Business Standard
Volume XXV Number 172
NEW DELHI | FRIDAY, 14 DECEMBER 2018

Dubious disinvestment

The REC-PFC deal makes little sense

The Union Cabinet has approved the sale of a majority stake in REC (formerly Rural Electrification Corporation) to Power Finance Corporation (PFC). This decision will create a single state-run company that will dominate the power finance sector, particularly lending to renewable energy projects. PFC will take over a 52.63 per cent stake in REC, leaving only 6 per cent with the government, and thus have control over the management of REC. In future, REC will depend on PFC when it comes to raising capital. In essence, this will count as a takeover although the government has insisted that the two companies would be allowed to hold on to their distinct identities. While this might help the government raise as much as ₹140 billion and thus move closer to the ₹800 billion disinvestment target that was set in the Union Budget for 2018-19, on most other considerations this move cannot be said to be justified.

While the two companies are both in the power sector, the truth is that they operate in very different ways. PFC is essentially a state-run non-banking financial company that focuses on power infrastructure, while REC is an implementation and finance company with a focus on generation. There is no clear justification, thus, for the merger and indeed many reasons why it is a bad idea. That there is no real strategic thinking lying behind this deal is evident from the fact that the earlier proposal was for the exact opposite — for REC to buy PFC. This was reversed on advice from the Union power ministry. But it is clear that the Union finance ministry is interested only in the funds that this transaction would bring the exchequer. Yet again — as with other such transactions in recent years — this does not in any real way count as disinvestment. The government managed to meet its disinvestment target last year purely thanks to the purchase of Hindustan Petroleum Corporation Ltd by Oil and Natural Gas Corporation, or ONGC, which brought almost ₹400 billion. If one government-run company buys a stake in another, it does not reduce state control over the economy. It is just one more way for cash reserves in the public sector to be tapped by the government to finance its own spending. This is neither the real purpose of disinvestment nor is it good for the companies and sectors involved.

In this case, it is particularly disturbing as the purchasing company will have to take on extra debt to finance the purchase and both companies have heavily burdened balance sheets — unsurprising, given the mess that is the Indian power sector. PFC has non-performing assets on its books worth 14,000 Mw, for example. This purchase is only likely to burden the joint entity further. Surely, given the state of the power sector, PFC has better use for any capital it can raise than to transfer it to the government. Unsurprisingly, Moody's Investors Service has put both REC and PFC on review for a possible downgrade, and ICRA has put their debt on watch. The government's claim that the post-takeover entity will be able to raise capital more cheaply is thus questionable. The decision must be re-examined, and the regulators involved — including the Competition Commission of India, Securities and Exchange Board of India, and the Reserve Bank of India — should demonstrate their independence in this matter.