Disinvestment Public Offers – Opportunities and Challenges

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Introduction

The commencement of the disinvestment process by Indian public sector enterprises can be traced back to 1991. It was in the Budget speech by then Finance Minister, Dr. Manmohan Singh that the disinvestment process commenced. Some of the objectives of this initiative were to reduce financial burden on the government; improve public finances; introduce competition and market discipline in these corporations; encourage wider ownership and, in some cases, to also fund growth of these enterprises.

In the budget speech of 2001, phase II of the disinvestment policy was announced and among other features, it was articulated that the entire receipt from disinvestment/ privatization would be used for meeting expenditure in social sectors, restructuring public sector enterprises and reducing leverage.

Thus far, the disinvestment plan of the government has met with satisfactory success. As on June 30, 2011, the 50 Central Public Sector Enterprises (CPSEs) listed on the stock exchanges contributed about 22% of the total market capitalization.

A win-win for both the Government and Investors

Over the years, we at Kotak Investment Banking have worked on some path-breaking government issues and have been great supporters of disinvestments in government companies. We have been involved with the disinvestment process in Maruti Udyog, beginning with the listing of Maruti Udyog and followed by two tranches of disinvestment through the French Auction route. Recently, we were involved with the very successful disinvestment in and listing of Coal India through an IPO, India's largest IPO till date. The public sector undertakings (PSUs) that tap the market are usually large, profitable and valuable companies with a strong track record. Companies which are typically monopoly or duopoly players, with solid fundamentals that attract both institutional and retail investors in capital market transactions.

Past experience has also shown us that in a volatile or falling market, PSU disinvestments have helped change the mood of the market and have succeeded in bringing investors back to the market. This is because investors recognize that the quality of paper from the government's portfolio is of high-quality and sizeable returns have been made in the past.

The Government has also always been very keen to encourage more retail participation in all PSU issues, which has helped increase the investor base.

The Coal India IPO – a case study

In the largest-ever IPO in the Indian Capital Markets, Coal India Limited received an overwhelming response making it a watershed IPO in many respects. Coal India has the world's largest resources of coal with more than twice the extractable reserves of the next biggest player.

The Rs. 152 billion IPO was subscribed 15.21 times across investor segments. The Qualified Institutional Book was subscribed 24.62 times with overwhelming participation from marquee investors. The IPO attracted several new investors and generated large demand from several long only FIIs and domestic institutional investors. The deal saw participation from many new global investors who are not regular investors in Indian markets. There were over 10 applications received with bids in excess of a billion dollars.

The issue received an excellent response across both the retail and High Networth Investors (HNI) segments. In the retail category, the issue received close to 16 lakh applications and an increased average application size of ~Rs 65,000. The HNI response was backed by large bank funding and some leading corporate treasuries participating.

Robust company fundamentals, optimal pricing (including a retail discount) and a comprehensive investor education program were some of the key success factors behind the issue. This was a great example of disinvestment through the capital market route.

Opportunities and Challenges

Over the years, the Department of Disinvestment (DoD) has institutionalized their systems and procedures to a level where the disinvestment process is now run as a well coordinated and professional effort. The Handbook on Disinvestment Through Public Offerings by the DoD that documents the broad aspects of the processes involved in public offers bear testimony to that fact.

The last two financial years – 2009-10 and 2010-11 – have been rewarding years for the DoD with around Rs 46,000 crore raised via eleven public offerings.

The outlook for PSU disinvestments looks positive with the number of unlisted profit-making Central Public Sector Enterprises (CPSEs) increasing steadily. In addition, listed CPSEs that do not meet Securities and Exchange Board of India's (SEBI) mandatory requirement of 10 percent public shareholding as well as follow-on public offerings by listed CPSEs taking into account their capital investment requirements will also seek to tap the markets.

Given the complexity and size of the transactions involved, there are certain shortcomings at times that need to be addressed. The long-winded process of approvals required in a PSU issue can hamper implementation, since capital market transactions require flexibility and speed in decision making. In addition to the commercial aspects of a transaction, the Government necessarily has to weigh many other considerations and evaluate the outcome for a number of interested parties.

Looking ahead, with a steady flow of good-quality companies tapping the markets at the right pricing, the Government will be able to continue prudently with its disinvestment policy, giving investors a chance to become stakeholders in some of India's leading companies while at the same time generating significant revenue for the government