# STATE OWNED ENTERPRISES

*Contributions to Socio Economic Milieu*

**Dr. K. Gopa Kumar**

# STATE OWNED ENTERPRISES

*Contributions to Socio Economic Milieu*

PART I

**Historical Overview**

The post second world war era witnessed liberation of colonies and emergence of independent nation states. The political leaderships of the newly formed independent nations were, apart from their responsibilities to solve various immediate issues of governance and social order, assigned with the responsibilities of designing future plans for self reliance and for strengthening their domestic economy. The newly independent third world countries were in shambles both in economic and social sense and the governments had to take a lead in developing their economic and productive sectors. The bourgeois class in many of these countries, comprador in nature till then, was not economically or technologically geared up for spearheading the advancement of the productive sectors. Hence, the growth strategies were to be crafted and sponsored at the aegis of the national governments. The socialist ideology that was predominant during that period was also a persuading factor for such a plan of action. This resulted in massive State, investments in core sectors of production drawing heavily from the national income. Further more state investments became inevitable to support initiatives laying a strong foundation for Research and Development in these areas. The wide network of public sector enterprises and institutions in many third world countries has its roots in these social and historical factors.

In the advanced countries also, especially after the great depression in the early 1930s, there was an inclination towards public spending, guided by the Keynesian model of development. This was mainly to create employment and ensure basic amenities to the society, which was not taken care of by the capitalist class, who controlled a sizeable share of national wealth. The public expenditure in these countries were notably in the welfare sectors with an intention to reconcile the risk of class antagonism making ways to massive revolts against the existing social systems. Schemes for providing public health, public education, unemployment allowances etc., were developed in these countries and well maintained for a considerable period without much deterioration.

In those countries where the public spending in the productive sectors was initiated for the development of core sectors, initially the same was welcomed by the bourgeois class as it was the main beneficiary of such a development. In some countries at least, this pattern of spending was propounded by the capitalism. The government-owned corporations played a pivotal role in the economic development of emerging economies because their participation was higher in the industrial and commercial activities of these economies. Resource constraints and limited scope of the private sector in the early stages of planning and development set the stage for predominance of the public enterprises in these economies. Thus, public sectors played a very important role in the leading developing countries of the world (including the countries in the BRIC region). Investments in public sector enterprises have also been greater which continued to accelerate growth in core sectors such as railways, telecommunications, nuclear power, defence etc. Many a times, public enterprises were created to operate in areas of national and international trade, consultancy, inland, and overseas communication and construction services; as a result, overall benefits of the public sector have not been restricted to certain sectors. In other words, the public sector was a heterogeneous combination of basic infrastructure industries, industries engaged in providing trade services, consumer goods industries, et al.

Rapid industrialisation and infrastructure creation for economic development were the basic rationale behind setting up public enterprises. Governed by this rationale, the public enterprises were set up by the government to ensure easy availability of important articles of mass consumption, and to promote even distribution of income while keeping tabs on prices of vital products. Protection of workers' interests was also one of the objectives as a large number of public enterprises were created by taking over sick private sector enterprises. Public sector enterprises were also encouraged for promoting and ensuring balanced development of geographical regions, besides providing import substitution.

In India and China, PSUs were key catalysts in capital formation in the early stages of industrial development. PSUs held a sizeable share in the economic activities of a number of developed and developing economies like France, Japan, Germany, Italy, Australia, South Korea, China, Malaysia, Philippines, Indonesia, Sri Lanka, and India. But in such countries, the figures show that it was the capitalist class that extracted maximum benefits in terms of raw material availability, subsidised power, improved transportation facilities, growing market, tax concessions etc. And due to structural issues of governance in several third world countries, many public enterprises were forced to function as appendage to the private capital operations.

### *a. Effect of Neo Liberal Capitalism and Structural Adjustment Programme*

Although, in many countries, the capitalist class initially supported the public sector endeavours, mainly for the benefits they could extract for their growth and widened opportunities, they started questioning the public spending on various grounds in later stages. The boom in economy through neo-liberal capitalist experiments in 1970s strengthened these groups and with the newly gathered strength they challenged the role of the State in the productive sectors.

Two other important factors that demand attention here, are (1) the growing fiscal deficits of the nations and (2) the poor performances of the public enterprises. Due to the former the States were compelled to slash the spending in the development sectors and the latter gave impetus to the neo-liberal capitalist lobby to spearhead their attack on the pro-psu stand of many governments. The collapse of Soviet Union and the socialist block in the early 1990s further strengthened the arguments of this group. Simultaneously, at the behest of the Bretton Woods institutions, as the Structural Adjustment Programmes (SAP) were implemented in many third world countries, the main agenda became the reduction of the role of PSUs in the national economy.

Through conditionalities that mainly focused upon the macroeconomic policy of a country, the SAP generally implemented "free market" programs and policies which included internal changes like privatization and deregulation as well as external ones, especially the reduction of trade barriers. A common policy required in SAP was the privatization of state-owned enterprises and resources. State-owned resources were to be sold whether they generated a fiscal profit or not. When resources were transferred to foreign corporations and/or national elites, the goal of public prosperity was replaced with the goal of private accumulation. In some cases at least, the fiscal losses of state-owned firms were mainly due to their social obligations, such as providing low-cost utilities and jobs. SAPs and Neoliberal policies have negatively affected many developing countries; the privatization of water in Bolivia and the privatization of the health system in Sub-Saharan Africa are few examples of such negative implications. Consequent to the implementation of SAP many public services were corporotized and then disinvested. For example, the Department of Telecommunication in India was first made as a corporation and disinvested thereafter. Large number of PSUs was privatised and many were closed down. Government support to various public enterprises were either stopped or curtailed significantly. Certain core sectors, hitherto earmarked exclusively for PSUs, were opened up for private investments and market forces, as a policy, were permitted to decide largely on the productive sectors. Labour, fiscal and monopoly restricting statutes were radically amended so as to facilitate a capital oriented and profit centred growth. The role of PSUs was considerably reduced and they were made to take a secondary role in the national economy.

The free market economy and the neo liberal ideology was the driving force in many countries for nearly two decades from late 1980s and the most affected sector during this period was the public enterprises. It was under the leaderships of Magaret Thatcher in UK and Ronald Reagan in USA that privatization gained worldwide momentum. In the UK the biggest public sector, the British Railways was privatised by John Major. Significant privatization of state owned enterprises in Eastern and Central Europe and the former

Soviet Union was undertaken in the 1990s with assistance from the World Bank, the U.S. Agency for International Development, the German Treuhand, and other governmental and nongovernmental organizations. Under the neo-liberal capitalist philosophy, role of the State in the economy was debated and there was a paradigm shift in the approach. The capitalist world in general accepted the Thatcherian slogan that it was 'not the business of the Government to be in businesses.' In the developed countries and also in their satellite nations government started withdrawing from enterprising activities and social welfare sectors. This had serious impacts upon the livelihood of common people and significant portion of the population was denied the access to the basic requirements such as health, clean drinking water, food security, primary education etc. Income disparity grew to magnificent level and a group of elite class was formed even in the most underdeveloped countries that started controlling the rare and valuable resources.

This period can be marked for the transcendental role of transnational finance capital and overblown speculative market.

***b. Bursting of Bubbles and Consequences***

Burst of the speculative dotcom bubble in year 2000 was the first shock to the neoliberal model of development. By 2001 the bubble was deflating at full speed. A majority of the dotcoms ceased trading after burning through their venture capital. Several communication companies could not withstand the financial shock and were forced to file for bankruptcy. WorldCom, a main player in the dotcom field, was found practicing illegal accounting practices to exaggerate its profits. WorldCom's stock price fell drastically and eventually filed the third largest corporate bankruptcy in the U.S. history. Mega companies like NorthPoint Communications, Global Crossing, JDS Uniphase, XO Communications, and Covad Communications also went bankrupt. Many dot-coms ran out of capital and they were either acquired or liquidated. Several companies were accused or convicted of fraud and the U.S. Securities and Exchange Commission fined top investment firms like Citigroup and Merril Lynch millions of dollars for misleading investors. It is calculated that the Stock Market Crash of 2000-02 caused the loss of $5 trillion in the market value of companies from March 2000 to October 2002.

But the crash of the dot-com bubble metastasized into the housing bubble in the U.S and the real estate became the primary outlet for the speculative frenzy that the stock market had unleashed. The combination of easy credit and money inflow contributed to the United States housing bubble. As part of the housing and credit booms, the number of financial agreements called Mortgage Backed Securities (MBS) and Collateralized Debt Obligations (CDO), increased considerably. Attracted by these financial innovations, investors world over were attracted towards the U.S. housing market. With abundant cash inflow and least regulatory mechanisms, aggressive financial institutions were clearing housing loan applications even without verifying the repayment capacity. This has resulted in a sharp decrease in the real housing prices. Falling prices also resulted in homes worth less than the mortgage loan, providing a financial incentive to enter foreclosure. Defaults and losses on other types of loans also increased significantly as the crisis expanded from the housing market to other parts of the economy. This was not a new development. Guided by the neo liberal capitalist policies, the U. S. Government from the 1970s onwards emphasized deregulation to encourage business, whereby uncontrolled financial activities became rampant and there were less disclosure of information about new activities undertaken by banks and other evolving financial institutions. Thus, increasingly important role played by financial institutions such as investment banks and hedge funds, also known as the 'shadow banking' system, went unnoticed. Till the symptoms of total collapse became visible, the policy makers were also encouraging such activities. Paul Krugman, laureate of the Nobel Prize in Economics, described the run on the shadow banking system as the "core of what happened" to cause the crisis.

The collapse of the housing bubble, which peaked in the U.S. in 2006, caused the values of securities tied to real estate pricing to plummet thereafter, damaging financial institutions globally. Economies worldwide slowed during this period as credit tightened and international trade declined. The off shoot of the housing bubble burst was a financial meltdown, as dreadful as the great depression of 1929. The extent of the problems has been so severe that some of the world's largest financial institutions have collapsed. Others have been bought out by their competition at low prices and in other cases, the governments of the wealthiest nations in the world have resorted to extensive bailout and rescue packages for the remaining large banks and financial institutions. The total amounts that governments have spent on bailouts have skyrocketed. From a world credit loss of $2.8 trillion in October 2009, U.S. taxpayers alone spent some $9.7 trillion in bailout packages and plans, according to *Bloomberg.* $14.5 trillion or 33% of the value of the world's companies had been wiped out by this crisis. The UK and other European countries had also spent some $2 trillion on rescue and bailout packages.

The bailout packages were severely criticised by many on the ground that it was not able to address the real cause of the crisis but was only a window dressing. On the Bailout Package Bill of Bush administration, Joseph Stiglitz, Nobel Laureate commented, *"I think it remains a very bad bill. It is a disappointment, but not a surprise, that the administration came up with a bill that is again based on trickle-down economics. You throw enough money at Wall Street, and some of it will trickle down to the rest of the economy. It's like a patient suffering from giving a massive blood transfusion while there's internal bleeding; it doesn't do anything about the basic source of the haemorrhaging, the foreclosure problem." (Democracy Now! October 2, 2008)*

The financial meltdown had devastating effect upon all spheres of activities. In the industrial, labour and social welfare areas it had more destructive effects. The economies of many continents have not recovered from the crisis so far and the problems are still persisting. The point of emphasis is that the neoliberal policies have once again proved to be dangerous to the social and economic development of the society. The fragility of unfettered monopoly capitalism has been again substantiated and the necessity of social control over the financial activities in the society has been recognized.

It is ironic to note that it was the public money and the governmetal agencies that has come forward to salvage the collapsing economy guided by the monopoly capitalism and neoliberal ideology wherin the roles of national governments and social control over the economy were challenged. The 'Wall Streets' were saved at the cost of 'Main Streets'.

***c. SOEs Acquiring New Status***

Consequent to the financial crisis of 2008 worldwide there is thinking in favour of public sector. The role of State Owned Enterprises (SOEs) in the social and economic spheres of the nation is again getting established. Recent work by the World Bank concludes that SOEs play a critical role in the economy, particularly in the Middle East, Africa and Asia. SOEs are part of a larger set of issues regarding state control over the economy. (Sunita Kikeri & Aishetu Kolo, *State Enterprises, WORLD BANK PUB. POL'Y J.* 304 (2006), http://rru.worldbank.org/PublicPolicyJournal) In Eastern Europe and the former Soviet Union, the public sector share of GDP varies from as little as around twenty percent (Czech Republic, Slovakia and Hungary) to as much as eighty percent (Belarus). Twenty of twenty six transition countries were in the range of twenty to forty percent of GDP of the state sector share. These numbers do not reflect changing developments around the world where financial crisis has caused a number of countries to nationalize some struggling firms. (World Bank, *Economies in Transition: An OED Evaluation of World Bank Assistance* 15 (2004).)

## PART II

### State Owned Enterprises In India

State Owned Enterprises play a pivotal role in Indian economy. As on March 31, 2007, there were 247 Central Public Sector Enterprises (CPSEs) with a capital investment of Rs. Rs.6,65,124 Crores. The turnover of the CPSEs for that year was Rs.9,64,410 Crores, with a net profit of Rs. 81550 Crores. The share of output of CPSEs in GDP at market price is around 8 percent. In 2005-06 it was 8.21 per cent and in 2006-07 it was 8.23 percent. The CPSEs made substantial contribution to the Central Exchequer through payment of dividends, interest on government loans and taxes & duties. In 2006-07 the total contribution was Rs. 147728.30 crores against the contribution of Rs. 125455.93 crores in 2005-06.

The largest investment is in the "industrial sector" comprising electricity, manufacturing, mining and construction sectors, which is about 62.58 per cent of the total financial investment. There were 16.14 lakh (excluding casual workers and contract labour) persons employed in these enterprises. The total employees in the central public sector units account for two third of the total workforce in the organised sector. The growth in turnover of CPSEs in the manufacturing sector was 64.62 per cent, followed by services (18.91), mining (11.75), electricity (4.69) and agriculture (0.03) sectors. Out of the net profit of Rs. 81,550 crore earned during 2006-07, the profit of profit-making CPSEs (156) was Rs. 89,773 crore, the total loss of loss-making enterprises (59) stood at Rs. 8,223 crore.

Apart from the Central PSUs there are State Level Public Enterprises (SLPEs) –about 1036 spread over 28 States and Union Territories out of which about 20% are not operating. Nearly 50% of the SLPEs are loss making and the net accumulated loss is around $11 billion over investment of $57 billion.

*a. The Origin and Pro-PSU Policies*

Prior to Independence, there were very few 'Public Sector' Enterprises in the country. These included the Railways, the Posts and Telegraphs, the Port Trusts, the Ordinance Factories, All India Radio, a few enterprises like the Government Salt Factories, Quinine Factories, etc. which were departmentally managed. In some princely states also industries were set up in the public sector. In the independent India the guidelines for the economic planning were mainly provided by the Bombay Plan, 1945 which was authored by stalwarts like Sir J.R.D. Tata, G.D. Birla, Sir Shri Ram, Kasturbhai Lalbhai, A.D. Shroff and John Mathai et al. They affirmed 'that practically every aspect of economic life will have to be rigorously controlled by the Government'. Indian bourgeois class which was not capable to take forward the industrialisation of the country, both in financial and technological sense, demanded that the federal government should take the initiative for setting up the core industries. It was also demanded in the Bombay Plan that when the private entrepreneurs become proficient to run such industries independently, their management should be handed over to private capitalists. H.V.R Iyenger of the Indian Civil Service who retired as Governor of the Reserve Bank of India said in the late sixties, 'Indeed, there seems little difference between the basic approach of the Bombay Plan and the approach of the Planning Commission of the Government of India… (Public Sector Units: Privatisation of Economic Destruction: N. Bhattacharya)

The strategy for setting up of public sector in India is laid down in the Industrial Policy Resolution of 1948 followed by the Industrial Policy Resolution of 1956. The 1948 Resolution envisaged development of core sectors through the public enterprises that was expected to correct the regional imbalances and create employment. It laid emphasis on the expansion of production, both agricultural and industrial; and in particular on the production of capital equipment and goods satisfying the basic needs of the people, and of commodities, the export of which would increase earnings of foreign exchange. The resolution stipulated that in addition to arms and ammunition, atomic energy and railway transport, which continued to be government monopoly, the State would exclusively be responsible for establishment of new enterprises in six basic industries - except the industries where in the national interest, private sector participation and cooperation could be allowed. The 1956 Industrial Policy Resolution gave primacy to the role of the State, which was directly responsible for industrial development. The Resolution also classified industries into three categories with respect to the role played by the State; the first category (Schedule A) included industries whose future development would be the exclusive responsibility of the State; the second (Schedule B) category included enterprises whose initiative of development would principally be driven by the State, but private participation would be allowed to supplement the efforts of the State, and the third category included the remaining industries, which would be left to the private sector. The new strategies for the public sector were later outlined in the policy statements in the years 1973, 1977, 1980 and 1991. The year 1991 can be termed as the watershed year, heralding liberalisation of the Indian economy. (See *Public Sector in India (Overview & Profile) Department of Public Enterprises, Government of India)*

Researchers classify the whole period of interaction of economic policy and state owned sector in the post-independence India into four phases: (i) 1950-1965, (ii) 1966-1984, (iii) 1984-91 and (iv) post-1991 policy regime.(See MadhuBala, *Economic Policy and State Owned Enterprises: Evolution Towards Privatisation in India* (http://mpra.ub.uni-muenchen.de)

During the first phase, i.e. 1950-65, the growth rates of the economy were generally high and state owned sector was occupying the position of 'commanding heights'. Despite the economy passing through crisis during this phase, the state owned sector enjoyed by and large a significant position.

The Industrial Licensing Policy 1970 placed certain restrictions on undertakings belonging to large industrial houses defined on the basis of assets exceeding Rs 350 mn. In 1973, the definition of large industrial houses was adopted in conformity with that of the Monopolies and Restrictive Trade Practices Act (MRTPA) 1969 and included companies whose assets exceeded Rs 200 mn. This move intended to provide the government more effective control on concentration of economic power.

The Industrial Policy 1977 provided greater interaction between agriculture and industrial sectors. The Industrial Policy Statement of July 1980 spelt out major policy initiatives such as XVIII optimum utilisation of installed capacity, correction of regional imbalances, high employment generation, promotion of economic federalism, and more importantly, focused on reviving efficiency of public sector enterprises through a time-bound programme of corrective action on a unit-by-unit basis.

***b. Paradigm Shift in Policy***

The policy adopted in 1982 was a step forward towards the process of liberalisation. In state owned enterprises, a visible change in the attitude took place. The economy was made predominantly dependent upon market forces rather than on the state. The industrial policy that was initiated in 1985 was the culmination of the process of drifting away, which started during the second phase of the economic policy in India.

The next major policy initiated by the government was the announcement of the Statement on Industrial Policy in July 1991. This statement consisted of the following strategic decisions:

i. The entire portfolio of investments made in the public sector was to be reviewed with an aim to focus on sectors of strategic importance, sectors that were technologically advanced and essential infrastructure sectors.
ii. Reservations were retained for the public sector to a certain extent, albeit, without any restraint on area of exclusivity to be opened up selectively to the private sector.
iii. The public sector was allowed entry into areas in which no reservations were made for it.
iv. Sick public enterprises that are unlikely to be turned around were referred to the Board for Industrial and Financial Reconstruction (BIFR) and other such institutions that were created for the same purpose.
v. Interest of workers likely to be affected by rehabilitation packages were kept in mind through social security mechanisms created for this purpose alone.
vi. Greater thrust was laid on performance improvement through MoUs signed between the government and enterprises.
vii. The boards of these enterprises were given wider powers.

The above statement of Industrial Policy brought in fundamental changes in the MRTP Act as well. From 17 industries exclusively reserved for the State in 1956, the statement in 1991 revised the priority of the public sector to four major areas - essential infrastructure goods and services, exploration and exploitation of oil and mineral resources, technology development and building of manufacturing capabilities in areas that are crucial for long-term development of the economy and where private sector investment is inadequate, and manufacturing products where strategic considerations predominate, such as defence equipment.

In the Post 1991, Policy Regime, the Eighth, Ninth and Tenth Plan documents suggested many policy initiatives towards restructuring, modernisation, rationalisation of capacity, product-mix changes, privatisation, autonomy, performance accountability and disinvestments policy. The trends of the privatisation of State Owned Enterprises from 1991 to 2000 points out that during this period, the government offloaded shares in as many as 39 state owned enterprises. However, since March 2000 emphasis has increasingly been on strategic sales of identified SOEs. The way the Indian PSUs that are owned by the Indian public has performed shows that they were a threat to the monopoly exploitation by the MNCs and hence they should be demolished for the very same reason. The pressures from the World Bank, IMF and WTO for globalization, corporatization and privatization of Indian PSUs, on the pretext of clearing the US $ 100 billion external debt, should be seen as a step towards gaining control over the economic and foreign policies of this country. The Indian PSUs, most of them were economically viable were in the process of getting corporatized and thereafter privatised, for raising enough funds to finance the fiscal deficit. (See N. Bhattacharyya, *Public Sector Units : Privatisation or Economic Destruction*?)

The studies suggest that the performance of disinvestments process in India based on the policy of disinvestment has been looked upon with scepticism. Though in the first place disinvestment / corporatization / privatization was recommended because of the low efficiency of the SOEs, there is no data to prove that private enterprises always enjoy better efficiency than a PSU. On the contrary available data stress that the profits enjoyed by the private sector is more on account of a government which is compelled (a negative intervention as far as Indian economy is concerned) to give more and more concessions to the big business houses e.g., no tax on profits from exports, concessions on depreciation allowances and development rebate etc. Very large companies who earn huge book profits need not pay any tax, even the minimum amount of corporation tax levied recently on the so-called no tax companies is going to be diluted. Non-performing assets of the nationalised banks stand today at more than Rs 45000 *crores* and a Confederation of Indian Industry committee suggested the winding up of three such banks with huge non-performing assets. When bank workers suggested that it was the big business houses that had failed to return the bank loans of the nationalised banks and that their names should be made public, the government departments took the plea of the 'secrecy' clause of the Banking Law. (N. Bhattacharyya, *Ibid*)

Data on SOEs further suggest that government of India has been following a policy of 'privatizing the profit making businesses and nationalizing the losses' by taking over the loss making private enterprises (jute mills in Calcutta, Cashew / textile mills in Kerala) nurture and bring back to health, while gain making PSUs are now being sold out in the market. Data clearly shows that most of our PSUs are economically viable units and the nation receives every year a huge amount of corporate taxes from them. Data also suggest that in disinvestments/ strategic sales/ privatisation, the government could not achieve the set targets. Table 1 shows how their disinvestment / sale campaign performed during the last decade.

In the National Democratic Alliance (NDA) Government, 199-2004, there was a Disinvest Commission and a Department exclusively for executing the disinvestments of SOEs in India. The programme went on with full vigour and many SOEs were either disinvested or privatised. However, the first UPA Government (2004-09) was forced to

Table 1

| **PSU Equity Disinvestments** (Rs. in Crores) | | |
|---|---|---|
| **Year** | **Budgeted** | **Actual** |
| 1991-92 | 2,500 | 3,038 |
| 1992-93 | 2,500 | 1,961 |
| 1993-94 | 3,500 | -48 |
| 1994-95 | 4,000 | 5,078 |
| 1995-96 | 7,000 | 362 |
| 1996-97 | 5,000 | 380 |
| 1997-98 | 4,800 | 912 |
| 1998-99 | 5,000 | 9,006 |
| 1999-2000 | 10,000 | 1,500 |
| **Total** | **44,300** | **22,189** |

close down the Ministry of Disinvestment and the Disinvestment Commission due to strong opposition from the Left Parties. Although there were serious plans for disinvestments of SOEs, the government could not implement them because of the stern stand taken by the Left Parties against it. But, the second UPA Government that came to power in 2009 is moving ahead with the disinvestment plans as there is no serious resistance from within the coalition. In May 2010 the Union Government announced measures to streamline and fasten the process of divesting stakes in public sector units, as it tries to meet the Rs 40,000 crore target from disinvestment proceeds in 2010-11. It was planned to disinvest ten PSUs in 2010-11 including Engineer's India Ltd., Coal India Ltd., and Steel Authority of India Ltd. About seven other PSUs including Indian Oil Corporation, MMTC, RINL, Shipping Corporation, Hindustan Copper, Power Grid and Manganese Ore India are also on the government's disinvestment agenda for the year.

***c. Performance of SOEs in India***

A D& B survey report titled 'India's Top PSUs 2009' brings out the commendable performances of SOEs in India. A study conducted by the World Bank in 2005 to assess the performance of SOEs in India has drawn certain interesting results. The sample included 25 state-owned enterprises and 582 private companies operating in the manufacturing sector. The comparisons were drawn over the period 1992-2005.

a. Return on assets (ROA) of private sector firms remained more than that of their state counterparts. The ROA of state enterprises started becoming negative after 1995 and remained negative till 2005.

b. Efficiency of state enterprises calculated as value of output over production costs, although positive, remained below that of private companies during this period.

c. Indirect taxes were the single-largest business costs for private companies followed by expenses on salary during the above period. On the other hand, for state-owned enterprises, marketing costs were the highest costs during the earlier years and these costs declined during the latter part of the period.

d. The performance of all companies deteriorated over time with respect to efficiency, ROA, and return on sales. However, they performed their best on all three measures during 1993-1996, with their performance worsening during 1997-2000 and 2001-2005. Central PSEs (CPSEs) on the whole registered a strong performance during the Tenth 5-year plan (2002-2007). The numbers of profit-making CPSEs went up while the number of loss-making ones reduced. Granting complete autonomy to CPSEs remains an unfinished agenda before the government.

***d. Public investment declines in subsequent 5-year plans***

In spite of remarkable performances the share of public investment in the country's total investments declined over successive Plan periods - from almost 35% in the Eighth Plan to 29% in the Ninth Plan, to 22% in the 10th Plan. As per the Planning Commission, the share is expected to stabilise in the 11th Plan at the 10th Plan level; however, these rates of investments require to be supported by a buoyant domestic savings rate of around 35%. The 11th plan also envisages a dominant role of public policy across various sectors. These sectors include agriculture and rural development; education and skill development; health and nutrition; infrastructure development and the energy sector. Public sector enterprises at the Central government level have been allocated resources worth Rs 21,565.7 bn with state governments and Union territories have been allocated Rs 14,881.5 bn of resources for the 11th Plan period.

***e. Per capita emoluments skyrocket in 3 decades***

The Department of Public Enterprises (DPE) advises the administrative ministries/ departments and CPSEs in matters relating to the wage policy and revision in pay scales of executives. CPSEs follow the Industrial Dearness Allowance (IDA) pattern pay scales with the Central Dearness Allowance (CDA) pattern in certain cases. The government policy relating to pay scales and pay pattern is that all employees of the CPSEs should be on IDA pattern and related scales of pay. Gross emoluments of CPSE employees increased from Rs 4,150 mn in FY72 to an impressive Rs 123.11 bn in FY92, and further rose to Rs 525.8 bn in FY07. Per capita emoluments of such employees grew at a CAGR of 12% between

FY72 and FY92. Again between FY93 and FY07, such emoluments registered a CAGR of 13.3%. A rise in the emoluments indicates the massive increase in employment and income generated by CPSEs over three decades.

***f. Increase in Capital Expenditure***

The importance of the public sector is reflective of the capital expenditure expended for various growth and developmental activities. In India, the public sector has witnessed a healthy and robust increase in capital expenditure across various sectors, primarily energy. Sectors that saw substantial expenditure included agriculture and allied service; rural development and special area programmes; irrigation and flood control; energy; industry and minerals; transport; education, including medical education and health. Planned outlay in the public sector almost doubled from Rs 2,102,030 mn in FY03 to Rs 4,412,850 in FY07. Investment in infrastructure in the public sector, at both the Centre and state levels, was 4.2% of the country's GDP. As per Planning Commission estimates, the same is expected to be 6.4% of the GDP by FY12.

***g. Public sector savings surge***

Public sector savings, which consist of savings of government departments/enterprises (both Centre and state) contributed substantially to the country's overall savings. In FY07, total Gross Domestic Savings (GDS) of the country stood at 34.8% of GDP up from 23.6% in FY03. While, PSU savings to the GDP rose up to 4% from 3.3% during the same period. However, if government administrative departments are considered, public sector saving indicators reported a negative figure till FY03. Furthermore, post FY03, these indicators turned positive largely due to several policy initiatives undertaken by the government to improve the performance of PSUs.

***h. MoU Rating for CPSEs Dwindle***

The MoU, which is a negotiated document between the government and the enterprise that specifies objectives of the agreement and obligations of both parties, was designed to grant greater autonomy to CPSEs. Under the MoU system, performance evaluations are based on the annual targets agreed upon between the government and the CPSE. The performance of CPSEs, who have signed the respective MoUs, is evaluated at the end of the year based on achievements of the mutually-agreed targets. During FY07, 94 CPSEs signed MoUs with the government, while 19 could not submit MoU performance evaluation reports for the above period. Additionally, 143 CPSEs signed MoUs with the government for FY08.

Based on the performance, the companies are graded on a five-point scale, namely excellent, very good, good, fair and poor. The performance evaluation is broken into financial and non-financial parameters and both carry equal weights. Non-financial parameters are further sub-divided into dynamic parameters, enterprise-specific parameters and sector-specific parameters. The financial parameters generally relate to profit, size and productivity, the dynamic parameters refer to project implementation, investment in R&D and extent of globalisation. Similarly, while the sector-specific parameters refer to macroeconomic factors like change in demand and supply, price fluctuations, variation in interest rates, etc, which are beyond the control of the management, the enterprise-specific parameters relate to issues such as safety and pollution, etc. The number of CPSEs that were awarded excellent ratings reduced from 54 in FY04 to 45 in FY07. The organisations that were awarded poor ratings increased from two in FY03 to 94 in FY07.

### *i. Key highlights of the public sector in India*

i. In FY07, the public sector, comprising administrative departments, departmental enterprises and non-departmental enterprises, constituted 21.4% of the GDP and 22.3% of the gross domestic capital formation. In domestic savings, on the other hand, the public sector had a share of 9.3%.
ii. The share of the public sector in India's GDS was -3.2% in FY00 and 9.3% in FY07.
iii. The Gross Savings Rate of the public sector was 3.2% in FY07.
iv. CPSEs account for more than 1/3rd of total revenue receipts of the Central government.
v. The net worth of all enterprises stood at Rs 4,530 bn (FY07)
vi. CPSEs paid a dividend of Rs 268 bn in FY07.
vii. The public sector accounted for 11% of the total merchandise exports and export earnings grew by 33% during FY04-FY06.
viii. CPSEs reported a 53% growth in turnover during FY04 and FY07.
ix. Net profits rose from Rs 695 bn in FY06 to Rs 816 bn in FY07.
x. Number of loss-making institutions decreased from 89 in FY04 to 59 in FY07.
xi. Internal resource generation of CPSEs grew by 21.7% in FY07.

### *j. Issues of Governance*

The Government, as a major shareholder in SOEs, faces a wide range of risks associated with the operations of SOEs, including financial, reputation, political and operational risks. It is the responsibility of each Executive Authority (in whom the primary responsibility for appropriate SOE oversight and accountability to Parliament rests) to ensure that these risks are identified, reduced and managed. In this regard, a key requirement of SOEs is to report and account for their performance to the relevant Executive Authority in respect of financial and non-financial matters, at the same time, however, maintaining independence in the conduct of their duties and free from day to day involvement by the Executive Authority. In order to ensure that there are no actual or perceived conflicts of interest and that SOEs achieve the Government's broad policy objectives and ensuring that the SOE's boards operate efficiently and effectively, the Government should spell out its intentions and envisaged relationship with SOEs, Shareholder Compacts and Policy Framework for SOE released by the relevant Executive Authorities from time to time.

One set of researchers argue that the gravity of globalization is so powerful that the countries will converge their corporate governance practices. Hansmann and Kraakman (2001) argue that the global corporate governance systems are converging towards the Anglo-American model which focuses on the shareholders' interest and they suggest that it is indeed desirable. They designate this shareholder-oriented model as 'standard model' and identify four more types of governance models, namely the manager-oriented model (adopted in the US from 1930s to 1960s), labor-oriented models (example of a labor-oriented model is the German style codetermination), state-oriented models (example: post-war France and Japan), and the stakeholder-oriented model (a variant on the manager-oriented and labor-oriented models. They argue that the shareholder primacy will predominate as there are other legal mechanisms to protect the interests of the other stakeholders). Further, the authors argue that the competitive pressures of global commerce will speed up the process of convergence. The other researchers like Coffee (1999) also agree with the view that convergence would happen. Hopt (1997) suggests that the needs and the chosen practice of large enterprises will force them to fall in line with American corporations.

Mukherjee-Reed (2002) confirms that even the developing countries are also moving towards Anglo-American governance model, the change being led by the modifications in the legal and regulatory systems. Verma (1997) argues that the Indian corporate governance systems are falling in line with the Anglo-American model. Khanna et al. (2006) points that the multi country economic bodies like OECD are developing the globally accepted corporate governance practices and it is an example of convergence of the corporate governance system.(Refer Bernard Black, *Does Corporate Governance Matter? A Crude Test Using Russian Data,* 149 U. PA. L. REV. 2131, 2133 (2001).

Whereas another set of researchers does not agree with argument that corporate governance models are converging. They argue that the corporate governance mechanisms of various countries will never converge. The main reason quoted is the path dependence of the economies of various countries.

Bebchuk and Roe (1999) identified two sources of path dependence—structure-driven and rule-driven. The existing corporate ownership structures in any country depend on the structures with which the economy started ('structure-driven' path dependence) and on the financial and corporate regulation ('rule-driven' path dependence) which in turn is influenced by the initial corporate structure. They argued that the rules and laws that an economy has at any given point of time depend on and reflect the ownership and governance structures that the economy had initially. They conclude that both structure-driven and rule-driven mechanisms tend to lead to persistence in ownership and control structures for reasons of efficiency because initial ownership patterns influence which type of corporate regulation would be efficient.

The emergence of CG has its own history in different parts of the world. In the present global environment, where economies are integrated with global market environment, it is imperative to develop a sound system of CG. It is more so in emerging economies like India. The first major stimulus for CG reforms was the Southeast Asian crisis during 1997-98 followed by the Enron debacle in 2001, which necessitated the need for ensuring better CG practices, culminating in the enactment of legal measures like Sarbanes-Oxley Act of 2002 in the US.

The Key Challenges of Corporate Governance in India, as summarized by Dr. YRK Reddy are:

- Lack of awareness of corporate governance framework, standards, their rationale and their socio-economic impact, among civil servants and political leaders.
- Lack of systematic training in Corporate Governance for Boards and top management of SOEs in the areas of performance appraisal, promotion of transparency and curbing inefficiency
- Disclosure of the reports of Audit Committee, Remuneration Committee and Shareholders'/Investors' Grievance Committee in the CG report.
- Constitution of separate board committees for effective governance of the company's affairs, e.g., Ethics Committee, Nomination Committee, Investment Committee, etc., and disclosure of the reports of these committees in the annual report.
- Disclosure on mechanism of evaluation of non-executive directors' performance.
- Creating incentives to mitigate entrenched interests; Sunk costs –among Ministries, Civil Servants.
- Potential resistance to some CG standards from Top Management of SoEs–especially relative to budgetary support; Government guarantees; purchase preferences; special status as civil servants etc.

Needless to say that the above issues are to be addressed not only for the efficient performance of the SOEs but also for their sustainability.

***k. Issues and challenges***

Over the years, the Public sector enterprises in India have performed commendably well. Not only did they expand production and profit levels but also became an important choice of investment for global and domestic investors. Market capitalisation of the public sector enterprises in India constitutes a major portion of the total market capitalisation and several SOEs attract huge investor interest. These enterprises are growing in size and stature, competing with the major competitors in domestic and international markets, by focusing on business growth and diversification as also profitability and productivity. In future, the SOEs will garner enough opportunities and will enhance their scope of strategy, apart from building their competitiveness through strong and proactive leadership, effective management, and efficient processes that govern business planning and development, and management of resources.

In recent years, the implications of corporate governance seem to have increased to significant proportions. Corporate governance includes policies and procedures adopted by a corporate entity in achieving its objectives with relation to its stakeholders, both internal and external. In the Indian context also, corporate governance is a major challenge for SOEs, especially in terms of the number of independent directors that are required as per listing agreement norms. The Securities Exchange Board of India, for instance, in its review of compliance of the listing guidelines, named a few leading public sector enterprises for not fulfilling requirements about the number of independent directors. Growing competition from the private sector within India and outside will pose new challenges, as existence of a level-playing-field will decrease the public sector's opportunities for special privileges and concessions that some of them enjoy. (See India's Top PSUs Second Edition, 2009. The major challenge before the SOEs is to remain as an SOE without getting the ownership diluted and to achieve the performance standards. The issues are of ownership and governance.

## PART III

### Kerala Experience

The turnaround' saga of the Kerala PSUs is a classical illustration of how a committed government with political will can take strategic initiatives to revamp the SOEs. While The Government of India is moving ahead with the disinvestment proposals the general consensus is that the impact of the global melt-down has been the minimum on the Indian economy on account of our robust PSUs in the crucial sectors. Though there has been an overwhelming demand from the private sector to take over the ailing PSUs in Kerala, it was the Left Democratic Front government in Kerala that proved that with a firm political will even the loss making PSUs could be 'turned around' into profitable ventures.

Kerala has a unique position with largest network of PSUs. Altogether there are 114 PSUs in the State. Under the Industries Department there are 63 PSUs out of which, 17 were closed down for long periods, 5 were welfare corporations and 4 were developmental agencies. 37 companies are presently engaged in manufacturing activities. In 2005-06, majority of the PSUs were making losses. Only 12 out of 44 the then opertaing companies were making profits. These units together made a loss of Rs.69.64 crores. All the nine sectors except Development and Infrastructure sector, which was mainly operating in the financial area, were making losses. The loss incurred by all the loss making units during that year was Rs.125.87 crores. From 2006-07 onwards the situation started changing. In 2006-07 there was a considerable leap both in the case of turnover and profit. The total turnover was Rs. 1763.74 crores against Rs. 1540.40 crores in the previous year and the total profit was Rs. 91.18 crores. The number of profit making companies increased to 24. In 2007-08, the number of profit making units was increased to 27 and the total profit was Rs. 80.30 crores. In 2008-09, in spite of global economic recession and corresponding shrink in demand, the companies presented extremely impressive results. Out of the 41 companies, 28 companies became profitable. Total turnover was Rs. 2105.01 crores and total profit was Rs. 169.45 crores. There was an increase of 16 percent in the turnover and 111 percent increase in profit compared to previous year. In 2009-10, out of the 37 companies, 32 companies became profitable. The total turnover was Rs.2190.73 crores and the total profit was Rs.239.75 crores. The loss incurred by the five loss making units was only Rs. 6.45 crores. There was an increase of 4.07 percent in turnover and 41.48 percent in profit from the previous year. An amount of Rs. 340.57 crores was remitted to the exchequer as Commercial Taxes, Excise Duty and Electricity charges. 5850 new appointments were made in this sector during the last four years, out of which 1647 were in 2009-10.

A brief sketch of the initiatives those contributed to the "turn around" is given below.

*Reorganising the Management*

The weakest part of the PSUs was the totally unprofessional and unaccountable management. Appointments of Chief Executives in these organisations were mainly on political considerations and their management expertise was never considered. In the case of second line management also there were severe gaps. There were two important issues before the Government; (a) attract management experts at the senior level and (b) improve the skills of the existing officers.

In order to get experts at the top level the appointment system itself was changed. A selection board was constituted for this purpose and appoints were made through open advertisement and interview. Search Committees were also constituted to identify experts of various sectors and some good and efficient people were selected through this way also. For capacity building of second line management, training programmes are being implemented. Under the aegis of Public Sector Restructuring and Internal Audit Board (RIAB), an annual training calendar is prepared and the officers are given training with the help of outside subject experts.

*Settlement of Dues to the Banks and Financial Institutions*

Many PSUs owed short term and long term loans from banks and other financial institutions, the pay back of which was not timely and proper which resulted in huge arrears and strained relations with the lenders. Consequently, these agencies withdrew from financing the PSUs and their operations were adversely affected. In 2006-07 the dues to banks by seven companies were too high and their financial operations were badly affected. Total amount to be paid by these companies was Rs. 359.66 crores. Government have taken special steps to settle this issue once for all. High-level discussions were held and the dues of Rs. 359.66 crores were settled for Rs. 89.39 crores payable at equal instalments.

***Periodical Monitoring of Performance***

For the last four years, monthly review of performances of the PSUs is done every month. The Minister and the high level officers of the Department attend these reviews. The monthly review has proved to be an effective tool for improving the performances of the companies. The details of performance of these units for a month are collected by RIAB by tenth of next month and the same is analysed by them and the report is presented in the review meeting. Detailed analysis of the performance is done in the meeting focussing on the implementation of the decisions in the previous meetings, achievement of production vis-a-vis target, financial position, implementation of modernisation / development projects, if any, etc. Decisions taken are furnished to them by the end of the meeting itself.

***Auditing of Accounts***

It was a matter of serious concern that there were huge arrears of auditing of accounts in the PSUs. Some companies had not audited their accounts for more than ten years. There existed no financial planning and the figures reported were not factually correct. The internal auditors in many companies had not brought out the real issues and at least in some companies they were giving tacit consent to the wrong practices of the management. To address these issues Government prepared a panel of Chartered Accountants and directed the companies to appoint internal auditors only from this panel with a direction to change them after three years. A fast track system was adopted to complete the pending audits with the help of Auditor General. Concurrent audit of more than one year was permitted by the AG and this has proven very effective. In almost all operating units the internal audits are up to date and statutory audits are pending in some companies mainly due to procedural problems.

***Mutual Support and cooperation***

Government initiated special steps to harness the synergy of PSUs and to organise their operations on terms of mutual benefits. Since many companies are operating in similar fields, combined sourcing of raw materials, providing technical support and avoiding competition between the companies could be achieved through this step. Financial assistance is being provided by well off companies to those, which are in need of money. Preferences were always given to other PSUs in case of sale / purchases of products and services. Support from the government departments also was ensured.

### *Strategic tie-ups with Central PSUs / Government*

It was an innovative idea of the government to associate with Central PSUs for the revival and modernisation of state enterprises for technology up-gradation and better professional management of these companies. The State government has a limitation on investing huge amounts in new projects for modernisation and technology up-gradation. We could overcome this by tying- up with central PSUs that have the synergy. Four companies are so far put forward to go for tie up with Central PSUs or Central Government agencies. They are TELK-NTPC, SCL- SAIL, KEL-BHEL, and SILK-AUTOKAST-RAILWAYS. KELTEC, a company primarily doing machine work was taken over by M/s Brahmos in 2007. Kerala Minerals and Metals Ltd., is setting up a 500 TPA Titanium Sponge Plant with full funding of VSSC and technology support from DMRL. The plant will be commissioned in January 2010. The whole Titanium Sponge produced in the plant will be taken by VSSC for their space application. Once this plant is set up, India will be the seventh country in the world having the Titanium Sponge manufacturing technology. Travancore Cochin Chemicals Ltd. is setting up a new Sodium Chlorate plant for ISRO at the cost of Rs.22 cr . The cost of this project is borne by VSSC and the product will be fully lifted by them.

In addition to the above, business relations are developed by Keltron with Indian Defence, BEL, ECIL and ISRO. Steel Industrial and Forgings Ltd. has long standing tie-ups with ISRO. Heavy Engineering Corporation of India Ltd. has expressed willingness to collaborate with Steel Industrials Kerala Ltd. Government is looking for more strategic tie-ups with Central Government and central PSUs.

### *Merger and Amalgamation*

A proposal to merge companies of similar line of production and to harness the synergy is under serious consideration. This will reduce the overhead expenses; improve cooperation in sectors of technology, manpower, marketing and finance. Moreover, a bigger organisation will be more capable to meet the challenges of markets. Some small companies have already merged into single entity. This is a time consuming process as lot of procedural formalities are involved. Some more SOEs are in the process of merger.

### *Expansion, Modernisation and New Projects*

In the budget for 2010-11, Rs. 54.80 crores is allotted for the development and modernisation of the PSUs. During this year it is planned to implement expansion programmes to the tune of Rs. 275 crores in nine companies. In addition to the above, ten more units are going to be started in this year investing Rs. 170 crores.

The turnaround of Kerala PSUs is the result of political will, pro-psu stand of the Government, Policy initiatives and effective implementation *"What is noteworthy about* *the Kerala case is not just that public sector units have been made profitable within a very short period of time, "turned around" as the phrase goes, but that they have been "turned around" without in any way compromising their public sector character, without adopting any of the rapacious methods associated with private monopoly capital, and without even using any of the usual strategies for "turning around" that are common employed by private monopoly capital. The "turn around" has been achieved without any recourse to land speculation, without any large-scale retrenchment of workers, and without any recourse to financial manipulations or jugglery. It has been achieved essentially by streamlining management and operations, and this has become possible only because the political will for doing so has been summoned".* (Prof. Prabhat Patnaik, Vice Chairman, Kerala Planning Board)

## PART IV

### Conclusion

As showed earlier, the SOEs are the result of deliberate political decisions of the governments at various levels to intervene in the economic activities for ensuring self reliance, welfare and development of the society. In many countries, the ruling capitalist class had welcomed such steps for various reasons. But, of late, there were demands from them to dilute the ownership structure of the SOEs. Many governments succumbed to the demand and the SOEs had lost the strategic positions in the national economies. But the neoliberal capitalist experiments were not successful and in many countries they were proved to be catastrophic. However, defeat of the neo liberal experiments has once again brought forward the importance of SOEs in the national economy and their contributions for the welfare of the society.

Different scholars have advocated various ways in which state can intervene in an economy be it a colony or a developing economy or an advanced corporate economy. The nature of intervention is different in each case. The SOEs are one such manifestation of state intervention. In many developing countries, state enterprises are assigned the responsibility of fulfilling specific social goals, which have their origin in colonial period. Whatever may be the idea behind the creation of such enterprises, they come into existence either by direct state investment or through nationalisation of private enterprises. The state intervenes through SOEs in the countries where investment needs for different projects are large and the expected returns at least in the short run are too low to motivate private capital to invest. (See Madhu Bala : *Economic Policy and State Owned Enterprises: Evolution Towards Privatisation in India,* 2006)

There are at least five different cases where such direct undertaking of economic operations on the part of the State becomes necessary.

1. Provision of necessary goods and services like food, education and health-care as the distribution or access to such goods and services in a free market capitalist economy produces significant deprivation for large segments of the population.
2. To break monopoly power through the countervailing presence of the state as a producer and seller.
3. In natural monopolies like in minerals, or where there are substantial economies of scale, exclusive public sector production, subject to social control exercised through the political process, is socially desirable.
4. Areas were private investors hesitate on account of lumpy investments, long gestation period; like iron and steel to fertilizers, to heavy electrical, to machine tools, to oil exploration and refining, to offshore oil extraction, the public sector becomes not only an effective counterweight to the monopoly position enjoyed by metropolitan firms, but also a means of enhancing domestic technological ability
5. To counter the perennial tendency of capitalist economies to experience involuntary unemployment owing to a deficiency of aggregate demand.

Hence the necessary role of public sector as a bulwark against monopolies, both domestic and foreign, and as a means of enhancing people's access to essential goods and services becomes a prerequisite for building a human society and they form an integral part of a democratic order. (Prof. Prabhat Patnaik, *Speech on the Resurgence of Kerala PSUs*, November, 2009)

Current the, owing to the financial meltdown, role of the Public Sector is debated world over. Inefficiency, corruption and liability upon the public exchequer are mainly argued against this sector. There are some truths in these arguments. But, these are not the peculiar characteristics of public sector alone. The performances of private sector are also not free from these vices. In India the number of sick private sector units outweighs the number of sick public sector units. In the case of corruption and violations also there is no evidence to show that the public sector units are more in number. Factually, it is otherwise. The poor performances of the enterprises, irrespective of the ownership structure, are due to certain fundamental issues. These issues are related to good governance, commercial wisdom, financial propriety, productivity and the management systems. Once these elements are put in proper place, the performances will improve notwithstanding the ownership title. When we are preparing an agenda for the resurgence of SOEs, these elements are to be taken into account very seriously.