Selling less while raising more

Clearer commercial focus and tighter financial discipline may yield a steady stream of dividends

OCCASIONAL ASIDE

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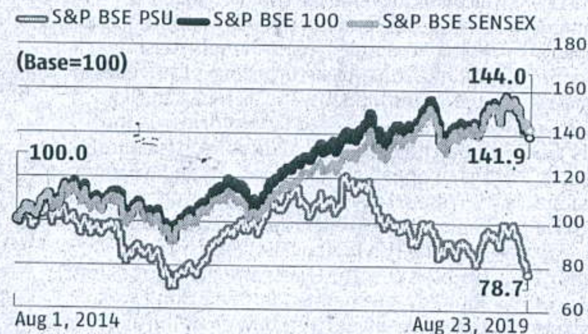
EXHIBIT 1: BSE PSU VS SENSEX VS BSE 100



Source: BSE, up to July 31

EXHIBIT 2: PSU ETF RETURNS

	1-Month	3-Month	1-Year	3-Year
S&P BSE Bharat 22 TRI	-12.32	-8.39	-4.24	-
Category returns	-7.02	-5.4	-2.93	-
Rank within category	107	102	70	-
Number of funds in category	107	107	94	-
CPSE ETF	-3.85	-17.17	-14.34	-14.1
Category returns	-1.95	-12.09	-8.14	10.26
Rank within category	3	3	3	3
Number of funds in category	3	3	3	3

Data as on August 2, 2019

Raising money from sale of public sector undertakings (PSUs) is now a critical item in meeting fiscal targets. This government has raised ₹2.71 trillion or 84.3 per cent of the targeted ₹3.21 trillion since 2014-15, meeting its divestment targets in the last two years. The tenacity with which the government is pursuing this one number is admirable.

During this period, no route to raise money has been off the table; the government has used buybacks (Oil India, National Hydroelectric Power, IRCON etc.), offers for sale (NALCO, National Fertiliser, Neyveli Lignite etc), piggybacking on PSU IPOs (Cochin Shipyard, GIC, New India etc), off-market transactions (HPCL-ONGC), strategic divestment (PFC-REC, Dredging Corporation), sale of SUUTI shares, sale through ETF's (CPSE ETF and Bharat 22) and even sale of enemy shares. Nor is any amount too small; the Dredging Corporation of India employees brought in ₹9.3 million through an OFS.

Despite the impressive amounts gathered from their sale, there are infirmities that ail the public sector. These come in the way of a more robust fund-raise. Some alternate sets of data point to this.

One, the trailing BSE PSU Index (Exhibit 1). ₹100 invested in the PSU index five years ago in August 2014 would return ₹88.0 today. A similar amount invested in the BSE Sensex would have returned ₹146.7 and in the BSE100 ₹147.0.

Two, this is reflected in the price performance of PSU ETFs. The CPSE ETF, which tracks 11 central PSUs, has raised ₹48,500 crore. And Bharat-22, its dizygotic twin, with 19 public sector companies and three SUUTI shares — Axis Bank, ITC and Larson & Toubro, has garnered ₹26,400 crore. Their performance lags as seen in Exhibit 2.

Three, governance is no longer an amorphous idea; it can now be measured on the IFC-BSE-IiAS Corporate Governance Scorecard. Excluding banks there are 16 PSUs in the BSE-100 index. Their average and median score out of 100 is 52.3. Our research shows companies that scored above 60 had a median return of 39 per cent over two years, (7 per cent over one), while those with lower scores, generated a 3 per cent return (negative 16 per cent). This is a pointer that poor governance lies at the heart of middling performance.

If the government wants to continue to mobilise resources from divestments, it needs to ask itself three questions: First, if there is clarity regarding the objectives in running PSUs. Second, is the current ministry-PSU linkage the best structure to ensure PSUs function efficiently, and three, is the divestment giving the government most bang for its bucks.

There is limited clarity regarding the objectives and purpose. Oscillating between achieving the greatest good for the greatest number versus running a profitable business muddles decision-making at the PSU level and confuses investors. It is perfectly legitimate to have national political-level objectives (development of a backward region), but these should be separated from those that control national resources (ONGC, Coal India), or building national champions (SBI). The government is better served pursuing just one goal. With clearer commercial focus and tighter financial discipline, the treasury can hope for a steady stream of dividends and of realising a fair price from the sale of shares and even entire businesses. This money is then available for its broader (social) objectives. The alternative of running a febrile business which consistently needs funds to be injected, does not serve the divestment agenda.

Oversight of a PSU is a small part of a ministry's responsibilities. Shortish tenures leave bureaucrats insufficient time to read the industry trends, let alone understand business nuances. An added downside is a very short institutional memory. Responsibilities towards the company give the appearance of being chores and need safe decisions: Why else will PSU boards be dominated by former bureaucrats — which compound the problem of limited skills and to a less robust board oversight. Then there is the mistaken belief in Delhi that Sebi's rules apply only to the private sector. Consequently, PSUs generally weigh in favour of their parent ministry; conversely market discipline is frequently breached. And while market discipline may not ensure business success, but its absence will ensure failure. Suffice to say, the ministries have exhibited extremely uninspiring stewardship over our PSUs.

Finally, divestment is a specialised job. Deciding between IPOs, offers for sales, follow-on offerings, bulk deals, QIPs is not an easy task. Add to this the complexity of deciding which company is ripe for sale. Will selling HPCL to ONGC be more value accretive than merging the two and then selling the combined entity? Should the general insurance companies be merged, and shares in the holding company be sold or should one sell shares in the operating business? Different market cycles will give a different answer. Unfortunately, the decision is likely to be driven by the fear of the Central Bureau of Investigation or the Vigilance Commissioner, rather than what markets dictate.

There are ownership models that address the challenges that plague Indian PSUs. They address governance issues and structures, a path towards gradual disengagement from non-core investments, beneficial asset monetisation and generating returns for the state. Temasek (Singapore), Khazanah (Malaysia), Solidium (Finland), Forsta AP-fonden (Sweden), ADIA and Mubadala (Abu Dhabi, UAE), are some successful models. All of them involve at the core, putting in place a governance structure where ownership shifts from individual ministries to a government holding company or a fund and furthering their governments agenda. Parenthetically, the report of the Committee to Review Governance of Boards of Banks in India aka the PJ Nayak Committee had a similar recommendation for government owned banks. Such structures will bring the desired focus, accountability, specialisation and sense of ownership to the task at hand. These are some examples of successful transitions and structures importantly within the 'state', that we should consider emulating.

This shift, even if begun today, will bear fruit in the medium to long term. Meanwhile there is undoubted fiscal pressure to raise funds. There are assets including Balco and Hindustan Zinc, that can be sold immediately — to Vedanta or even the public. Shareholding with SUUTI can also be monetised relatively quickly. These and other such ideas will serve for the short term. For the long term, unless we bring about transformative change, the pipes will choke.

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