BLOCK III:
Public Enterprises

Unit 1: Public Enterprise and Restructuring, Sickness in Public enterprise and its revival

Unit 2: Disinvestment - its objectives, components and policy

Unit 3: Public-Private Partnership

Unit-1
Public Enterprise and Restructuring, Sickness in Public Enterprise and its Revival

Unit Structure:

1.1 Introduction

Public Sector Enterprises are significant part of the Indian economy which comprises the public services and enterprises. An organisation owned and managed by Government is called public sector enterprise. The Public Sector enterprise might be a corporation, statutory corporation or a nationalised bank.

1.2 Objectives

After going through this unit you will be able to–

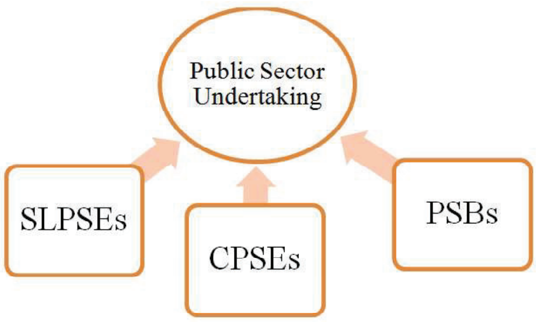
- understand the meaning of Public Sector Enterprises and its Objectives,
- understand the important Characteristics of PSEs,
- describe the benefits and Challenges of PSEs in India,
- explain the restructuring of PSE and its need,
- analyse the causes of Sickness in PSEs and Steps for its revival.

1.3 Public Sector Enterprises- Introduction

In India, public sector enterprises are those enterprises in which the Union Government or State Government or any Territorial Government owns a share of 51% or more. A public sector enterprise may be identified as any commercial or industrial undertaking owned, managed and controlled by the government with a view to maximise social welfare and uphold the public interest. This sector refers to commercial ventures of the Government where user fees are charged for services rendered. In general, Public Sector Enterprise or Undertaking refers to a Government Company which is defined under Section 2 (45) of the Companies Act, 2013 as "Any company in which more or equal to 51% of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company." At present in India there are only three sectors left reserved for the government i.e. Railways, Atomic Energy and Explosive Material. Private sectors/players are not permitted to operate in these sectors.

According to N.N. Mallya, "Public enterprises are autonomous or semi-autonomous corporations and companies established, owned and controlled by the state and engaged in industrial and commercial activities."

Classification of Public Sector Enterprises



Public Sector can be classified as Central Public Sector Enterprises (CPSEs), State Level Public Enterprises (SLPEs) and Public Sector Banks (PSBs). Let us understand each of them:

SLPEs: The term state level Public Enterprise (SLPEs) encompasses those government companies in which the direct holding of the state Government is 51 percent or more and the subsidiaries of such Government Companies. Example : APDCL, ASTC etc.

CPSEs : Any company in which not less than 51 percent of paid up share capital is held by central Government or partly by Central Government and Partly by State Government and includes subsidiary of Government Company. Example : ONGC, BHEL

PSBs: Public Sector Banks are those in which the government holds more than 50% of the total stock. The Public Sector Banks operate under the government rules and regulations. Example : State Bank of India

1.4 Objectives of PSEs

The Objectives of PSEs are highlighted hereunder:

1. To promote rapid economic development through creation and expansion of infrastructure;
2. To encourage the activities relating to export promotion and import substitution for the development of the country;
3. To support balanced regional development by launching regional promotional undertakings in less developed regions;
4. To encourage the growth of ancillary and small scale industries for development of the country;
5. To supply necessary financial assistance through public financial institutions for long term capital formation.

1.5 Characteristics of Public Sector Enterprises

Looking at the nature and objectives of the public enterprises their basic characteristics can be summarised as follows:

1. Government Management and Control: The public enterprises are owned, managed and controlled by the central or state government or by the local authority. The government may either own the whole enterprise or maybe own of it, part with the private industrialists or with public. But in any case the control and management of the enterprise remains primarily with the government. For example, Indian Oil Corporation Limited (IOCL) is established by the Government and but general public are also part of company as shareholder. So is the case with Oil and Natural Gas Corporation Limited (ONGC), Oil India Limited (OIL), etc.

2. Financially Independent: Though investments in public sector undertakings are done by the government, they become financially independent. These enterprises get their capital from government funds and the central and state government used to make provision for their capital in the budget.

3. Public Welfare and Utility Services: Public Sector is not guided by profit motive. The focus of these enterprises is to provide service or commodity to the society at a reasonable price. Public Sector Enterprises concentrate on providing utility services to the public at subsidised price like transport, electricity, telecommunication etc

4. **Implementation of Policies**: Government policies and plans are always implemented with the help of public enterprises. These enterprises do not serve any particular section of the society instead they are useful for the entire population. These enterprises serve all the sectors of the economy for the development of the nation.

5 Autonomous and Semi Autonomous Bodies: Public sector enterprises are autonomous and semi autonomous bodies owned managed and controlled by government. Funding is arranged by the government but government does not interfere in the day to day functioning of the organisation.

1.6 Benefits of Public Sector Enterprises

The benefits of PSEs are detailed below:

1. Balanced Regional Development: one of the basic objective of PSE is to bring balanced regional development in the country when a PSE is established in a remote and undeveloped region of the country, the particular region is bound to develop because with along with it the PSE bring various economic activity in that region.

2. Greater public welfare*:* The basic motto of private enterprise is to earn maximum profit but the case is not same for PSUs. Public enterprises do not work for making profit rather their focus welfare of the general public. PSUs main aim is to make available certain commodities and services of basic necessity to the general public at reasonable price regardless of profit margin.

3. Abolition of Monopoly*:* If a business sector is completely controlled by private companies, then there are high chances of monopoly i.e., they will start exploiting the consumers by charging high rates for the goods and services which is not favourable to the consumers. This risk of monopoly can be eliminated by the public enterprises as these are controlled by the Government.

4. Proper Utilization of Resources: As public enterprises are established in all the states of the country, it is easy to utilise local labour, natural resources, raw materials etc. available for the growth and development of the country.

5. Equal Distribution of Wealth: With the help of the public sector enterprises government is trying to reduce the inequalities of income and wealth among the people. Both state and central government are taking measures for equal distribution of wealth in the society.

6. ***Economies of Scale***: Since public enterprises operate on a large scale, they can obtain the benefits of economies of scale. The benefits derived from economies of scale can be forwarded to the general public in the form of subsidised prices, stability in prices, better quality of services etc.

7. ***Employee Welfare***: Public sector enterprises follow their own recruitment policy. They used to hire the best talent through various modes and provide them appropriate training. Better perks and amenities are provided to the employee that helps in improving their motivation level. With the help of these measures public enterprises are able to maintain a healthy employer-employee relationship, attract and retain human resources and improve productivity levels.

8. Minimisation of Red Tapism and Speedier Functioning: In a public enterprise red tapism and bureaucracy are reduced to a great extent which helps in speedier actions to any problems. Delays in decision making are avoided and problems are sorted out easily at a quicker note. Overall functioning of the organization is improved and opportunities can be tapped in a better way.

9. Comparative Prices of Goods and Services: As public enterprises are not working with the objective of profit earning they do not strive to charge high prices for their products and services. Since the prices are charged on nominal basis by them, more citizens are able to enjoy the services of these enterprises.

10. Ease of Raising Funds: Since these enterprises are government owned statutory bodies, they can raise the required funds by issuing bonds as and when required. Being the public sector enterprises it becomes comparatively easy to raise funds by them for further activities.

*11. **Accomplishment of Self-Reliance:*** As public sector enterprises help domestic industry to grow, it is possible for the industry to be self reliant and the country to eliminate foreign goods and services.

Check Your Progress
1. Define Public Sector Enterprises along with its classification.
2. Discuss briefly the benefits enjoyed by PSEs in India.

1.7 Challenges Faced By Public Sector Enterprises

Apart from many benefits, PSEs are also suffering from certain challenges such as:

***1. Political Meddling**:* Public enterprises are owned by central and state government. Though autonomy in operations is said to be one of the strong points of public enterprises, the reality is otherwise. Ministerial interference in the working of these enterprises is found to be frequent and far-reaching. Many times due to undue influence of politicians, the public sector cannot run smoothly and effectively and as a result it hampers the efficient conduct of operations.

2. Limited Choice for Consumers: As we know Government is having monopoly in many areas therefore consumers have no choice of selecting the goods and services from different parties. Due to monopolistic attitude of the government the buyers lose their right of choice.

***3. Sluggish Growth**:* Public sector enterprises are experiencing limited scope for diversification, expansion and modernisation as they take a long period to establish and the return on investment is also not so high.

***4. Lack of Efficiency**:* Lack of profit motive leads to inefficiency and slow working in many public enterprises. Therefore decision making is not so quick and takes much of their time.

5. Technological Gap: Many of the public sector enterprises in India are suffering from technological gap as these enterprises could not adopt updated technologies in their production system leading to high unit cost and slow or lower return. Enterprises like SAIL, Eastern Coalfields Ltd. etc. are suffering from this constraint.

***6. Poor Management**:* As a result of excess interference by the Government and political parties, public sector enterprises cannot be managed on sound lines or as per the plans laid out. The financing of public sector is fully in the hands of the Government, which limits the scope for development and growth.

*7. **Surplus Manpower:*** It is noticed in some of the public sector enterprises there is the problem of excess manpower which is creating drainage of resources which leads to increase in the unit cost of production. Political considerations also contribute towards overstaffing of inexperienced workers in these units.

8. External Factors: External factors like too much trade unionism, union rivalries and labour management relations are also disrupting the smooth functioning of the production system of these public sector enterprises in the country.

Stop to Consider

Public enterprises are autonomous or semi-autonomous corporations and companies established, owned and controlled by the state and engaged in industrial and commercial activities. PSEs are classified as Central Public Sector Enterprises (CPSEs), State Level Public Enterprises (SLPEs) and Public Sector Banks (PSBs).

1.8 Restructuring of Public Sector Enterprises

Restructuring is an action taken by an enterprise to significantly modify the financial and operational aspects of the enterprise, usually when the business is facing financial pressures. Restructuring is a type of corporate action taken that involves significantly modifying the debt, operations, or structure of a company as a way of limiting financial harm and improving the business. When a company restructures internally, the operations, processes, departments, or ownership may change, enabling the business to become more integrated and profitable. Financial and legal advisors are often hired for negotiating restructuring plans. Parts of the company may be sold to investors, and a new Chief Executive Officer (CEO) may be hired to help implement the changes.

Restructuring is required in both profit making and loss making public enterprises because of changing competitive environment and changes in government policies. The purpose for restructuring process inter alia would include: technological up gradation, improvement in productivity and quality, profit maximization, cost reduction, shedding of non- productive areas etc. Each organisation has its own individual entity and characteristics and, therefore, non-common prescription can be given to all public enterprises.

Government is committed to reform and restructure the Public Sector Enterprises so that they stand poised with the best of their kind in the world. Government's strategy towards public enterprises will continue to encompass a judicious mix of strengthening strategic units, privatizing non-strategic ones through gradual disinvestment or strategic sale and devising viable rehabilitation strategies for weak units.

1.9 Sickness in Public Sector Enterprises

Sickness in PSEs can be defined as a steady imbalance in the debt-equity ratio and distortion in the financial position of the enterprise. A sick unit is one which is unable to support itself through the operation of internal resources. Once the sick units continue to operate below the break-even point (at which total revenue is equal to total cost), enterprises are forced to depend on the exter-nal sources for funds of their long-term survival.

Industrial Sickness is a universal phenomenon. To a layman, a sick unit is one which is not healthy. To an investor, it is one which skips dividends. To an industrialist, it is a unit which has incurred cash losses and tottering on the edge of closure. To a banker, it is a unit which has incurred cash losses in the previous years and is likely to repeat the performance in the current and following years.

The Reserve Bank of India has defined a sick unit as one "which has incurred a cash loss for one year and is likely to continue incurring losses for the current year as well as in the following year and the unit has an imbalance in its financial structure, such as, current ratio is less than 1: 1 and there is worsening trend in debt-equity ratio."

The State Bank of India has defined a sick unit as one "which fails to generate an internal surplus on a continuous basis and depends for its survival upon frequent infusion of funds."

1.10 Causes of Sickness

The various internal and external causes of PSE Sickness in India are discussed below:

A. INTERNAL CAUSES

1. Faulty planning: At the planning stage itself, weak foundations may be laid, which may ultimately result in downfall of the unit.

2. Incompetent Entrepreneurs: Many entrepreneurs start a new business without proper technical know-how of the product they want to manufacture. They sometimes plough into production activity, without bothering to find out the market potential of their product or sometimes they start production without estimating the final cost. Poor maintenance of plant and machinery, constant technical problems with maintenance of production volume, quality, time schedule and cost limits may ultimately spell doom for the business.

3. Problems relating to Management: Since Production, marketing, finance, etc. are in the hands of management, any wrong decision by them in regard to these fields may ultimately ruin a firm. The management may lack business expertise to make demand projections, to push the product in the market, to build up market image and customer loyalty, to face competition and so on.

4. Improper use of working capital: Inappropriate use of working capital can also ruin an enterprise. When the current requirements of the company becomes more than its assets and the organization is not in the position to fulfil that requirement it leads to sickness of that enterprise.

5. Financial Barriers: For running any business whether big or small, finance is one of the most important factor. An enterprise wants finance even to manage their day to day activities such as purchasing of goods, purchasing of raw material, salary pay-outs and many other important things. If the finances are not handled properly the company may face the closure.

6. Human Resource Problems or Managerial Inability: As Public Sector Undertakings/ Enterprises in India are self responsible for their technical and non technical recruitment. Thus, lack of skilled technicians, lack of supervisors, lack of skilled labour, insufficient knowledge about project, less staff, salary disputes among staff and company, delay in various modern HR practices and many such factors may become the reason why PSEs become sick. Sometimes Human resource teams are very efficient the resources are complete but the managing department of the organization is not capable of managing various activities. There can be various reasons behind this like- uninteresting job profile, inadequate work knowledge or irrelevant education that doesn't have any link with that business. Thus, if any of these experiments are tried then the company will definitely incur losses and may be get closed

B. EXTERNAL CAUSES

1. Recession in the Market: Sometimes recession hits the whole industry as a result of which individual enterprises are unable to sell their products. The availability of credit is also restricted during such times which jeopardize the production activities of such units. Hence, the work of these units comes to a standstill.

2. Decline in Market Demand for the product: A product may reach a stage of maturity and ultimately a stage of decline. This happens when a new or better product invade the market and make the old product superfluous.

3. Excessive competition in the Market: Excessive competition in the market will justify the survival of only the fittest enterprise. The high cost units over time will become weak and fall sick.

4. Erratic supply of Inputs: Erratic and insufficient supply of inputs like raw-materials, power, skilled man-power, finance, credit and transport at reasonable prices could cause disturbance in the production schedule and ultimately result in sickness of the firm.

5. Government Policy: Excessive Government control and restrictions on capacity utilisation, location, product mix, product quality, prices, distribution etc. come in the way of smooth functioning of the enterprise and often result in sickness of the firm. Further, frequent changes in government policy relating to industrial licensing, import and export, taxation, credit can make healthy units sick overnight.

6. Unforeseen circumstances: Natural calamities such as droughts, floods earthquakes, accidents and wars etc. may turn some units sick and enviable.

The above causes are general causes of PSE sickness. A firm could get sick because of one or more of the above causes. However, it has been found that PSE sickness results more due to faulty, careless behaviour and attitude of management, than due to any other reason. In many cases, irresponsible and unsympathetic attitude of the managers has been found to be the most important cause of sickness for the firm.

Check Your Progress

1. Under what circumstances a PSE is restructured. Explain
2. What are the main causes of PSEs Sickness? Discuss briefly.

1.11 Steps Taken for Revival of Sick Units

The Government of India has taken a number of steps for the revival of sick units. Important among these are:

1. Setting up of Industrial Reconstruction Bank of India (IRBI) for rehabilitating sick units.
2. Introduction of margin money scheme for sick units.
3. Instructing banks and financial institutions to detect sickness in the incipient stage and to take corrective measures on time.
4. Close monitoring of sick units by the Reserve Bank of India.
5. Setting up of the BIFR (Board for Industrial and Financial Reconstruction) under SICA (Sick Industrial Companies Act of 1985) for determining preventive and remedial measures.
6. Introduction of the 'scheme of excise loan' to sick units.
7. Instructions to banks that have earlier financed the units under consortium agreement to rehabitate such units if they have turned sick.

1.12 Summing Up

Public Sector Enterprises: Public enterprises are autonomous or semi-autonomous corporations and companies established, owned and controlled by the state and engaged in industrial and commercial activities

Restructuring: It is a type of corporate action taken that involves significantly modifying the debt, operations, or structure of a company as a way of limiting financial harm and improving the business.

Sick enterprise: It means the enterprise which fails to generate an internal surplus on a continuous basis and depends for its survival upon frequent infusion of funds. Steady imbalance in the debt-equity ratio and distortion in the financial position of the enterprise.

1.13 Model Questions

1. What are Public Sector Enterprises? What are its objectives?
2. Narrate the benefits and challenges faced by the PSEs.
3. How a PSE is restructured? Explain
4. Explain the concept of Sickness in PSEs. What are the main causes of PSE sickness?
5. Discuss briefly the steps taken for revival of PSE.

1.14 References and Suggested Reading

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Unit-2
Disinvestment- its Objectives, Components and Policy

Unit Structure:

2.1 Introduction

In general, Investment refers to conversion of money or cash into securities, debentures, bonds or any other claims on money. Similarly, disinvestment involves the conversion of money claims or securities into money or cash. In short, when the Government sells its shares of a public sector undertaking to private sector undertaking / individual it is termed as disinvestment.

Disinvestment means selling off few assets such as a manufacturing plant, a division or subsidiary, or a product line. It is also described as the opposite of capital expenditures. Disinvestment is also known as *divestiture* or *to divest.*

It has been rightly said that all privatization are disinvestment but all disinvestment are not privatisation. If the PSU sell its share or stake to private parties but return 51% of the share with itself, then it is called disinvestment but not privatisation. On the other hand, if it sells 100% of the share to the private parties then it is called privatisation therefore, privatisation is the result of disinvestment but disinvestment may or may not always result in privatizations.

2.2 Objectives

After completing this unit you will be able to–

- understand the meaning and Concept of Disinvestment Policy,
- understand the objectives and Different methods of Disinvestment,
- describe the components of Disinvestment,
- explain the concept of Privatisation and its Objectives,
- analyse the reasons behind Privatisation and its Impact,
- explain the advantages and Disadvantages of Privatisation.

2.3 Objectives of Disinvestment

The following are the objectives of the disinvestment policy

i) Reducing the financial burden on the Government.
ii) Improving public finances.
iii) Encouraging the wider share of ownership.
iv) Introducing the competition and market discipline.
vi) Helping the public enterprises to upgrade their technology to become competitive.
vii) Rationalising and to retrain the workforce.
viii) Building the competence and strengthen the Research and Development.
ix) Initiating diversification and expansion programmes.

Thus, disinvestment is expected to reduce or mitigate fiscal deficit, bring about a measure of economic stabilisation or to improve efficiency in public undertakings through structural adjustments initiated to improve their efficiency and productivity.

2.4 Methods Implemented to Achieve Disinvestment

In order to achieve the various objectives and goals of disinvestment many methods have been formulated and implemented. These include:

1. Initial Public Offering (IPO) : In this method the unlisted CPSEs or the Government Companies offers share to the public through general prospectus for subscription. Offering shares of public sector enterprises at a fixed price through a general prospectus. The offer is made to the general public through the medium of recognised market intermediaries. Initially equity is offered to retail investors through domestic public issues. This is followed by issuance of the Global Depository Receipts (GDRs) to tap the overseas market.

2. Sale of Equity: Sale of equity is done through auction of share amongst pre-determined clientele, such predetermined client might be large in number. The reserve price for the PSE's equity can be determined with the assistance of merchant bankers.

3. Offer for Sale: In this method the shares of PSU are offer for sale through auction on the platform provide by the stock enhance such auction invites open bidders and accepts the highest bidders quotation.

4. Cross Holding: In the case of cross holdings, the government would simply sell part of its shares of one PSU to one or more PSUs.

5. Golden Share: A golden share is a type of share that gives its shareholder veto power over changes to the company's charter. It holds special voting rights, giving its holder the ability to block an other shareholder from taking more than a ratio of ordinary shares. In this model, the government retains a 26 percent share in the PSU. This 26 percent share will continue to give the Government the status of majority shareholder.

6. Warehousing: Under this method, the government owned financial institutions buy and store the government's share of select PSUs and hold them until third buyer emerge.

7. Strategic Sale: Under this method, the government sells a major portion (51 percent and above) of its stake to a strategic buyer and also gives over the management control. Disinvestment price will be market based and not prefixed and PSUs shares will be under the department of Disinvestment.

2.5 Components of Disinvestment

There are primarily three components/ types of Disinvestment such as:

1. Minority Disinvestment: A minority disinvestment is one such in which, the government retains a majority stake in the enterprise, typically greater than 51%, thus ensuring management control. Previously, minority stakes have been either auctioned off to financial institutions or offloaded to the public by way of an Offer for Sale. At present, the government has made a policy statement that all disinvestments would only be minority disinvestments via Public Offers. Examples of minority sales via Offer for Sale include Power Grid Corporation of India Ltd., Rural Electrification Corporation Ltd., NTPC Ltd., NHPC Ltd. etc.

2. Majority Disinvestment: A majority disinvestment means the government in the post disinvestment period, retains a minority stake in the company i.e. it sells off a majority stake. It is also called Strategic Disinvestment. Previously, majority disinvestments have been usually made to strategic partners, these partners could be other CPSEs themselves. As discussed earlier in the case of minority disinvestment, the stake in majority disinvestment can also be offloaded by way of an Offer for Sale, separately or in conjunction with a sale to a strategic partner. As for example BRPL to IOC, MRL to IOC. At the same time, these can be private entities, like the sale of Modern Foods to Hindustan Lever, BALCO to Sterlite, CMC to TCS etc.

3. Complete Privatisation: Complete privatisation is a form of disinvestment where 100% control of the company is passed on to the buyer. An example of complete privatisation includes 18 hotel properties of ITDC and 3 hotel properties of HCI.

Disinvestment and Privatisation are sometimes used interchangeably. There is, however, a vital difference between the both. Disinvestment may or may not always result in Privatisation. If the Government retains 26% of the shares carrying voting powers while selling the remaining to a strategic buyer, it would have disinvested, but not privatised, because with 26% of shares in hand, it can still take vital decisions for which generally a special resolution (three-fourth majority) is required.

Stop to Consider

Disinvestment means extending from dilution of the stake of the government to a level where there is no change in the control to dilution that results in the transfer of management. The transfer of ownership may take place when in an enterprise the dilution of government ownership is beyond 51 percent

Check Your Progress

1. Discuss the concept of Disinvestment.
2. What methods are implemented to achieve disinvestment in India?
3. Explain briefly the components of Disinvestment policy.

2.6 Privatisation-Introduction

In the narrow sense, privatisation involves altering public ownership to private ownership, that is the publicly owned companies or enterprises are managed by private entities. It simply means inducing private ownership, management and control into public sector enterprises. It is opposite of nationalising private firms. It implies disinvestment in public sector units and passing of management rights to private hands. In few cases the management and control of public undertakings may be transferred to private sector without transferring the ownership also. However, in the broader sense, it denotes public management of public sector enterprise. In layman's terms, it is a way of reconfiguring the relationship between state and the private sector so that the function and responsibility of the private sector get enhanced to increase functioning and efficiency.

Privatisation is the procedure of selling government owned assets to the private sector. It is argued the private sector tends to run a business more effectively and efficiently because of the profit motive. Since 1991 there was a transformation in attitude and perception regarding public sector's role in the economy. There were a number of issues and problems allied with the public sector which were restricting the economic growth of the country. These problems were low productivity, unproductive management, over recruitment, no or little technological up gradation, lack of attention to research and developments, poor development and management of human resources etc. as a result of which new industrial policy of 1991 suggested the privatisation of public sector. Yet, critics argue private units can exploit their monopoly power and ignore wider social costs. Privatisation is often achieved through listing the new private company on the Indian stock market.

Following **objectives** has been observed behind privatisation:

1. To create an environment for rapid industrialization.
2. To produce resources for a deficit budget.
3. To free the government from the loss making organisation.
4. To exploit natural resources of the nation with efficiency.
5. To develop and encourage competitive efficiency in the industries.
6. To improve the operational effectiveness of Public Enterprises.
7. To earn foreign currency by promoting export.
8. To manage public enterprise on commercial basis.
9. To persuade globalisation of domestic industries.

2.7 Reasons for Privatisation

There are numerous reasons why government enterprises turn to privatisation. Cost reduction is the driving force for privatisation. The aspiration to transfer risk from the public sector to the private sector can also lead to privatisation. Another reason for privatisation could be as a new source of revenue. A higher level of service can also be a ground. An absence of expertise within the government enterprise is another. The timeframe with which a project needs to be completed could also be a factor in the decision for privatisation. Even one of the reasons for privatisation is the flexibility provided by the private sector.

1. Transfer of Risk

Governments often desire to transfer the risks of few projects to the private sector. By contracting out for certain services, the government is trying to exchange the risk associated with those services for a monetary sum. In these transactions, the private sectors gets the monetary rewards for undertaking these services, but also bear the risk that these services will cost more or take longer to provide than estimated when agreeing to do them.

2. Service Quality

The quality of service provided can also be a reason for privatisation. Private sector enterprises may be able to offer a higher level of service for a similar cost. Governments may be looking for a higher level of service but cannot provide it by themselves due to certain constraints. The private sector may be able to meet the level of service desired without raising much cost to the consumers.

3. Expertise and Skill

Contractors may be able to have expertise that governmental units do not afford or do not wish to. These kinds of expertise services are needed so rarely that it does not make financial sense to maintain staff with these skills. Examples of expertise services that are often contracted for are architecture and engineering for the construction of buildings.

4. Timeframe

The aptness with which a project requires to be completed can also lead to privatisation. In many instances, the government may have the skills to complete a project but they may not be able to complete it within the desired time limit due to a lack of resources or time. Private sector can complement the government's efforts and allow a project to uphold the time schedule that would otherwise not be met.

5. Flexible in Nature

Often, due to collective bargaining agreements, the public sector is unable to hire and release employees as easily as private sector can. The private sectors are more able to cope with the seasonal demands of some projects which usually require a large amount of labour during some period of the year but less at other times. This flexibility is only available in private sector to complete the projects on time without much hassle.

2.8 Benefits of Privatisation

The benefits which can be derived by the way of privatisation and disinvestment are discussed below:

1. Enhanced efficiency

The private companies can increase the efficiency by cutting the cost of production. Since the private company is driven by project motive hence it is inclined to cut cost and operate efficiently.

2. Lack of political interference

Privatisation limit the government participation in economic activities and thus safeguards the private sector from under government and political interference.

3. Pressure from Shareholders

It is said that a private firm has pressure from shareholders to perform ingeniously. If the firm is unproductive then the firm could be subject to a takeover. A government owned firm doesn't have such work pressure and so it is easier for them to be incompetent and lethargic.

4. Better Service to the Customers

The survival and growth of private sector enterprises totally depends on customer satisfaction. Therefore they try to provide better quality goods and services to their customers and after sale services are also provided by them.

5. Easy to fix responsibility

In private sector enterprises authorities, responsibilities and accountability are normally fixed by the Board of Directors and corporate laws. Therefore, it is easy to fix the responsibility of the concerned employee in the case of success or failure in performance.

6. Operating Philosophies

Proponents of privatisation state that private firms are more likely to experiment with different and creative approaches to retain their customers, whereas government enterprises tends to stick with the same approach as any changes may create political difficulties for the elected officials. In addition, private enterprises may use retained earnings to finance research or to purchase new capital equipment that lowers unit production costs which is not implemented by government enterprises easily.

2.9 Disadvantages of Privatisation

With a number of benefits, privatisation and disinvestment also suffers from certain disadvantages such as:

In certain case, such as railways and tap water supply there is no scope for having competition among several firm. Since the fined cost is very high. Therefore in this case privatisarion would just create a private monopoly which might seek to set higher prices which exploit consumers.

1. Monopoly

Privatisation creates private monopolies, such as tap water and railways. These need to be regulated to prevent misuse of monopoly power. Therefore, there is still need for government regulation. Hence, it is better to have a public monopoly rather than a private monopoly which can exploit the consumers.

2. Public interest

There are many sectors which perform some vital public services, such as education, health care and public transport. Social cause will disappear if these organisation's primary motive will be profit earning. More for example, in case of health care if complete privatisation is allowed than greater priority is given to profit rather than patient's health.

3. Short term Nature

Just as the the government being motivated by short term pressures of elections and other political objectives same case may be with the private enterprises as well. To satisfy the shareholders the enterprise may focus to increase short term profits and avoid investing in long term projects.

4. Lack of Accountability

The public does not have any control or oversight of private companies and as a result they can easily exploit the consumers by charging higher prices for their products and services.

5. Lack of Transparency

Another problem often come with privatisation is the lack of transparency. Once public assets or services are transferred from public to the private sector, some of this transparency is often lost. This problem can be minimised by mandating certain reporting criterion in the contract and employing public oversight in the form of boards or authorities.

6. Profit Maximisation is the Main Motive

The main objective of private enterprises is to maximise profit. A private enterprise will serve the needs of those who are most willing (and able) to pay, as opposed to the needs of the majority, and are thus termed as anti-democratic.

2.10 Methods of Privatisation Adopted in India

Following are the methods of privatisation adopted in India

1. Initial Public Offers (IPO)

In this method, the shares/equity holdings of the Public sector enterprises are sold to the private retail investors and institutions like Mutual Fund houses, Pension Funds and Insurance Companies etc. This is one of the most favoured methods of privatisation followed in the developed and developing countries.

2. Strategic Sale

Strategic Sale is a method in which the government decides to sell Public Sector Undertakings shares to a strategic partner which can be other CPSEs as well. The administration in all such cases passes to the strategic buyer.

3. Sale to Foreign Firms

The method is termed as an alternative of the strategic sale method where the government decides to sell the share of PSUs to the foreign firms.

4. Management and Employees Buy outs

In this route of Privatisation, management and other employees of the PSUs come forward to buy the shares and equities of the organisation.

Check Your Progress

1. Name the methods of privatisation in India.
2. What are the objectives of privatisation in India?

2.11 Impact of Privatisation on Indian Economy

The Government of India prefer mixed economy in which both public and private sectors are permitted to operate. The private sector undertakings had to function within the provisions of the Industries (Development and Regulation) Act 1951 and other relevant legislations. In regard to this, the Industrial Policy Resolution 1956 stated that Industrial undertakings in the private sector have essentially to fit into the framework of the social and economic policy of the State and will subject to rules, regulations and guidelines in terms of the Industries (Development and Regulation) Act and other relevant legislation of the nation. The GOI identified that it would be advantageous to allow such undertakings to develop with as much freedom as possible, consistent with the targets and objectives of the national plan. Since many decades, various modern industries have been set up in the private sector. Imperative consumer goods industries were established in the Pre-Independence period itself such as cotton textile industry, sugar industry, paper industry and edible oil industry etc. These industries were established in response to the opportunities provided by the market forces. They were extremely suitable for private sector since they guaranteed good returns and required minimum capital for establishment. Though the engineering industries were not established during the Pre-Independence period, however Tata had started in the field of iron and steel industry at Jamshedpur. After Independence, many industries related to consumer goods were set up in the private sector. In today's date, India is practically self-reliant in its requirements for consumer goods. As per the IPR 1956 resolution, "Industries producing intermediate goods and machines can be set up in the private sector." Accordingly, chemical industries like paints, varnishes, plastics etc. and industries manufacturing machine tools, machinery and plants, rubber, paper, etc. have been set up in the private sector.

In India, there is a necessity of privatisation of companies to improve its economic status. Though the public sector enterprises have added a lot to develop the industrial base of the nation, but many a times at also continue to suffer from a number of inadequacies. Many PSUs have been incurring and reporting losses on a continual basis and are referred to as loss making units. As a result, the aim of privatising the economy has been adopted by the Indian Government. Initiatives such as abolition of licence raj for deregulation of the industries, scrapping of legislations such as MRTP and FERA, approval for 100% equity for NRIs, streamlining of approval committees, disinvestment in Public Sector Undertakings (PSUs), and reference of sick industrial units to Board of Industrial and Financial Reconstruction for rationalisation were meant for more and more privatisation of the Indian economy. Some of the examples of privatisation of companies in India are Bharat Aluminium Company limited, Hotel Corporation Limited of India, Hindustan Zinc Limited, Videsh Sanchar Nigam Limited etc.

2.12 Summing Up

- **Disinvestment:** disinvestment means selling off few assets such as a manufacturing plant, a division or subsidiary, or a product line. Disinvestment is also described as the opposite of capital expenditures. Disinvestment is also known as *divestiture* or *to divest.*
- **Sale of Equity:** Sale of equity through auction of share amongst pre-determined clientele, whose number can be large. The reserve price for the PSE's equity can be determined with the assistance of merchant bankers.
- **Golden Share:** Here the government retains a 26 percent share in the PSU. This 26 percent share will continue to give the Government the status of majority shareholder.
- **Minority Disinvestment:** A minority disinvestment is one such in which, the government retains a majority stake in the enterprise, typically greater than 51%, thus ensuring management control.
- **Majority Disinvestment:** A majority disinvestment means the government in the post disinvestment period, retains a minority stake in the company i.e. it sells off a majority stake. It is also called Strategic Disinvestment.

- **Privatisation:** Privatisation involves altering public ownership to private ownership, that is the publicly owned companies or enterprises are managed by private entities. It simply means inducing private ownership, management and control into public sector enterprises. It denotes public management of public sector enterprise.
- **Initial Public Offers (IPO):** In this method, the shares/equity holdings of the Public sector enterprises are sold to the private retail investors and institutions like Mutual Fund houses, Pension Funds and Insurance Companies etc.

2.13 Model Questions

1. What are Disinvestment and its Objective?
2. Discuss the methods implemented to achieve Disinvestment.
3. What are the components of Disinvestment? Explain briefly.
4. State the important reasons behind Privatisation of PSUs and its impact.
5. Discuss the advantages and disadvantages of Privatisation in India.

2.14 References and Suggested Readings

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Unit-3
Public- Private Partnership

Unit Structure:

3.1 Introduction

Public- Private Partnerships involve collaboration between a government agency and a private-sector company that can be used to finance, build, and operate projects such as public transportation networks, parks, and convention centres etc. Financing a project through a public-private partnership can allow a project to be completed sooner or make it a possibility in the first place. Government agencies represent the public partner at a local, state and/or national level. The private partner can be a privately-owned business, public corporation or consortium of companies with a specific area of expertise.

PPP is a broad term that can be applied to anything from a simple, short-term management contract with or without private investment requirements to a long-term contract that includes funding, planning, building, operation, maintenance and divestiture. Public-private partnerships often involve concessions of tax or other operating revenue, protection from liability, or partial ownership rights over nominally public services and property to private sector, for-profit entities. Common sectors associated with PPP are Transportation, Power and energy, Water and Wastewater, Telecommunications, Healthcare, Education, Social Infrastructure etc.

3.2 Objectives

After completing this unit you will be able to–

- define the meaning and Characteristics of Public- Private Partnership,
- understand advantages and Disadvantages of Public- Private Partnership,
- discuss the P3 Model,
- explain the risk involved in PPP Projects.

3.3 Features of Public-Private Partnership

To understand the PPP concept, we must know its fundamental features. Some of these are discussed in detail below:

1. Service-Oriented: The PPP approach deals with the facilitation of long-term public services. It includes roads for transportation, dams for electricity and water supply and street lights for lighting.

2. Whole Life Costing: In the PPP model, the project's total cost is computed for its entire life span, taking into consideration the initial capital expenditure, repair and maintenance expenses, modification expense and the eventual disposition cost.

3. Innovation: With the involvement of the private firms, the PPP approach also initiates the implications of creativity and new technology to the infrastructure projects.

4. Participants: The two parties involved in the public-private alliance are; the government and the respective private company.

5. Risk Allocation: Infrastructure projects involve high risk; thus, PPP helps the government to transfer this risk to private firms.

6. Long-term Relationship: These projects are usually for years; therefore, the government authority and the private entity remains associated for an extended period.

7. Resource Sharing: The capital, financial, design and other resources required are shared between the government and the firm for successful project accomplishment.

Stop to consider

Public- Private Partnerships involve collaboration between a government agency and a private-sector company that can be used to finance, build, and operate projects. A Public-private partnership (PPP) is often defined as a long-term contract between a private party and a government agency for providing a public asset or service, in which the private party bears significant risk and management responsibility (World Bank, 2012).

3.4 Benefits of Public-Private Partnership

Partnerships between private companies and governments provide advantages to both parties. The benefits are discussed hereunder:

1. They provide better infrastructure solutions than an initiative that is wholly public or wholly private. Each participant does what it does best.
2. They result in faster project completion and reduced delays on infrastructure projects by including time-to-completion as a measure of performance and therefore of profit.
3. A public-private partnership's return on investment (ROI) might be greater than projects with traditional, all-private or all-government fulfilment. Innovative design and financing approaches become available when the two entities work together.
4. Risks are fully appraised early on to determine project feasibility. In this sense, the private partner can serve as a check against unrealistic government promises or expectations.
5. The operational and project execution risks are transferred from the government to the private participant, which usually has more experience in cost containment.
6. Public-private partnerships may include early completion bonus that further increase efficiency. They can sometimes reduce change order costs as well.
7. By increasing the efficiency of the government's investment, a P3 allows government funds to be redirected to other important socioeconomic areas.

8. The greater efficiency of P3s reduces government budgets and budget deficits.
9. High-quality standards are better obtained and maintained throughout the life cycle of the project.
10. Public-private partnerships that reduce costs potentially can lead to lower taxes.

3.5 Disadvantages of Public-Private Partnership

Public Private Partnership also have various disadvantages:

1. Every public-private partnership involves risks for the private participant, who reasonably expects to be compensated for accepting those risks. This can increase government costs.
2. When there are only a limited number of private entities that have the capability to complete a project, such as constructing a high-speed rail system, the relatively small field of bidders might mean less competition and thus less cost-effective partnering.
3. Profits of the projects can vary depending on the assumed risk, the level of competition, and the complexity and scope of the project.
4. If the expertise in the partnership lies heavily on the private side, the government is at an inherent disadvantage. For example, it might be unable to accurately assess the proposed costs.

Check Your Progress

1. Discuss briefly the concept of Public Private Partnership alongwith its important features.
2. "Public Private Partnership bring advantages to both parties involved in it"- Explain.
3. State briefly the disadvantage of PPP.

3.6 Public- Private Partnership (P3) Model

Commonly adopted model of PPPs include Build-Operate-Transfer (BOT) ,Build-Own-Operate (BOO), Build-Operate-Lease-Transfer (BOLT), Design-Build-Operate-Transfer (DBFOT), Lease-Develop-Operate (LDO), Operate-Maintain-Transfer (OMT), etc. These models differ on the level of investment, ownership control, risk sharing, technical collaboration, duration, desired outcome, financing etc.

1. Build-Operate-Transfer (BOT): It is **conventional PPP model** in which private partner is responsible to design, build, operate (during the contracted period) and transfer back the facility to the public sector. This is generally used to develop a discrete asset rather than a whole network, for example a toll road. This simple structure provides the most freedom for the private sector partner during construction and the public sector bears the equity risk.

2. Build-Own-Operate (BOO): This is a similar structure to BOOT (below), but the facility is not transferred to the public sector partner. A BOO transaction may qualify for tax exempt status and is often used for water treatment or power plants.

3. Build- Own- Operate- Transfer (BOOT) : The private sector builds and owns the facility for the duration of the contract, with the primary goal of recouping construction costs (and more) during the operational phase. At the end of the contract the facility is handed back to the government. This structure is suitable when the government has a large infrastructure financing gap as the equity and commercial risk stays with the private sector for the length of the contract. This model is often used for school and hospital contracts.

4. **Build-Operate-Lease-Transfer (BOLT):** In this approach, the government gives a concession to a private entity to build a facility (and possibly design it as well), own the facility, lease the facility to the public sector and then at the end of the lease period transfer the ownership of the facility to the government.

5. Design-Build-Operate-Transfer (DBFOT): In this model, entire responsibility for the design, construction, finance, and operation of the project for the period of concession lies with the private party. This type of partnership can reduce time, save money, provide stronger guarantees (as the work is with a single entity rather than a consortium) and allocate additional project risk to the private sector.

6. Lease-Develop-Operate (**LDO):** In this type of investment model either the government or the public sector entity retains ownership of the newly created infrastructure facility and receives payments in terms of a lease agreement with the private promoter. It is mostly followed in the development of airport facilities.

7. Operate-Maintain-Transfer (OMT): In an OMT contract, a private operator operates and maintains the asset for the public partner, usually to an agreed level with specified obligations. The work is often sub-contracted to specialist maintenance companies. The payment for this contract is either via a fixed fee, where a lump sum is given to the private partner, or more commonly a performance-based fee.

3.7 Risks in Public-Private Partnership Projects

The risks involved in PPP projects are of several types. These are discussed briefly:

1. Construction Risk: Construction risk in PPP projects are related to several individual factors which effect the construction of infrastructure of project. Some risk factors are Estimated Cost vs. Real Project Cost, Project Completion Time etc.

2. Operating Risk: Operating risk is related to operations and maintenance cost of infrastructure of project. In general private parties take the responsibility of operating risks unless there is increase in due to new or increased taxes. Regular periodic reviews and adjustment of charges will improve sustainability of long term PPP projects.

3. Design Risk: Design risk is related to any mistakes or defects in the design specifications or in the design of structural elements. If there is any damage of structural element, then it is difficult to decide that the damage is due to mistakes in design parameters or the very design itself. The design risks are generally within the control of design contractor. So, during the design the design contractor should take the responsibility to eliminate this type of risks.

4. Market and Revenue Risk: If a project is not able to get the revenue which it would actually generate then it is considered as revenue risk. A PPP project may face the market and revenue risk due to several reasons i.e. **Insufficient Income from Fares or Tolls, Insufficient Income from Other Operations etc.**

5. Legal Risk: Legal risk may occur in public-private partnership projects due to many reasons and some of them are:

- Property Lease issues
- Ownership agreements
- Breach of documents
- Financial failure of private sector
- Corporate and security structure

6. Financial Risk: In General, funds will be raised for projects which require large working capital. Both the parties need to consider this risk seriously. **Exchange Rate Risk** Exchange rate risks are occurred when there is an involvement of foreign currency exchange or international finance in the project. The exchange rates of International currency are unstable in many developing countries, so this risk should be considered. **Interest Rate Risk** Interest rate risk is involved when a large amount of money is borrowed for the project at variable interest rates. To reduce this risk, the money should be borrowed at fixed interest rate.

7. Political Risk: The PPP projects may also have to face political risks from public sectors such as present government, opposition government, country's legislature etc. The political risk involves Tax Increment, Payment failure by public sector, delay in approvals from authority etc.

8. Force Majeure Risk: Force majeure risk are generally unrelated to the project. They cannot be controlled and prevented by any of the parties of project. They generally arise due to Natural events/ forces which includes natural disasters such as floods, earthquakes, cyclones etc.

9. Environment Risk: Environmental risk are related to the effects on environment during the implementation of project. It is important to check if there is any presence of strict environmental liability within the project zone. Proper planning is needed in such a way that the project should fulfil the current environmental legislation.

3.8 Summing Up

Public-private partnership: A Public-private partnership (PPP) is often defined as a long-term contract between a private party and a government agency for providing a public asset or service, in which the private party bears significant risk and management responsibility (World Bank, 2012).

P3 Model: Commonly adopted model of PPPs include Build-Operate-Transfer (BOT) ,Build-Own-Operate (BOO), Build-Operate-Lease-

Transfer (BOLT), Design-Build-Operate-Transfer (DBFOT), Lease-Develop-Operate (LDO), Operate-Maintain-Transfer (OMT), etc.

PPP Risk: There are several risk associated with PPP Projects such as construction risk, operating risk, design risk, market and revenue risk, legal risk, political risk and environmental risk.

3.9 Model Questions

1. What is PPP? State its important features.
2. Discuss the advantages and disadvantages of PPP.
3. Discuss briefly any 5 Models of P3.
4. What are the different types of risk involved in PPP Projects? Explain.

3.10 References and Suggested Readings

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