Sustainability of Public Sector Enterprises for Nation Building: An Assessment of Disinvestment Strategies in India

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Abstract

The Public Sector Enterprises (PSEs) have contributed significantly in the growth and development journey of India. Over the past few years, survival and viability of some of the PSUs have posed significant challenges before the Government. Keeping in view the declining productivity and operational efficiency, Government has initiated disinvestment process for the selected PSUs to make them viable and sustainable. The disinvestment process of PSEs in India has been subject to a number of challenges, impacting their fair valuation in pre-disinvestment era resulting in not getting their fair price. Many of the previous studies have felt the need for a fair and reasonable disinvestment policy. This study has suggested a framework with required modifications that will help the PSEs to receive fair price through appropriate valuation. This will help in maintaining the sustainability of PSEs in the long run.

Keywords: DCF Technique, Special Purpose Vehicle, disinvestment, strategic valuation, fair price.

1. Introduction

Though the disinvestment policy for PSEs was formulated in 1991 but it was given a new direction in the union budget 2020-21. The Central Government issued a new policy document titled, Strategic Disinvestment of Public Sector Enterprises. The main objective of this document was to provide a roadmap for initiating disinvestment process in both the strategic and non-strategic sectors. The Government also fixed an

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ambitious target to mobilize an amount of Rs.1,75,000 crore out of the disinvestment during the year 2020-21. The sectors that were targeted for the disinvestment during the year included, the Central Public Sector Enterprises (CPSEs), Public Sector Banks, and Public Sector Insurance Companies.

Further, the Government categorized the Public Sector into two categories, viz. Strategic Sector and Non- Strategic Sector. In case of non - strategic sectors, the Government proposed to withdraw from all businesses and have a 'bare minimum' involvement primarily in four broad strategic segments viz. (i) Atomic energy, Space and Defense, (ii) Transport and Telecommunications, Power, (iii) Petroleum, Coal, and other minerals, Banking, Insurance, and financial services.

It was also proposed that the Government would provide incentives to states for disinvestment of their Public Sector entities. To achieve this objective, separate incentive package of Central Funds for states would be formed and help the states to implement this task in practice. The new disinvestment policy further envisages closure of 151 PSUs adopting case-by-case approach. Among these, 83 holdings are the companies and 68 subsidiaries are in non-strategic sectors. Also, Special Purpose Vehicle (SPV) would be created in the form of a separate entity to carry out monetization. The following strategies were suggested:

i).The strategic disinvestment should be undertaken through a consultation process among different Ministries/Departments, including NITI Aayog;

ii). NITI Aayog to identify CPSEs for strategic disinvestment and advise on the mode of sale, percentage of shares to be sold and method for valuation of the CPSE;

iii).The Core Group of Secretaries on Disinvestment (CGD) will consider the recommendations of NITI Aayog to facilitate a decision by the Cabinet; and.

iv). Committee on Economic Affairs (CCEA) on strategic disinvestment will supervise/monitor the process of implementation.

Source- Department of Inverstment and Public Asset Management (DIPAM), Disinvestment policy.

There seems to be a shift in the Government approach towards privatization of PSUs more so in the last few years. The Government had strong inclinations towards aggressive privatization of Central Public Sector Enterprises (CPSEs) where disinvestment targets announced on higher side in the last two budgets viz. Rs.2.1 lakh crore in 2020–21 and Rs.1.75 lakh crore in 2021–22. According to Jain (2021), though the targets for disinvestments are high, disinvestment policy continues to be a politically sensitive policy decision.

A study was undertaken by Jain (2021) for 11 CPSEs where strategic disinvestment commenced during 1999–2000 and 2003–04. To measure the performance, net worth (equity capital and profits), net profit (profit after tax), gross revenue, return on assets (profit after tax to assets), return on equity (profit after tax to net worth), net profit margin (profit after tax to operating income), sales growth, and gross profit per employee (profit to the number of employees) were used. The findings indicate a positive impact of privatization as shown in Table1.

Table 1: Decentalised Identified (DiD) Measure for Select Performance Indicators

Indicator	DiD value
Return on assets	5.04%
Return on equity	0.89%
Net profit margin	15.26%
Sales growth rate	4.89%
Gross profit/employees	21.34 (in lakhs)

Source: Compiled from Chapter 9, Economic Survey, 2019–20.

There is a view that privatization is assumed as an option to bring efficiencies and improvements in the functioning of public sector entities but slow pace of disinvestment of PSUs in India is not in tune with it. There is a good amount of literature supporting the positive impact of disinvestment in India (Majumdar 1998; Ghosh 2008; Gupta 2005; Jain 2017; Chhibber and Gupta 2018). The revival plan pursued for performance of CPSE in India should involve a systematic approach by segmenting the entities into different categories based on their past performance like, future profitability, industry scenario and possibilities of revival. Then appropriate policy tools may be customized based on the above criteria. "Strategic disinvestment as the "go-to" policy option reflects the strong emphasis on the current government's short-term capital gains. Mere reduction of the solution to privatization indicates the narrow lens through which PSEs have been evaluated in the *Economic Surveys* of 2019–20 and 2020–21."

The new policy on disinvestment has added focus on loss making units. "To ensure completion of closure of loss-making CPSEs, we will introduce a revised mechanism that will ensure timely closure of such units," Union Finance Minister Nirmala Sitharaman had said in her FY22 budget speech. The budget also proposed to set up a Special Purpose Vehicle (SPV) for monetization of non-core assets, largely surplus land, with ministries and CPSEs.

All said and done, there is another problem with CPSEs disinvestments regarding Minimum Public Shareholding (MPS) where every listed company has to maintain a public shareholding of at least 25 per cent according to provisions of Securities Contracts (Regulation) Rules (SCRR). It is observed in case of CPSEs disinvestment that many CPSEs have not achieved Minimum Public Shareholding (MPS) norms. Table 2 presents the status of non-achievement of 25 per cent MPS.

Table 2: Details of Disinvestment of PSEs as of February 2021

Year	Target	Achievement	Achievement %	Total Receipts
1991-92	2,500	3,038	121.51	3037.74
1992-93	2,500	1,913	76.5	1912.51
1993-94	3,500	0	0	0
1994-95	4,000	4,843	121.08	4843.1
1995-96	7,000	168	2.41	168.48
1996-97	5,000	380	7.59	379.67
1997-98	4,800	910	18.96	910

1998-99	5,000	5,371	107.42	5371.14
1999-00	10,000	1,585	15.85	1860.14
2000-01	10,000	1,871	18.71	1871.26
2001-02	12,000	3,268	27.24	5657.69
2002-03	12,000	2,348	19.57	3347.98
2003-04	14,500	15,547	107.22	15547.42
2004-05	4,000	2,765	69.12	2764.87
2005-06	0	1,570	N.A.	1569.68
2006-07	0	0	N.A.	0
2007-08	0	4,181	N.A.	4181.39
2008-09	0	0	N.A.	0
2009-10	25,000	23,553	94.21	23552.96
2010-11	40,000	22,763	56.91	22762.73
2011-12	40,000	14,035	35.09	14035.27
2012-13	30,000	23,857	79.52	23956.81
2013-14	54,000	21,321	39.48	21321.04
2014-15	58,425	24,349	41.68	24348.71
2015-16	69,500	24,058	34.62	24057.73
2016-17	56,500	46,378	82.09	46246.58
2017-18	72,500	1,00,642	138.82	100056.91
2018-19	80,000	85,063	106.33	85063.17
2019-20	90,000	49,828	55.36	50298.64
2020-21	2,10,000	18,223	8.68	18223.22

Source: (Compiled through Government websites).

The above table reveals that actual performance of achievements of disinvestment targets have been much below except during the period of last 3 decades beginning from 1991-91 to 2020-21. This is despite of the fact that all the governments have stressed for disinvestment of PSEs in their regime. However, looking to the targets, it can be assumed that present government has had fixed higher targets as compared to earlier governments. The targets fixed for the year 2020-21 were on much higher side. The government fixed a target of Rs 2.10 trillion for FY21 for PSEs sale and stake sale in state owned entities. This included Rs 1.20 trillion from selling stakes in the Central Public Sector Enterprises (CPSEs) and Rs 0.90 trillion from sale of public sector banks and financial institutions. Later on, the government revised the target of disinvestment to Rs 0.32 trillion. However, the government has achieved Rs 0.328 trillion through sale in the CPSEs and buybacks of shares in the financial year 2020-21. It is 15.64 per cent of total target, 27.36 percent of target for CPSEs disinvestment, and 102 percent of the revised target of disinvestment.

A view on recent Performance under disinvestment

Following are the highlights of the performance of PSEs that were divested:

- "According to the Department of Investment and Public Asset Management (DIPAM), between 2004-05 to 2013-14, disinvestment raised Rs. 1.07 lakh crore, on an average yearly collection of Rs. 10,700 crores.
- However, from 2014-15 to 2017-18, the collection went up to Rs. 2.12 lakh crore, i.e., a yearly collection of Rs. 53,000 crores.
- The Government exceeded the target of Rs. 1 lakh crore in 2017-18 and Rs. 80,000 crores in 2018-19.
- The success of BHARAT-22 Exchange Traded Funds (ETF) takes government closer to the disinvestment target. The ETF is a benchmark to an index named BHARAT22 consisting of 22 companies (19 PSEs and 3 private).
- However, in 2020-21 due to the COVID-19 pandemic, the disinvestment process was hindered in between. It could only gather disinvestment revenues of Rs 31,000 crore against a target of Rs 2.1 lakh crore.

The government had planned that a maximum of four CPSEs in the strategic sector would be allowed and state-owned firms of non-strategic sector would eventually be divested. It was proposed to sell a part of the government's holding in Life Insurance Corporation of India by way of initial public offer. Besides that, the government planned to sell the balance holding of the government in IDBI Bank to private, retail and institutional investors through the stock exchange. At present, the Government holds 47.11 percent and LIC holds 51 percent stake in IDBI Bank.

2. Challenges of disinvestment

i) The first and foremost challenge will be as regards to sale of profit-making and well performing PSEs that will result in the loss to the Government since the government will be foregoing the regular income received by it by way of dividend and other receipts from these enterprises. In all, it looks that the entire exercise aims on resource mobilization by the government. However, there is an ample scope for improving the functioning and organizational structure of PSEs to make them more effective to contribute for the growth and development of the country.

ii) The government's decision for continuing the government holdings up to 51 percent have impediments in terms of the valuation of shares and this impacts the fair valuation adversely. There is a widespread feeling that if the government continues to hold majority ownership, the public enterprise will remain under the direct control of the government and operate on traditional lines following the traditional culture, systems and procedures in which they have been operating since long.

iii) In principle and practice too, the Government is averse of losing its control over the PSEs operations despite its focus on disinvestment policy and programs. Even in the budget presentation of 2019-20, it was emphasized that government is willing to change the extant policy of government. The budget document said that it would change the policy of holding 51 percent or above in a CPSEs to one where the total holding, "direct" plus "indirect", is maintained at 51 percent. It infers that government would continue exercising its control over PSEs.

iv) There are many evidences from various research studies that suggest that the process of disinvestment has many obstacles due to bureaucratic control at different stages. There are undue influences in taking various decisions related to valuation, bidding processes and procedures. Also, PSEs face lot of administrative problems, delays in decisions, decentralization of powers. All these have adverse impact on operational and financial efficiency of the PSEs.

v) A number of experts and professionals opine that strategic disinvestment of PSEs may pose problems to Oil sector as well as a threat to national security. According them, oil being a strategic natural resource, transfer of ownership to the foreign companies may not be in consistence with strategic goals. For example, disinvesting Bharat Petroleum Corporation Limited (BPCL).

vi) Further, the loss-making PSEs are not found lucrative by the investors and therefore investments for them are not easily available. It depends upon the perception of investors about the PSU being offered. This has been noticed that many PSUs are not able to mobilize the minimum subscription from the public as per SEBI guidelines. The perception of investors assumes more significance in the case of strategic sales, where the amount of investment is very high.

vii) There is a need for serious consideration and justification for disinvestment for using funds from disinvestment is to bridge the fiscal deficit. Objective of disinvestment to create a vibrant and strong structure of PSEs for the growth of the country bringing operational efficiencies so that they could contribute to the core services.

3. Literature Review on Valuation Methods followed for PSEs Disinvestment

Gupta et.al (2011) evaluated various aspects of disinvestment process in PSEs and also studied the problems and challenges they face in the privatization process. The study concludes that in majority of cases disinvestment process has not been able to achieve the desired performance, among various factors responsible the over loaded cost structure, inefficient and non-competitive organizational structure, operational inefficiency, undue interference, unsuitable environment conditions, the smaller proportion of disinvestment and therefore inefficiency in capital market. The study suggests strategic sale method of disinvestment since minority extent of disinvestment have not been found as viable and productive propositions. The study concludes that full privatization with broad base proprietorship and control management of the enterprises will be the better option for bringing more efficiency in the privatization process. Augustine (2012) investigated and suggested that Air India privatization program may not be a viable alternative due to lesser interest of foreign investors in the Indian capital market. The study suggested an alternate option could be to opt for Public Private Partnership (PPP) The aircrafts can continued to be used by the legislators and owned by businessmen. Public private participation can resolve the issues identified with disinvestment and in the meantime acquire the upsides of private area proficiency and public sector viability.

Gurmu (2012) examined financial and operating performance of State Owned Enterprises to assess potential impact of privatization in the leather Sub Sector. The relationship between privatization of public enterprises and financial and operational performance of these to State Owned Enterprises has also been studied. The study concludes that privatized enterprises performance could not improve in terms of operating performance and profitability but it provided conducive environment in terms of better investment, improved liquidity position, decline in overstaffing and debt reduction. The findings also suggest that poor performance may be on account of inadequate finance, increase in production costs, lesser number of employees and management is it inefficiency and an inappropriate assets valuation method at the time of privatisation. Bai et. al (2013) examine the effects of privatization in China, where all controlling and ownership rights are transferred to private sector and the partial privatization performance where shares are transferred to private sector rather than the controlling rights. The study analyzed and found that partial privatized firm‘s performance is better as compared to the fully privatized firms. The study suggests that fully privatized firms may not perform in a desired manner in transition economies of China on account of inefficient legal system. The findings emphasized the importance of minor shareholders at the time of privatization and argue against private block shareholders.

Koner and Sarkhel (2014) explain the difference between disinvestment and privatization and the changes and initiatives taken by the government towards disinvestment of PSEs.The study also highlights certain issues related to disinvestment like, the rationale of disinvestment, extent of disinvestment and the process of disinvestment. It suggests fair valuation of the PSEs proposed to divested, to enhance the value of shares and attract the better capital appreciation. The study recommends three vital areas of restructuring that include financial restructuring, business and technological restructuring and corporate restructuring. Further, it suggest that disinvestment decision should consider the prevailing capital market conditions

Khatik S.K and Singh P.K (2005) have attempted to assess and evaluate the profitability and financial performance of Industrial Development Bank of

India (IDBI) using the application and technique of Ratio Analysis. Capital adequacy ratio, non-performing assets, priority sector advances, statutory liquidity ratio, cash reserve ratio and credit deposit ratio were the major components used during the Study. The study analyzed that the bank emphasized on lowering the cost of deposits, improving fee based income, operational efficiency and managing cost. Though the challenges faced by the bank were severs in nature but it has made significant improvements and progress during the period of study. Harshvardhan Halve and Anurag Singh (2006) had his overview on disinvestment that the valuation of business entity is a balanced combination of Art and Science. There is no `Surefire' way to value a company or a business entity. The bottom line is, of course, that the business is worth what a buyer is ready or willing or able to pay. So, the value of an entity finally by all practical means becomes the value as perceived by the involved parties.

Omrane and Jeffrey (2011) evaluate 1866 privatized firms involving 37 countries to assess the impact of disclosure norms and legal institutions that direct auditors on the method chosen for disinvestment of the state-owned enterprises. The study observed agency conflict between minority and controlling shareholders that prevented the policymakers from taking disinvestment decision and privatize the enterprises. Therefore, selling government stake to a wider range of investors in the capital market through issue of shares to generate important spillover economic benefits was hampered and shares were sold to a small group of buyers. The study finds sale through public shares became more significant when countries followed strict disclosure norms. The study further observes that investors valued reforms and became more participative when disclosure norms were elaborative and transparent and auditors adopted severe private and public enforcement on other legal determinants.

Koner and Sarkhel (2014) in a study described various policy decisions on disinvestment policy taken up by the government which got criticised from different groups both, within the government and outside the government. The criticism related to many areas and issues of disinvestment decisions like, the rationale and approach of government`s classification of 1999 disinvestment policy of strategic and non-strategic sectors, the logic and desirability to disinvest profit - making public enterprises, the types of arrangements and strategies for disinvestment through public offer on stock exchange or strategic sale to a private partner, the methods and procedures of valuation of a public enterprise before a bid for disinvestment and process of utilization of disinvestments proceeds. Kumar, R.S (2017) highlighted political interference, unnecessary opposition by political parties, extent of differences among states and Central Government policies, inter-ministerial conflicts and delay in the disinvestment process were major hindrances in the execution of disinvestment process and its implementation in India. Further, the study pointed out incompetency of those involved in disinvestment process, their ignorance of technicalities, restructuring process, lack of transparency in valuation, faulty method of valuation, under realization of resources, further deteriorated the effective implementation of the disinvestment process and progress.

Nagaraj (2005) opines that disinvestment is unlikely to affect economic performance since the state continues to be the dominant shareholder, whose conduct is unlikely to be influenced by share prices movements (or return on equity). Privatization can be expected to influence economic outcome provided the firm operates in a competitive environment; if not, it would be difficult to attribute changes in performance solely or mainly to the change in ownership. Kaushik (2018) explains that a large part comes from strategic disinvestment, where there is sale of a substantial portion of the government shareholding of a PSE (up to 50 percent or higher as determined by the competent authority) including transfer of management control. World Bank, (2020) and Willemyns (2016) have expressed concerns in the WTO by developed countries such as the US, Australia, Germany, etc., that PSEs can be used by certain countries to distort investment flows and competition in trade, affecting the development of efficient Global Value Chains (GVCs) and opening up of domestic markets for foreign investment. A study on sustainable privatization of infrastructure projects by, Kumar Das (2009) suggests a way for government to make infrastructure delivery more effective and efficient as compared to public provisions. The study concludes disinvestment leads to significant improvement in profitability, efficiency and optimum output of business firms. It also provides certain fiscal measures to increase revenue to the government.

Sarkar and Sensarma (2010) analyzed the impact of partial privatization on performance of state-owned banks during the period 1986-2003 assuming that privatization brings improvements in the functioning even in the case where government holds ownership controls. Their results reveal improved performance of public banks in India during the post privatization period. The success of this goes to partial privatization. The study also revealed that banks that are listed performed significantly better. Ochieng and Ahmed (2014) examine the effect of privatization on the financial performance of the Kenyan aviation industry before and after it was privatized by analyzing financial statements throughout this period., with specific reference to the Kenya Airways Limited. They analyzed that performance of Kenya Airways after the privatization program has been improved in terms of leverage and liquidity ratios when compared to pre - privatized performance. In addition to this effect, the operation performance indicator of asset turnover and income efficiency was increased but there is a decline in employment in the years that followed privatization.

Trien and Jonathan (2010) suggest that state ownership and debt both have adversely impacted the performance in transition economies and the conjunction of both the components may not be harmful. The results of this study reveal that on the one hand, debt and state ownership have a negative impact on firm performance if it is used in isolation, while on the other, their interaction has a positive effect on the performance of the firm. This emphasized the need for strong interactions between the two. Estrin et.al (2009) evaluated the impact of privatization based on the experiences of post-communist (transition) economies. They differentiated the impact of privatization on efficiency, profitability, revenue growth and on other relevant indicative components. It is observed that effect of privatization is mostly positive in Central Europe, but quantitatively smaller as compared to foreign owners and greater in the later than earlier transition period. In the Commonwealth of Independent States, privatization to foreign owners results in a positive or significant impact while privatization to domestic owners leaves a negative or insignificant effect.

Those who believe that privatization improves efficiency and thereby performance of firms. Megginson *et al.* (1994), Djankov and Murrell (2002), McKenzie and Mookherjee (2002), Wolf and Pollitt (2008), Pratap (2011), Kumar (2014) and Ojonugwa and lrunmoluo (2015) have found a significant improvement in the post-privatization performance of firms. They claim that privatization leads to improvement in performance of firms as they do away with political interferences and divert their attention towards economic objective of maximizing returns over their investment. Verma Gakhar and Phukon (2018) concluded that around 61% of the studies reveal positive effects of privatization on performance in terms of operating efficiency, cost and price efficiency, easy access to market -based finance facility, transparency and good governance, productivity and profitability. They further established ample research evidences which support the proposition that privately owned firms are more efficient and profitable than their counterpart State-Owned Enterprises (SOEs).

According to a study by Chaitanya (2007), India is one of the fast emerging economies which has been striving to control and bring down the deficit by all possible measures by introducing several economic reforms. The study covering the performance of selected PSEs over the six year period suggests that disinvestment policy of PSEs implemented in 1990-91 as part of economic reforms in India resulted in privatizing about thirty PSEs in the country and their performance had found to be improved. Boardman and Vining (1989, 1992) in their study compared performance of Private, state owned enterprises and Mixed Enterprises among the largest non-industrial corporations. The study used four profitability measures for analysis viz., a) Return on Equity, b) Return on Assets, c) Return on Sales, and d) Net Income. To examine aspects related to competence like sales per employee and sales per Rupee of Asset, the study used two procedures. For analyzing the competitive position of each firm, the study included assets, sales, employees and a measure of market share. The study concluded that Assets, sales, employees' measure size reflect economies of scale and to some extent influence the market power also.

Sharma (2016), in a study on impact of disinvestment on financial performance of PSEs in India emphasizes that Public Sector Undertakings (PSUs) have been playing a dominant and unique role in industrial performance of Indian economy. The study used secondary data for the enterprises divested during the period 1991-2004 and analyzed the financial growth of the privatized entities. It was concluded that PSUs performed better in the post-reform period. Rastogi and Shukla (2013) while analyzing the performance of privatized units, cite many reasons about the poor performance of PSEs such as, monetary losses, over capitalization, wrong policies, faulty control and inefficient management. The privatization policy that the government adopted was closely related to efficient channelization and utilization of resources, but the progress often was not that satisfactory. Finally the privatization led to the concept of disinvestment that had reflection over the needs of economy for the both productive and non- productive entities, but unfortunately the proceeds from disinvestment were used in an objectionable manner. Thus the belief of privatization, as a lead to better performance has become questionable! Hence, the government should change its mind and move from earth to heaven, keeping in view the global experience as a cushion and caution agent to improve the efficiency of inefficient units and create competitive market in the present bloodthirsty environment to enable the PSUs to work efficiently for the good health of the economy and in turn the nation.

A good amount of literature is available related to valuations aspects, issues and methodology in different countries. The majority of the studies indicate that holding of 50 percent stake in the divested PSEs is a major issue that impacts the larger participation by the outside investors. Then, the valuation methodology is not transparent and it does not have commercial considerations. The value of the enterprises is not assessed adequately and therefore the share price is also not fair. The studies raise the issues like, kind of arrangements for disinvestment- public offer through the stock exchange or strategic sale to a private partner, the quality of method of valuation of a PSU before a bid for disinvestment is made and the process of utilizing the proceeds from disinvestments, etc. Majority of studies also suggest valuation of the enterprise on commercial lines and remove the limit of 50 percent stake of the government holdings. The studies observed mixed results but in majority of cases, the performance of divested enterprises was found improved in terms of selected financial parameters and operational efficiency. Various studies suggested that performance could be much better if functional autonomy and effective leadership was provided to the divested enterprises.

4. An Evaluation of Strategic sale for Disinvestment

In case of a strategic sale, the disinvestment offer generally involves transfer of management control of a going enterprise to the strategic partner. In such a scenario, these enterprises might possess surplus assets like land building and other infrastructure that may not be included under the core assets required for business operations. This will obviously impact the fair value of the business in case the valuation is based on Discounted Cash Flow (DCF) or Market Multiples. Therefore, to safeguard the interest of such PSEs, certain restrictions are imposed on the use and disposal of surplus assets by the strategic partners. These restrictions include: land and property of the business enterprise cannot be sold or used for other purposes by the strategic partner. Even in that case, there will be some economic benefits that may accrue from such assets since the strategic partner will have majority interest as an owner in the enterprise. Therefore, the asset valuation method may not be able to provide the optimum estimate of the value of the business firm. The asset valuation approach would help provide fair value to the asset and thus facilitate a reasonable measurement to the Reserve Price. This approach has been practically used for valuation of Central Public Enterprises (CPSEs) which were identified for disinvestment. The DIPAM has also suggested the asset valuation methodology to be followed while arriving at the valuation of an enterprise in case of strategic sale. However, the Asset Valuation method has certain limitations as under:

(i) In practice, it is not that easy to measure the exact replacement cost of the assets owned by a business enterprise on account of the following factors:

(a) Changes in technology over a period of time (resulting in certain products not being produced at all or being produced with far more efficiencies than earlier);

(b) Absence of a marketplace where such assets are or can be traded;

(c) Inability of the seller to be able to actually realize the value of assets in one go should the company be liquidated;

(d) Changes in the duty structure (like excise, import duties, etc. which may impact the value of the asset over different periods of time), etc.

(ii) The Asset Valuation approach also does not take into account the very purpose for which a company acquired the assets, i.e. for future economic benefits. Hence, the historical or replacement cost of a particular asset may tend to convey a wrong picture of the value that the buyer may perceive in the asset. These factors often tend to result in a higher value being attributed to the assets and the companies, if the asset valuation approach is followed. Assets are bought and sold for their future economic benefits, and for established and running businesses; the economic benefits of owning the assets are far more relevant than the historical cost or replacement cost of the assets.

(iii) The asset valuation approach also tends to overlook the intangible assets that a company, over a period of its existence tends to build, such as goodwill, brands, distribution network, customer relationships, etc. all of which are very important to determine its true intrinsic value.

(iv) In majority of the PSUs, it may be found that the replacement cost or liquidation value is higher than the intrinsic value of the company, if determined on the basis of the company's future profitability (cash flows). As against this, a company, which has been generating very healthy returns and has built strong brand equity, goodwill etc., will tend to command a value that is far higher than the value of its tangible assets.

The above mentioned limitations of the asset valuation approach have been highlighted very clearly in the valuation reports submitted by the Advisors in different cases of valuation so far. In case of strategic sales, the Advisors have expressed that the DCF approach may be the most appropriate methodology to be relied upon for valuing businesses on a going concern basis.

It should be noted that the DCF methodology expresses the present value of the business as a function of its future cash earning capacity. This methodology works on the premise that the value of a business is measured in terms of future cash flows, discounted to the present time at an appropriate discount rate. The methodology is able to capture the value of all the tangible and intangible assets of the enterprise based on the expected future cash flows. But the value of all the intangible assets held by an enterprise like, brand, marketing and distribution network and goodwill may fetch higher sales or as higher profits as compared to its competing partners who might not be equipped with similar brand or distribution network. In view of this, the asset valuation methodology may be found useful to some extent for valuation of non-core assets where DCF approach may not be an appropriate approach to value this kind of assets.

5. Standardizing the Valuation Approach

In practice, all the above four valuation techniques are followed for valuation of CPSEs. These methodologies have been adopted based on the Discussion Paper of the DIPAM as well, following the best market practices. However, it is very much imperative to develop a standardized approach for valuation of CPSEs being targeted for disinvestment. This will help all the PSEs in disinvestment process and minimize the scope for variations among the CPSEs. Therefore, this research work suggests the following framework to be followed for valuation for all the CPSEs where disinvestment process commences.

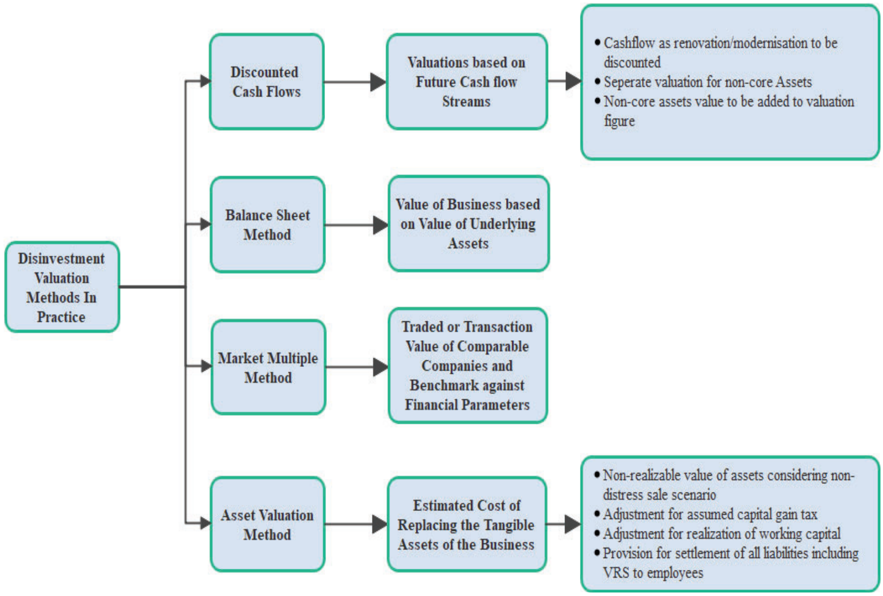

Figure 1: Recommended framework for PSEs – combination of DCF & Asset Valuation

Source: Authors

The above suggested framework envisages basically on two approaches of valuation for CPSEs disinvestment, i.e. DCF and Asset Valuation methodologies. The framework further suggests the following improvements in respect of both the techniques. This will help to provide a fair valuation to a larger extent and also serve as indicative Benchmark for arriving at the Reserve Price.

6. Additional considerations under the DCF Method

While measuring the cash flows under the DCF technique, the extent of cash outflows for renovation and modernization of plant and machinery need to be discounted so as to arrive at the most appropriate figures. The non-core assets are not truly reflected under the cash flows if valued according to the Asset Valuation Method. Therefore, there should be a mechanism to value the non-core assets exclusively so that their value could be added to the overall valuation figure as arrived at by under the DCF method.

7. Additions under the Asset Valuation Method

In general, the approach should be used primarily to value the non-core or surplus fixed assets, whose values are not appropriately accounted for in the valuation by DCF or other approaches. However, in cases, where the entity has significant non-core assets and where the application of Asset Valuation approach to the enterprise is deemed necessary, following should be noted:

- The Asset Valuation would be more realistic, if we compute the value of only the realizable amount, after discounting the non-realizable portions. The realizable market value of all real estate assets, either owned by the company as freehold properties or on a lease/rental basis will be determined, assuming a non-distress sale scenario. The value would be assessed after taking into account any defects/restrictions/encumbrances on the use/lease/sublease/sale, etc. of the properties or in the title deeds, etc.
- Asset Valuation normally reflects the amount which may need to be spent to create a similar infrastructure as that of a business to be valued or the value which may be realized by liquidation of a company through the sale of all its tangible assets and repayment of all liabilities, adjustments for an assumed capital gains tax consequent to the (hypothetical) outright sale of these assets as also adjustments to reflect realization of working capital. Settlement of all liabilities including VRS to all the employees will have to be made." (Compiled as per DIPAM Report)

8. Conclusion

This study analyses the disinvestment motives and more so the new strategic disinvestment initiatives of the government. The paper has reviewed good amount of literature available on the subject to understand various aspects of PSEs disinvestments. There are different methods available for PSEs disinvestment and DIPAM has suggested guidelines for the PSEs going for disinvestment to follow such guidelines. E-study observes that none of the methods can be standardized as the combination and composition of assets and liabilities differ from industry to industry. Considering all the relevant facts, a suitable framework is suggested for valuation of CPSEs disinvestment with required modifications and additions in the relevant components so as to arrive at the fair value.

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