Disinvestments through Public Offers – The Road Ahead

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Since 2004, Political compulsions have led to the government's 'go-slow' policy on disinvestments in Public Sector Undertakings (PSUs). Disinvestments happened selectively only through fresh public issues and follow-on offers. This was in sharp contrast to the post'99 period where privatization or strategic sale was the order of the day with Hindustan Zinc, IPCL, VSNL, CMC and Modern Foods moving onto private hands. The disinvestment landscape has undergone a sea change in the current phase necessitated largely by an inclusive growth agenda, robust capital markets and fair price discovery. While privatization through strategic sale has been put on the back burner, public issues are ensuring that the government gets to offload their stake without losing control while growth oriented companies gets sufficient funds for their expansion. The current phase of disinvestment has brought with itself new set of challenges, not least due to the increased realities of globalization we are witnessing in recent times.

One of the biggest challenges faced by the current regime is to meet the target reduction in fiscal deficit levels envisaged in the budget. This is significant as reducing fiscal deficit from the current astronomical levels of 6.6%of the GDP is essential to maintain India's sovereign credit ratings. With the budget estimates not provisioning for compensation to oil marketing companies for under-recoveries, there is a strategic rationale for heightened activities of disinvestment. Although disinvestment alone won't resolve the problem, it certainly does provide 'elbow-room' to the government to keep the deficit under control.

Fiscal necessities not withstanding, PSUs stand to gain a lot by the government's disinvestment program in the long run. The government, aware about these long term benefits, is also working towards ensuring fructification of their disinvestment plans. Increasing private sector equity participation is going to breed a higher sense of professionalism. While the government entities have always maintained highest measures of corporate governance, disinvestment brings in the much needed sense of competition with the private sector. Continuous research interaction, quarterly results analysis and comparison across all performance parameters help in sharpening the competitive edge. History shows stark difference in long term performance of companies prior and subsequent to their listing. NTPC, listed in 2004, which grew at a CAGR of a meager 4% between FY00-04, grew at a staggering rate of 17.5% during the FY04-FY09. Similar growth stories can be witnessed with respect to companies across sectors like BHEL, ONGC, and BEML amongst others. While the remarkably improved performance cannot be entirely attributed to disinvestment, it surely does play a part. It ensures that not only these companies are concerned about absolute growth, parameters like relative growth, operating margins, segmental performance are also given due importance. The government in its endeavor to disinvest will also reap in the benefits of these changes which take place over a period of time.

While the improved financial performance is the effect, causal relationship can be established with the structural change which disinvestment brings about. Largely due to increased institutional participation of financial majors in India, any sizeable listing gets high visibility across the globe enhancing brand awareness and creating equity in the long run. All these factors play a part in instilling confidence amongst the PSUs to go out for inclusive growth beyond domestic shores. PSUs have gone ahead and followed an aggressive strategy of owning equity assets abroad for reasons varying from gaining energy security (ONGC Videsh) to organic expansion (Bank of Baroda) to acquiring distressed assets (HPCL acquiring Kenya Petroleum Refinery). Besides, there have been several JVs and public-private collaboration that has brought the concept of mixed model into the fore-front.

With India precariously placed on the fiscal front, the government has been determined to avoid any fiscal profligacy. The first step in ensuring little unsolicited burden is by asking PSUs to fetch for funds directly from the open markets. This has considerably reduced the pressure on the government's budgetary allocations especially for capital sensitive sectors like banking and financial services which are in perpetual need for funds. The current disposition is to allow companies to raise funds for their growth plans to the extent they continue to be under Government control. REC has been a prime example of a growth oriented company thriving without any direct government equity funding and raising substantial money twice in a span of two years in turbulent market conditions. Markets have always accepted good-quality PSU paper and government has been riding the wave to simultaneously offload chunks of their holding in almost all the Issues. Thus, disinvestment is being used as a platform by the government to monetize and PSUs to sow for future growth.

There is a broader justification for disinvestment through the IPO / FPO route. Although, there are other modes available for fund raising / offloading stake in entities, the incumbent government has decided for the public issue route which serves the twin purpose of dispersing national wealth to the public at large and in the process minimizing any opposition from recalcitrant allies belonging to diverse political ideologies. Follow-on public issues of PSUs have a larger portion reserved for non-institutional investors lending further credence to the government's intention of ensuring that common man reaps in direct benefit of participating in the nation's growth story. Various measures have been initiated to provide retail investors a platform to take an informed decision. SEBI's move to provide an option for early closure of the QIB book and 100% margin on QIB bids is a step in that direction.

However, the path of disinvestment also presents some challenges. While some of these challenges are market driven and at times beyond control, some are derivative of specific policy decisions taken from time to time. The recent disinvestment phase has been witness to perhaps the most tumultuous global economic environment since the 1930s. Terms like sub-prime, sovereign defaults, asset bubbles and decoupling became part of common parlance. Credit to Indian regulatory and banking system, India has always been free from many of these chronic structural slipups. However, since the global economy is now more integrated than ever before, capital markets tend to overreact on both sides. So much so that, seemingly India centric growth stories also gets neglected in bout of global madness and liquidity extraction. In such a scenario, long term wealth creation platforms like disinvestment also get conveniently neglected by the investors, retail and institutional alike. Lukewarm investor response in some of the government offerings was largely due to the issue period coinciding with volatile market movements which lead to risk aversion. Government's challenge of ensuring continuation of the disinvestment program stems from this handicap. Need to overcome this problem cannot be overemphasized given Government's strict fiscal Balance Sheet.

While the impact of global market sentiments cannot be avoided, there is a need to have a closer look at the process of pricing government offerings. This becomes especially important in case of follow-on public issues where the pricing benchmark is readily available for investors to take investment calls and in certain cases even hedge their decisions by appropriate positions in the derivatives of the underlying shares. Pricing is the single most important risk facing government Issues. While subscription to the government paper has never been a problem, subdued retail participation in almost all recent Issues is worth serious consideration given the huge disinvestment pipeline. Government has taken various steps such as introduction of anchor investors (comfort on Issue quality), modified book building (better price discovery), 100% QIB margin (reasonable subscription levels), reduced listing timelines (reduced market risk) and optional early closure of the QIB book (informed decision), to provide implicit comfort to retail investors. Besides these steps the Government should also look at providing greater pricing cushion to investors compared to listed peers in case of IPOs and market price for FPOs.

The recent move to raise the minimum threshold level of public shareholding to 25% for all listed companies has added a new dimension to the entire disinvestment landscape. With many PSUs needing to increase their public shareholding, effectively this amendment puts the disinvestment process of listed entities in an auto mode with a 3 year time frame. This also puts to rest the hypothesis that the government may hold back disinvestment in certain sensitive sectors. What remains to be seen though, is the impact of this move on the secondary markets as a successful co-existence will need continued liquidity sustenance from foreign institutional investors.

Going forward, the government is sure to confront a different predicament on disinvestment. Over the past few years, while disinvestment has been gaining ground, none of the offerings resulted in the government sacrificing majority stake in these companies ('Privatisation'). With most of these companies in expansion mode, there is an insatiable desire for equity capital. Government's self-imposed fiscal discipline might make it difficult for them to fund all these PSUs through direct capital infusion. In coming years the government will need to take the intricate call of either providing them with public funds or allowing them to 'cross-the-bridge' by letting-go of their majority ownership. This will be especially critical for sectors like Banking where sector sensitivity further add to the need to take well thought-out policy decisions. Government's decision on this aspect might shape the next round of disinvestments and will surely have a meaningful impact on the Indian capital markets.

It is not a coincidence that some of the world's global majors like Volkswagen, TNT and Rolls-Royce have been ex-PSUs. Central governments across the globe have followed a similar strategy of nurturing the PSUs while opting for disinvestment in tranches. In 1980s many European governments issued Golden shares, which can veto all other shares, to themselves while deciding on privatization. Subsequently, as they became more comfortable, these golden shares were allowed to lapse allowing free movement of capital. Thus, selective handholding initially and letting go of ownership in a phased manner has been a time tested formula which works for PSUs. While some of the Indian PSUs are already on the Forbes Global 500 list, the world keenly awaits the next big jump from these companies and it remains to be seen whether disinvestment results in similar success stories in India.