of new capacities, there is going to be an oversupply scenario in the medium term. Another factor influencing competition is dumping of HR/CR products by the CIS countries.

Till recently, SAIL was the only integrated steel manufacturer of Galvanised Plain (GP)/ Galvanised Corrugated (GC) sheets with a majority of CR manufacturers in the secondary segment being GP/GC manufacturers. Oversupply in the HR sector could result in increase in the number of integrated manufacturers or commissioning of additional CR capacity which could lead to an oversupply in this segment also.

### Long Product Segment

Structurals, bars and wire rods are used in industries ranging from construction, fabrication and wire manufacture. Bars and rods account for nearly 31% of the total steel consumption in India in volume terms. The secondary sector dominates the bars and rods market. Though SAIL has a high captive share in heavy structurals, the share is much lower in the overall structurals segments which includes light and medium structurals. This is another segment in which the secondary segment has a strong

presence. Growth in the industrial segment and opening up of various sectors like power, oil exploration, refining, port development etc. to the private and foreign investors is expected to fuel demand for long products in the long term. SAIL being the largest producer in this segment is expected to perform well. Traditionally, the Government has been the major buyer in the longs segment. Further, private investment in infrastructure sector hasn't really taken off. Growth in this segment has been depressed on account of reduced off-take by the Government.

Table 4 Longs Production Statistics (‘000 tons)

Year	Integrated Steel Plants							Secondary Sector		Total Production	Apparent Consumption
	SAIL		TISCO		RINL		Total	Vol.	%	Vol.	Vol.
	Vol.	%	Vol.	%	Vol.	%	Vol.				
FY 97	2,296	20%	666	6%	1,452	13%	4,414	7,100	45%	11,206	11,553
FY 96	2,164	18%	630	6%	1,340	12%	4,134	6,860	38%	10,409	11,024
FY 95	2,209	24%	621	7%	969	10%	3,799	5,505	28%	7,994	9,190
FY 94	2,152	26%	567	7%	666	8%	3,385	4,810	23%	7,005	7,479

The longs segment was characterised by a large number of manufacturers with small capacities. However, the high power tariffs, increase in steel scrap prices and the recession in the country led to the closure of several uneconomic small units. Decrease in demand coupled with the increase in production capacity has led to a surplus in the longs segment and consequently have affected the prices of long products. Further, long products fetch lower realisations as compared to flat products due to lower value addition.

## Business Analysis

SAIL is the largest integrated producer of steel in India and has a wide product range which includes flats, longs, semis, pig iron and special steel products like electrical sheets, galvanised sheets, tinplates and pipes.

SAIL produces iron and steel at four integrated steel plants and two speciality steel plants located principally in the eastern and central regions of India and situated close to domestic sources of raw materials, including the Company's iron ore, limestone and dolomite mines. The capacity and production of these units are given below:

Table 5 Capacity and Production for FY 97

('000 tonnes)

Steel Plants	Capacity		Production	
	Crude Steel	Saleable Steel	Crude Steel	Saleable Steel
<b>Integrated Steel Plants</b>				
Bhilai Steel Plant (BSP)	3925	3153	4187	3582
Bokaro Steel Plant (BSL)	4000	3156	3644	3046
Rourkela Steel Plant (RSP)	1802	1225	1240	1180
Durgapur Steel Plant (DSP)	1800	1586	1245	1093
<b>Total</b>	<b>11527</b>	<b>9120</b>	<b>10316</b>	<b>8901</b>
<b>Special Steel Plants</b>				
Alloy Steel Plant (ASP)	246	183	248	201
Salem Steel Plant (SSP)	-	175	-	133
<b>Total</b>	<b>11773</b>	<b>9478</b>	<b>10564</b>	<b>9235</b>

Bokaro Steel Plant (BSL) is India's first integrated steel plant with 100% basic oxygen furnace (BOF) steelmaking technology producing a wide range of flat products. The unit has embarked on a modernisation programme which involves the setting up of continuous casting facilities in its second steel melting shop (SMS) and upgradation of its Hot Strip Mill (HSM) and is scheduled to be commissioned by FY 1998.

Bhilai Steel Plant (BSP) is the first Indian integrated steel plant to adopt continuous casting techniques. BSP essentially manufactures long products like bars and rods, structurals, rails, plates, and other semis. It is currently the only domestic supplier of rails to the Indian Railways. The unit has performed commendably on critical techno-economic parameters and operated at high capacity utilisation levels.

Rourkela Steel Plant (RSP) is the second of SAIL's flat products plants. Its products include plates, HR coils, CR coils, galvanised sheets, pipes and semis. In order to restore the operational viability of the unit, SAIL had taken up large scale modernisation programme for the unit. The modernisation of facilities is likely to be complete by FY98 which will increase the crude steel capacity to 1.9 mtpa. After modernisation, 87% of steel will be produced by continuous casting methods.

Durgapur Steel Plant (DSP) manufactures predominantly long products. DSP also manufactures railway products such as wheel & axle etc. Due to ageing of the plant & machinery, DSP has been less efficient in operational terms in comparison to the other units. DSP has undergone a massive modernisation programme. The prime focus of the modernisation was in the feed preparation (sinter plant) and steel making (BOF shop) stages. However, after the commissioning of the project in the first quarter of 1997, there have been significant improvements in energy consumption efficiency and productivity.

At the Alloy Steel Plant (ASP) also located in Durgapur the product mix consists of higher value-added products, including carbon alloys, tools and stainless steel grade. ASP markets its products to the defence, railways, energy, automobile and petrochemical and machine tool industry. ASP uses the power intensive electric arc furnace (EAF) technology. The plant's electric arc furnaces are smaller than the minimum economic size capacity.

The Salem Steel Plant (SSP) is the largest supplier of wide stainless steel cold rolled coils in India. As it does not have a steel making facility, SSP sources slabs from ASP.

SAIL products are marketed and distributed through a Central Marketing Organisation with 42 Branch Sales Offices, 37 Stockyards and 14 Consignment Agencies spread throughout the country. SAIL also exports around 5-6% of its total turnover. The principal products exported by SAIL are mild steel plates and semis particularly continuously cast slabs. SAIL has developed markets in China, Japan, USA, UAE, Canada, Europe, Australia and in the South East Asian regions.

The primary raw materials required for the manufacture of steel are iron ore, coal/coke, limestone and dolomite. Since raw materials account for a significant component of steelmaking costs, the availability of major raw materials in the desired quantity and quality is critical. SAIL meets most of its iron ore, dolomite and limestone requirements from the captive mines. The company is thus fairly comfortable as far as sourcing of all raw materials other than coke is concerned. This places it at a natural advantage as compared to most of the new players, both in terms of assured availability as well as on account of lower costs. TISCO too has similar advantages. SAIL sources coking coal from Coal India Limited (CIL) to the extent of around 53% with the balance through imports. The indigenous

coal contains higher ash and in order to have a proper mix, SAIL imports a part of its coal requirements. SAIL has captive power plants at most of its manufacturing facility supplying upto 55% of overall requirements. The rest is met from State Electricity Boards.

In India, most of the integrated steel plants (ISPs) have been set up in the late sixties and early seventies and accordingly, operations are primarily labour intensive both in the case of the public and private sector units. However, with the development of technology and mechanisation and automation of operations, the high workforce became redundant and inefficiencies crept in. ISPs are attempting to restructure their labour in order to cut costs and remain competitive.

SAIL is having a total employee strength of approx. 1,83,000 out of which over 1,25,000 are located at its manufacturing facilities. The large workforce and nature of technology in various units have adversely affected labour productivity which has remained very low (94 tons / man-year) compared to international standards (350-400 tons / man year).

With labour costs accounting for around 15-18% of the cost of sales, the effectiveness of this workforce rationalisation exercise would be crucial for the long term stability of the ISPs specially in view of the potential competition from the new units employing state of the art technology and limited workforce. Around 34,000 personnel are due to retire from SAIL within the next five years, which should augur well for the company.

## Subsidiaries

SAIL has taken over the following companies as its subsidiaries :

Table 6 SAIL's Subsidiaries

Year	Subsidiary	SAIL's ownership
1979	Indian Iron and Steel company Limited (IISCO)	100%
1986	Maharashtra Elektros melt Limited (MEL)	95%
1989	Visvesveraya Iron and Steel Limited (VISL).	60%*

\* 66% as at March 1996. Subsequently, SAIL took over 100% equity in March, 1997

MEL and VISL primarily manufacture ferro-alloys used in steel industry and special steels and are small in comparison to IISCO.

## The Indian Iron & Steel Company Limited (IISCO)

IISCO was a private sector sick company, the management of which was taken over by Government through the IISCO (Taking Over of Management) Act, 1972. The Government acquired the outstanding shares in IISCO in 1976 through a Nationalisation Act and transferred the same to SAIL in 1979, thus making it a 100% subsidiary of SAIL. IISCO is an integrated steel plant located at Burnpur with a foundry and cast iron spun pipe plant at Kulti. It has three captive collieries and two captive iron ore mines. IISCO employs around 29000 people to run the above facilities.

Due to ageing plant and machinery, IISCO continued to incur losses. A number of attempts to modernise its facilities were made since 1977, but no investment decision could be taken mainly due to resource constraints. Public Investment Board (PIB) in 1991 suggested to the Ministry of Steel (MoS) to explore the possibility of private participation in IISCO modernisation and then approach the Cabinet to seek final approval for the project. MoS constituted a Committee of Experts (CoE) to obtain and evaluate offers, to initiate discussions with the offering private parties and to recommend a suitable private party to participate and finalise terms of participation. However, in view of the provisions contained in the Parliamentary Legislation enacted at the time of take-over and Nationalisation of IISCO, a Bill to amend the Act to enable transfer of shares to private persons was introduced in the Parliament in December, 1993 but it encountered all round opposition at the introduction of the Bill itself. Hence the bill was withdrawn and referred to the Department-Related Parliamentary Standing Committee. In the meantime, IISCO was referred to BIFR under SICA.

Currently, Government is considering a revival plan involving a total capital outlay of Rs. 2107 crores to be taken up by SAIL and simultaneous conversion of the equivalent amount from SDF loan of SAIL to capital reserve without any tax liability. In addition, accumulated losses of IISCO (including unprovided liabilities) would be written off by corresponding write off from SDF loans of SAIL. This will involve cash infusion by SAIL to the extent of Rs.2107 crores which will have to be raised by SAIL from the market.

Pending investment for modernisation, IISCO continues to incur losses. The accumulated losses of IISCO as on 31st March, 1997 are Rs. 1431 crores (inclusive of unprovided liabilities of Rs. 270 crores). In the absence of



any support from Government of India, SAIL has been providing financial and other support to IISCO to meet their losses and minimal capital expenditure to keep the operations continuing, which SAIL finds increasingly difficult. SAIL's net financial stake in IISCO is about Rs. 1150 crores (excluding Government loans routed through SAIL and interest accrued thereon totalling to Rs. 333 crores). Under the current market conditions, the losses of IISCO are likely to increase and are estimated to be about Rs. 250 - 300 crores per year.

## Financial Analysis

The financial performance of SAIL for the past five years is given below:

Table 7 Financial Performance

(Rs. crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Gross Sales	14131	14710	13867	11671	10175
Operating Profit	2458	2712	2397	1820	1821
Profit after Tax	515	1319	1108	545	423
Equity Capital	4130	4130	3986	3986	3986
Tangible Net Worth	7998	7937	6556	5663	5272
Gross Margin (%)	17.4	18.4	17.3	15.6	17.9
Net Margin (%)	3.6	9.0	8.0	4.7	4.2
ROCE (%)	17.2	22.9	18.5	22.3	20.2
RONW (%)	6.4	16.6	16.9	9.6	8.0
Earnings per Share (Rs.)	1.25	3.30	2.78	1.37	1.06
Dividend (%)	2.5	6.4	6	4	2

Gross sales in FY97 were 4% lower than sales in FY96. This is the first instance in the last ten years that turnover had declined over the previous year as a result of slowdown in demand and competitive pressures. Competition from imports as well as the domestic players has affected SAIL's realisations as well as sales tonnage in FY97 in comparison to FY96, which was one of SAIL's best years. Sales tonnage of saleable steel declined by 7% in FY97 over the previous year.

SAIL's main cost heads include materials, stores, employee costs and power and fuel costs. These four heads account for nearly 70-75% of total income.

Material costs as a percentage of total income have increased in FY97 over the previous year on account of the 27% hike in coking coal prices in April and October 1996 respectively. Coking coal accounts for nearly 55- 60 % of the total material costs. Employee costs as a percentage of total income (14.0% in FY97) has been declining over the past five years till, FY97 as labour productivity has been increasing and overall labour strength has been declining. SAIL is partially insulated to power and fuel cost increases, as nearly 55% of the power is met through captive sources and is cost competitive in comparison to power supplied from public utilities. The increase has been significant in FY97, on account of average tariff rise by 25%. However better energy efficiency, as an outcome of the modernisation process, will partially offset this.

The decline in operating margins - gross as well as net in percentage terms in FY97 - reflects material and power cost increase as well as the market conditions which were responsible for lower realisations on saleable steel products.

As SAIL is currently undertaking a massive modernisation programme, the debt equity ratio has gone up significantly. This has risen from a level of 1.81:1 in FY 93 to 2.16:1 in FY 97. One of the major constituents of SAIL's debt is the loan from Steel Development Fund (SDF) which is a peculiar type of debt. The details of SDF is as below:

### Steel Development Fund (SDF)

SDF was set up, in June 1978, through a contribution (determined from time to time) per tonne of iron and steel sold by the integrated producers only (SAIL & TISCO) with the objective of providing funds to steel industry for financing schemes, projects and other capital expenditure for modernisation, rehabilitation, R&D, diversification, renewals and replacements etc. As mentioned above, the contribution was made only by integrated producers and for the remaining producers, the amount equivalent formed part of sales realisation. This fund did not form part of the Consolidated Fund of India.

The SDF was managed by the SDF Management Committee comprising of Secretary (Expenditure), Advisor (Planning Commission) with Secretary (Ministry of Steel) as the Chairman. Out of the fund, loans were given

to the contributors to finance the above mentioned activities. These loans had a 12 year maturity with 4 year moratorium, carrying an average interest rate of about 7%. The half-yearly interest payments as well as principal repayments falling due as per the terms are being rolled back as fresh loan. Hence this fund is being operated on a non-cash basis.

The pricing and distribution of steel was de-regulated in January, 1992. However, the requirement of SDF contribution was discontinued only in April, 1994. Since then, the amount equivalent to SDF contribution formed part of the sales realisation of the main producers. Though the contribution based on steel sold stopped flowing into the fund, the inflows in the form of interest and principal repayments rolled over resulted in increased debt burden on the Company.

Meanwhile, Ministry of Steel is contemplating a partial discharge of the interest and principal repayment in cash (approximately Rs. 200 crores per annum) and its utilisation for R&D expenditure, export promotion, small scale sector subsidy etc.

As on March 31, 1997, the total SDF dues on account of loan and accrued interest, as appearing in the books of SAIL amounted to Rs. 5755 crores. Similarly TISCO had Rs. 1087 crores outstanding as on 31st March, 1997.

## Strengths and Areas of Concern

### Strengths

*Fully integrated facilities* SAIL is a fully integrated company with facilities from raw materials to finished steel products. The company is having 100% captive iron ore mines and 55% of its total power requirement is met through own generation.

*Market Leader* SAIL is the largest steel producer in the country and has dominant market share in all important product segment. It has got a well integrated marketing and distribution network with 42 branch sales offices, 37 stockyards and 14 consignment agencies spread throughout the country.

*One of the low cost producers* SAIL is one of the low cost producer in the country due to its own captive sourcing of iron ore, power generation etc.

*Low operational risk* SAIL has the ability to weather stress created by external environment due to diversified product mix, low cost of production, multi-locational facilities, diversified customer base etc.

## Areas of Concern

*Strained financial flexibility* SAIL financial flexibility is low due to significant modernisation programme ahead, existing debt repayments, high leverage and rising interest burden etc. Funding options are gradually growing narrower.

*Overmanning & increasing labour cost trend* SAIL employs more than 183,000 employees which are far in excess of requirement. All of SAIL's plants suffer from surplus labour. SAIL will have to incur large expenditure to restructure labour and bring at par with their peer companies. Despite natural attrition, labour costs of SAIL have been growing at rate faster than growth of saleable steel realisation. This poses a major threat to cost structures of companies like SAIL with large labour force.

*Poor coal linkages* Coal is one of the principal raw materials used in steel making. SAIL doesn't have its own captive coal mines. Hence it has to depend on domestic monopoly coal company (Coal India Limited) or has to import, which affects its profitability in the event of rupee depreciation or general demand-supply fluctuations.

*Social and other costs* Being a public sector in India, SAIL bears a lot of social costs, such as maintaining townships and other facilities, like schools and hospitals. The annual cost on social amenities is approximately Rs.450 crores. Apart from this, SAIL is funding losses of subsidiaries on an ongoing basis.

*Quality considerations* As a significant part of demand in India will consist of high quality steels (consumer goods), the domestic producers will have to invest in quality or lose out to imports in the process. This is particularly relevant in the HR and CR segments.

*Integration with the international steel markets* The fall in import duties makes Indian steel more vulnerable to international demand and supply, international pricing and also dumping from supply surplus regions.

## Recommendation

As discussed above, SAIL is passing through a difficult phase due to adverse market conditions, arising out of general slowdown of the economy and new project activities, competition from imports and new high technology small and medium private sector steel producers with greater efficiencies, etc. In addition, SAIL is currently in the midst of modernisation of its steel plants at Durgapur, Rourkela and Bokaro at a total estimated cost of about Rs. 12,000 crores. SAIL plans to spend about Rs. 15,000 crores in the Ninth Plan on technological upgradation to bridge the technology gap and to meet the competition. Bulk of these funds will have to be raised from the market, since internal resources will not be sufficient.

SAIL's current high wage cost and debt-equity ratio are significantly higher than its competitors in India and abroad. In addition, the generation of internal resources is currently under stress, due to slowdown in steel demand leading to softening of prices of steel, poor offtake and continuing escalations in input prices. Under these circumstances, SAIL has to mobilise funds from the market to complete ongoing modernisation and future technological upgradation plans. The Company is not in a position to raise funds from the equity market because of very low share prices (currently below par). Raising of funds from debt market would also become increasingly difficult, in view of high debt to equity ratio and the current down grading of SAIL's credit rating.

After a detailed analysis, the Commission is of the view that SAIL has certain structural problems such as substantial fund requirement for technological upgradation, loss making subsidiaries, high manpower costs etc. which may make it difficult for the company to derive full advantage of any future upturn in the industry. Further, it has been perceived that uncertainty of IISCO's revival and potential cash outflow from SAIL on account of SDF will keep the investor interest in SAIL stock down. Any further investment in IISCO by SAIL will have negative implications on SAIL. Under these conditions, it would be difficult for both the Company as well as Government of India to raise funds by selling SAIL's equity shares in the market. It is feared that unless certain measures are taken to address these concerns immediately, the long term financial health of the company will be under tremendous stress. The Commission therefore recommends that Government should not disinvest its holding

**in SAIL presently and should initiate action to address the issues of IISCO and SDF immediately. In this regard, the Commission recommends the following measures to improve the shareholder value, which will ultimately yield higher realisations to Government.**

IISCO cannot be revived in the current form due to huge accumulated losses and outstanding liabilities. In order to enable revival of IISCO, its accumulated losses need to be written off. However, it would not be appropriate to burden SAIL with losses of IISCO because IISCO, as a sick company was taken over by Government and attached with SAIL as its subsidiary. The accumulated losses of IISCO as on 31st March, 1997 were about Rs. 1431 crores (inclusive of unprovided liabilities of about Rs. 270 crores). IISCO has the following outstanding loans which can be waived to enable it to write off its accumulated losses.

**Table 8 IISCO's Loans outstanding (Rs. Crore)**

	<b>Particulars</b>	<b>Amount</b>
1.	Non SDF GoI Loans incl. interest accrued (through SAIL)	333
2.	Direct SDF loans	45
3.	Loans incl. Interest accrued from SAIL (direct)	1022

The government may waive its loan routed through SAIL to IISCO, which will enable SAIL to grant corresponding waiver to IISCO. Similarly, SDF loan to IISCO can be written off. In order to enable SAIL to grant waiver of its direct loans and interest thereon as above, matching waiver of loans of SAIL from SDF should be provided.

**Hence Commission recommends that Government should write off IISCO's losses against (1) Non-SDF Government loan through SAIL (Rs 333 crore), (2) the direct SDF loan to IISCO (Rs 45 crore) and (3) SAIL's loan to IISCO (Rs 1,022 crore). With this, Rs 1,400 crores out of IISCO's accumulated losses of Rs 1,431 crores can be written off.**

The above amounts are based on actual position as on 31 March, 1997 and are likely to undergo changes due to on-going operations upto the date of final decision. Hence actual amounts would have to be determined at the time of taking actions on these measures. This will attract investor interest

in IISCO due to the fact that IISCO's accumulated losses would be wiped out and the company will not have any major liability except the normal bank borrowings.

As discussed above, IISCO is currently under BIFR and a proposal for modernisation of IISCO by SAIL is currently under consideration of Government. As the requirement of funds by SAIL itself is quite substantial, the Commission is of the view that SAIL may not be in a position to raise required funds from the market to finance IISCO's revival. **Hence the Commission recommends that Government should allow SAIL to disinvest majority stake (51% - 100%) in IISCO to a strategic buyer with management control after cleaning up of IISCO's balance sheet as mentioned above. The selection of strategic buyer should be undertaken through a transparent competitive bidding process with pre-qualification of bidders.**

The consideration received by SAIL by selling its stake in IISCO should be utilised for realisation of equity investment of SAIL in IISCO (presently Rs. 375 crores) and the balance can be used for repayment of SDF dues by SAIL.

The revival of IISCO under a joint venture will have significant future impact on SAIL, as IISCO in the current market conditions and operating levels, may incur annual losses of about Rs. 250-300 crores, cash deficits of approximately Rs. 100 crores are being financed by SAIL at present. The proposal for disinvestment by SAIL should be submitted before BIFR. The Government may move suitable legislation, if so required, for facilitating disinvestment of IISCO by SAIL.

SDF is a debt appearing in SAIL's book in the nature of quasi equity since this money was contributed out of the sales realisation by the integrated steel producers. However, being structured as debt, SDF outstanding has an adverse impact on the debt-equity ratio and the profitability of SAIL. As a result, it is difficult for the Company to raise funds either as debt or as equity critically required for completion of current modernisation programme and for future technological upgradation. The total SDF dues as on 31st March 1997 on account of loan and accrued interest as appearing in the books of SAIL amounted to Rs. 5,755 crores. Out of this amount, SDF loans to SAIL amounting to Rs.

1,022 crores will be adjusted as mentioned above, leaving a balance SDF loan outstanding of Rs. 4,733 crores.

**The Commission recommends that SAIL's SDF loan together with interest accrued thereon (after adjustments relating to IISCO sale, as mentioned earlier) should be converted into equity capital in SAIL at a fair price. The fair price could be determined based on book value, current value of assets and future prospects after taking into account the benefits of modernisation and impact of the IISCO sale and SDF conversion. Government may engage services of an outside expert for such valuation.**

Though the recommendations regarding IISCO and SDF are inter-linked, the Commission suggests that the conversion of SDF loan into equity capital of SAIL be taken up immediately as SAIL's financial position needs to be corrected without loss of time, in view of its own requirements of raising funds from the market. As the surplus realisation from IISCO sale after adjustment of SAIL equity investment in IISCO would be used for repaying a portion of SAIL's SDF dues, the actual amount of conversion cannot be determined precisely before completion of IISCO sale transaction. Government may therefore convert a suitable proportion of the SDF dues immediately into equity and the balance may be converted after completion of adjustments relating to IISCO.

The Commission's recommendations will have the following benefits for IISCO, SAIL and Government.

#### *Benefits for IISCO*

- IISCO's balance sheet would be cleaned which will attract private sector investment in its revival with protection of employment for a substantial number of 29,000 employees.
- In the absence of revival, IISCO may have to be closed down resulting in loss of employment to its 29,000 employees.

#### *Benefits for SAIL*

- Drag on SAIL due to IISCO's cash deficits of about Rs. 100 crores would no longer be there and adverse impact on the future of SAIL itself will be avoided.



- The equity investments in IISCO would be recovered.
- SAIL's management time on IISCO could be saved.
- SDF conversion will have the following positive impact.
  - Debt to equity ratio will come down from the current level of 2.2x to about 1.0x. This will improve the debt raising capacity of the company.
  - Interest burden will be reduced with positive impact on net margins. This will improve the shareholders value.

### *Benefits for Government*

- Large funding by Government for revival of IISCO would be avoided and funds thus saved can be utilised for social and infrastructural facilities.
- IISCO's revival, which is pending for a long time, could be achieved expeditiously with protection of employment, contribution to steel production and revenues to the Government.
- The surplus realisation to SAIL from IISCO sale would be used for repayment of part of SDF loan, which otherwise may not be recoverable.
- Government will have a larger number of SAIL shares in exchange for unrealisable SDF loan and will be able to realise better price at the time of future disinvestment of these shares.

SAIL's current manpower strength is quite high when compared with domestic and international competitors. Moreover, labour cost has risen faster than other elements of costs. In order to meet the intensifying competition, reduction of manpower is imperative. Even though about 34,000 employees are retiring in the next five years, Commission feels that SAIL should further reduce its manpower in order to remain competitive. **The company should formulate a Voluntary Retirement Scheme (VRS) in order to reduce manpower. A pension-cum-insurance scheme as an alternative to a one-time payment for the employees can also be thought of.** The Commission has taken note of the VRS recently introduced by the company on deferred benefit basis. **If the company feels the need to implement an alternate**

**scheme involving one time payment to yield desired results, the funds required for this purpose could be provided from the proposed Disinvestment Fund.**

Similarly, in order to improve shareholder value, the Commission has noted the initiatives proposed by the management such as plans to hive off non core assets, spinning off utilities such as power plants and oxygen plants into separate entities etc. which is likely to help the company in releasing resources critically required for its ongoing modernisation and other capital expenditure programmes. This may also help in addressing the concerns about high debt equity and low return on capital employed, which in turn, may have positive impact on shareholder value in the medium term. The Government may provide necessary support wherever needed for carrying out the above measures.

In July 1997, Government conferred autonomy to the Board of the company on the lines of the Navratna category in order to enable SAIL to become a global entity. However, in reality the grant of autonomy has yet to take place as Government has yet to appoint all the non-official directors on the board of the company. **The Commission would strongly urge the Government to expedite this process. While this autonomy is a welcome step, the Commission is of the view that SAIL requires greater levels of financial and managerial autonomy to undertake the restructuring as mentioned above.**

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DISINVESTMENT  
COMMISSION

AUGUST

1998

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# *Part A*



## **1. GENERAL RECOMMENDATIONS**

The Disinvestment Commission has so far submitted seven reports covering 41 PSUs out of 43 referred to it by Government since its formation in August, 1996. The last batch of 10 PSUs out of 43 was referred to the Commission in March 1997. With this final Report covering the remaining two PSUs - Central Electronics Limited and Air India Limited - all the 43 PSUs referred to the Commission have been dealt with. Three more PSUs have been referred to the Commission recently.

In its various reports, the Commission has recommended a broad strategy for disinvestment in the public sector, modalities for the different forms of disinvestment in individual cases and also closure of some PSUs. As a part of this strategy, a number of general recommendations have been made covering the following major areas :

1. Criteria for classifying PSUs into strategic, core and non-core categories with reference to the public purpose served by PSU and the associated limits on disinvestment.
2. Delinking disinvestment from the budgetary process so as to maximise realisations. It was suggested to place the proceeds of disinvestment in a Disinvestment Fund to be used for specific purposes, viz. restructuring of PSUs before disinvestment, VRS benefits to the employees and their retraining, investment in social infrastructure and retirement of public debt.
3. Grant of autonomy to all PSUs in a graded fashion taking account of financial status and post performance.
4. Financial, business and manpower restructuring to enhance the share value.
5. Sale of shares in domestic market including retailing of shares to small investors and PSU employees.
6. Full time machinery for implementing the decisions of Government on disinvestment.

For each of the 43 PSUs referred to it, recommendations on disinvestment have been made taking into account their recent economic and financial performance, their future business and financial prospects, consultations with the management and the concerned ministry and the available contextual options before the PSU.

The Commission has emphasised that the general and specific recommendations should be viewed in totality in order to maximise the benefits of disinvestment.

Most of the general recommendations still await Government decisions. Of the various specific recommendations made by the Commission, one GDR sale has been made in MTNL shares but no sale of shares has been made in India from any of the PSUs so far. Out of the 24 cases for which strategic and trade sales have been recommended by the Commission, Government decisions have been taken with some modifications in respect of only three and even in respect of these three cases, implementation has been slow. The recommendation of the Commission for setting up a full time Implementation Machinery awaits Government's decision.

In view of the present state of the Indian and Overseas Capital Markets, offerings in these markets may not achieve optimum realisation. The Commission, therefore, suggests giving a big push to strategic sales of PSUs recommended by the Commission. At the present juncture, the advantages of such a big push operation for strategic sales are many. They are

1. Since strategic sales depend not on capital market conditions but on the intrinsic value of the concerned enterprises, they can be undertaken straightaway.
2. The response to the offer of strategic sales will send the right signals about the confidence of the international community in the Indian economy. This will also stimulate foreign direct investment in India.
3. Substantial amounts of foreign exchange can be earned to strengthen our foreign exchange reserves.
4. Successful strategic sales will boost the confidence of the Foreign Institutional Investors and induce their increasing support to the Indian capital market. This will also encourage domestic investors. Even the GDR market is likely to pick up as a result of successful strategic sales.
5. Government's realisation from proceeds of disinvestment would be substantial.

In order to realise these benefits, it is not only necessary to expedite decisions on the recommendations of the Disinvestment Commission for strategic and trade sales but also to set up a full time Implementation Machinery as recommended by the Commission.



The terms of reference of the Commission were considerably circumscribed by the Notification of January 1998 by which it was rendered a purely advisory body for issues referred to it. In its VII Report, the Commission had pointed out that the said revision rendered the Commission ineffective and had recommended the restoration of its role in monitoring and supervising the implementation of the disinvestment process, as originally envisaged. There is a clear need for monitoring the disinvestment process and supervising the implementation so as to make it transparent and effective. The Disinvestment Commission is the logical choice for this purpose as it is also the institution for advising the Government on the strategy and procedure of disinvestment through its general and PSU-specific recommendations.

The Commission hopes that Government would urgently address these issues in the present organisation of the disinvestment process so that it becomes an effective means of public sector restructuring and enhancing resources of the Government, both of which are indispensable for rapid economic growth.



*PART B*



## 2. SPECIFIC RECOMMENDATIONS

### 2.1 Air-India Limited

#### Evolution

Air-India (AI) was set up on October 15, 1932, as Tata Airlines, the first scheduled airmail service in India. In July 1946, the company was converted into a public limited company and renamed as Air-India. By the end of 1947, Air-India International was launched for international services, with the participation of the Government of India. In 1952, the Planning Commission recommended nationalisation of the air transport industry. Nationalisation was effected on August 1, 1953 with the creation of two corporations, viz. Air-India for international services (as the nation's flag carrier) and Indian Airlines for domestic services.

**The paid up share capital of AI as on 31<sup>st</sup> March, 1997 was Rs. 153.8 crores and is wholly owned by Government of India.**

#### Global Industry Analysis

Air carriers can be classified mainly into two by the type of operations they offer; scheduled carrier and non-scheduled carrier.

At the end of 1996, there were some 720 air carriers world-wide providing scheduled passenger services (international and/or domestic) and about 70 operating scheduled all-freight services.

In 1996, the total tonne kilometre performed by scheduled services of scheduled carriers was 315 billion. Out of this, passenger traffic accounted for 70% while freight traffic constituted the balance. The total scheduled traffic carried by the airlines of the 185 Contracting States of International Civil Aviation Organisation (ICAO) amounted to about 1,380 million passengers. The shares of two types of passengers in number, available seat kilometre and passenger kilometres flown in 1996 are given below:

Table 1 : Share of Passenger and Freight in 1996

Particulars	International	Domestic
Passenger Carried	30%	70%
Available Seat Kms	56%	44%
Passenger Km. flown	57%	43%

**Although the share of international passengers is lower in numbers, their share is higher in passenger kilometre flown and available seat kilometre, due to relatively longer distances. The average passenger load factor was 69%.**

Demand for air traffic is primarily determined by economic development and consumer spending. Other factors, which have affected traffic demand, include changes in operating costs, availability of air services, regulatory developments and tourism.

Some salient features of the industry are described below:

*Capital intensity* The modern jet aircraft are products of intensive research and commercial application and are hence very costly. This implies that airlines companies should have the ability to mobilise enormous resources for acquisition and maintenance of their fleets.

*Service Orientation* As the basic aircraft gives little scope for product differentiation, airlines are harping on high level of on-time performance, wide network that offers better connectivity, better in-flight services, attractive frequent flyer's programme, superior lounge facilities etc. to attract passengers. Airlines are, thus, dependent on the skills of the flying crew and pleasant behaviour of the cabin crew for attracting and retaining passengers.

*Limited manufacturers* Most of the aircraft are manufactured by two manufacturers: Airbus Industrie and The Boeing company. As a result, basic features like carrying capacity, speed, range and facilities offered are likely to be similar for same type of aircraft operated by different airlines.

*High level of regulation* Operations of the air transport industry are governed by the agreements entered into between countries in which the aircraft are registered. These agreements prescribe the names of the carriers that can operate between the countries, the frequency, seating capacity and rights to pick up and discharge passengers. Countries have to negotiate bilaterally for these rights. Government support is, therefore, essential for the survival of the airline industry.

*High level of concentration* Although there were more than 700 airlines in the world, the top seven (in terms of revenue) accounted for 33% of the total tonne kilometre performed in 1996. Again, approximately 35% of the total volume of scheduled passenger, freight and mail traffic was accounted for by the airlines of the United States. On international services, about 18% of all traffic was carried by the airlines of United States.

*Declining Yield* Despite impediments to open competition, due to government regulations and restrictions on landing slots at key air ports, international airline industry is fiercely competitive. An ICAO study has shown that during the last 35 years, airlines have used advanced technology and management methods for improving productivity of aircraft, labour and fuel and the benefits of higher productivity have been largely passed on to consumers in the form of lower fares and rates, in real terms. This makes it very difficult for airlines with lower productivity and high costs to survive, as falling yield will lead to losses.

*Low margins* In 1996, world's scheduled airlines had an estimated operating profit of US \$12 billion on revenues of US \$282 billion, an operating margin of just 4.3%. An examination of the top 25 airlines in terms of revenue shows that Singapore Airlines had the highest net margin of 14.3%, while Cathay Pacific was second with 11.80% and British Airways was third with 6.60%. The wide difference between the first and third airline is a pointer to the extent to which profits are under pressure in the industry. Operating margins are generally low for a capital intensive industry.

*Tendency to consolidate* Faced with intense competition and falling yields, the major players in the industry are moving towards consolidation through block space arrangements (reservation of certain number of seats in one airline's flight is reserved for sale of another airline), code sharing (seats can be sold by two airlines bearing codes allotted to more than one airline), alliances and joint ventures. In 1996, six major alliances controlled 59% of the revenue, 56% of the fleet, 55% of employees and 60% of total tonne kilometre for the top 100 airlines in the world. Through alliances, the partners attempt to edge out marginal players on different routes.

*Outsourcing tendency* The modern airline is trying to restrict itself to its core competency of transporting passengers and freight from one place to another and outsource activities like ground services, maintenance, catering, cleaning, baggage handling, ticket processing, IT support and hotels. This has enabled many airlines to cut costs, enforce better productivity norms and protect margins.

### *Outlook upto 2000*

With a large number of Governments bestowing greater operational freedom to their airlines, more airlines are likely to respond to market forces to determine the type of services to be provided. Airlines are likely to increasingly resort to alliances and co-operative devices like code sharing to obtain access to new markets, improve existing ones and stymie the competition. Fierce competition is likely to keep revenue yields under

pressure and edge out marginal players, thereby resulting in even more concentration in both domestic and international markets. Those airlines that fail to respond to the market forces are likely to fall by the wayside. The process of private and foreign equity participation in state run airlines has been already set in motion and is likely to gain further momentum as cash strapped governments will find it difficult to extend the necessary resource support to the industry. Privatisation, alliance building, consolidation and outsourcing are the forces that shape the future of the airline business.

## Business Analysis

AI is engaged in carrying passengers and cargo between India and others parts of the world. AI is the designated national carrier under the various bilateral agreements for traffic rights negotiated by Government of India (GOI). The company has 26 passenger carrying and two combi (cargo and passengers carrying) aircraft. AI operates scheduled international flight services over a network of 34 international and 11 domestic stations. It also provides airport handling and engineering services to other airlines at the international airports at Mumbai, Delhi, Calcutta, Chennai and Thiruvananthapuram. It has two fully owned subsidiaries:

1. Hotel Corporation of India Ltd., operating hotels under the 'Centaur' brand name and aviation catering services under "Chefair" brand; and
2. Air-India Charters Ltd., for providing security services to foreign air carriers. Its operations have not been very significant.

AI is predominantly a passenger carrier with over 80% of its revenues coming from passenger traffic. The traffic to/from India is 10 million passenger per annum market and is expected to grow at about 6% pa during the next five years. AI increased its capacity from FY 95 onwards with the phased acquisition of new aircraft and taking aircraft on wet lease. This has resulted in improved capacity utilisation. However, the growth has come at the cost of profitability as is evident from the table given below:

Table 2 : Key Financial Statistics

	HFY98	FY97	FY96	FY95	FY94	FY93
Total Revenue (Rs. Mn.)	17041	32891	31991	27686	23789	22585
Yield per RTK (Rs.)	23.13	21.93	19.89	19.99	21.75	20.63
Growth in Yield	5.48	10.25	-0.50	-8.08	5.43	30.01
Yield per RTK (US \$)	0.65	0.61	0.59	0.63	0.75	0.71
Growth in Yield(%)	5.48	4.04	-6.43	-15.49	6.32	NA
Operm. Costs per RTK(Rs.)	23.60	24.16	20.82	19.03	20.35	17.91
Growth in costs(%)	-2.30	16.04	9.41	-6.51	13.60	25.55
Spread (Rs.)	-0.47	-2.23	-0.93	0.96	1.40	2.72



AI has been operating at negative spreads from FY96 onwards. The improvement in performance indicators for first half of FY98 is more due to seasonal factors. The yield on European and North American sectors is normally higher in the first half due to the busy summer season.

AI's share of traffic to and from India has consistently fallen, from almost 50% about 30 years ago to about 33% in mid – 80s to 22% currently though still the highest. There are around 55 airlines operating to and from India. The following table lists the top few airlines in terms of their percentage market share of traffic to and from India.

**Table 3 : Shares of Various Airlines in the Traffic to and from India**

Airline	Seat/week	% share
Air-India	32078	21.7%
Indian Airlines	16406	11.1%
Gulf Air	8968	6.1%
Saudi Arabia Airlines	7074	4.8%
British Airways	6544	4.4%
Singapore Airlines	5838	4.0%
Lufthansa	5400	3.7%
Emirates	5154	3.5%
Air Lanka	4255	2.9%
Royal Nepal Airlines	3990	2.7%
Kuwait Airways	3492	2.4%
Biman	3323	2.3%
Cathay Pacific	3240	2.2%
Others	41799	28.3%
<b>Total</b>	<b>147561</b>	<b>100.0%</b>

The main reasons for low yields of AI are:

- Inability to attract the high yielding first/business class passengers. The first/business class passenger revenue forms about 11% of the total passenger revenue for AI as against the industry average of about 25%. The data on load factors in the first and business class was not available, but they are unlikely to be high.
- Increasing competition from international airlines on profitable sectors.
- Deterioration of AI's product over the years. The main causes for the deterioration are pathetic on-time performance (about 55%) till FY96, low service quality and limited network on offer.

AI flies about 16-17 routes, out of which only India-Gulf, India-US and India-Japan are major contributors to profit. In FY97, only the Gulf routes were profitable. The overdependence on Gulf and US routes has made AI very vulnerable to competition from foreign airlines in these routes. IA has captured substantial share of the India-Gulf by offering direct connections from various Indian cities to Gulf using its smaller size aircrafts. Routes such as India-Europe, India-Canada has made heavy losses despite many years of operations and decent load factors. The freighter operations have also been incurring losses.

Due to its limited fleet size, AI is often unable to utilise its landing rights immediately on securing the bilateral rights. This automatically allows the foreign carrier to establish leadership on the new route. Also, by the time AI

is ready to deploy an aircraft on the new route, the premium time slots at the destination airport are often not available. This reduces the attractiveness of the new route offered by AI further. The following table shows the summary of Indian entitlements which are unutilised Landing Rights on Routes currently operated/not operated by AI/IA.

**Table 4 : Utilisation of Landing Rights by Air-India**

Routes	Routes currently operated (in seats)			Routes not currently operated (in seats)
	Total	Unutilised	% age	
USA	7140	2760	39	
Europe	28590	19468	68	7850
Russia and CIS countries	2400	2271	95	4865
Africa	3000	1648	55	4500
Gulf	27950	2753	10	6600
Asia/Pacific	18195	6473	36	7100
Neighbouring Countries	31165	20487	66	
<b>Total</b>	<b>118440</b>	<b>55860</b>	<b>47</b>	<b>30915</b>

AI's services are marketed through a network of 78 General Selling Agents (GSAs) world wide. The GSAs are appointed for various regions and are legally the 'agents' of AI in a particular region. In India, AI has three GSAs covering different parts of the country. It also uses a network of 1,306 IATA approved agents to generate sales in India.

Schedule reliability, on-time performance, customer service and network are the main aspects of the product offered by airlines. AI's product has suffered on these counts in the recent past. However, AI is making concerted efforts to improve its product. It has stabilised the schedule of flights, thus increasing the reliability of the product. It has also introduced a performance linked incentive scheme for employees, based on, among others, the on-time performance of the airline. This improved on-time performance from less than 60% before May 96 to above 85% during May 96 to March 97. To improve the network, AI has started code share and joint frequent flyer programme with Indian Airlines.

The steps taken by AI to improve its product are:

- The introduction of 'Maharaja club' and 'The Executive Club' to woo the high yield premium customer.
- A 'Frequent Flyer' programme jointly with Indian Airlines.
- Training its customer contact personnel for providing better service.
- Introduction of additional features such as tele check in and city transport services.

Freight accounted for about 11% of AI's total revenue in FY97. Freight operations have not been AI's strength traditionally and AI has been making losses in this segment. The main reasons for the losses are:

- The 'open skies' policy for freight operations does not extend any protection to Air-India.
- AI has only two cargo aircraft, which severely limits the network of its freight operations. AI is dependent on the cargo originating/destined for India only.
- Global carriers, who have dedicated freighter fleet and operate large networks, often operate in India at marginal costs, thus outpricing AI.

The composition of AI's fleet as on December 31, 1997 is given below.

Table 5 : Aircraft Fleet of Air-India

Aircraft Type	Nos.	Average	Utilisation in 96 (Hrs per day)	Industry Average (Hrs per day)
Boeing 747-200	7	21.0 yrs	4.9	9.6
Boeing 747-300 combi	2	9.2 yrs	5.6	10.1
Boeing 747-400	6	3.1 yrs	9.0	12.2
Airbus 310-300	8	10.6 yrs	6.8	6.8
Airbus 300-B4	3	15.4 yrs	5.5	4.3
TOTAL/AVERAGE	26	12.1 yrs	-	

Out of the seven Boeing 747-200 aircraft, two 26 year old aircraft have been identified as 'surplus' (not being used) by AI. Thus, the real effective fleet is 24 aircraft only. The fleet size of AI is very modest by international standards. Also, delay in aircraft acquisition and disposal decisions have affected the age of the fleet and led to lower operational efficiency and passenger appeal. In the near future, Air-India would have to replace its aged aircraft to improve operational efficiency and control maintenance cost. Such replacement would require substantial funds.

AI's utilisation of Airbus fleet compares favourably with industry averages, but it is quite low for the Boeing fleet.

The comparative cost structure of AI with industry averages is given below:

Table 6 : AI's Operational Performance as Compared to the Industry

	As % of total cost		As % of total revenue	
	Air-India	Industry	Air-India	Industry
Fuel	19%	14%	21%	13%
Staff	17%	23%	19%	22%
Landing Charges	7%	10%	8%	10%
Service costs	11%	14%	12%	13%
Maintenance	9%	9%	10%	9%
Administration	10%	9%	11%	9%
Commission	9%	10%	10%	10%
Lease Rentals	10%	0%	11%	0%
Depreciation	6%	11%	9%	11%
TOTAL	100%	100%	112%	96%

The key components of controllable costs are staff cost, fuel, maintenance and depreciation/lease cost etc. Fuel cost for AI is substantially high when compared with industry due to higher fuel rates in India. Even though the staff cost of AI is lower compared with industry, its productivity is also low. This has prevented AI from taking advantage of the lower staff cost in India.

### Inter-firm Comparison

Although AI is India's national flag carrier, it is a small player compared to other international airlines. Further, its operations are not profitable, as compared to the upswing in the profits of international players, which can be seen from the following table:

Table 7 : Inter-firm Comparison – Operating Performance

	British Airways	Singapore Airlines	Cathay Pacific	Thai Airways	Malaysian Airlines	Air-India
Year ended	31-3-97	31-3-96	31-12-95	30-9-96	31-3-96	31-3-97
Stores, Repairs, Insurance		7	10	8	5	10
Fuel and Oil	10	12	12	11	13	21
Employee Cost	27	14	22	25	19	19
Administrative Expenses		6	5	11		11
Lease Rentals					6	11
Other operating expenses	49	19	21	11	30	20
Selling Expenses		16	9	7		10
Depreciation	6	12	10	14	16	8
Interest on Fixed Loans	2	0	2	6	7	5
Operating Profit	6	14	9	7	4	-15
PAT	7	15	10	4	4	-11

**The above table shows the difference in the efficiency of AI and its peers in South East Asian region and also British Airways Plc. Interestingly, Singapore Airlines (SIA) set up in the early '70s, primarily with technical and personnel support from AI, is arguably the most efficient and profitable airline in the world today.**

The difference between AI and its peer group is more evident when compared on operating parameters as given below:

**Table 8 : Inter-firm Comparison – Productivity**

<b>Airline</b>	<b>British Airways</b>	<b>Singapore Airlines</b>	<b>Cathay Pacific</b>	<b>Thai Airways</b>	<b>Malaysia Airlines</b>	<b>Air-India</b>
<b>Year end</b>	<b>Mar-97</b>	<b>Mar-97</b>	<b>Dec-96</b>	<b>Sep-96</b>	<b>Mar-97</b>	<b>Mar-97</b>
<b>Fleet size</b>	256	80	62	73	93	26
<b>Average Age (Years)</b>	10.1	5.3	6.2	NA	4.1	12.1
<b>Aircraft Utilisation (hrs)</b>	8.5	11.1	11.4	NA	9.3	7.69
<b>RTK in billions</b>	12.73	9.51	7.07	3.94	3.7	1.50
<b>Staff per aircraft</b>	227	341	254	303	170	663
<b>Passenger Load factor</b>	73.2	74.4	72.6	69.4	69.6	65.7
<b>Yield/RTK (US c)</b>	104.07	53.78	59.2	78.6	70.16	61.78

As is clear from the above comparison that AI has many problems, such as small size of fleet, overstaffing, aged fleet, under-utilised fleet, low load factors and low average yields. First and business classes account for about 10% of Passengers and about 25% of the revenue for other airlines. For AI, these classes account for just 11% of passenger revenue, pointing to poor yield management. In fact, even the yield per RTK is on the lower side, when compared with the costs incurred (cost per RTK) by other airlines, as given below:

**Table 9 : Inter-firm Comparison - Yields**

<b>Airline</b>	<b>British Airways</b>	<b>Singapore Airlines</b>	<b>Cathay Pacific</b>	<b>Thai Airways</b>	<b>Malaysia Airlines</b>	<b>Air-India</b>
<b>Year end</b>	<b>Mar-97</b>	<b>Mar-97</b>	<b>Dec-96</b>	<b>Sep-96</b>	<b>Mar-97</b>	<b>Mar-97</b>
<b>Yield</b>	104.07	53.78	59.2	78.6	70.16	61.78
<b>Unit costs</b>	95.69	47.11	52.27	69.11	62.28	73.65
<b>Operational Profit</b>	8.38	6.67	6.93	9.49	7.88	-11.87

## Financial Analysis

The financial performance of AI for the past five years is given below:

Table 10 : Financial Highlights

(Rs. Crores)

	FY 97	FY 96	FY 95	FY 94	FY 93
Operating Income	3539	3427	2983	2588	2436
Operating Profit	-83	79	348	361	475
Profit after Tax	-391	-272	28	202	333
Equity Capital	154	154	154	80	80
Tangible Networth	738	1135	1435	1310	1121
Gross Margin (%)	-2	2	12	14	19
Net Margin (%)	-11	-8	1	8	14
ROCE (%)	-11.1	-6.2	2.7	5.8	16.4
RONW (%)	-41.8	-21.2	2.1	16.6	35.3
Earnings per Share (Rs.)	-25.4	-17.7	1.8	25.3	41.6

The total revenues have grown at a CAGR of about 12.5% in the past five years. The growth in business has been from leased aircraft and new jumbos purchased. In terms of operating profitability, FY 93 was the best year of operations. Operations in FY 94 were affected due to increased interest and depreciation on three newly acquired aircraft and increased competition in the most profitable sector (Gulf) with the introduction of Indian Airlines. Thereafter, deterioration in performance has resulted from various factors such as decline in product quality, erosion in brand equity, intensifying competition in the industry, low share of premium (first and business class) passengers, huge increase in labour and interest costs.

With the declining trends in the operations of the company, AI had to resort to heavy borrowings which resulted in a high debt equity ratio of 4.28 in FY 97 as against 2.3 in FY 96. This has also resulted in significantly high interest coverage of 2.38 times. AI had raised both rupee and foreign currency loans of approximately 800 crores for working capital purposes. Apart from this, AI is having large borrowings through US EXIM Bank guaranteed loans from overseas commercial banks. As a part of these loan agreements, there are some covenants, which put a condition that Government of India will continue to hold majority stake in the equity of AI.

## Strengths and Areas of Concern

### Strengths

*National Carrier* AI is the national carrier and has a network connecting 34 international and 11 domestic stations. AI has strategically concentrated on the ethnic market of Indians living and working abroad.

*Large real estate* AI is having large real estate whose market value is substantially higher than the book value. Its 100% subsidiary, Hotel Corporation of India also has valuable real estate in Mumbai and New Delhi.

### Areas of Concern

*Weak Financials* AI's financial position started deteriorating since FY 95 with steep fall in profits and during FY 96 & FY 97, AI incurred huge losses. This has resulted in large borrowings. Overall gearing ratio, which stood at 1.82 in FY 95 rose to a high of 4.28 in FY 97. In order to meet the operational losses, AI may have to further borrow. This may put AI's financial solvency in jeopardy.

*High Cost of operations* The main operating cost parameters of AI such as Stores, repairs etc. are significantly high when compared with other international airlines. Similarly, the fuel cost is the highest for AI compared with other airlines.

*Small fleet size* AI's fleet size is only 26, which is significantly less when compared with other international airlines. British Airways has 256 aircraft while Singapore Airlines is having 80 aircraft.

*Poor Brand Image* Schedule reliability, on-time performance, customer service and network are the main aspects of the product offered by airlines. Since it is a service industry, only the quality of service will ensure success in business. AI's product has suffered on these counts in the recent past due to which it has lost its business to other airlines.

### Government's Options on Air-India

The analysis of Air-India's business reveals that AI has a very small fleet of 26 aircraft with an average age of 12.1 years. Due to the small size of the fleet, AI is able to operate in very few sectors. The fleet size also doesn't allow AI to offer frequent connections on profitable routes thus, making itself an unattractive airline on the routes. It has been able to utilise 47% of India's total landing rights available through bilateral agreement (together with Indian Airlines). Even with the small size of the fleet, AI has not been able to optimally utilise its capacity.



Air-India's share in the traffic in and out of India is only 22%, which has come down from a level of over 50% in late seventies as AI was unable to expand with the traffic in & out of India.

Over the years, AI's financial performance has deteriorated substantially. AI has been incurring operating losses since FY96. The operating losses incurred by AI during the last three financial years amounted to about Rs. 900 crores. In the past, AI had to borrow heavily to bridge its cash losses, as a result of which its debt to equity ratio has gone up from a level of 1.82 in FY95 to 9.86 as of March 1998. **At the current level of financial performance, AI's networth will be wiped out within the next two years and is likely to turn into a sick company.**

AI's employee base is substantially high as compared to its competitors. The average manpower per aircraft is 700 in case of AI whereas internationally it is only 200-250. The employee expenses can be partially offset by lending technical services to other airlines operating in India and operating the related departments as profit centres. However, an effective solution to the financial problems of AI appears to be an expansion of AI's fleet, to the internationally competitive level, thus utilising the existing manpower efficiently and productively. Additionally, a Voluntary Retirement Scheme can be immediately introduced to initiate reduction in manpower.

Airline is a service industry and is currently witnessing over-capacity due to intense competition. As a result, the various airlines are engaged in consolidation, strategic alliances and privatisation, with an aim of improving their competitive positions. Air-India is today a minor player in the industry with a fleet of only 26 aircraft. Additionally, Air-India being in the public sector has limited operating flexibility restricting AI's capability in improving its competitive position. Moreover, out of these 26 aircraft, 7 aircraft need to be replaced in the short term and would cost approx. Rs. 4,500 crores. Expansion of the fleet would cost roughly Rs. 12,000-15,000 crores.

**Under these circumstances, AI's turnaround assumes importance.** In order to improve its financial performance, AI would have to undertake financial restructuring to reduce its debt servicing obligations. It is understood that Air-India is seeking a revival package from the Government amounting to Rs. 2,000 crores for the following purposes.

- Rs. 1,000 to repay costly working capital loans. The subsequent annual interest savings would be around Rs. 110 crores.

- Rs. 500-600 crores for refurbishment of the fleet and assets
- The balance to offset losses incurred by AI in meeting its social obligations

This infusion is expected to cut its losses, which for the year 1998-99 are expected to be Rs. 340 crores. However, this package would not be sufficient to entirely offset the losses of AI. The continuation of AI's losses, without any significant improvement in the operating efficiency, would necessitate similar repeated financial support in the future.

On the basis of the above analysis, the Commission is of the view that the Government has four options in dealing with AI which are enumerated and evaluated below:

	Option	Financial Implications for GoI	Remarks
1	No financial support by GoI	Nil	AI would turn sick and may have to be reported to BIFR within two years.
2	Continual sustenance support to AI	Rs. 100 crore immediately and regular similar infusion in future	No operational improvement; postponement of sickness by few years
3	Addressing all financial needs of AI including expansion	Rs. 1000 crore immediately, regular similar infusion in future, Rs. 4500 crore for replacement and Rs. 12000—15000 crore for fleet expansion	Even after doubling of fleet size AI continues to be one of the smaller international airlines; uncertainty regarding future performance as AI continues to be a PSU
4	Providing the immediate financial support and induction of a strategic partner	Rs. 1000 crore immediately, offset by inflow through disinvestment	AI benefits from the financial technical and managerial support of the strategic partner, for fleet expansion and improvement in operating efficiency. This will enable AI to be commercially successful in future.

### Option 1

As AI is not likely to bring about significant improvement in its operating efficiency in the short run and with no Government funding, Air-India's financial performance is bound to deteriorate further and AI would become a sick company in the near term. Sickness of AI would result in total dominance of traffic in and out of India by foreign airlines with attendant consequences.

### Option 2

In this option, the Government would have to infuse Rs. 1,000 crores, as per AI's estimates, for immediate correction of AI's financial structure. This infusion would result in interest savings for AI but may not improve its operating efficiency. **Unless AI's operating performance improves substantially, the benefits of financial restructuring would not be sustainable in the medium term and similar fund infusion would need to be repeated at regular intervals, implying recurring and substantial financial burden on the exchequer.**

### Option 3

In this option, the Government not only provides Rs. 1,000 crores, as per AI's estimates, for immediate correction of AI's financial structure but also meets all funding requirements for future losses, fleet replacement/modernisation/ expansion to the extent of about Rs. 20,000 crores. Even after doubling of fleet size, AI would continue to be one of the smaller international airlines and would face uncertainty regarding its future performance as AI would continue to be a PSU with attendant disabilities operating in this globally competitive and service oriented airline industry.

### Option 4

AI is experiencing considerable financial difficulties and is not in a position to fund expansion/ modernisation/ replacement of its fleet from its own resources and hence would have to look for external sources of funds. The owner of Air-India, Government of India, owing to budgetary constraints, is not in a position to provide requisite funds for the expansion. Moreover, for tapping any external sources of funds AI would need to improve its balance sheet by a suitable financial restructuring exercise. In this option, the Government would need to infuse Rs. 1,000 crores, as per AI's estimates, as equity for immediate correction of AI's financial structure and also induct a strategic partner in AI to meet its future financial needs for expansion, modernisation and replacement of its fleet and to enhance its market share. The equity infusion would raise AI's equity to only Rs. 1,154 crores.

It would therefore be necessary to bring in a strategic partner with capability of bringing in necessary financial, management and technical support. Current aviation policy permits foreign equity participation in Indian airline companies upto 40%. However, foreign airlines are not permitted to own equity stake in the domestic air transport services. There are no such restrictions on investment in an international airline like Air-India.

The selection of strategic partner would have to be made after pre-qualification of the bidders, who should be consortia of airlines and investors with at least 25% of the equity brought in by the consortia, being held by Indian investors. Bidders will be pre-qualified on the basis of their financial, technical, marketing and managerial capabilities and commitment for fleet expansion. Selection of strategic partner from pre-qualified bidders would have to be made on the basis of global competitive bidding.

Considering the large fund requirements by AI for replacement, modernisation and expansion of its fleet, the strategic sale should be through the issue of fresh shares providing 40% stake to the partner and diluting the Government holding to 60%.

Out of the Government's equity holding of 60%, Government should thereafter disinvest 20% of the total paid-up equity capital by offering 10% to domestic institutional investors at the price paid by the highest bidder for AI shares and the remaining 10% to the retail investors and employees at a discount. Any shares not taken up by retail investors and employees may be offered to domestic institutional investors. This would eventually bring the Government shareholding in AI to 40%. These sales will also result in partial recovery of funds by Government provided to AI at the time of financial restructuring.

With this pattern of disinvestment, Air-India can continue to be the designated carrier for utilisation of the bilateral treaties for landing rights.

## Recommendation

**In the light of the above analysis, the Commission is of the view that the fourth option discussed above would clearly be beneficial for both the Government and Air-India. This would prevent AI from becoming sick and would turnaround its operations.**

**The Commission therefore recommends the disinvestment in AI as per the following steps:**

- **The Government should immediately provide Rs. 1,000 crores as equity, as per AI estimates, for financial restructuring of Air-India which would raise the paid up share capital of AI to Rs. 1,154 crores.**
- **Simultaneously, initiate process of induction of a strategic partner in AI, on the basis of global competitive bids, through issue of fresh equity shares of the face value of Rs. 770 crores. This would enhance the paid-up equity capital in AI to Rs. 1,924 crores and will reduce**

**Government holding to 60%. The strategic partner should be a consortium of airlines and investors, with at least 25% of the equity brought in by the consortium being held by Indian investors. The selection of strategic partner should be through global competitive bidding among the pre-qualified bidders. The pre-qualification of bidders should be based on their financial, technical, marketing and managerial capabilities and commitment for AI's fleet expansion. A shareholder agreement providing for an appropriate share in the management to the strategic partner would also be necessary.**

- **Government should thereafter disinvest 20% of the total paid-up equity capital by offering 10% to domestic institutional investors at the price paid by the highest bidder for AI shares and the remaining 10% to the retail investors and employees at a discount. Any shares not taken up by retail investors and employees may be offered to domestic institutional investors. This would eventually bring the Government shareholding in AI to 40%.**

Subsequent to the implementation of these steps, Government and the strategic partner would each hold 40% of the equity capital of AI and the remaining would be dispersed among the domestic institutional investors, employees and the public.

Global Advisors may be appointed for assisting in conducting the strategic sale and the offer of sale, as already elaborated by the Commission in its First Report.

While steps are taken for putting through the strategic sale expeditiously, the following measures may also be taken.

1. The maintenance, engineering and ground support operations of AI, which are inherent strengths of AI, could be hived off as a separate companies. In line with the current global trend, this would enable AI to benefit from outsourcing of these services and reduce its overheads.
2. Currently, AI connects major international destinations with all major international airports in India. A well-knit and effective hub and spoke arrangement with Indian Airlines would enable Air-India to provide direct and convenient connectivity with all Indian airports to its customers. For this purpose, there should be a clear demarcation of roles that these two airlines have to play in providing better customer service and jointly competing with other international airlines.
3. A Voluntary Retirement Scheme should be immediately introduced to initiate reduction in manpower.

4. Since airline is a highly service oriented industry, Air-India should initiate steps to improve quality of its service that will help AI in enhancing its market share.
5. In its Sixth Report, Commission had given its recommendations on Hotel Corporation of India Ltd., a wholly owned subsidiary of Air-India. The recommendations included sale of Delhi and Mumbai Centaur hotels as separate units, initiation of dialogue with J&K government for Centaur Srinagar and the decision regarding flight-catering services to be taken by Air-India. AI management should take suitable view on these recommendations while undertaking financial restructuring exercise.

## 2.2 Central Electronics Limited

### Evolution

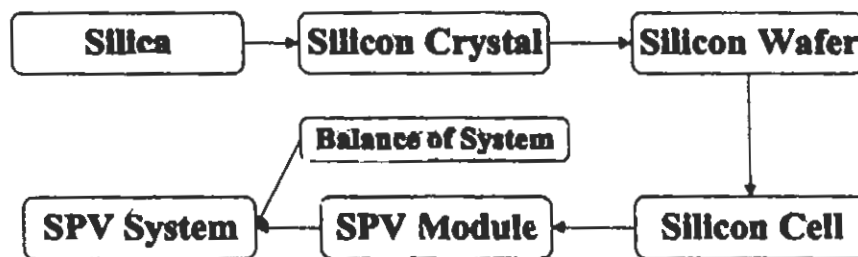
Central Electronics Limited (CEL) is a wholly owned Government of India undertaking incorporated in 1974. As part of the promotion of the non-conventional energy sources, the primary objective of CEL was the commercialisation of the production of various electronic items for which know-how on a laboratory scale had been generated at various national laboratories.

CEL's products include Solar Photo Voltaic (SPV) Systems and Modules, ferrite and electronic components, electronic systems (for Railways), microwave components and communication systems.

### Industry Analysis

Solar energy can be tapped either by a 'solar thermal' (conversion of solar heat to electricity) route or 'Solar Photo Voltaic' (conversion of solar light to electricity) route.

The primary raw material used for SPV cells is silicon, which is the second most abundant element on earth. Various stages of manufacture of crystalline SPV products are depicted below:



Crystalline 'solar grade' silicon wafer, which forms the primary raw material for manufacture of SPV cells, is manufactured from silica (which is present in sand) by a crystallisation process, producing a cylindrical silicon crystal. The middle portion of the silicon crystal is of high purity and is used in the semi-conductor industry, while the lower purity end-portions are sliced into wafers, usually of 4 inches diameter and 400 microns (0.4 mm) thickness. The silicon sold to the semiconductor industry carries higher value as compared to that sold to the SPV industry: the realisations ranging from \$2 per wafer from the SPV industry to \$10 per wafer from the semiconductor industry.

'Balance of system' (BOS) refers to other accessories which go into a SPV system, like inverter, charge controller, battery bank and connecting cables.

Silicon used by the SPV industry is extracted from silicon in a very pure form (with impurities measured in parts per billion). Technologies available for manufacture of SPV cells include Mono-crystalline silicon, Polycrystalline silicon, Amorphous silicon and thin film technologies based on Cadmium Telluride, Copper Indium Di-selenide etc. For commercial solar applications, mono-crystalline silicon technology is the most widely used.

The main advantages of SPV products/systems are the following:

- Environment friendly process of electricity generation.
- SPV systems can last upto twenty years with negligible supervision/maintenance costs, as they have no moving parts.
- Power can be generated in any sunny environment including space and offshore applications, deserts and high altitudes.
- An SPV system can be located closer to the point of usage, reducing the transmission losses and costs.

The main impediment in development of SPV industry has been its prohibitive capital cost. With silicon forming the major portion (over 40%) of the cost of an SPV cell, efforts have been on to reduce the cost of wafers as well as to increase the efficiency of cells. The cost per peak watt of SPV electricity, thus came down from about US.\$100 in early .70s to around US \$4 to 5 at present. The efficiencies (proportion of solar energy converted to electricity) achieved for commercial applications have also moved up from around 10% then, to around 16% now. Scientists in other countries, under laboratory conditions, have achieved an efficiency of 24%. To compete with conventional energy, cost per peak watt has to come down to \$1-\$2 levels.

Despite higher cost of SPV systems, governments all over the world (especially in US, Japan and Germany) are encouraging the use of solar power, by providing subsidies to the manufacturers and/or users. Simultaneously, sponsored R&D efforts are also directed towards increasing the efficiency of the solar cells as well as reducing the cost of the cells by various means (mass production, developing other technologies etc).



Some major SPV global manufacturers and their market shares are given below.

**Table 1 : Major Global SPV Manufacturers**

Name	Country	Market share (%) [1996]
Siemens Solar Industries	Germany	20.7
Solarex Corporation	US	13.4
BP Solar Inc	US	10.9
Kyocera	Japan	7.3
ASE Americas, Inc.	US	4.9
Sharp	Japan	3.6
CEL	India	1.0
Others	-	38.2
Total		100.0
<b>Total world market – 90 MW, valued at \$1 bn</b>		

### Indian SPV Industry

The installed capacity of power from non-conventional energy sources is estimated at 800 MW (1996), about 1% of the total installed capacity of power. The share of SPVs is less than 10% of the installed capacity from non-conventional energy sources.

India by virtue of being in the tropical region has abundant sunlight and is ideally suited for SPV applications. The mean solar radiation is 5.5 Kwh per Sq meter in a day and on an average (for over 300 days in a year) sunshine is adequate. These conditions are considered ideal for successful operation of SPV plants.

Major Indian players in the SPV sector include CEL, Bharat Heavy Electricals Ltd, Bharat Electronics Ltd, Tata BP Solar, Renewable Energy Systems Ltd, Pentafour Solec Technology Ltd, Udhaya Semiconductors Ltd and WEBEL SL Systems Ltd, with an aggregate capacity of about 13 MW.

Table 2 : Inter-firm Comparison

Company	Pentafour Solec Tech.	Renewable Energy Systems Ltd	Webel Si Energy Systems Ltd	CEL
Product Range	Non-conventional energy systems	SPV systems	SPV systems	SPV systems & balance of systems
Gross Sales (Rs. Cr)	32.7	112.4	10.0	60.6
SPV sales (Rs. Cr)	32.7	101.7	10.0	47.8
Staff Strength	250	N.A.	102	870
Salaries (% of Gr Sales)	1.2	1.8	2.9	23.8
PAT (% of Gr. Sales)	12.2	5.2	-3.0	1.0
Capital Employed (Rs. Cr)	27.5	210.9	19.5	46.3
ROCE (%)	25.5	26.3	5.4	9.1

*1996-97 figures except 1995-96 for Pentafour*

Metkem Silicon Ltd (MSL), belonging to the Chemplast group based in Tamilnadu, is the only company in India manufacturing silicon wafers. Only around 20% of the requirement of wafers are met indigenously, while the rest is imported. At present imported wafers are cheaper than the wafers supplied by MSL.

While the institutional segment of users (DoT, ITI, AIR, Doordarshan, etc.) is not subsidised, it is characterised by high competition, the retail segment is heavily subsidised by Indian Renewable Energy Development Agency (IREDA) and state level agencies acting as marketing intermediaries. DoT is the major end user of SPVs, accounting for about 70% of demand in India, at present.

### GOI Policy Framework

The high capital cost of SPV power makes its usage prohibitive, thus making subsidies imperative for its acceptability. The capital cost of one MW of SPV power plant works out to about Rs. 40 crore, about ten times the cost of a conventional, coal-based thermal plant.

IREDA was established as a nodal agency in 1987 for the promotion, development and financing of renewable sources of energy technologies. For accelerated development of Solar Photo Voltaic production, 'socially oriented schemes' involving Central subsidy are implemented through State Nodal Agencies, while the 'market oriented schemes' are assisted through IREDA by providing soft loans.

## Business Analysis

The company has its production facilities and corporate office at Sahibabad (U.P.) near New Delhi and sales offices at New Delhi and Bangalore.

CEL's operations are organised under three major groups:

- i) Solar Photovoltaic (SPV) Group
- ii) Components Group
  - a. Professional Ferrites Division (PRD)
  - b. Electronic Ceramics Division (ECD)
  - c. Microwave Electronics Division (MED)
- iii) Systems Group - Systems Production Division (SPD)

The company achieved a gross sales turnover of Rs. 60.6 crore in FY 97. Percentage share in sales values (including inter-divisional transfers) of different products of CEL for the last five years are summarised as under :

Table 3 : Percentage Share of Various Products in Total Sales

Year ending March 31	1993	1994	1995	1996	1997
Solar Photovoltaic Products	79	75	73	66	80
Microwave electronics	0	2	0	6	6
Professional Ferrites	7	6	7	6	5
Electronic Instruments & Systems	7	8	6	10	5
Peizo Electrical Elements	3	3	3	5	2
Consumer Electronics	3	4	9	6	1
Silver Paste	1	2	2	1	0
TOTAL	100	100	100	100	100
Total Sales (Rs. Crore)	46.6	43.8	43.1	34.2	60.2

### A. Solar Photovoltaic Group

SPV applications are based on the generation of electricity from solar energy. Solar energy initiates a flow of electrons between the two sides of an SPV cell and generates "Direct Current" (DC) electricity. An inverter is connected for "Alternating Current" (AC) applications. Rechargeable batteries are used to store electricity during the daytime, for use in the night, so that power is available throughout the day.

Though CEL has facilities to slice wafers from crystals, it currently procures silicon wafers and manufactures SPV cells, modules and systems. Only 20% of CEL's requirement of silicon wafers are met domestically and the balance is imported.

CEL's main products are :

**Solar Lighting Systems**

- Street Lighting Systems
- Home Lighting Systems
- Solar lanterns
- Community Systems suitable for Powering Lamps and a TV Set
- Solar Water Pumping Systems
- Power Plants of 10 kW and above

**Industrial Applications**

- Off shore well head Platform
- Obstruction warning light at Airports
- Very Low Power TV Transmitter
- Petrol/Diesel Dispensing Stations

**Other Applications**

- Powering Cathodic Protection of Oil/Gas Pipelines
- Railway level crossing Radio warning systems
- Powering of traffic lights
- Illumination of Hoardings, Glow signs, Media for outdoor advertisements

SPV business contributes 79% of total sales (1996-97) of CEL. The SPV industry is highly competitive with a large number of private manufacturers. The operating performance of CEL compares poorly with its competitors. One major factor contributing in this is CEL's large workforce. Salaries as a percentage of gross sales of CEL are 24% while that of its competitors is in the range of 1-3%.

**B. Components Group**

*Professional Ferrites Division (PFD)*

Ferrites exhibit magnetic properties and find applications in power electronics. CEL manufactures 'soft' ferrites for communication, defence and consumer electronics industries. A major part of the ferrites is sold to Original Equipment Manufacturers (OEMs) and a small portion through its dealer network. CEL's market share is estimated to be around 5 to 10% for consumer electronics ferrites and 15% for communication ferrites. All its competitors are in the private sector.

### ***Electronic Ceramics Division (ECD)***

**This division manufactures Piezo ceramic parts and High Alumina Ceramic Products.**

Piezo Ceramic materials are used for manufacture of “transducers” which are capable of converting electrical energy to mechanical energy, and vice-versa, in a highly efficient manner. CEL is the only Piezo Ceramic manufacturer in the country.

Alumina offers high resistance to abrasion, corrosion and chemical deterioration and is characterised by high mechanical strength and high temperature resistance. CEL has developed alumina compounds called ‘CELAL A’ and ‘CELAL B’, which are used for manufacture of crucibles for high temperature applications like glass melting, calcination and sintering.

ECD obtained as ISO 9000 certification in Nov 1997.

### ***Microwave Electronics Division (MED)***

Microwave Ferrite Phase Shifters and Phase Control Modules are used in radars to track enemy missiles as soon as they are launched. MED supplies Phase Shifters to Electronics Research & Development Organisation and Frequency/Phase correlators to Defence Electronic Research Laboratory.

CEL has also developed an advanced Direction Finder (DF) system to track high speed aircraft or missiles while being ‘invisible’ on the aircraft’s radar. This technology has been developed by DRDO and transferred to CEL for production.

### **C. System Group - Systems Production Division (SPD)**

Four main product lines of this division are:

- i) Railway Electronics products - Axle Counter and Block Proving Systems (which detect the presence of a train in a particular section) and Level Crossing warning systems.
- ii) Cathodic Protection Systems – Cathodic Protection systems for oil and gas pipelines. Main customers are IOC, ONGC and GAIL.
- iii) Electronic Switching Systems - Very Small Aperture Terminals (VSATs) used for satellite communication. Buyers include DoT and Dept of Science & Technology.
- iv) Charge Controllers

CEL is having large workforce. The ratio of executive to non-executive category of employees is also high. The following table illustrates CEL's grade-wise and division-wise manpower strength as of January 1, 1998.

Department	Executives	Non-Executives	Total
ECD	16	24	40
MED	20	24	44
PFD	26	79	105
SPD	56	105	161
SPV	71	188	259
Admin	118	143	261
<b>Total</b>	<b>307</b>	<b>563</b>	<b>870</b>

### Financial Analysis

The financial performance of CEL for the past seven years is given below:

Table 4 : Financial Highlights

(Rs. Crore)

	FY97	FY96	FY95	FY94	FY93	FY92	FY91
Total Income	60.2	34.2	43.1	43.8	46.6	36.9	17.7
Operating Profit	-0.8	-10.1	-4.3	-0.4	3.1	2.1	-7
PAT	0.6	-9.1	-3.3	-0.3	3.4	2.6	-7
Equity Capital	32.3	29.2	25.5	25.5	21.5	18.9	18
Tangible Networth	22.7	19.6	6.9	10.6	7.2	1.2	-1.6
Gross Margin (%)	5%	-15%	6%	5%	13%	13%	-17%
Net Margin (%)	1%	-27%	-8%	-1%	7%	7%	-40%
ROCE (%)	9%	Neg.	6%	5%	17%	17%	0%
RONW (%)	3%	Neg.	Neg.	Neg.	82%	Neg.	0%
Earning Per Share (Rs. per each Rs 1000 share )	18.6	Neg.	Neg.	Neg.	159.5	135.9	Neg.
Dividend (%)	-	-	-	-	-	-	-

The growth in revenues of CEL, since 1991, has been uneven partly due to fluctuating orders from DoT and other GOI Departments. The highest growth registered in FY92 (108%) is because of a bulk order from DoT. Total income in FY96 fell by 21% as the order from DoT did not materialise, and the selling price of SPVs fell substantially. CEL had to reduce its quote by 25% to match the quote of the lowest bidder.

Raw material cost formed about 60% to 70% of the total income during the last five years. Salaries and wages came next, forming about 20% to 30%. Salaries and wages increased by more than 40% during FY97 on account of the payment of arrears following a pay revision, and provision for leave encashment on an actuarial basis.

Long-term debt to equity ratio and overall gearing at 3.78 and 6.86 respectively as on March 31, 1995, fell to substantially lower levels of 0.33 and 1.25 as on March 31, 1996 after the write-offs of loans and interest. Overall gearing stood at 1.04 as on March 31, 1997.

The company's debt obligations as on March 31, 1997 were as under:  
Table 5 : Debt Obligations of CEL

	Rs. Crore
<b>Secured Loans</b>	13.92
Fund Based facilities from Banks (Cash Credit/Working Capital Demand Loan/Bills)	
Demand Loans against Fixed Deposit Receipts	1.87
<b>Total</b>	<b>15.79</b>
<b>Unsecured Loans</b>	
Loan from DSIR for capital outlays	6.81
Loan from Dept of Electronics Develop. Projects	0.58
National Research Develop. Corpn. Loan	0.06
IREDA user loan for SPV pump programme	0.31
<b>Total</b>	<b>7.76</b>
<b>TOTAL</b>	<b>23.57</b>

#### Support from Government of India

CEL gets budgetary support from GOI in the form of loans and equity (in equal proportions) for capital purposes. Budgetary support received from FY93 to FY97 is given below:

Table 6 : Government Support

Year	Equity	Loan	R & D Grant
FY'93	2.58	2.58*	6.4
FY'94	3.99	3.99*	6.4
FY'95	-	-	2.4
FY'96	3.77	3.77	2.4
FY'97	3.05	3.05	2.9

\*Written off as per capital restructuring.

CEL incurs R & D expenditure against the grants received from GOI.

## Strengths and Areas of Concern

### Strengths

*Leading SPV Manufacturer* : CEL is among the top ten SPV manufacturers in the world.

*R & D Base* : CEL has a good R & D base with experienced technical manpower and has successfully commercialised production of SPV modules and high quality Ferrite components, amongst others.

*Increasing demand for SPV* : Due to the fast depleting fossil fuel reserves, inherent advantages of SPV systems, abundant sunshine in India and continuous improvement in the SPV technology the demand for CEL's products is expected to grow in future.

### Areas of Concern

*Products' reliance on subsidies* : Main products of the company - SPV modules and systems, are not commercially viable at present and rely heavily on subsidies.

*Dependence on Government for sales* : CEL is heavily dependent on GoI for selling its products as majority of the sale is to DoT and other GoI departments. In a liberalised environment, Government agencies are likely to enjoy greater autonomy and may not restrict sourcing equipment from PSUs.

*Poor financial position*: Accumulated losses may prevent the company from getting additional sources of funds for operations.

*Unrelated products* The company is into SPVs and electronic items that are totally unrelated to each other, lending no synergy.

*Relatively lower efficiency of cells* : CEL's cells have a lower efficiency (13% maximum) compared to imported cells (16%), acting as a cost disadvantage for downstream products.

*High staff strength* : The company's manpower strength is high as compared to the industry standards.

### Restructuring

GoI approved a substantial financial restructuring proposal in January 1997, involving write-off of GoI loans, waiver of interest for ten years w.e.f. April 1994, postponement of repayment schedules of all GoI loans by ten years and reduction in the rate of interest applicable for loans granted for SPV related activities.



CEL's profitability is highly dependent on the financial support received from GoI as demonstrated in the following table.

Table 7 : Cost to Government for Supporting CEL

(Rs. Crores)	FY91	FY92	FY93	FY94	FY95	FY96	FY97	FY98	FY99	FY00	FY01	FY02
	Actual							Projected				
1 Reported PAT	-7.0	2.6	3.4	-0.3	-3.3	-9.1	0.6	0.4	1.7	3.3	4.8	6.1
2 Additional Loan		0.9	1.8	2.9	0.0	3.8	3.1	3.4	4.8	3.8	3.5	0.0
3 loan written-off (FY95)					25.6	25.6	25.6	25.6	25.6	25.6	25.6	25.6
4 Total Loan	17.1	18.0	19.8	22.7	25.6	29.4	32.5	35.9	40.7	44.5	48.0	48.0
5 Interest Subsidy by GoI (assumed @13%)	2.2	2.3	2.6	3.0	3.3	3.8	4.2	4.7	5.3	5.8	6.2	6.2
6 R & D grant	2.4	1.6	6.4	6.4	2.4	2.4	2.9	2.5	2.5	2.5	2.5	2.5
7 Adjusted PAT (1-5-6)	-11.6	-1.3	-5.6	-9.7	-9.0	-15.3	-6.5	-6.8	-6.1	-5.0	-3.9	-2.6
8 Equity Contribution		0.9	2.6	4.0	-	3.7	3.1	2.5	4.7	3.9	3.5	-
9 Total Equity	18.0	18.9	21.5	25.5	25.5	29.2	32.3	34.8	39.5	43.4	46.9	46.9
10 Loss of return on equity (assumed @13%)	2.3	2.5	2.8	3.3	3.3	3.8	4.2	4.5	5.1	5.6	6.1	6.1
11 Annual cost to GoI (5+6+10)	7.0	6.4	11.8	12.7	9.0	10.0	11.3	11.7	12.9	13.9	14.8	14.8
12 Cash support by GoI (2+6+8)		3.4	10.8	13.3	2.4	9.9	9.1	8.4	12.0	10.2	9.5	2.5

## Government Options on CEL

As can be seen from the above table, CEL's performance is dependent on the Government support. In FY95 GoI wrote-off loans amounting Rs. 25.6 crores and also waived interest on subsequent loans provided to CEL. All R&D projects of CEL are also sponsored by GoI. The total support by government to CEL is substantial. Under these circumstances, the Government has the following options vis-à-vis CEL.

### 1. Continued financial support to CEL

In this scenario, GoI will continue to incur the annual cash outflow of Rs. 8 - 12 crores. The total cost to GoI including the interest subsidy, R&D grant and the loss of return on equity is in the range of Rs. 12-15 crores every year.

This will enable the company to generate modest returns in the future and continued employment to the 870 employees of CEL.

## **2. No financial support**

**In case the financial support to CEL, by way of waiver of interest, additional loan/ equity infusion and R&D grants is stopped, CEL's profitability can be estimated by the adjusted profits projected in the above table.**

**If the current situation continues, CEL is likely to become a sick company in the medium term and would possibly have to be referred to BIFR.**

**Under such circumstances, there is a need to protect the interest of the 870 employees of CEL. The new VRS scheme proposed in the budget for 1998-99, which envisages payment of enhanced VRS benefits to employees in case of closure, could be effectively used and the unit could be subsequently closed.**

**The cost of VRS would work out to be approximately Rs. 35 crores based on the average salary earned by a CEL employee and the years till superannuation. This cost would be offset by the sale of assets, which according to the management's estimates could realise Rs. 40 – 50 crore.**

## **Recommendation**

**CEL's origin can be described as an extension of DSIR's commercialisation of its research activities. This has resulted in a strong R&D in CEL set up right from the beginning. CEL has also been involved in developing new commercial applications using the extensive R&D by CEL and certain other research laboratories of the country. CEL receives support from the Government for its R&D activities of approx. Rs. 3 crore, as annual grant.**

**However, over a period of time, in majority of the activities undertaken by CEL, private sector investments started coming up. Due to this, CEL has lost its initial competitive advantage. In case of SPV, which is the most important business activity for CEL today (contributed 79% of FY 97 sales), its market share is about 35% of the domestic market.**

**CEL's financial performance has been poor due to the following major reasons:**

- **Poor competitive position of CEL in the highly competitive SPV industry**
- **High employee expenses, a major contributor in the operating losses of CEL**

**These factors have substantial bearing on the future sustainability of CEL. Unless an urgent action is initiated to correct this situation, the performance of CEL is likely to continue to be grim. However, CEL's strength lies in**

development and application of the R&D activities in the non-conventional energy sector and defence related work, which are important activities.

**Under these circumstances, the Commission recommends that priority should be accorded to the performance improvement of CEL to make it independent and commercially viable.**

Since employee cost is a major concern, reduction of manpower by introduction of an attractive Voluntary Retirement Scheme is recommended. The necessary funds for the VRS would need to be provided by the Government. Special efforts should be made to ensure that the reduction is achieved within one year. If these efforts succeed, a further period of one year should be given to CEL to improve its performance. In case there is no substantial reduction in surplus manpower within one year, CEL cannot improve its financial position and disinvestment can then be taken up on the lines suggested below. In case substantial reduction of manpower is achieved within one year and the financial performance of CEL improves within the following year, CEL could be allowed to continue in the public sector as a commercially viable undertaking. This will save the Government from the annual cash outflow of about Rs. 8-12 crores in the form of loan, equity and R&D grant etc. currently being provided to CEL.

The Commission also recommends that in case there is no significant reduction of manpower through VRS and no visible improvement in the company's performance within the period stipulated above, CEL should no longer continue in the public sector. In that event, the following steps should be taken:

- The Microwave Electronics Division (MED) that supplies phase shifters to Electronics Research and Development Organisation (ERDO) and frequency/phase correlators to Defence Electronic Research Laboratory (DERL) should be hived-off and merged with Government's other research laboratories/PSUs such as ERDO, DERL, BEL, BDL etc., which are engaged in similar activities connected with Defence.
- Government should therefore disinvest its entire holding in CEL through a trade sale. Financial advisors may be appointed to undertake the valuation and co-ordinate the trade sale process.

**The above process should be adopted only after giving fair and equitable compensation to employees.**



# *Appendices*



## Terms of Reference of the Commission

MINISTRY OF INDUSTRY  
(Department of Public Enterprises)  
RESOLUTION  
New Delhi, the 23rd August, 1996

**No. 11013/3/96-Admn.** - In pursuance of the Common Minimum Programme of the United Front, Government hereby constitutes a Public Sector Disinvestment Commission, initially for a period of three years.

2. The composition of the Commission will be as follows :-
1. Shri. G.V. Ramakrishna, Full-time Chairman
  2. Shri. Dipankar Basu, Part time Member
  3. Shri. M.R.R. Nair, Part-time Member \*
  4. Dr. Suresh Tendulkar, Part-time Member
  5. Dr. D.M. Nanjundappa, Part-time Member

The commission will have a full-time Secretary who will be appointed separately.

Shri G. Ganesh<sup>wa</sup> appointed Member Secretary vide Govt. of India Notification No. 13/18/97-ED(SMI) dated 11-12-1997 vice Shri P. Shankar.

3. The broad terms of reference of the Commission are as follows :-
- I. To draw a comprehensive overall long term disinvestment programme within 5-10 years for the PSUs referred to it by the Core Group.
  - II. To determine the extent of disinvestment (total/partial indicating percentage) in each of the PSU.
  - III. To prioritise the PSUs referred to it by the Core Group in terms of the overall disinvestment programme.
  - IV. To recommend the preferred mode(s) of disinvestment (domestic capital markets/international capital markets/auction/private sale to identified investors/any other) for each of the identified PSUs. Also to suggest an appropriate mix of the various alternatives taking into account the market conditions.
  - V. To recommend a mix between primary and secondary disinvestments taking into account Government's objective, the relevant PSU's funding requirement and the market conditions.
  - VI. To supervise the overall sale process and take decisions on instrument, pricing, timing, etc. as appropriate.
  - VII. To select the financial advisers for the specified PSUs to facilitate the disinvestment process.

\*Shri Rajendra Singh, C.M.D., N.T.P.C. has been appointed part time Member in place of Shri M.R.R. Nair, vide Department of Public Enterprises Resolution No. A-12023/2/97-Admn. dated 14-10-1997.

- VIII. To ensure that appropriate measures are taken during the disinvestment process to protect the interests of the affected employees including encouraging employees' participation in the sale process.
  - IX. To monitor the progress of disinvestment process and take necessary measures and report periodically to the Government on such progress.
  - X. To assist the Government to create public awareness of the Government's disinvestment policies and programmes with a view to developing a commitment by the people.
  - XI. To give wide publicity to the disinvestment proposals so as to ensure larger public participation in the shareholding of the enterprises; and
  - XII. To advise the Government on possible capital restructuring of the enterprises by marginal investments, if required, so as to ensure enhanced realisation through disinvestment.
- 
- 4. The Disinvestment Commission will be an advisory body and the Government will take a final decision on the companies to be disinvested and mode of disinvestment on the basis of advice given by the Disinvestment Commission. The PSUs would implement the decision of the Government under the overall supervision of the Disinvestment Commission.
  - 5. The Commission while advising the Government on the above matters will also take into consideration the interests of stakeholders, workers, consumers and others having a stake in the relevant public sector undertakings.

**S. TALWAR**  
**Joint Secretary**



## List of PSUs referred to the Commission

*First List - September, 1996***S No Name of the PSU**

1	Air India	AI
2	Bharat Aluminium Co. Limited	BALCO
3	Bharat Earth Movers Limited	BEML
4	Bharat Electronics Limited	BEL
5	Bongaigaon Refineries & Petrochemicals Limited	BRPL
6	Container Corporation of India Limited	CONCOR
7	Engineers India Limited	EIL
8	Fertiliser & Chemicals (Travancore) Limited	FACT
9	Garden Reach Shipbuilders & Engineers Limited	GRSEL
10	Gas Authority of India Limited	GAIL
11	Hindustan Aeronautics Limited	HAL
12	Hindustan Copper Limited	HCL
13	Hindustan Latex Limited	HLL
14	Hindustan Zinc Limited	HZL
15	Hotel Corporation of India Limited	HCIL
16	HTL Limited	HTL
17	IBP Co. Limited	IBP
18	India Tourism Development Corporation	ITDC
19	Indian Petrochemical Corporation Limited	IPCL
20	ITI Limited	ITI
21	Kudremukh Iron Ore Co. Limited	KIOCL
22	Madras Fertilisers Limited	MFL
23	Mahanagar Telephone Nigam Limited	MTNL
24	Manganese Ore (India) Limited	MOIL
25	Modern Food Industries (India) Limited	MFIL
26	National Aluminium Co. Limited	NALCO
27	National Fertilisers Limited	NFL
28	National Hydro Power Corporation	NHPC
29	National Thermal Power Corporation Limited	NTPC
30	Neyveli Lignite Corporation Limited	NLC
31	Northern Coal Fields Limited	NCF
32	Oil India Limited	OIL
33	Oil & Natural Gas Corporation	ONGC

34	Pawan Hans Helicopters Limited	PHL
35	Power Grid Corporation of India Limited	POWERGRID
36	Rail India Technical & Economic Services Limited	RITES
37	Shipping Corporation of India Limited	SCI
38	South Eastern Coal Fields Limited	SECF
39	Steel Authority of India Limited	SAIL
40	Western Coal Fields Limited	WCF

*Second List - March, 1997*

1	Hindustan Vegetable Oil Corporation Limited	HVOC
2	Nepa Limited	NEPA
3	Electronic Technology & Trade Dev. Corpn. Limited	ET&TDC
4	Hindustan Prefab Limited	HPL
5	Ranchi Ashok Bihar Hotel Corporation Limited	RANCHI-ASHOK
6	Pyrites, Phosphates & Chemicals Limited	PPCL
7	Central Electronics Limited	CEL
8	Engineering Projects (India) Limited	EPIL
9	Utkal Ashok Hotel Corporation Limited	UTKAL-ASHOK
10	Rehabilitation Industries Corporation Limited	RICL

*Third List - July, 1998*

1	Minerals and Metal Trading Corporation	MMTC
2	State Trading Corporation of India Ltd	STC
3	Project & Equipment Corporation of India Ltd.	PEC

**Appendix III**

**List of PSUs withdrawn from the Commission**

1. Bharat Earth Movers Limited	BEML
2. Bharat Electronics Limited	BEL
3. Garden Reach Shipbuilders and Engineers Limited	GRSEL
4. Hindustan Aeronautics Limited	HAL
5. South Eastern Coal Fields Limited	SECF
6. Western Coal Fields Limited	WCF
7. Northern Coal Fields Limited	NCF

## Appendix IV

## General Recommendations by the Commission and action taken thereon by Government.

### A. General Recommendations

#### 1. Establish Disinvestment Fund (I:3.1, II:1 and V:1)

The proceeds from the disinvestment may be placed separately in a 'Disinvestment Fund' and the National Renewal Fund should also be merged with this Fund. The resources of the Fund may be primarily used for

- temporary funding of losses of some PSUs in preparation of disinvestment,
- for providing benefits to workforce found to be surplus
- for conducting the publicity campaign for the disinvestment of PSU shares

The Fund would also help the government in undertaking disinvestment at the most opportune time in the market for maximum realisations.

*Action Taken* : According to Government communication, Fund had been set-up in September 1996. Details regarding the scope or purpose are not available.

#### 2. Delink the disinvestment process from the Budgetary Exercise of Government (IV:1)

Linkage of the implementation of disinvestment with the budgetary exercise may hinder achievement of the larger objective of the disinvestment exercise.

*Action Taken* : Decision awaited.

#### 3. Standing Empowered Group (I:4.1)

Given the advisory nature of the Commission, the Commission recommends formation of a Standing Empowered Group (SEG) to ensure smooth implementation of its recommendations. SEG may also be entrusted with the selection of Financial Advisors, supervision of the overall sale process and decisions on instrument, pricing, timing, etc. SEG could comprise the Cabinet Secretary, Secretaries of the Ministry of Finance, Department of Public Enterprises, Administrative Ministry of PSU alongwith the CEO of the concerned PSU.

*Action Taken* : Core Group has been empowered as recommended.

#### **4. Transfer of Management (V: 1)**

While selling a substantial stake in the Undertaking, management would be transferred to the strategic buyer and the time frame for a further dilution of its share holding, where necessary, as agreed with the strategic buyer.

*Action Taken* : Decision Awaited.

#### **5. Reduction of Government Equity (V: 1)**

The Commission also recommended that in the interest of establishing credibility with the strategic buyers, the Government may, where necessary, keep its direct share holding below the level of investment being offered to the strategic bidder by divesting some portions of its equity to multilateral financing institutions, private equity funds, mutual funds and a few select PSUs, who have business interest in the particular PSU being disinvested.

*Action Taken* : Decision Awaited.

#### **6. Referral of PSUs to the Commission (V:1)**

The matter whether a PSU should be considered by the Commission for disinvestment or not should be sorted out between the SEG and the administrative ministry before the referral to the Commission. This would avoid wastage of the Commission's time and efforts and Government resources. Also, the subsidiaries of PSUs should not be referred to the Commission, as the decision in this regard would have to be taken by the Boards of Management of the concerned parent PSU.

*Action Taken* : Government has decided not to refer subsidiaries of PSUs to the Commission.

#### **7. Voluntary Retirement Scheme (II:1 and IV:1)**

Commission recommends that Government should frame a clear cut policy statement on the terms of VRS on a stable and long term basis and also suggest a modality for the implementation of VRS. A pension cum insurance scheme could be thought of as an alternative to a one-time payment.

*Action Taken* : Decision awaited

#### **8. Disinvestment without reference to the Commission (III:1 and IV:1)**

Disinvestment of the PSUs whether through Joint Venture participation or strategic sale not referred to the Commission, is likely to deny the benefits of detailed consideration by an independent body. Therefore, Government should review the position and decide whether such cases should be kept outside the purview of the Commission.

*Action Taken* : Decision awaited

**9. Public Offer of equity by the PSUs referred to the Commission (III:1)**  
Primary issue by any PSU referred to the Commission, without involvement of the Commission, would be inconsistent with the terms of reference of the Commission to take a co-ordinated view or to recommend a mix between primary and secondary disinvestment.

*Action Taken* : Decision awaited

**10. Disinvestment Package (IV:1)**

The Commission reiterates that undertaking disinvestment without implementing the general recommendations of the Commission, - in particular those relating to corporate governance, managerial autonomy, managerial remuneration, accountability, incentives, professionalising the Board of Management and restructuring where necessary - would result in undervaluation of Government shares and loss to the national exchequer.

*Action Taken* : Decision awaited

**B. Guidelines on Modalities**

**1. Offer of Sale (I:4.2 and II:1)**

“Book building” process similar to that followed in the international market for GDR issue should be followed for Domestic Offer of Sale to institutions also.

*Action Taken* : Book Building followed in GDR issues.

**2. Strategic Sale (I:4.2 and V:1)**

Detailed and transparent procedure for the selection of strategic partners recommended including the selection of Financial Advisors for strategic sale. In order to ensure that the strategic partner brings in necessary technological and financial inputs the selection should be made through a process of pre-qualification.

The Government should assure the strategic buyer of its commitment to withdraw from the PSU by spelling out the details, including the time frame. The restructuring and VRS measures should be implemented before inviting the offer for strategic sale for realising the efficiency gains in the disinvestment proceeds.

The Commission recommends that the Government may keep its direct share holding below the level of investment being offered to the strategic bidder by divesting some portion of its equity to multilateral financing institutions, private equity funds, Mutual funds and a few select PSUs who have business interest in the particular PSU being disinvested.

*Action Taken* : Process for selection of global financial advisors for the strategic sale of BALCO and KIOCL has been initiated.

### **3. Selection of Intermediaries (I:4.3 and V:1)**

Detailed and transparent procedure for the selection of all intermediaries for the Offer of Sale of shares either in domestic or international market. The financial advisors need not evaluate the disinvestment options recommended by the Commission.

*Action Taken* : Accepted

### **4. Retailing of PSU shares to Small Investors and Employees (I:4.4)**

Detailed procedure for offer of shares to small investors and employees has been recommended by the Commission. The Commission has also recommended on the maximum number of shares and the discount to be offered to small investors and employees.

Sale of shares of the PSUs, especially the profit making ones, to the small investors would broad base the shareholding.

*Action Taken* : Accepted

### **5. Recommendation on Joining the NSDL (II.1)**

In order to enable the PSUs to prepare for meeting the demands of the capital market, Commission recommends that all PSUs which were earlier disinvested and which are proposed for disinvestment to join the NSDL.

*Action Taken* : Accepted

### **6. Audit of Disinvestment Transactions (V:1)**

It would be desirable to conduct an audit of the disinvestment transaction within six months by C&AG with the involvement of professionals familiar with working of the industry and capital markets. This provides

opportunities for improving the quality of subsequent disinvestment transactions.

*Action Taken : Decision Awaited*

### **C. Recommendations on Delegation of Autonomy**

Commission has recommended delegation of autonomy on a graded scale as given below :

#### **1. Professionalising the Board of Directors (I:3.4)**

The Commission recommends that the Government initiate necessary steps to select experts and professionals from outside the Government as non-executive Directors on the Board of Directors of PSUs.

*Action Taken :* Government has decided to broadbase Boards of PSUs by inducting at least three non-official part-time Directors (four for Navratna PSUs). Government has also specified that such Directors should be at least one-third of the total strength of the Board. These Directors would be selected by Search Committee comprising of Chairman, PESB; Secretary, DPE; Secretary of the Administrative Ministry; and some eminent non-official(s).

#### **2. Provision for Elected Directors (I:3.4)**

Government, in the interest of efficient management of the PSU, should enable election of Directors who would represent the minority shareholders in the PSUs. Also the Government should enable election of employee representatives on the Board of Directors in proportion to the extent of employee shareholding.

*Action Taken : Decision Awaited*

#### **3. Selection of Top Management (I:3.4)**

The Commission recommends that the Public Enterprise Selection Board (PESB) should be broad based. PESB has to be given more powers to select the CEOs and other functional directors without going to the Appointments Committee of the Cabinet. Minimum tenure of five years for the CEOs and Functional Directors are recommended and the age of superannuation be relaxed, if necessary, for this purpose.

*Action Taken : Decision Awaited*



**4. Salaries and Incentives for Top Management (I:3.4)**

In order to attract and retain talents, the salaries and allowances for CMDs in Schedule (A) post should be raised to Rs. 50,000 per month immediately and should be reviewed and brought in line with industry in a gradual manner. Similar revision should be undertaken for all in other Schedules.

*Action Taken* : Decision Awaited

**5. Autonomy in Price Fixation (I:3.4)**

PSUs should be fully empowered on par with the private sector units to determine the prices of their products and services.

*Action Taken* : Decision Awaited

**6. Accountability (I:3.4)**

Present MoU should be revamped in order to measure the performance of PSUs more qualitatively with reference to meaningful and challenging targets. Performance assessments should be carried out at routine intervals by a joint team of the Secretary of Ministry, CEO and an outside senior professional.

*Action Taken* : Accepted

**7. Setting up of Pre-Investigation Board (I:3.4)**

An independent specialised institution viz., the Pre-Investigation Board is to be set up to evaluate the instances of malfeasance in PSUs. It should evaluate all questionable commercial decisions at the Board level to determine whether the decisions were taken with malafide or corrupt intent. The members of the Pre-Investigation Board could include among others retired top executives from the financial sector, former CEOs of leading PSUs and professionals with relevant business experience.

*Action Taken* : Decision Awaited

**8. Strengthening the Investor Interface (I:3.4)**

PSUs in general should equip themselves to meet the investor queries by setting up investor relations group. This group should regularly communicate with the investors and update them with the performance of the PSU.

*Action Taken* : Decision Awaited

Apart from the recommendations in respect of corporate governance, mentioned above, which are applicable to all PSUs, the Commission recommends additional autonomies to Moderate Performers and Strong Performers.

### **9. Moderate Performers**

#### **(i) Powers to Dispose of Assets (I:3.4)**

Board of Directors should be empowered to transfer assets to a subsidiary or for the propose of outright sale, with requiring Government approval.

*Action Taken* : Decision Awaited

#### **(ii) Freedom of Investment within certain limits (I:3.4)**

The Government should enhance the investment limits in cases where banks or institutional lenders have appraised and financed the projects and link the limits to the turnover and requirement of funds in the medium term.

*Action Taken* : Category I PSUs have been allowed to incur capital expenditure on new projects, modernisation, purchase of equipment, etc. upto Rs. 300 crores or equal to their networth, whichever is lower while Category II PSUs have been given a limit of Rs. 150 crores or upto 50% of their networth, whichever is lower.

### **10. Strong Performers**

#### **(i) Powers to form joint ventures (I:3.4)**

The Board of Directors of these PSUs should be empowered to form joint ventures with Indian or foreign companies so long as the other partner holds less than or equal stakes, without prior approval of the Government other than the regulatory approvals as applicable to private sector.

*Action Taken* : Category I PSUs have been empowered to establish JVs and subsidiaries in India by investing upto Rs. 100 crores or 5% of their networth in any one project or 15% of their networth in all JVs/subsidiaries put together. Category II PSUs can invest upto Rs. 50 Crores or 5% of their

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\* *Category I PSUs* are PSUs that have made a profit in the last three years continuously and earned pre-tax profits of more than Rs.30 crores or more in at least one of the three years and have a positive net worth. *Category II PSUs* are PSUs that have made profit for the last three years continuously and have a positive net worth.

networth in any one project or 15% of their networth in all JVs/subsidiaries put together to establish JVs and subsidiaries in India.

(ii) Full freedom with regard to investments (I:3.4)

The Commission has recommended complete autonomy to these PSUs with respect to investment decisions subject to the condition that these projects are appraised and financed by banks or institutional lenders or where the total requirements of funds are met from internal accruals.

*Action Taken* : The autonomy granted to strong performers is same as that granted to the moderate performers.

## Appendix V

## Recommendations for 43 PSUs and action taken by Government

	Recommendations	Government Action
1.	Modern Food Industries India Limited (MFIL) (I:5.1) Sale of entire Government shareholding on an as-is-where-is basis	Decided to reduce Government shareholding in Modern Foods from present 100% to 50% in Phase 1 Process of selection of Global Advisors for the strategic sale initiated
2.	Gas Authority of India Limited (GAIL) (I:5.2) -25% disinvestment through GDR Autonomy under Strong Performer Criterion  Implement TL Sankar Committee Recommendations	24.84% (210 million shares) disinvestment through GDR Granted Autonomy under "Navaratna Status" Implemented
3.	Indian Tourism Development Corporation (ITDC) (I:5.3) Handing over the hotels located in prime locations to established hotel chains to run on long term structured contract on lease cum management basis. The hotels in other locations may be demerged into separate companies and Government to sell 100% of its equity in those new companies.	Decided to appoint global adviser to evaluate four options as identified by Core Group <ul style="list-style-type: none"> <li>• Acceptance of the Disinvestment Commission's recommendations</li> <li>• Acceptance of the view of the Ministry of Tourism (limiting disinvestment upto 49%)</li> <li>• Reduction of Government shareholding to 50% in favour of strategic partner</li> <li>• Reduction of Government shareholding to less than 50% in favour of strategic partner</li> </ul>
4.	Bharat Aluminium Company Limited (BALCO) (II:2.1) Immediate disinvestment of 40% of the equity to a strategic partner with an agreement to dilute Government holding to 26% through public issue within 2 years. The Government to disinvest its balance holding of 26% in full at an appropriate time in future	Accepted and process of selection of Global Advisors for the strategic sale initiated
5.	Bongaigaon Refineries and Petrochemicals Limited (BRPL) (II:2.2) Strategic sale of 50% of Government holding with an agreement to further dilute to 26% or below through public offer at a later date.	Decided to appoint global adviser to evaluate two options <ul style="list-style-type: none"> <li>• Disinvestment Commission's recommendations for a strategic sale</li> <li>• Ministry of Petroleum's suggestion of merger of Oil India and BRPL to make it a integrated oil company and disinvest Government holding to 50% or below in the merged entity</li> </ul>

	Recommendations	Government Action
6.	<p>HTL Limited (HTL) (II:2.3) 3 options for disinvestment -</p> <ul style="list-style-type: none"> <li>• Sale of 100% shares in HTL alongwith ITI in the process of Strategic Sale</li> <li>• 50% of shares of HTL may be offered to a strategic partner through a global competitive bidding</li> <li>• if none of the above options is feasible, straight sale of assets of the company through competitive bidding</li> </ul>	Core Group broadly endorsed the recommendations, however waiting for the views of the Telecom Commission.
7.	<p>ITI Limited (ITI) (II:2.4) Immediate reduction of manpower through VRS and hiving off the Defence Division in Bangalore and merge with Bharat Electronics Limited followed by strategic sale of 50% of the shares with an agreement to reduce the Government holding to 26% through public offer to Indian institutions, small investors and employees later</p>	Core Group broadly endorsed the recommendations, however waiting for the views of the Telecom Commission.
8.	<p>Madras Fertilisers Ltd (MFL) (II:2.5) Recommended to initiate negotiations with National Iranian Oil Company to change the terms of agreement which would permit sale of 50% of the shares in the company to a strategic partner</p>	Approval for negotiations with NIOC along the lines suggested by the Commission
9.	<p>Manganese Ore India Limited (MOIL) (II:2.6) - No immediate disinvestment</p>	Accepted
10.	<p>Container Corporation of India Limited (CONCOR) (III:2.1) -10 million shares offer to institutional investors and public and at a later stage the company could go in for fresh issue of 12.5 million shares thereby reducing the Govt's share to 51%</p>	Disinvestment of 6 million shares approved along with fresh issue of 12.5 million shares - Distribution of issue between domestic and international market to be based on the market conditions
11.	<p>Kudremukh Iron Ore Company Limited (KIOCL) (III:2.2) Strategic sale of 30% and induction of the strategic partner in the management. There should be an agreement with the strategic partner for further dilution of Government equity to strategic partner and public offering within 2 years.</p>	Process of selection of Global Advisors for the strategic sale initiated
12.	<p>Mahanagar Telephone Nigam Limited (MTNL) (III:2.3) - 60 million shares in GDR market and 28.3 million shares in domestic market through book building</p>	Disinvested 40 million shares along with fresh issue of 30 million shares through GDR issue in December, 1997 Proceeds Rs. 940 crores
	<p>Financially restructure - by formation of a new company for raising funds for DoT Grant of Autonomy under Strong Performer Criteria</p>	<p>Decision awaited  Granted Autonomy under "Navaratna Status"</p>

	Recommendations	Government Action
13.	Oil India Limited (OIL) (III:2.4) - Disinvestment and Company's IPO only after company's prospects are clearly established through the outcome of exploration activities in the North Brahmaputra area and Government's policy on APM	Accepted
14.	Oil and Natural Gas Commission Ltd. (ONGC) (III:2.5) - Disinvestment after the organisational changes are in position and Government's policy on APM	Accepted
15.	Rail India Technical & Economic Services Ltd (RITES) (III:2.6) - No disinvestment	Accepted
16.	Hindustan Copper Limited (HCL) (IV:2.1) - Two options suggested: <ul style="list-style-type: none"> <li>• HCL to implement the expansion programme and also restructure the ICC mining operations by closing down mines through VRS. Afterwards, Government to divest 51% of its holding through a strategic sale. The balance 22% to be disinvested through offer of sale to domestic institutions, small investors and employees</li> <li>• Immediately disinvest 51% through a strategic sale and after restructuring and expansion, disinvest balance 22% through offer of sale to domestic institutions, small investors and employees</li> </ul>	Decision awaited
17.	Pawan Hans Helicopters Limited (PHL) (IV:2.2) - Recommends writing off the Westland loans together with interest. Offer the entire Government holding to ONGC. If ONGC not interested, sell the entire holding of Government to an investor.	Decision awaited
18.	Power Grid Corporation of India Limited (POWERGRID) (IV:2.3) Disinvestment only after entire electricity sector is fully restructured.	Decision awaited
19.	Shipping Corporation of India Ltd (SCI) (IV:2.4) Government to disinvest 40% of its holding to oil refineries. (30% to public sector and 10% to private sector refineries). This can be followed by the company's own equity raising.	Decision awaited

	Recommendations	Government Action
20.	Engineers India Limited (EIL) (V:2.1) GoI to hold 26% for retaining the character as an Indian Consultancy company in strategic areas; GoI to divinvest 30% equity stake in the company alongwith appropriate role in management; 10% to employees under ESOP; 10% to public sector oil companies and other user PSUs; 24% through public offer to domestic investors after the strategic partner is inducted.	Decision awaited
21.	Engineering Projects (India)Limited (EPIL) (V:2.2) GoI firstly to try disinvestment of 74% of its holding as approved by Cabinet; in the absence of satisfactory response, closure and sale of asset	Decision awaited
22.	Hindustan Prefab Limited (HPL) (V:2.3) GoI to offer 74% of its holding to a strategic buyer	Decision awaited
23.	IBP Limited (IBP) (V:2.4) GoI to hold 26% and offer upto 33.9% of the company's equity out of GoI holding of 59% to strategic buyer	Decision awaited
24.	National Thermal Power Corporation (NTPC) (V:2.5) - No disinvestment presently	Decision awaited
25.	NEPA Ltd. (NEPA) (V:2.6) Immediate sale of 51% to a strategic partner which could go up to 100%	Decision awaited
26. & 27.	Ranchi Ashok Bihar Hotel Corporation and Utkal Ashok Hotel Corporation Ltd. (V:2.7,2.8) ITDC to disinvest 100% holding in favour of any private entrepreneur	Decision awaited
28.	Electronics Trade and Technology Development Corporation (ET&T) (VI:2.1) ET&T to discontinue all its operations with immediate effect and sale of assets of the company	Decision awaited
29.	Hindustan Vegetable Oils Corporation Ltd. (HVOC) (VI:2.2) hiving off breakfast food division and sell off 100% ; Close down of operations in vanaspati and packaging of refined oil	Decision awaited
30.	Hindustan Zinc Ltd. (HZL) (VI:2.3) 25% equity to be offered to strategic partner with role in management	Decision awaited
31.	Hotel Corporation of India Ltd. (HCIL) (VI:2.4) The hotels at Mumbai and Delhi to be sold as separate units; Initiate dialogue with J&K government for Centaur Srinagar and AI to decide about the flight catering services	Decision awaited

	Recommendations	Government Action
32.	National Hydroelectric Power Corporation Ltd. (NHPC) (VI:2.5) No disinvestment presently	Decision awaited
33.	Pyrites Phosphates & Chemicals Ltd. (PPCL) (VI:2.6) Initiate action to sell Amjhore and Saladipura units to strategic buyers and close down Dehradun operations	Decision awaited
34.	Rehabilitation Industries Corporation Ltd. (RICL) (VI:2.7) With immediate effect discontinue all the operations and sale of assets	Decision awaited
35.	Fertiliser and Chemicals Travancore Ltd. (FACT) (VII:2.1) Offer a minimum of 51% equity to strategic buyer along with management control	Decision awaited
36.	Hindustan Latex Ltd (HLL) (VII:2.2) Offer a minimum of 51% equity to strategic buyer along with management control	Decision awaited
37.	Indian Petrochemicals Corporation Ltd. (IPCL) (VII:2.3) Offer 25% equity to strategic buyer along with management control	Decision awaited
38.	National Aluminium Co. Ltd (NALCO) (VII:2.4) Offer of sale of upto 30% equity to retail as well as institutional investors including a GDR issue of 15%	Decision awaited
39.	National Fertiliser Ltd (NFL) (VII:2.5) Offer a minimum of 51% equity to strategic buyer along with management control	Decision awaited
40.	Neyveli Lignite Corporation Ltd (NLC) (VII:2.6) No disinvestment, presently.	Decision awaited
41.	Steel Authority of India Ltd (SAIL) (VII:2.7) No disinvestment, presently. Government assistance in writing off IISCO's losses and sale of IISCO. Conversion of SAIL's SDF dues into equity.	Decision awaited
42.	Air India Ltd (AI) (VIII:2.1) Infusion of Rs. 1000 crore as equity, followed by strategic sale by issue of new shares reducing Government holding to 60%. Subsequent offer of sale of 20% to domestic investors.	*
43.	Central Electronics Ltd (CEL) (VIII:2.2) Priority to CEL's performance improvement. One year to reduce manpower through VRS and another year to improve performance. If substantial surplus manpower reduction is not achieved, disinvest CEL through a trade sale after hiving-off defence related operations.	*

\* (42 & 43) Recommended in this report



## Appendix VI

**Disinvestment Modalities Recommended in Report I to VIII and action taken by Government**

Modalities of Disinvestment	No. of PSUs	Name of PSUs	Action taken by Government
Trade Sale	6	ITDC, MFIL, R-Ashok, U-Ashok, HCIL, PHL	MFIL (Selection of Global Financial Adviser)
Strategic Sale	19	HTL, ITI, BALCO, BRPL, KIOCL, MFL, EIL, HPL, IBP, NEPA, HZL, PPCL, NFL, FACT, IPCL, HCL, SCI, HLL, AI	KIOCL, BALCO; Selection of Global Financial Adviser)
Offer of Shares	5	GAIL, CONCOR, MTNL, MOIL, NALCO	GAIL, CONCOR, MTNL (GOI holding disinvested 6.7%)
No Disinvestment	1	BITES	N.A.
Disinvestment deferred	8	OIL, ONGC, NTPC, NHPC, POWERGRID, SAIL, NLC, CEL	N.A.
Closure/sale of assets	4	EPIL, ET&TDC, HVOC, RICL	N.A.
<b>Total</b>	<b>43</b>		

**MINISTRY OF INDUSTRY**  
**(Department of Public Enterprises)**

**RESOLUTION**

**New Delhi, the 12th January, 1998**

No. 11013/3/96-Admn. - In partial modifications of this Ministry's Resolution No. 11013/3/96-Admn. dated 23-8-96 constituting the Public Sector Disinvestment Commission, Paras 3,4 and 5 thereof are deleted and substituted by the following :-

- 3(i) The Disinvestment Commission shall be an advisory body and its role and function would be to advise the Government on Disinvestment in those public sector units that are referred to it by the Government.
- 3(ii) The Commission shall also advise the Government on any other matter relating to disinvestment as may be specifically referred to it by the Government, and also carry out any other activities relating to disinvestment as may be assigned to it by the Government.
- 3(iii) In making its recommendations, the Commission will also take into consideration the interests of workers, employees and others stake holders, in the public sector unit(s).
- 3(iv) The final decision on the recommendations of the Disinvestment Commission will vest with the Government.

**S. Talwar,**  
**Joint Secy.**



