Chapter 3
Literature Review on Aspects of PSEs

Abstract The objective of this chapter is to present the major research works and their findings on aspects such as the performance of public sector enterprises (PSEs), disinvestment in PSEs, Memorandum of Understanding (MoU), and measures of financial performance (including ratio analysis). The literature survey shows that there are potentials for further inquiry which focuses on the policies and reforms of public sector enterprises primarily in terms of disinvestment and Memorandum of Understanding (MoU).

Keywords Public sector enterprises (PSEs) • Disinvestment • MoU • Financial performance • Measures of performance and ratio analysis

3.1 Introduction

The objective of this chapter is to present the major research works and their findings on aspects such as performance of public sector enterprises (PSEs), disinvestment in PSEs, Memorandum of Understanding (MoU), and measures of financial performance (including ratio analysis).

3.2 Literature Review

For better exposition, literature review has been broadly classified into the following four major heads:

(a) Transition and performance of public sector enterprises in India,
(b) Disinvestment and privatization,
(c) Memorandum of Understanding (MoU), and
(d) Measures of financial performance.

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Table 3.1 Studies related to performance of public sector enterprises, 1974–2012

S. no.	Year	Author(s)	Issue studied
1.	1974	Sharma	Public interest and development perspective of economies.
2.	1982	Ahmad	Political economic approach of government
3.	1986	Trevedi	Growth and performance of PSEs
4.	1988	Reddy	Need of reforms and price regulation
5.	1990	Narain	Compares economic and non-economic objectives of PSEs
6.	1994	Kumar	Role of PSEs and their financial profitability (FP)
7.	1997	Gouri	Hierarchical structure of the government in India
8.	2001	Ganesh	States the position of PSE's restructuring
9.	1998, 1999 and 2001	Ghuman	Contribution towards economic and social development
10.	2002	Sengupta	A case on Indian Telephone Industries (ITI) Ltd.
11.	2004	World Bank	Suggestion for Indian environment and industry
12.	2004	Naib	Principal-agent problem in public enterprises
13.	2005	Kaur and Singh	Problems of PSEs and the outcome of reforms
14.	2006	Patnaik	Recruitment issues and incentives in PSEs
15.	2006	Bala	Role of state in economic development of PSEs
16.	2005	Jain and Yadav	Financial performance of the central PSEs
17.	2006	Dept of PSEs	National Common Minimum Program (NCMP)
18.	2007	Mukul G. Asher	Reforms in Urban Cooperative Banks
19.	2008	Arnold et al.	Growth of India's manufacturing sector PSEs
20.	2009	Dilip K. Das	Performance of Indian economy
21.	2010	Chris	Public sector compensation
22.	2010	BMI Report	State of Indian petrochemicals industry
23.	2010	Frank Ohemeng	Failures in public management and suggestion to deal with them
24.	2011	BMI Report	Indian telecom industry
25.	2011	Chubrik et al.	Problems of transition
26.	2011	Meine Pieter	Structural weaknesses observed in Chinese economy during global financial crisis
27.	2011	Muhammad et al.	Performance of select public organizations in Rawalpindi and Islamabad
28.	2011	Mustaruddin	Corporate social responsibility and corporate financial performance
29.	2012	Michaela	Aspects of economic globalization
30.	2012	Ahmet and Asli	High-performance companies in matured economies
31.	2012	Anshu	Problems of Indian economy

3.2.1 Transition and Performance of Public Sector Enterprises in India

This part primarily deals with select studies (a) related to financial performance of PSEs and (b) other important aspects such as their contribution to the development of economy, problems faced, and suggestive measures and recommendations to improve their performance. Table 3.1 lists (in a chronological order) the studies reviewed under this sub-head.

Sharma (1974) has focused on the issues of public interest and profit. He suggests the best public interest which public enterprises can serve is to fulfill all the desired financial and economic obligations as per the government's plans and perspectives.

In an economy where the government is committed to a socialist pattern of society for reasons of social and economic policy, it will be incumbent on the government not only to interfere but have a decisive hand also in all important matters such as price fixation and plowing back of profits.

Ahmad (1982) uses a political economy approach to show that size and nature of the public sector in a country depends upon the class interest of the dominant political groups. Jones and Mason (1982) assume that governments are pragmatic and rational. They claim that the size of the public sector increases until the marginal benefit from doing so just becomes equal to the marginal cost.

The real solution to the problem of poor performance of PSEs requires action on two broad fronts. First, the government is to decide on the criteria to monitor public enterprises. Second, it is to devise a control mechanism, with appropriate incentives and disincentives to motivate its agents (public enterprise) to pursue these criteria.

Trivedi (1986) sketches the profiles of the Indian public sector enterprises (PSEs) and traces their growth and performance over time. He has attempted to diagnose the reasons for the poor performance of the PSEs in India. One major reason identified is that public managers are intrinsically inefficient; the other reasons cited are controlled output prices, while input prices continue to increase, setting up non-commercial objectives, different output mix, overemployment, corruption, and lack of autonomy. He suggests that the government needs to design proper criteria to monitor performance and effective institutionalized arrangements to implement a performance evaluation system.

Reddy (1988) focuses on the need of reforms due to the fiscal crisis. Due to this, the government finds it necessary to lend some urgency to reform public enterprises with an implicit admission of relatively limited liability of the government to inject finances unlike in the past. He emphasizes the need to examine/quantify the loss, attributable to subserve social obligations.

Most of the profit and loss leaders (implying PSEs) operate in an atmosphere of price regulation, and a large part of the markets in which they operate (input or output) are in the exclusive domain of public sector enterprises themselves. This makes any analysis of profitability very unrealistic. Further, it is not clear which of the loss leaders have had "locational" problems and how much its effect on the costs are taken into account in price fixation by the government. Moreover, non-availability of inputs like power, fuel, etc., indicates mismatch between supply and demand within the PSEs. More importantly, pricing restrictions or general price policies appear as much relevant to profit leaders as to loss leaders. Price increases in most loss leaders would have led to higher input prices to other public enterprises.

Narain (1990) has evaluated the performance of the organization; it has been judged in the light of its objectives. Unfortunately, there is no clarity about the objectives of government companies in India. Many of the objectives are vague, difficult to quantify, and, to an extent, conflicting with each other. In fact, the economic and non-economic objectives have got so inextricably mixed up in the case of public enterprises that it is not easy to judge their overall performance. A public

enterprise may be located at an economically unviable place in backward region and may adopt a technology with high employment potential which may be economically unsuitable. In the face of these constrains, its performance in financial terms (analyzed with reference to their gross profits, operating profits and net profits) may not be up to the mark.

He further stresses that it is difficult to lay down a uniform pricing policy for public enterprises in view of their widely varying nature of business and competitive environment. Some of these are industrial, while others are commercial, promotional, or developmental in nature. Some of these are operating in the competitive market, and some have monopolistic market. Hence, no single pricing policy can be suitable in all these cases.

Kumar (1994) emphasizes the important role played by the public sector enterprises (PSEs) in the Indian economy. The public sector has indeed attained commanding heights in many crucial areas and has been the vanguard of the country's variegated development. It plays a key role in the infrastructure sector of the nation's economy. Public enterprises are instruments of public policy. Their operations should enhance social welfare. Since an increase in financial profitability is neither a necessary nor a sufficient condition for the enhancement of society's well-being, a more comprehensive system of assessing performance than the present/traditional one is obviously required. Policy-makers must devise a policy to improve the performance of public enterprises in order to serve public purpose as well.

Gouri (1997) describes a complex hierarchical structure of the government which constitutes the public sector in India. The PSE is a subsystem of the public sector system and consists of departmental enterprises and non-departmental enterprises. Although they form a part of the government financial systems, departmental enterprises have separate accounts of income and expenditure. However, their surpluses or deficits are merged in the accounts of the departments of government, e.g., Indian railways, telecommunication, and postal departments.

Non-departmental enterprises are legally separated from the government and are made to maintain a separate account of all their financial transactions and to set them out in the form of a profit and loss account. These enterprises are set up either under the Companies Act or under special statutory provisions.

Ganesh (2001) has conducted a study on PSEs and suggests that even though PSEs were set up half century ago as an extension of the socio-economic philosophy, they have fallen from the "commanding heights" of economy as they were expected to scale. He has advocated restructuring which deals with business operations, organizational management, technology up-gradation, and financial reengineering. Staff is up in arms due to measures such as reduction of staff strength and redeploying the surplus staff elsewhere. The voluntary retirement scheme (VRS) may also pose problems due to financial paucity. Therefore, good governance of PSEs, though a possible and appropriate solution, is difficult to achieve.

Ghuman (1998, 1999, 2001) acknowledges the critical contribution of public enterprises to India's economic and social development. He argues that positive note must be taken of their performance and achievements, as they continue to perform a vital role in the management of public affairs. An analysis of national enterprises

since the 1980s indicates that many have achieved commendable levels of performance and often outperformed enterprises in the private sector.

Public enterprises have played a pivotal role in the Indian economy. Their contribution to national income, capital formation, industrialization, and the provision of economic and social infrastructure has been impressive. Their financial performance has varied over time, but with a clear distinction between the pre-reform period and the period since the reforms began to be introduced in the early 1990s. Indicators such as percentage of net profit to capital employed, internal resource generation, and contribution to the exchequer show that their performance has improved during the reform period, even when the Indian economy was experiencing a downturn. The constant reduction in the government's budgetary support for them seems to have had a positive impact on their ability to generate resources.

They are themselves increasingly more conscious of the need to promote and achieve management excellence, as testified by the introduction of the Standing Conference of Public Enterprises (SCOPE) awards for excellence in public management. While recognizing the impressive achievements of public enterprises, it is essential not to deny such persistent and major shortcomings as over-capitalization, overstaffing, under-utilization of installed capacity, delays in the implementation of projects, and inadequate attention to R&D. These matters as well as the effects of various privatization initiatives taken to date clearly deserve to be studied and addressed by concerted government action. Yet, at the same time, the author opined that they must not be allowed to overshadow the very positive aspects of India's public enterprise experience.

Sengupta (2002) deals with a case of Indian Telephone Industries (ITI) Ltd., India's oldest public sector company, and describes the recommendations of the Arjun Sengupta Committee (appointed by the Government of India in 1984 and submitted its report in 1986). First, the committee recommended that the PSEs should operate in the core sector. Secondly, it suggested various measures for the improvement of performance of the PSEs such as technology up-gradation, organizational restructuring, dependence on public borrowings, and some degree of linkage of wages and productivity. Third, the loss-incurring, non-core enterprises should be studied in detail so that they could be made economically viable. Fourth, those enterprises which incurred losses over a period of time and where the value added per employee had been less than the average emoluments and where equity capital had been wiped out by mounting deficits should be closed down.

World Bank Report (2004) states that India has provided an interesting environment for study. Rapid liberalization in the service sector during the 1990s followed the economic and political success of the liberalization of the manufacturing sectors in the late 1980s and early 1990s. In the 1980s, the service sector in India was dominated by state enterprises; there were restrictions on the entry of private, domestic, and foreign service providers, and prices of services were largely fixed by the government.

Naib (2004) says poor monitoring is a common criticism of public ownership and finds principal-agent problem in public enterprises is more severe than private enterprises. The reason is that the full monitoring hierarchy includes voters, elected political representatives, civil servants, and the managers of state-owned enterprises

(SOEs); this leads to a number of principal-agent problems. The politicians and/or bureaucrats responsible for monitoring SOEs can themselves be viewed as agents of the wider public (the principals), and it is the welfare of the public that is the ultimate benchmark against which performance should be judged. The incentives for politicians to act in the best interests of the wider public will depend upon factors such as the nature of the relevant political system and the closeness of impending elections.

There are considerable informational asymmetries between politicians and voters. Informational asymmetries indicate that an efficiency improvement may sometimes lead to worsening of the electoral prospects. On the other hand, there would be electoral benefits in setting politically sensitive low prices even below marginal costs, since the direct positive impact on consumers is more visible than the indirect negative effects arising out of giving subsidy to SOEs.

Bureaucrats and politicians can introduce their own agenda (say, redistribution of resources to favored/interest groups) into the process. Bureaucratic agenda may, therefore, result in excessive monitoring and control over SOEs. This implies that the objectives of political decision makers can be expected to deviate significantly from social welfare objectives. Political attractiveness of SOE reforms depends on its political costs and benefits. In a typical case, the political costs must be borne up-front in the form of antagonizing labor unions, managers, suppliers, and other powerful beneficiaries of state ownership. In return, some political benefits may flow immediately.

The main cause of fiscal crisis has been attributed to the failure of the public sector to generate investible resources and unbridled non-plan government expenditure. This situation arose because of a variety of problems such as an inefficient, high-cost, and non-competitive industrial structure and serious infrastructure-related bottlenecks. The reforms initiated in 1991 were distinct precisely because they recognized the need for a system change, involving liberalization of government controls, a larger role for the private sector, and greater integration with the world economy.

From 1991, increasing levels of deregulation and globalization have ushered in an era of intense competition in the economy, the effects of which have been felt on certain PSEs. In some cases, even profitable PSEs have been adversely affected, while in some other cases, the losses of the loss-incurring PSEs have compounded. The main reasons for poor performance of PSEs are overstaffing, outdated technology, and lack of funds to invest.

Kaur and Singh (2005) identify the problems of PSEs. The major problems include lack of proper management of human resources, proper planning, organizational structure, and autonomy in decision making. This, in turn, causes low total production in relation to cost and investment, inefficient internal administration, poor financial planning, and ineffective rules and regulations regarding the higher-level decisions.

Huge amount of investments with little or no return on investment have created heavy burden of borrowings along with interest burden, which further mounts the fiscal deficit and the losses. This has led to the idea of reforms in the PSEs by initiating disinvestment.

Patnaik (2006) states that the recruitment in PSEs is carried out by individuals who (themselves) have poor incentives to maximize the performance of the firm. A variety of conflicts of interest induce bad decisions in recruitment. Interference by the

political system plays its own part in reducing the quality of recruitment; once a person is recruited, the PSEs fail to adequately incentivize the person; whether a person performs well or badly, there is little variation in the wage; the probability of being sacked from a PSE is negligible.

Bala (2006) endeavors to look into the evolution of the role of the state and its intervention in the economic development within the contours of socio-economic and political circumstances.

In many developing countries, state enterprises are assigned the responsibility of fulfilling specific social goals. The state intervenes through state-owned enterprises in the countries where investment needs for different projects are large and the expected returns (at least in the short run) are too low to motivate private capital to invest. Excessive political interference and lack of managerial interests (autonomy) hamper the performance of state enterprises. It has resulted in the reflection of various theories on assessing the performance of state enterprises which includes property rights theory, public choice theory, non-market failure, and competition theory.

Jain and Yadav (2005) have evaluated financial performance of the central PSEs. The central PSEs were sub-divided in two categories, namely, manufacturing and services. Their analysis of the relevant data relating to return on total assets (ROTA) of PSEs indicates that service enterprises have better profitability than manufacturing enterprises during the aggregate period (1991–2003). They have also examined in depth the financial management practices of PSEs in India.

The *Public Sector Enterprises Survey (2005–2006),* in the National Common Minimum Program (NCMP), outlines the policy of the government with respect to the public sector, including disinvestment of government's equity in Central Public Sector Enterprises (CPSEs). The salient features of the NCMP are as follows:

1. The government is committed to a strong and effective public sector whose social objectives are met by its commercial functioning. For the purpose, there is a need for selectivity and a strategic focus. The government is committed to devolve full managerial and commercial autonomy to successful and profit-making PSEs/companies operating in a competitive environment.
2. In general, profit-making companies will not be privatized. The government will retain existing "Navratna" (performing very well) companies in the public sector; these companies raise resources from the capital market. While every effort will be made to modernize and restructure sick public sector companies and revive sick industry, chronically loss-incurring companies will either be sold off or closed, after all workers have got their legitimate dues and compensation. The government will induct private industry to turnaround companies that have potential for revival.
3. The government believes that privatization should increase competition, not decrease it. It will not support the emergence of any monopoly that only restricts competition. It also believes that there must be a direct link between privatization and social needs. Public sector companies and nationalized banks will be encouraged to enter in the capital market to raise resources and offer new investment avenues to retail investors.

Mukul G. Asher (2007) has identified certain areas of reforms in Urban Cooperative Banks (UCBs), i.e., current business model, governance and regulation practices, and capital adequacy. The study suggests for a paradigm shift by the UCBs and how better governance and regulatory structure can assist this shift. He also suggests that if the UCBs are to remain relevant and play a significant developmental role in India, they will require the same quality of governance and regulation as well as professionalism and modernization as practiced in the commercial banks. The governance and regulatory structures need to be brought in conformity with India's current and prospective economic structure.

Arnold et al. (2008) perceive that conventional explanations for the post-1991 growth of India's manufacturing sector are focused on trade liberalization and industrial de-licensing. They demonstrate the contribution of India's policy reforms in services. The link between these reforms and the productivity of manufacturing firms has been examined using panel data for about 4,000 Indian firms for the period 1993–2005.

They observed that banking, telecommunication, and transport reforms had laid significant positive effects on the productivity of manufacturing firms. Service sector reforms benefited both foreign and locally owned manufacturing firms, but the effects on foreign firms tended to be stronger.

Dilip K. Das (2009) enumerates the performance of the Indian economy in the context of its growth rate acceleration. He emphasizes that sluggish and tardy reform implementation is one of the serious bottlenecks. In 2008, myriads of domestic and global factors coalesced to drive GDP growth rate sharply down. He infers that the growth spurt of the Indian economy is unsustainable. Sustainability of high-growth momentum is regarded as a serious challenge. Unlike that in China, the implementation of economic reforms in India was tardy and slow. Bureaucratic incompetence, foot-dragging and powerful vested interests, political wrangling, and constants disagreements were among the principal causal factors.

Chris (2010) suggests that public sector compensation is becoming a high-profile policy issue. While private sector wages and benefits have stagnated during the recession, many governments continue to increase compensation for public sector workers. At the same time, there are growing concerns about huge underfunding in public sector retirement plans across the nation.

Business Monitor International (BMI) Report (2010) states that overcapacity and high inventories are major downside risks for Indian petrochemicals producers. Despite increased global supply, the domestic market will find difficult to prevent price volatility. Although India's economic recovery could be rocky in the short term, the mean real GDP growth over the next 10 years is forecasted at 7.6 % compared with 7.2 % in the previous 10 years. This should sustain demand for petrochemicals and ensure that India remains a net importer over the long term. The main downside for the Indian petrochemicals industry is the massive increase in global capacities, which will push down prices at a time of rising feedstock costs, thereby putting pressure on petrochemicals margins.

Further, the report states that the product mix is favorable to the development of an export-oriented petrochemicals industry in the context of global market patterns. Another factor in favor of Indian producers, as opposed to foreign imports, is the immediacy of supply.

Frank Ohemeng (2010) develops a theoretical framework to explain the failure in public management of wholesale policy transfer from well-developed to developing economies. He suggests that the context in which public sector reform policies are implemented matters. In short, the environment (with structural and contextual variables) is an essential element in the success of policies. He explains "how" and the "why" of the success or failure of such models has become a daunting task for many because of the lack of a general theoretical framework that can be used to compare and explain why such models work in their original location but not in other environments. The analysis indicates that the socio-economic and political environment, including a country's history, past development, system of governance and relationship with the outside world (particularly, International Financial Institutions), the bureaucracy, and the culture should all be of serious concern in determining the policies for reforms.

Business Monitor International (BMI) Report (2011) has observed that the growth and development is having a positive effect on India's telecom industry, though the sector continues to be mired in corruption and regulatory mismanagement scandals. The Indian government revived a proposal in February 2011 to merge the two operators in order to boost their competitiveness in India's increasingly harsh business environment. Prospects for India's state-owned Bhartiya Sanchar Nigam Ltd. (BSNL) and Mahanagar Telephone Nigam Ltd. (MTNL) continue to look bleak after the two telecom companies reported net losses due to the launch of mobile number portability in January 2011. The country's telecom industry remains attractive in the long term due to its growth potential. However, the short-term outlook is uncertain as the industry continues to be hampered by the ongoing political wrangles and regulatory uncertainties.

Chubrik et al. (2011) analyzed the process of post-communist transition, both in economic and political spheres. The lack of democracy and freedom makes it difficult to fight corruption and improve the quality of state institutions. The decade of the 2000s was marked as the era of rapid economic growth, falling poverty rates (but not necessarily inequality), lower inflation, and a relatively favorable fiscal situation. However, in 2006–2008, many countries started to experience signs of overheating, with current account deficits widening rapidly and inflation pressures growing. The crisis adversely affected and worsened their fiscal situation.

van Meine Pieter (2011) highlights the structural weaknesses in the Chinese economy during the global financial crisis of 2008–2009. These include the functioning of its capital and labor markets and the substantial income differences between the developed eastern and less developed western provinces.

Muhammad et al. (2011) examine the performance of the select public sector organizations working in Rawalpindi and Islamabad. They suggest that the combination of the latest technology and qualified manpower as well as improved infrastructure has increased the competition among different organizations, necessitating the performance appraisal. They assess the performance of the public sector organizations using non-financial measures based on an eight-item scale. The results indicate that productivity obtains the highest rank compared to other indicators; profitability has been ranked second; quality of products, market share, personnel activities

coordination, and internal process coordination stood third, fourth, fifth, and sixth, respectively, in ranking. Finally, personnel voluntary rotation is ranked second last aspect followed by personnel absenteeism as the least preferred item to indicate the performance of public sector organizations.

Mustaruddin (2011) examines the relationship between corporate social responsibility (CSR) and corporate financial performance (CFP) of Malaysian public listed companies (PLCs) in an emerging market setting. They are 200 in number, using panel data analysis during 7-year period (1999–2005). Results indicate that they are positively and significantly related. Two of the CSR dimensions, namely, employee relations and community involvement, were observed to be positively related to financial performance. This proves that CSR practices can be considered as an effort to enhance the financial performance of PLCs in Malaysia. The findings suggest that Malaysian PLCs should be involved consistently in their CSR practices as CSR has a significant impact on improving financial performance in Malaysian PLCs. Thus, the Malaysian PLCs which are actively involved in CSR activities are also able to create customer loyalty in the long term.

Michaela (2012) focuses on the impact of three specific aspects of economic globalization: trade, foreign direct investment, and technological progress on the US labor market. He analyzes that the inward as well as outward foreign direct investment contributes to employment in the USA and provides an additional boost to the US labor market.

Ahmet and Aslı (2012) have examined the characteristics of high-performance companies (HPCs) in mature economies and in an Asian emerging economy (India). This study of HPCs in the developing economy investigates Turkish companies that are listed in the Istanbul Stock Exchange (ISE) and companies that display specific characteristics of HPCs, namely, superior cash flow returns, growth rates and total shareholder returns. They test the hypothesis that there will be no significant difference between the financial performance drivers and measures from before the financial crisis era (2005–2007) and those of after the financial crisis (2008–2009). When comparing HPCs with ISE ordinary companies, both in the pre-financial crisis period (2005–2007) and the post-financial crisis period 2008–2009, Turkish HPCs were shown to maintain superior asset management and performance profitability, lower financial risk, and stronger cash flow returns compared to the benchmark group over economic periods of rapid growth and stable market conditions as well as the periods of economic decline and uncertainty. The results provide direction for the management of companies that aspire to HPC status and to maintain HPC status, especially during periods of financial crisis.

Anshu (2012) has discussed that the Indian economy has been adversely affected, to a marked extent, by factors such as high fiscal deficit, poor infrastructure facilities, sticky legal system, and cutting of exposures to emerging markets by banks. Genuine borrowers face the difficulties in raising funds from banks; either the bank is reluctant in providing the requisite funds to the genuine borrowers or if the funds are provided, they come at a very high cost to compensate the lender's losses caused due to high level of non-performing assets (NPAs).

3.2.2 *Disinvestment and Privatization*

To gain better insight, literature relating to privatization or disinvestment has further been sub-divided into two parts. While part one deals with the global experience and studies related to privatization, literature related to Indian perspective has been classified in part two; Tables 3.2 and 3.3, respectively, present the brief review of the empirical studies carried out on these aspects.

Table 3.2 Studies related to disinvestment in PSEs at global level, 1952–2012

S. no.	Year(s)	Author(s)	Issue studied
1.	1952	Little	Incentives and productive efficiency after disinvestment
2.	1986	Kay and Thompson	Privatization in the UK, their objectives, and problems
3.	1986	Brittan Samuel	Aims of denationalization
4.	1988, 1991	Bishop and Kay	Compared performance of privatized UK companies with public sector enterprises
5.	1989	De Fraja and Delbono	Shareholding position, problems, and benefits
6.	1989	Boardman and Vining	Relationship between ownership and performance
7.	1991	Lorch	Financial performance of textile mills in Bangladesh
8.	1992	Takano	Nippon Telegraph and Telephone (NTT)'s privatization
9.	1994	Galal et al.	Cases of privatization in four countries with non- privatized enterprises
10.	1993	Dewatripont and Roland	Conditions, dynamics, and feasibility for rapid and gradual privatization
11.	1994	Megginson et al.	Financial and operating performance after privatization
12.	1995	Martin and Parker	Examine the impact of privatization on 11 British firms
13.	1997	Newberry and Poliitt	Social cost-benefit analysis on Central Electricity Generating Board (CEGB)
14.	1996	Zsuzsanna et al.	Dynamics and evolution of privatization
15.	1997	Ramamurti	Restructuring and privatization
16.	1998	Sueyoshi	NTT's performance before/after privatization
17.	1998	LaPorta and Lopez	Competitive and noncompetitive markets
18.	1998	Matsumura	Performance of private firm and privatized firm
19.	1998	Boubakri and Cosset	Performance in full or partial privatization
20.	1998, 1999	D'Souza and Megginson	Privatization of telecommunication firms
21.	1998	Koen	Size of the PSEs after privatization
22.	1999	Frydman et al.	Compare privatized with non-privatized firms
23.	1999	Bradbury	Financial performance of Government Computing Services (GCS)
24.	2000	Gupta et al.	Fiscal constraints and partial privatization

(continued)

Table 3.2 (continued)

S. no.	Year(s)	Author(s)	Issue studied
25.	2001	Asian Development Bank	Effectiveness of privatization
26.	2002	Maw	Policies and objectives of partial privatization
27.	2003	Bennett and Maw	Ownership effects on investment and production
28.	2003	Abelson	Cases of Australian jurisdictions, industry and disinvestment methods
29.	2005	Gonzalez P. and De Cos	Problems of government-owned organizations
30.	2006	Hamid and Chao	Privatization effects on environment
31.	2008	Carino	Challenges of privatization
32.	2009	Jonas Nnanna Okafor	Privatization in Nigerian Telecommunications
33.	2010	Akintayo, D. I.	Privatization during recession in Nigerian industry
34.	2010	Lisa	Short-term effects of government bailouts
35.	2011	Mushtaq and Zahir	Model for privatization in developing countries
36.	2012	Goher and Wali	Privatization policies and impact of privatization

Table 3.3 Studies related to disinvestment in public sector enterprises in India, 1988–2011

S. no.	Year(s)	Author(s)	Issue studied
1.	1988	Mishra and Nandagopal	Feasibility of privatization
2.	1989	Sankar and Reddy	Purpose and factors of disinvestment
3.	1992	Kumar	Categories and performance of PSEs
4.	1994	Basu	Reforms, restructuring and commercialization
5.	1994	Sankar and Mishra	Objectives of disinvestment program
6.	1997	Gouri	Ownership transfer and its effects
7.	1999	Das	Performance at post-reform period
8.	2001	Naik	Plans and actual achievements in disinvestment
9.	2001	Ganesh	Pros and cons of privatization
10.	2002	Ray and Maharana	Progress in the process of disinvestment
11.	2004	Naib	Objectives and performance of privatization
12.	2004	Gupta and Kaur	Objectives and experiences related to disinvestment
13.	2004	Kaur	New economic policies
14.	2005	Kaur and Singh	Utility and process of disinvestment
15.	2005	Nagaraj	Affects of disinvestment
16.	2005	Sangeeta	Reforms, policies and categories
17.	2005	Gupta	Impact of privatization
18.	2006	Patnaik	Rationale and process of disinvestment
19.	2005	Gupta	Importance and difficulties in privatization
20.	2007	Vadlamannati	Determinants and impact of disinvestment
21.	2007	Disinvestment Manual	Recommendations for privatization
22.	2008	Arnold et al.	Conventional measures used for disinvestment
23.	2008	Shivendu	Institutional qualities and determinants of privatization
24.	2008	Cuong and Tyrone	Reforms in public financial management
25.	2009	Sabnavis	Ideology of disinvestment
26.	2011	Kumar	Factors associated with privatization

Part I, Global Perspective

This part describes the literature related to the disinvestment at global level; the brief of the subject/issue reviewed is presented in Table 3.2.

Little (1952) was concerned with PSEs' neglect of appropriate incentives to productive efficiency. He emphasized on the burgeoning literature on business management, which would stress increasingly that efficient organization required those managers who would have specific objectives and their performance was monitored in relation to them.

Kay and Thompson (1986) examine the privatization in the UK. One purpose is to improve the economic performance of the industries concerned. Another is to resolve the persistent problems of management and control, i.e., the relations between government and nationalized industries. The treasury is greatly interested in the revenue which can be obtained from privatization. A final objective is the promotion of a kind of popular capitalism through wider share ownership.

They further observe that each one of these objectives of PSEs at different times has been sacrificed for others. The outcome is that no objective has been effectively attained. Dissatisfaction with the performance of nationalized industries led to repeat the attempts to prescribe more specific objectives. The authors are concerned with incentives of both productive and allocative efficiency. Productive efficiency requires whatever is done should be achieved at minimum cost; allocative efficiency implies what is done meets consumer needs at prices which reflects the costs of provision.

Brittan (1986) lists five possible aims in the denationalization of public sector industry: (i) improvement of economic performance of the industries concerned, (ii) resolving the difficulties of relations between government and nationalized industries, (iii) revenue raising, (iv) reduction of the power of the public sector unions, and (v) the promotion of a popular capitalism through wider share ownership.

Bishop and Kay (1989, 1991) compare performance of privatized UK companies with those that stayed in the public sector. They find no strong evidence to indicate that privatized firms perform better. They have measured profitability, in terms of return on capital employed (ROCE) and return on sales (ROS), and found both ROCE and ROS were generally higher among the privatized companies than among the public sector ones, but this had been true even before the companies had been privatized. Thus, it appears that the more profitable firms were sold early, leaving the less profitable ones in the public sector.

De Fraja and Delbono (1989) show that welfare may be higher when a public firm is profit maximizer rather than welfare maximizer. They also suggest that full privatization is not optimal.

Boardman and Vining (1989) classify 55 research results during 30 years' time span (1956–1987) into three categories (6, 16, and 33), based upon the relationship between ownership and performance. The first six empirical results, including Bruggink (1982), Neuberg (1977), Hirsch (1965), and Pier et al. (1974), support that public corporations are more efficient than private firms. The second 16 empirical studies, including Becker and Sloan (1985) and Caves and Christensen (1980),

indicate that no performance difference has been observed between the two types of ownership. The last 33 research works, including De Alessi (1974), McGuire and VanCott (1984), and Schlesinger and Dorwart (1984), empirically confirm the economic assertion.

Lorch (1991) compares the performance of 24 privatized textile mills in Bangladesh with 35 other mills that the government did not privatize by using unconventional measures of performance. He focuses on four functional areas: procurement, production, sales and support function. "Efficiency" was defined as "cost advantage." He concludes that the Bangladesh textile industry does not offer a very strong endorsement of privatization as far as its efficiency implications are concerned.

Takano (1992) studied the privatization of Nippon Telegraph and Telephone (NTT, converted from a public corporation to a joint-stock company in April 1985). Starting in late 1986, shares of the company were sold through the stock market in trenches, and government's shareholding had been reduced to about two-third of the shares. As a result, the "privatization" of NTT was partial in nature, and the control of the company did not change hands. Simultaneous with the privatization of NTT, government has introduced significant competition and deregulation in essentially all the markets in which NTT operates. He identifies two critical differences between the privatization and non-privatization scenarios: (1) non-operating income and (2) personnel expenses. The privatized NTT also lowered non-operating expenses in terms of a substantial reduction in interest costs.

In another study, Galal et al. (1994) analyzed the post-privatization performance of 12 companies in Chile, Malaysia, Mexico, and the UK to determine whether the transfer of ownership has increased efficiency. The authors documented net welfare gains in 11 of the 12 cases. They examined the performance of three privatized firms in each country and compare it to a hypothetical counterfactual of how the firm would have performed had it not been privatized. This approach has the important benefits of controlling, at least in principle, for environmental effects such as economic growth or government policy. The study has examined at the overall welfare impact of privatization rather than just the performance of the enterprise. The study provided a desegregation of the distribution of welfare impact among consumers, workers, owners, competitors and the government.

According to them, it is unfair to hold privatization accountable for all the problems of transition. China presents an interesting case where, to begin with, the country moved its loss-incurring state enterprises to market conditions more slowly than other transition countries and at the same time had explosive growth of new enterprises. But, of late, China's effort in fundamental restructuring of large number of state-owned enterprises (SOEs) has led to massive lay off of excess workers. This has resulted in huge loss of jobs which can lead to social turmoil.

In terms of financial performance, improvement in profitability, real sales, sales efficiency, and dividend payout has been recorded. Leverage ratios have shown decline. Although the studies have not examined the linkage between improvement in profitability and price increase, they have offered indirect evidence that performance gains were not the result of market power exploitation.

Dewatripont and Roland (1993) make a strong case for gradual privatization programs with the option to reverse reform at a low cost. Gradual privatization is a strategy that implements privatization in stages: possibly to be followed up by complete privatization later (if successful).

Roland (1994) and Katz and Owen (1995) are proponents of gradual privatization; they claim that it can make the transition process smoother and less painful and, at the same time, increase the chance for strong economic progress by taking advantage of the "learning by doing" effect. There are two reasons for a government to privatize partially. Some governments may view partial privatization as the final stage of privatization; these governments may never want to fully privatize. Other governments may eventually want to fully privatize the economy. They view partial privatization as the intermediate/experimental stage; they may proceed to fully privatize the economy subject to the success or failure of partial privatization.

The study provides a complete characterization of the dynamic patterns which arise in this case. The resulting models closely predict the paths of evolution in economies such as Cuba, the USA, the United Kingdom, India, and many others. In the second part of the chapter, they study some history-dependent patterns induced by habit formation, learning by doing, and revolution of rising expectations. The dynamics obtaining in these cases is more complex and resembles patterns observed in Russia and China and economies in Central and South America.

Megginson et al. (1994) compare the pre- and post-privatization financial and operating performance of the period of 3-years-after with that of the 3-years-before privatization of 61 companies from 18 countries (6 developing and 12 industrialized) and 32 different industries that experience full or partial privatization during the time span of 1961–1989. Under these companies, the government sold off its equity but no capital flowed to the firm itself. Therefore, any improvement in performance after divestment must be traced to changes in incentives, regulation, and ownership structure rather than to cash injections into the firm from a new capital issue. They document significant increase in profitability, output per employee, capital spending, and total employment after privatization.

Megginson et al. (1994), Boubakri and Cosset (1998), and D'Souza and Megginson (1999): these three studies collectively examine 211 companies from 42 countries and 50 different industries. Of these firms, 103 are from 26 developing countries and the remaining 108 from 16 industrialized nations. All the four studies yield consistent findings regarding increase in profitability, efficiency, output, leverage, and dividend payments after privatization.

Martin and Parker (1995) examined whether 11 British firms privatized from 1981 to 1988 had improved their profitability (measured as return on invested capital) and efficiency (annual growth in value added per employee-hour) after being divested. They found mixed results.

Newberry and Politt (1997) performed a social cost-benefit analysis of restructuring and privatization of the Central Electricity Generating Board (CEGB). The authors concluded that CEGB's restructuring and privatization was in fact "worth it"; they further observed that these steps could have been implemented more efficiently and

with greater concern for the welfare of the public. The study finds strong evidence that privatization improves performance.

Zsuzsanna et al. (1996) examine the dynamics of privatization and provide an explanation for the different patterns of evolution of private ownership. In their model, they choose degree of privatization and associated corporate governance mechanisms. The management's objective and its alignment with that of the government are determined by the level of privatization. They are able to distinguish characteristics of privatization in stages (experimentation) from those of partial privatization.

There are a large number of cases where governments have implemented different patterns of privatization in stages. In some cases such as Russia and other countries in Eastern Europe, rapid privatization reforms have been initiated even as the economy was in disarray. In other cases such as China, although there is some move towards private ownership, the process is gradual. In other countries while the economy had been booming, steps towards privatization implemented were partially reversed later (Laban and Wolf 1993).

Some researchers and politicians have favored mass privatization plans with no definite sequencing. Frydman and Rapaczynski (1991), Frydman et al. (1993), Lipton et al. (1990), and Blanchard et al. (1991) have advocated this approach. Proponents of immediate full privatization argue that it is necessary to achieve very quickly a critical mass of private ownership in order to get firms to respond to market signals. Otherwise, there is a danger of inertia and continued soft-budget constraints. Moreover, full rapid privatization can be seen as a way of committing the state to avoid continuous intervention in enterprise activity. Avoiding state interference in firm decision making is crucial to privatization.

Frydman and Rapaczynski (1991), Boycko et al. (1996), and Boycko et al. (1992) state that avoiding state interference in firm decision making is crucial to privatization. In contrast, Roland (1994), Dewatripont and Roland (1992a, b, 1993) argue that political constraints necessitate a gradual approach to privatization. They argue that privatization which progresses too fast may cause politically undesirable restructuring prematurely, leading to partial re-nationalization and preventing gradual hardening of budget constraints while developing a private banking and financial sector.

Ramamurti (1997) examines the restructuring and privatization of Ferrocarriles Argentinos, the Argentine national freight and passenger railway system. He observes the incredible 370 % improvement in labor productivity and an equally striking 78.7 % decline in employment (from 92,000 to 18,682 workers). He stressed that performance improvement could not have been achieved without privatization.

Sueyoshi (1998) examines the economic assertion by comparing Nippon Telegraph and Telephone (NTT), a Japanese government company's performance before and after its privatization, and presents the management problems occurring within the partial privatization.

This empirical study has found that NTT's partial privatization has had an impact on its productivity enhancement, primarily due to a natural reduction in personnel. It has failed to achieve any significant improvement in cost management even

after its privatization. The performance and corporate behavior of a firm cannot be determined only by its ownership. The two performance measures are influenced by many other external factors, including the type of corporate environment (regulation or deregulation) and the type of client (government or private firms). A public firm facing serious competition may behave as a private firm. Meanwhile, as identified in this NTT's case study, a private firm under governmental regulation may still function like a public firm.

It is believed that the privatization of a public firm needs major structural changes, including replacement of leadership and education of managers, in order to successfully shift to a competitive private firm. Furthermore, the Japanese government needs to reduce its political control/influence, providing NTT with more corporate freedom. This policy suggestion is very important because the strong governmental regulation delays the future development of Japanese information infrastructure (Hayashi and Sueyoshi 1994) and invites unnecessary misunderstanding from other industrial nations (Sueyoshi and Baker 1994).

NTT's management and its labor union supported the direction of privatization because both believed that its operational inefficiency was directly caused by governmental interference in controlling the telecommunication industry; as reported by Maeda (1985) and Takano (1992), NTT's operation was always restricted by the Japanese government (Naib 2004).

LaPorta and Lopez-De-Silanes (1998) have covered 218 firms in 26 different sectors, privatized between 1983 and 1991. They found that profitability, measured by the ratio of operating income to sales, increased by 24 percentage points. The authors have segregated the gains into three components: increase in prices, reduction in workers, and productivity gains. They found that 57 % of the gains were on account of enhanced productivity.

Matsumura Toshihiro (1998) compares a private firm and a privatized firm jointly owned by the public and private sectors. The private firm maximizes profits, while the privatized firm takes both profits and social welfare into consideration. He considers as to how many shares the government should hold in the privatized firm and finds that neither full privatization (the government does not hold any shares) nor full nationalization (the government holds all of the shares) is optimal under moderate conditions.

Boubakri and Cosset (1998) examine the change in the financial and operating performance of 79 companies from 21 developing countries that have experienced full or partial privatization during the period from 1980 to 1992. The authors used accounting performance measures adjusted for market effects in addition to unadjusted accounting performance measures. Both unadjusted and market-adjusted results show significant increases in profitability, operating efficiency, capital investment spending, output, employment level and dividends. They also find decline in leverage following privatization.

D'Souza and Megginson (1998) examine performance changes in 17 national telecommunication companies that have gone for privatization between 1981 and 1994. They find persuasive evidence that profitability, output, operating efficiency, capital investment spending, the number of access lines, and average salary per

employee all increase significantly after privatization. Leverage declines significantly and employment declines insignificantly.

D'Souza and Megginson (1999) compare the pre- and post-privatization financial and operating performance of 85 companies from 28 countries (13 nonindustrialized and 15 industrialized) for the period of 1990 through 1996. It is based on the methodology used by Megginson et al. (1994) and Boubakri and Cosset (1998). They document significant increase in profitability, real sales, sales efficiency, and dividend payments and significant decreases in leverage ratios after privatization. However, employment decreases after privatization. The most intriguing result of this study was that firms in non-competitive industries showed significantly greater increase in profitability, real sales, sales efficiency, and dividends plus significantly greater reductions in leverage than competitive industry firms.

Koen (1998) stresses that privatization has reduced the size of the public sector; however, the public sector is still quite prominent across the economy. He has suggested that privatization alone is not the answer of good governance. Managerial skills, the existence of performance incentives, transparency, and a sound legal system are also required.

Frydman, Gray et al. (1999) evaluated the impact of privatization on firm performance, by using a standard panel data treatment evaluation procedure, with privatization viewed as the treatment variable. They compared the performance of the group subjected to the treatment (privatization) with that of the non-treatment group (state firms), while controlling for potential pre-privatization between the two groups. The sample consisted entirely of firms that were state owned at the beginning. There were 218 firms, 90 of them state owned and 128 privatized, drawn from three countries, the Czech Republic, Hungary, and Poland, and cover the period 1990–1993. The authors concluded that privatization did work as it increased revenue and employment.

Bradbury (1999) carries out a case study of the comparative financial performance of Government Computing Services (GCS) as it moves from a government department to privatization. The results show that the financial performance of GCS improves. The prime performance measures used in the study are return on equity (ROE), return on assets (ROA), and return on revenue (ROR). Growth in revenue is also measured. Similar measures are employed in major studies that utilize accounting ratios to examine economic performance (Rumelt 1974; Boardman and Vining 1989; Karpoff and Rice 1989).

Gupta et al. (2000) state that fiscal constraints seem to be the main motivating factor in choosing partial privatization and this is consistent with the empirical findings. It is also possible, however, to interpret revenue maximization as a political objective. The ability to generate revenue enables a government to soften the employment impact of the transition process; it raises the government's ability to pay state workers and so on. These factors are arguably very important in gaining support for the transition process.

Asian Development Bank, ADB (2001) describes that privatization is a process for change of ownership and control. It indicates that for privatization to be successful, it is essential to define the roles and powers of participants and ensure that legal, regulatory, and enforcement mechanisms precede divestment.

Maw (2002) analyzes the justifications that have been put forward for adopting partial privatization. These are related to the objectives of economic efficiency and the generation of government revenues as well as to political motivations. The issues covered are the stock-flow problem, risk sharing, restructuring, informational considerations, the role of market structure, bargaining, foreign investment, and the irreversibility of reform. Governments have chosen privatization policies to pursue a variety of objectives. Political objectives have undoubtedly been very important in the choice of policy. Choosing to sell to insiders or outsiders or choosing to distribute ownership to the population at large is a politically motivated decision.

Bennett and Maw (2003) examine how partial state ownership affects the firms' subsequent investment and output behavior. They determine how the state ownership share depends on product-market competitiveness and find the conditions under which it would be preferable to sell the firms to a single owner.

Abelson (2003) reports nine cases that cover a variety of Australian jurisdictions, industry and disinvestment methods. Out of the nine case studies, the author derives three main lessons. First, long-term financial returns have played very little part in the decision to privatize. In all cases, it appears that citizens of Australia have not been adequately compensated for the loss of previously collectively owned assets and governments are concerned mainly with short-term issues. Second, considerable transformation had taken place in many of the organizations in the preparation for the sale, including assistance for the government; he argued that this transformation and assistance were largely responsible for the success of the organizations post-sale. Third, there is a consistent pattern of winners and losers from the privatization. The winners were the financial institutions, the new shareholders and private consultants; the main losers were the workers in the pre-sale organizations and future taxpayers.

In a major review of privatization, Megginson and Netter (2001) conclude that the studies cited almost unanimously report increases in performance associated with privatization. This consistency is perhaps the most telling result; they report privatization appears to improve performance in many different ways and in many different countries.

Gonzalez-Paramo and De Cos (2005) observe that government-owned organizations do not thrive on account of the fact that the expertise, knowledge, experience, skills, and performance of public administrators are inadequate to ensure effectiveness, operational efficiency and accountability.

Hamid and Chao (2006) use a simple model to identify the conditions for assessing the privatization effect on environment. They have shown that privatization may have a negative effect on the environment.

Carino (2008) suggests that privatization initiatives are not without challenges because the citizens would like to know how the shift of functions, control, ownership, and leadership styles from public sector to the private sector would enhance operational efficiency, effectiveness, accountability and productivity. The myths surrounding privatization are often caused by several misconceptions, such as the false impression of removing all state-run welfare activities that create and maintain infrastructure and the ill-founded belief that it leads to exploitation of national resources by foreign establishments (Basu 1994).

Jonas Nnanna Okafor (2009) has explored the factors that hindered government-owned organizations in Nigeria from achieving operational efficiency, effectiveness, accountability and productivity. He examines whether privatization of Nigerian Telecommunications (NITEL) has helped or would help the country to overcome these problems. The study participants were 20 NITEL employees. The study used one-on-one, semi-structured, open-ended interviews; the study explored the relationship between privatization, leadership, efficiency, effectiveness, accountability and productivity. Findings from the study are lack of leadership, performance measures, implementation of best practice strategies, and performance management systems accounted for the failure of Nigerian government-owned organizations from achieving operational efficiency, effectiveness, accountability and productivity.

The privatization exercise in Nigeria has been received with mixed feelings because the proponents of privatization believe that privatization will bring competition and improve quality of goods and services, while the opponents fear that privatization will result in the increase in prices of goods and services. The study provides a baseline to measure the perceptions of the study participants on how privatization may have influenced leadership, efficiency, effectiveness, accountability and productivity. The privatization exercise in Nigeria, as in many other developing countries, is challenged or resisted because the proposed shift in functions, control, and ownership from public to private sector raises questions about the fundamental values, meaning, and purpose of government-owned organizations. Justification for privatization is not limited to the expected efficiency gains but also on leadership, accountability of public officials, operational effectiveness, and increase in productivity (Gollust and Jacobson 2006). The main purpose of reforming the structure and management of public organizations in Nigeria is to increase operational efficiency and productivity.

Akintayo, D. I. (2010) examines the effect of privatization of public enterprises in Nigeria on industrial relation practices in a mixed recessionary economy. He states that privatized public enterprises in a recessional economy do not create enabling environment for harmonious labor management relations. Though privatization policy enhances efficiency and improved workers performance, retrenchment and job insecurity of workers are always the resultant effects of these enterprises. Therefore, privatization policy implementation should normally be designed to guarantee the job security of workers, while pragmatic efforts towards sustaining the level of efficiency and productivity attained by privatized public enterprises should always be given a priority.

Lisa (2010) states that government bailouts of the private sector have an impact on the attitudes of the overall market and economic output in the short term. Using event study methodology, he examines the short-term effects on the greater domestic economy of nine government bailouts of the private sector: Lockheed (1970), Penn Central Railroad (1971), Franklin National Bank (1974), Chrysler (1980), Continental Illinois National Bank and Trust Company (1984), Savings and Loan (multiple institutions 1989), Long-Term Capital Management (1998), the Airline Industry (2001), and the most recent bailouts enacted through the Troubled Asset Relief Program (2008 and 2009).

The results show that public bailout of a private firm or industry appears to have a small, but significant, positive impact on the S&P 500 in the very short term. Due to the ease and efficiency with which trading can be done, investor expectations of the financial markets are quickly factored into the pricing and indexing, thus enabling the S&P to serve as a leading indicator of economic recovery or recession. The speed with which it incorporates new information is even more pronounced when the bailout occurs in the financial industry. It signifies an increase in investor confidence in the government's ability to manage and mitigate a financial crisis.

Mushtaq and Zahir (2011) describe a planning and implementation model for privatizing the state-owned enterprises (SOEs) in developing countries. They emphasize that active support of key stakeholders is essential for privatization in developing countries to succeed. Targeted marketing strategies, together with financial considerations and public sector initiatives and oversight, can bolster successful implementation of privatization objectives and initiatives. The privatization of failed or poorly performing SOEs into viable private sector firms can improve market efficiencies, reduce government deficits, offer better service alternatives, meet public service expectations, and promote economic development. It also improves resource use and fosters collaboration between the public and private sectors and highlights the critical role of marketing in achieving success with private and public partnership initiatives.

The marketing model encapsulates the role of marketing in harnessing both the government and private sectors to convert failed or inadequately performing SOEs into responsible private organizations with minimal economic, social, and structural displacements. Support from various groups during and after the SOEs going to private and strategic marketing programs may improve perceptions, goals, and benefits from privatization. Such success can enhance market efficiencies, reduce government deficits, improve public service alternatives, and promote economic growth through improved resource use, allocation, and collaboration between the public and private sectors.

Goher and Wali (2012) state that privatization is one of the options with the government to enhance their production capabilities and improve the productivity of the state-owned entities, when they are observed to be under-performed. They have reviewed privatization policies of Pakistan. Privatization is commonly known as transfer of burden of production of goods or services to the private sector, by reducing the public/government control over the production; it facilities either partially or fully, for efficient conduct of businesses. The study analyzed two major impacts of privatization of state-owned industries on economy of Pakistan in terms of foreign direct investment and employment opportunities. The results showed positive impact of foreign direct investment on employment opportunities. The results also explore negative impact of privatization on the economy by creating uncertainty in the employees working in the state-owned organizations, which have potentials to be privatized.

They are of the opinion that privatization has not as much benefited as it should be. In privatization process, neither labors leaders nor on social partners were involved by the government in any decision-making process with respect to

privatization policy. From the analysis, it appears that the government's revenue maximization objective has led to the transfer of adversely affected state firms to the highest bidder irrespective of the merit of the buyer; it has not only adversely affected the state of industry but also imposed a high cost in terms of job losses. Attention, therefore, needs to be focused on the manner in which privatization is proceeded with.

In many cases, private parties have obtained entire enterprise for just the value of land and inventories. Many of them had neither the capacity nor the intention to operate the plants.

The privatization of few units have created ethnic problems in the local communities, as a few buyers are from other areas, which have employed labor from their native town, while ignoring the local communities. The process of privatization has generated adverse effect on wages and benefits. The losses in job market and increasing unemployment had resulted in deterioration of workers bargaining position. Privatization has almost finished the unions.

Part II, Indian Perspective

Literature related to disinvestment in India has been described in this part; Table 3.3 provides a brief outline of such issues examined by various studies carried out in this regard.

Mishra and Nandagopal (1988) discuss the feasibility of the privatization of PSEs. They attempt to answer the question "Is there a need to privatize PSEs at all?" Their turnover test ranked the nationalized industries (based on the business performance), and they were of the view that privatization of the industries would add to consumer welfare.

Sankar and Reddy (1989) have prepared a divestment matrix. State-owned enterprises (SOEs) are considered high or low (for disinvestment purposes) on three factors, namely, social purpose, profitability and resource mobilization. According to their model, SOEs operating in competitive markets having low social purpose and also low resource mobilization are the most suitable candidates for disinvestment.

Kumar (1992) categorizes SOEs on the basis of their being high or low with reference to market structure, efficiency and social obligations. The model suggests divestiture of enterprises which are low in efficiency and social obligations. An SOE set up as a statutory corporation under an Act of Parliament or as government department first needs to be transformed into a stock corporation subject to ordinary company laws so that shares can be offered to the private sector.

The profitability of a company, obviously, is one of the determinants of how easy or difficult its sale will be. The experience of developed and developing countries alike demonstrates that privatization is limited only to strong performing SOEs; an SOE in weak financial condition and with a poor record of performance generally cannot be sold "as it is."

Direct sale through competitive bidding is preferable as it allows high degree of transparency and comparison of offers by competing bidders and selects the buyer based not only on the highest purchase price but also on the greatest compliance

with various government requirements and privatization objectives. One of the principal advantages of private sale of shares is that the prospective owner is known in advance and can be evaluated on the basis of his/her ability to bring in benefits such as management, technology, market access, etc.

Basu (1994) contends that divestiture without private sector development can remain "stillborn." The study supports the policy of state government related to selective privatization/disinvestment of loss-incurring public and cooperative enterprises operating in "non-core" sectors. The primary objective of government's privatization policy has been to revive potentially viable loss-incurring enterprises and to safeguard the interest of the workers and to create opportunities for further job creation by catalyzing the dynamism of the private enterprises. Efforts are made to establish a system of good corporate governance practices in these core enterprises, so as to enhance transparency and accountability in their operations and stimulate their performance.

Sankar and Mishra (1994) contend that the divestment of PSEs shareholdings is an economic necessity. At a time when the country was on the brink of economic disaster and facing the threat of being declared insolvent by the external economic community, the Government of India rightly swung into action to initiate the divestment of shareholdings of PSEs.

Gouri (1997) observes that privatization in India is low. Privatization for ownership transfer is limited to the disinvestment of public sector enterprises (PSEs) for raising non-inflationary resources. At the same time, there is a gradual withdrawal of budgetary support from PSEs resulting in a gradual dilution of equity as enterprises tap the capital market. Simultaneously, economic liberalization policies have emphasized a level playing field for the public sector. In terms of economic management, and more so public sector management, there is lack of a comprehensive policy on privatization.

Das (1999) examined post-reform periods. He found that productivity performance of Indian industries worsened in the 1990s vis-à-vis the 1980s. Further, Nambiar et al. (1999) report that import liberalization has shrunk India's manufacturing base. When markets are deregulated, the performance of firms (public as well as private) improves. Contrary to expectation, profitability, liquidity, and assets turnover dropped instead of improving; the expected relationships that there should be drop in employment levels, reduction of debt vis-à-vis total assets, increase in dividend payout, and improvement in sales efficiency were confirmed. Finally, he observed that there was an increase in employment levels in the case of enterprises operating in monopoly environment and drop in sales efficiency in the case of enterprises operating in competitive environment.

Naik (2001) has discussed about the hurdles that existed between plans drawn up and the actual achievement in the process of reforms pertaining to privatization of PSEs since 1991. He is of the opinion that the process of reforms has not moved beyond the limited divestment of equity in select profit-making public sector undertakings (PSUs).

The divestment that has taken place so far has been largely with an eye on reducing the fiscal deficit of the center rather than bringing about a real improvement in

the working of the concerned PSUs. The entire approach has been ad hoc and piecemeal. Because of the frequent changes in government at the center, particularly after the 1996 General Elections and a lack of consensus among coalition partners in the government, it was not possible to make any worthwhile progress towards PSU reforms and privatization. Improving the productive efficiency of the Indian industry to make it globally competitive was among the important objectives of the reform process launched in 1991. For the achievement of this objective, it was imperative that urgent measures were initiated to reform and privatize the public sector, which accounts for a major share of industrial output in the country. The government has been finding it increasingly difficult to continue to subsidize the public sector through budgetary support. The problem has been compounded by the proliferation of public sector enterprises in areas such as hotels, tourism, bakeries, and so on, which was not a part of the original design of industrialization.

Even in core areas that were explicitly reserved for the public sector, the performance fell far short of plans and expectations. Instead of generating resources for development, they have been a burden on the exchequer. He suggested unless the government musters courage to sell off or close down the chronically sick and loss-incurring units and is able to get the cooperation of the coalition partners as well as the state governments, the situation is unlikely to change.

Ganesh (2001) has discussed about the pros and cons of privatization. To achieve the goal of "privatization in India," proper competitive law supervised by forming Competition Commission is necessary to avoid dominance, prevention of cartels, and merger control. Regulatory authorities to frame suitable rules and regulation, connected with market economy, are also necessary.

Ray and Maharana (2002) have attempted to examine the progress of the process of PSE disinvestment in India during the decade of 1991–2001. In terms of action to the PSE disinvestment, very little has actually materialized. They suggest that the controversies and criticisms against disinvestment can be largely avoided through a transparent process. Disinvestment of government equity in PSEs has many social, economic, and political implications.

There are different forms of privatization, ranging from managerial privatization to the extreme step of partial or complete disinvestment. In the managerial privatization, the ownership of PSEs continues with the government, but the management/board of directors comprises of experts from the private sector. In a joint venture arrangement, a private enterprise owns a part of equity in PSEs and the government owns the balance. The joint venture model is considered to be a transitional arrangement, leading to eventual total disinvestment. Privatization may also take the form of franchising the development of new technology by the PSEs for use by the private sector.

Naib (2004) states that disinvestment of equity has been the key determinant of the Indian public sector reforms. The common perception among various countries that have engaged in substantial program of divestiture is that this not only raises resources for the governments and reduces fiscal deficit but also releases resources for public investment in essential areas like primary education and basic health. It is accordingly argued that such programs ultimately are desirable to create jobs and

add for mass welfare in the long run. It has been revealed that the vast investments have failed to produce the surpluses which they were expected to generate and the return on capital employed is quite low. This raises the issue whether the present ills of the state-owned enterprises (SOEs) can be corrected by change in their ownership.

It is generally believed that in SOEs neither incentives nor sanctions are closely related to performance. Further, objectives of SOEs are likely to include certain social obligations which may be poorly defined and hard to quantify. The resulting looseness of the objectives makes monitoring of SOE performance much difficult. Divestiture results into a shift in the objectives of owners and type of incentive systems for management.

In terms of all profitability indicators, mixed enterprises perform no better and often worse than SOEs. These results also suggest that partial privatization where a government retains some percentage of equity may not be the best strategy. Boardman and Vining (1989) also suggest that partial privatization may be worse, particularly in terms of profitability, than complete privatization or continued state ownership.

Gupta and Kaur (2004) indicate that privatization leads to competition; this, in turn, promotes efficiency. According to them, the following are the primary objectives of privatization of the public sector in India:

- Solution to the problem of low profitability and inefficiency in public sector enterprises.
- End of political interference in economic decisions.
- Increase in government reserves through sale of shares of public sector enterprises.
- Freedom from pulls and pressures on the budget due to the losses in PSEs.
- Solution to the problem of the lack of autonomy and inadequate management incentives.
- Synchronizing with the economic liberalization wave in the world.

Unlike the experience in many other countries (like Great Britain) which have gone for large-scale privatization, the public sector in India continues to be an important component of Indian industry; even after liberalization, disinvestment has larger implications than just selling government equity at the best price.

Authors opined that there should be closure and winding up of sick PSEs. Such terminally sick PSEs are mostly those which were earlier taken over from the private sector as sick units and which are a major contributory factor for the overall unsatisfactory performance of the public enterprises.

Kaur (2004) reports that fiscal compulsions have forced the Government of India to sell their equity in the 1990s and later. So far 39 SOEs have been partially disinvested, while 35 SOEs have been strategically sold. A total of approximately Rs. 300 billion has been raised through disinvestments. However, unlike many other developing economies where an aggressive policy of privatization (i.e., a transfer of ownership from the public sector to the private sector) has been adopted as part of liberalization, this has not been the case in India. In India, the new economic

policies of liberalization are more in the nature of *Greenfield Privatization*. Such policies have prompted private industrialists to venture into areas earlier reserved for the public sector, such as power, aviation, telecommunication, roads and railways. These policies are expected to have a major thrust on enhancing efficiency in the industry.

The process of privatization raises a set of questions. In the first set are questions such as the following: What are the economic consequences of selling public sector enterprises? Is the government doing the right thing by disinvesting? Will privatization deliver? However, in cases where state failures dominate, privatization, in fact, may be a better option. That is to say that ownership does matter. The ownership of the firm (public or private) materially affects the systems of monitoring managerial performance, the incentive structures, the behavior of managements, and hence the efficiency of the organization. Thus, the economic consequences of selling public sector enterprises will get reflected in enhanced efficiency of the privatized unit. However, in the Indian scenario, changes in performance of SOEs have not materialized due to the nature of disinvestment modality adopted till recent years.

Kaur and Singh (2005) state about the utility and process of disinvestment in India. Disinvestment process through liberalization and privatization leads to cost reduction, improved quality, and operational efficiency. It improves efficiency and pushes up growth rates; growth provides jobs and employment; disinvestments also help to attract global capital as well as domestic capital.

They highlight that the major weaknesses of the public sector units are lack of proper management, lack of autonomy, lack of financial resources, low productivity, overstaffing, outdated technology and inefficient staff, etc. Governments and their agents are process oriented, whereas firms have to be result oriented. The two main causes of its failure appear to be the heavy weight of non-commercial obligations of the state; it is required to carry and untrammeled discretionary power with the government that erodes its autonomy.

Nagaraj (2005) opines that it is widely believed that PSEs' profitability ratio (gross profits to capital employed) is mainly on account of the surpluses of the petroleum sector enterprises. Yet, it is important to mention that the profitability ratio of PSEs has improved since the 1980s even after excluding the petroleum sector enterprises; it is a clear evidence of improvement in PSEs' financial performance.

He further states that disinvestment is unlikely to affect economic performance since the state continues to be the dominant shareholder, whose conduct is unlikely to be influenced by share price movements (or return on equity). Privatization can be expected to influence economic outcome provided the firm operates in a competitive environment; if not, it would be difficult to attribute changes in performance solely or mainly to the change in ownership.

Sangeetha (2005) has divided the policy measures adopted by countries to reform the public sector enterprise performance into two broad categories. The first category focuses on distancing the government from ownership and control of these enterprises. Partial privatization falls in the first category of reform. The second

category aims at improving the environment in which these enterprises operate, e.g., delegation of operational and functional autonomy to managers of publicly owned enterprises through performance contracts.

The second category of reforms has been aimed at improving the environment in which the PSEs operate, rather than change the ownership of the firm. Proponents of this viewpoint contest that “ownership per se does not matter.” Instead, they believe that removing the environmental imperfections and distortions in which the state-owned firms operate (Bartel and Harrison 1999; Kalirajan and Shahd 1996; Kornai 1979), improving incentives to top management and linking their benefits to firm’s performance (Bardhan and Romer 1992), delegating enhanced functional and operational autonomy to top management (Gordon 1992; Groves et al. 1994), and introducing product-market competition and capital market discipline (Rawski 1997; Sarkar et al. 1998; Vickers and Yarrow 1991) would make public firms perform as efficiently as private enterprises.

The incremental impact of ownership reform of partial privatization in firms that have undergone environmental reforms on an average does not seem to have laid any impact on the firm performance. One recommended policy measure that may improve the enterprise performance is complete privatization, with both ownership and control of the enterprise being passed on to private participants. Similar reform policy measures adopted in several other developing and industrial countries (D’Souza and Megginson 1999) have given positive results. However, as seen in this study, going half way and implementing privatization partially where the control over the management is still under Central Government has not been effective in improving the performance of the PSEs.

Gupta (2005) observes that partial privatization has a positive impact on profitability, productivity and investment. The study is based on 339 manufacturing and service sector firms owned by the Central (247) and State Governments (92) of India for the year 1990–2002. Firms experience a significant increase in profitability, labor productivity, R&D investment and intensity, assets size, and employment after partial privatization. Partial privatization leads to an increase in the productivity of labor and output without layoffs.

Patnaik (2006) argues that the main rationale for disinvestment is to increase the efficiency in the utilization of resources (labor and capital) of the economy. The study shows that even partial privatization, with the government retaining control, has yielded improved productivity. Disinvestment of profit-making enterprises by public offering of shares is desirable as it leads to dispersed shareholding and avoids concentration of economic power. Above all, the most important argument in favor of disinvestment lies in the improvement of efficiency.

In a study of 40 firms over the period 1990–2000 in which only non-controlling shares were sold, Gupta (2005) found that even with such partial privatization, the levels and the growth rates of profitability, labor productivity, and investment spending improved significantly. Disinvestment could be the vehicle through which government makes progress on the important problems of corporate governance in the country. This would pave the way for a further flowering of widely held, professionally managed companies in the years to come.

The incentives of employees of PSEs could be influenced by sale of shares and employee stock option plans (ESOPs) whereby every employee in the company would end up having a stake in obtaining a higher stock price. This would serve to align the interests of employees with the interests of owners and improve the working of PSEs.

The author further observes that it may be sometimes difficult to privatize the loss-incurring companies even through the strategic sales route. The company can be in such poor shape and saddled with such large obligations that nobody in the private sector is willing to pay money. Yet, it remains important to take the company off the hands of the government and to utilize the resources that lie trapped within it. In order to do this, in a privatization auction, the government should permit negative bids: a bid where government pays someone to take the company off its hands. Negative bids were an important part of the massive privatization which took place in Germany after the end of socialism and helped to get productive assets rapidly into the hands of efficient managers in the private sector.

Vadlamannati (2007) says that India is one of the fast-emerging economies in the world which is striving hard to control all its deficits while implementing all possible measures in the form of economic reforms which were initiated in the 1990s. He attempts to answer whether privatization is one of the determinants of deficits.

Disinvestment and privatization, as one of the measures of economic reforms, was implemented in 1990–1991 in India which resulted in privatizing about 30 public sector undertakings (PSUs) in the country. It is, therefore, expected that it has had direct and indirect influence on these deficit variables. The study used data over 16 years, 1990–2005, and econometric models were used for the analysis. The empirical results show that the correlation of disinvestment and privatization (in India) in relation to these variables is very feeble and weak in view of the very small-sized and slow-paced disinvestment and privatization program.

Disinvestment Manual, Department of Disinvestment (2007) contains no standard recipe for disinvestment in public sector enterprises (PSEs) at the national level or at the state level. It suggests that country would do well to learn from the successful experiences of the West; it would have to be careful with the pitfalls, which were responsible for setback to some of the economies in the East.

In the final analysis, while experience of other countries is available to India by way of guidance, it would have to evolve its own techniques, best suited to its level of development. The historic, cultural, and institutional context influences the way in which and the pace at which privatization is implemented. Where market economy is not fully developed, ways would have to be found to safeguard the interests of consumers and investors, which would ensure a fuller play to the wealth-creating role of the entrepreneurs. The main purpose of this manual is to demystify this process and to share with policy-makers the national and international experience on implementation of privatization.

Arnold et al. (2008) suggest that conventional explanations for the post-1991 growth of India's manufacturing sector have focused on goods, trade liberalization and industrial de-licensing. However, the pace of policy reform has varied across

sectors, and it is determined primarily by political considerations (Hoekman et al. 2007). Sectors in which privatization and competition would mean restructuring and large-scale layoffs were slower to benefit from the reforms than those in which incumbents could remain profitable and employment would not decline even as foreign and local private competitors entered the market. The elimination of barriers to entry in services provoked a dramatic response from foreign and domestic providers. Foreign direct investment (FDI) inflows into services following liberalization by far exceeded than those into other sectors.

They demonstrate a strong and significant empirical link between progress in services reform and productivity in manufacturing industries. They also investigate the relative contribution of reform in each of the service sectors to the productivity of manufacturing firms and find that liberalization in the banking and telecommunication sectors had the largest productivity effects on manufacturing firms over the period.

Shivendu (2008) finds that privatization programs have not been driven by ideological or efficiency reasons, but rather by the pragmatic cost-benefit tradeoffs made by the politicians. The economics of privatization often dominates its politics. Using data from 43 countries on more than 4,700 privatization transactions, the author finds strong empirical support for institutional quality as consistent and significant determinant of proportion of partial privatization. Surprisingly, countries having higher corruption tend to have higher proportion of privatization in competitive sector, but lower privatization in core sector.

Counter to anecdotal evidence, political constraints have no significant impact on partial privatization proportion. Further, fiscal crisis drive politicians to privatize, but has no significant effect on privatization proportion. The findings motivate a political economy model of privatization and indicate three results: First, the distortion in the privatization proportion depends upon the institutional quality parameter relative to a measure of private sector efficiency, and the distortion increases as institutional quality declines; second, the effort level of private buyer firm declines as institutional quality declines. And third, under heterogeneous preferences of citizens, the privatization proportion declines.

Political variable appears to play a role only in determining partial privatization proportion in the core sector irrespective of the fact whether control is transferred or not. He has not observed either political constraint or political fractionalization to play any significant role in partial privatization, though studies (Bortolotti et al. 2004; Banerjee and Munger 2004) have noted a strong relationship between privatization and political factors.

Cuong and Tyrone (2008) enumerate that the literature on public financial management reform has devoted comparatively little attention to the detail and effect of reform process implementation in developing economies. Their study contributes to an understanding of this phenomenon by examining the impact of privatization on a sample of previously state-owned enterprises in Vietnam. Using data sourced from audited general-purpose financial statements, the analysis suggests evidence of material variation in financial performance and position of post-privatization compared

to the position observed immediately prior to privatization. They suggest that after being privatized, firms generally exhibit reductions in profitability, improved liquidity, some degree of improvement in working capital management, an increase in financial leverage accompanied by a higher degree of solvency risk, and greater calls on cash resources for the purpose of funding capital expenditure. The results suggest that the impact of privatization as a reform technique in developing economies may assist policy-makers and managers to target areas of likely risk, during the process of transition from public to private ownership.

Improved profitability is by no means a guaranteed outcome of the decision to transition from public to private ownership, particularly if that transition also occurs against the backdrop of a general recourse to greater competition in product and service markets. They found margin maintenance difficult and were in general unable to reduce their cost structures by an amount sufficiently great to fully compensate, with the result that profitability fell, even in the face of expanded sales volumes. They faced the need to replace obsolete equipment in order to better face more competitive open markets being created as other elements of the government's process, and this, in turn, required them to increase their reliance on external capital, principally debt. The results suggest that irrespective of any of the concerns which might typically be raised in relation to privatization programs such as that adopted in Vietnam (e.g., narrow wealth transfer effects), the enterprises were generally more financially and operationally robust after a 3-year journey into the realm of the private.

Sabnavis (2009) enumerates that disinvestment must be treated more like an IPO where the share capital remains intact and the money goes as premium to the "reserves account." It is not surprising that at a time when fiscal constraints are dominating government thinking, the scanner will turn to disinvestment. The author briefly revisits the ideology behind disinvestment (in Indian context).

In 1991 when this idea was propagated, the objective was to broad base equity, improve management, and raise resources for the enterprise which would help strengthen the organization. The 1991–1992 budget focused on raising resources, encouraging wider participation and increasing accountability. The limits for the so-called privatization went through iterations with the Rangarajan Committee settling for 49 % in certain non-critical sectors, which later increased. By 1999, disinvestment is concerned with helping in restructuring and reviving the PSEs. It was only after 2001–2002 that this program began to be viewed with the purpose of covering budgetary support for social infrastructure and to generate funds to reduce public debt. Now, the question is two fold: Should we be going in for disinvestment, and if so, how should the proceeds be deployed?

Further, he opines that disinvestment makes economic sense when it restricts the thought process to the initial motivations outlined earlier where the idea is to make the units stronger through better management practices, wider dispersal of interest, and probably the introduction of the private sector ethic. However, in the face of the failure of private enterprise, particularly in banking, across the world, the undisputed superiority of a private sector model needs to be qualified. This means that

disinvestment should be preferred in non-profit-making companies which need better management. However, loss-making companies would not generally garner interest (Modern Foods and ITDC could be some glaring exceptions), though ideally they would be the natural choices.

The second question is about the deployment of the disinvestment proceeds. It does not appear to be prudent to use these proceeds to finance the budget. This is because it sets a precedent of moral hazard and leads to slackness in maintaining fiscal balances.

Second, divestible amounts are not infinite and hence cannot be government policy in the long run. Government has raised just over Rs. 53,000 crore (2009–2010), and this is not really substantial to make a lasting impact. Third, disinvestment should ideally be focused on the unit rather than the government. The rationale is that the money which is picked up must be used by the company to grow. When an owner divests, the money belongs to him and he may not be bound to reinvest the money. However, when the entity is the government, it should ideally be used to strengthen the enterprise. The diversion of the funds would be weakening the financial position of the company. In the private sector, any dilution of equity provides funds for growth and ultimately enhances the shareholders' value. But, here, the exercise does not contribute to the company at all.

This will hold for both profit- and non-profit-making companies. At present (2011–2012), there are 161 profit-making central PSEs which can command a premium in the market. These proceeds could instead be channeled to revive the 53 non-profit-making units. Therefore, when funds are scarce for all companies, in general, raising resources through alternative debt routes is expensive and disinvestment provides an effective solution.

Fourth, it is often argued that disinvestment proceeds should be used for repaying debt. While, prima facie, this appears to be a viable option, it has to be a concerted action to have really an impact. It has to be done at a time when these funds are not being used to support the budget, as is being done today. Lastly, there is an argument for using these funds for "inclusive development" which certainly deserves deeper thought.

Kumar (2011) examines the factors associated with sustainable privatization of infrastructure projects. He contends that privatization offers a way for governments to make infrastructure delivery more effective and efficient than exclusively public provision, but often the promise is fraught with peril. Project cancellation rates, though rising, are still low. Although trends in cancellation may not be an issue for private infrastructure projects as a whole, it is a concern in the water and sewerage sector. The high probability of cancellation and relatively low level of fresh investment in the sector highlight a declining role for the private sector in making available this essential service. There is value for money to governments from entering into Public-Private Partnerships in infrastructure. Divestment leads to significant improvement in profitability, efficiency, and real output of firms, besides providing some fiscal boost to the government. However, the impact on employment is negative.

Table 3.4 Studies related to Memorandum of Understanding (MoU), 1990–2012

S. no	Year(s)	Author(s)	Issue studied
1.	1990	Murthy	Impact of MoU on the performance of PSEs
2.	1991a and 1991c	Trivedi	Conceptual foundation and usefulness of MoU
3.	1989 and 1990	Trivedi	Ability and purpose of MoU
4.	1991b	Trivedi	Results achieved due to MoU
5.	1994	Kumar	Static and dynamic aspects, strategies and evaluation system
6.	2001	Naik	Purpose and objectives of MoU
7.	2001	Ganesh	Impact of MoU
8.	2001	Vithal	Linking MoU targets with internal incentive schemes
9.	2002	Sengupta	Efficacy and constrains to be removed in MoU
10.	2004	Kaur	Need, goals, and evaluation criteria under MoU
11.	2005	Nagaraj	Composite criteria for MoU
12.	2005	Sangeetha	Case study of Indian reforms
13.	2009	Saroj Koul	Development of organization and competencies
14.	2010	Accord Fintech	MoUs under different public organizations
15.	2012	Raj	New government guidelines for changes in business
16.	2012	Shantanu	Mechanism of MoU
17.	2012	Mohapatra	MoU system and its importance

3.2.3 Memorandum of Understanding (MoU)

The brief outline of the studies relating to Memorandum of Understanding (MoU) has been presented in Table 3.4.

Murthy (1990) describes that the policy of MoU is a typical good news-bad news story. The good news signals an increase in the level of interest and awareness regarding the existence of the MoU policy. The bad news is that it is, unfortunately, factually quite inaccurate and betrays a surprising lack of clarity regarding the current status of the MoU policy.

Trivedi (1991a, c) explains the conceptual foundations of the MoU policy and offers an explanation for widespread misunderstanding regarding this policy. Surely but silently, the performance evaluation of public enterprises by the government has undergone a revolutionary change. From ad hoc, ex post procedure-oriented process, it has now become a systematic and result-oriented exercise. This is exactly what the Industrial Policy Resolution of 1956 had intended, but its implementation has been carried out after introducing the policy of Memorandum of Understanding (MoU) in the 1990s.

Trivedi (1989, 1990) states that the 5-point rating scale used in the MoU system is meant to measure the ability of public enterprise management to meet its commitments; it measures the ability and motivates enterprise to perform better. While carrying out such an exercise, it is not possible for the enterprise to include soft targets due to multiple reasons. Firstly, MoU targets are to be set in the context of public enterprise's corporate plans, which have to be consistent. Secondly, each

MoU is supposed to mention the last 5 year's achievement for every indicator included in the MoU. Therefore, any sudden deviation from the 5-year trend has to be explained convincingly to the ad hoc Task Force. Thirdly, the ultimate responsibility of ad hoc Task Force is to ensure the quality of targets included in the MoU. Finally, the 5-point scale used in the MoU system is supposed to measure the ability of public enterprise management to meet its commitments. However, they (most of the enterprises pointed out in the post-MoU era) now prefer to provide realistic targets with intent to have realistic assessment/evaluation of their performance.

Trivedi (1991b) states that both privatization and MoU are a response to the general perception that public enterprises have not delivered what was expected of them. Privatization involves privatization of public assets. MoU, on the other hand, implies privatization of the public style of management. The former believes that ownership per se is the problem. The latter finds fault with the quality of the control mechanism used by governments to manage their public enterprise portfolio. Privatization generally represents an ideological response to the perceived problems in the public sector, whereas the MoU is rooted in a more technocratic and pragmatic approach to the same problems.

MoU and privatization are complementary to each other in other ways also. In South Korea, performance improvement through an MoU-like system was used to increase the value of public enterprises before selling them.

Kumar (1994) enumerates that MoU takes into account both commercial and non-commercial criteria in their static and dynamic aspects while ensuring performance by making the autonomy aspects more transparent. The objectives of the public enterprises are now more transparent; the performance incentive system has been improved, and comparison of the performance of essentially dissimilar enterprises has become possible.

He stressed that policy-makers must devise a policy to improve the performance of public enterprises in order to serve public purpose as well. For this, he had suggested the basic strategies such as:

- Improving the performance of implicitly loss-incurring public sector enterprises through MoUs with emphasis on cost-effectiveness, higher capacity utilization, energy saving, efficient use of working capital and diversification
- Improving the performance of those loss-incurring public sector enterprises which have high social obligations through restructuring MoUs and partial/full divesture of such public sector enterprises where turnaround is not possible.

Further, the policy options include encouraging workers' participation in management and ownership, creating competition by inviting the private sector to invest in core/non-core sectors, sale of equity to the public at large, and structural reorganization of public sector enterprises.

Naik (2001) has suggested that some of the measures introduced to reform the PSUs include signing the Memorandum of Understanding with the government to improve performance; restructuring involving modernization, rationalization of capacity, downsizing the workforce, product-mix changes, and so on; gradual phasing out of budgetary support to loss-making units; and referring the sick PSUs

to the Board of Industrial and Financial Reconstruction (BIFR) to initiate measures for the rehabilitation of potentially viable units and to recommend closure of non-viable ones. A National Renewal Fund (NRF) was also created to provide relief to the workers affected by downsizing and closure. The World Bank also came forward to provide assistance and augment this fund.

The system of MoUs, which has been in existence since 1988–1989, was extended to more enterprises post-reform, to facilitate granting of greater autonomy to PSUs. The purpose was to achieve the negotiated and agreed objectives without the ministerial and bureaucratic interference in the day-to-day affairs of the enterprises. However, even as more and more MoUs were entered into over the next few years (by 1993–1994) to cover almost 50 % of the PSUs, the financial performance of the units actually saw a further deterioration; they found it difficult to cope with the growing competition from domestic private as well as foreign companies.

Ganesh (2001) observes that the "MoU" system, introduced to revitalize the public sector units, has had little impact.

Vithal (2001) states that managers, on their part, to achieve commitment from the lower-level managers and employees, are found to link the MoU targets to internal incentive schemes for the junior managers and employees. According to the author, emphasis on replacing multiple objectives/multiple principles by few clear goals for the management to achieve and provide functional and operational autonomy through the MoU system helps management to focus their efforts on improving the performance of the PSEs.

Sengupta (2002) deals with the case of Indian Telephone Industries Ltd. (ITI), Indian's oldest PSE. The author emphasized that the Government of India should adopt a system of drawing up MoUs with different public enterprises in order to improve their performance.

The efficacy of the MoU in improving performance depended upon how well it removed the internal and external constraints that affected the functioning of the public enterprises. The internal constraints included excess manpower, lack of motivation among the executives and workers, poor internal control systems and inadequate resources, while the external constraints related to the interference of the politicians and bureaucrats in appointments, transfers and award of contracts. Sankar (1990) observes that MoU does not make any attempt to remove these internal or external constraints.

Kaur (2004) discusses the concept of Memorandum of Understanding (MoU). It is supposed to be a "freely" negotiated performance agreement between a public enterprise and the government acting as an owner of the public enterprise, in which both parties clearly specify their commitments and responsibilities. The need for this device arose because no one, including the public enterprises, knew what was expected of them.

The author suggested that the performance of a PSE should be evaluated on a 5-point scale (referred to as 5 criterion values), varying from 1 to 5 (indicating excellent, very good, good, fair, and poor) at the end of the period. Then, through the process of interpolation, a raw score is estimated for each criterion. This raw score when multiplied by its weight gives the weighted raw score (WRS). Summation of all WRS gives a "composite score" (Kaur 1998).

Nagaraj (2005) describes profitability, as a yardstick of measuring PSEs performance; it has gained importance when governments world over started feeling the burden of loss-incurring PSEs on their budget deficit. India followed the suit in this regard; this is evident from the importance accorded to financial performance ratios in the Memorandum of Understanding (MoU). By 1993–1994, 50 % weightage was given to financial profitability (nearly 20 % to return on assets, ROA) in the composite score evaluation of targets set under MoU, by almost all PSEs signing MoUs.

Sangeetha (2005) analyzes the case study of India, where both types of reforms have been implemented over the past decade (1990–2000). India's centrally owned PSEs have undergone environmental reforms of delegation of authority through signing of MoUs, dereservation of sectors by the government that were earlier under public sector domain to private investment, and hard-budget constraints where government put pressure on PSEs to live within their budget. Functional autonomy was delegated to Indian PSE managers through signing of Memorandum of Understanding (MoU).

The results indicate that the incremental impact of delegating authority to PSE management by setting performance targets and grading them for their performance through the MoU system has significant positive impact on the profitability of PSEs. One reason for it may be explicitly stating one/few objectives and attaching weights to them in the individual enterprise. MoU has helped to the managements of PSEs to focus its efforts on improving the performance of the PSEs. Autonomy to managements in achieving these targets through the MoU system and the existence of managerial labor markets (Gerard and Khalid 2000) act as additional incentives for the management to perform better.

Positive results evidenced in this study (Sangeetha 2005) signify that setting of one/few explicit objectives for the enterprise to achieve with higher weightage to profitability targets and delegating authority to top management for achieving these targets through the MoU system helped the PSE management to focus its efforts in improving the firm's profitability performance.

Saroj Koul (2009) has examined the development of the organizational structure, functions, and competencies of the corporate communication/public relation (CC/PR) in the department of the central public sector enterprises (PSEs) in India. She observes that in many PSEs, the development of full-fledged CC departments is still at a nascent stage; however, in other PSEs the development of CC is already streamlined with company vision and is mature as a division. Key acceptable PR roles include communication for the desired perception among target audience and brand sustainability. In established CC departments, CC is a strategic management tool, synchronizing all intentional forms of internal and external communications, thus helping the PSEs to define its corporate image and improve corporate performance. An accelerated need in communication management is evident as India emerges as a world power in economics, trade, and manufacturing, all areas where the country seeks to make its contribution to the world.

Accord Fintech (2010) has mentioned that Neyveli Lignite Corporation (NLC) has entered into a MoU with Uttar Pradesh Rajya Vidyut Utpadan Nigam (UPRVUNL) for setting up a 2,000 MW coal-based thermal power plant in Ghatampur Tehsil of

Kanpur Nagar District in Uttar Pradesh with an equity participation of 51 % by NLC and 49 % by UPRVUNL.

Neyveli Lignite Corporation's net profit stood at Rs. 273.71 crore for the quarter ended 30 September 2010 compared to Rs. 243.59 crore for the quarter ended 30 September 2009, up by 12.36 %. Its total income had increased by 17.71 % to Rs. 1229.60 crore for the quarter ended 30 September 2010 from Rs. 1044.58 crore for the corresponding quarter of the previous year.

Raj (2012) states that in order to help India's top state-run companies to meet their investment targets involving other public sector firms, the government is considering new guidelines that will allow for revising their commitments by factoring in changes in business conditions.

Further, the author suggests that in situations where MoUs have unrealistic targets, greater operational flexibility should be encouraged. In the case of Maharatnas and Navratnas, he proposes to have a review mechanism and appeal mechanism where MoU targets can be revised if there is a change in the business environment. It has been suggested that investment plans that have been provided by the PSUs will be built into the Memorandum of Understanding so that they can be suitably appraised as a part of the MoU.

Shantanu (2012) opines that the target setting mechanism called Memorandum of Understanding (MoU) is crucial for nearly 200 profit-making central PSEs such as ONGC, Indian Oil, Coal India, NTPC, etc. As their performance-related pay goes up to 200 % of the basic pay in case of a CMD, it actually depends on whether they achieve those targets or not. This MoU mechanism ensures autonomy to those enterprises while making them accountable to the government which sets targets and evaluates their performances.

He further explains that one of the major concerns before government is how to bring loss-making public enterprises into the ambit of the MoU system. The department of public enterprises (DPE) has formed a working group. The panel is examining the possibility of different MoU formats for different sizes and categories of CPSEs including Maharatna and Navratna companies and whether more operational flexibility could be given to CPSEs while setting targets.

Mohapatra (2012) has described the role, purpose, and usage of the MoU system; the MoU system was first introduced in India in 1986, based on the Arjun Sengupta Committee Report (1984); the Committee has recommended agreements for 5 years that may be reviewed annually. Since the planning exercise laid much emphasis on the core sectors of steel, heavy engineering, coal, power, petroleum, and fertilizers, the Committee favored MoUs in respect to such enterprises only. According to the MoU system, the management of the enterprise is made accountable to the government through a promise of performance or "performance contract."

The MoU system did help public enterprises; it was corroborated by the profitability of MoU-bound enterprises. Their profits increased from Rs. 12,013 crore in 1994–1995 to Rs. 91,062 crore in 2007–2008. MoUs were critical to the turnaround of many enterprises like National Building Construction Corpn. Ltd. (NBCC), Electronics Corporation of India Ltd. (ECIL), Engineering Projects India Ltd. (EPIL),

Table 3.5 Studies related to financial performance of corporate enterprises, 1985–2011

S. no	Year(s)	Author(s)	Issue studied
1.	1985	Barbro	Weaknesses of cost-benefit analysis
2.	1991	Vickers and Yarrow	Ratio analysis to assess profitability
3.	1988	Sarkar et al.	Profitability ratios to assess 541 companies
4.	1988	Jain	Measures to assess operational and allocational efficiency
5.	1989	Boardman and Vining	Profitability measures and concentration ratio
6.	1990	Sheikh	Factors associated with PSEs
7.	1992	Boardman and Vining	Private, public, and mixed enterprise performance
8.	1992	Kumar	Case study approach
9.	1993	Murli	Regression technique
10.	1994	Megginson et al.	Financial ratios
11.	1998	Boubakri and Cosset	Accounting performance measures
12.	1999	Bradbury	Accounting ratios
13.	2005	Jain and Yadav	Profitability ratios
14.	2005	Sangeetha	Regression technique
15.	2005	Gupta	Fixed effect regression technique
16.	2007	Amiti and Konings	Productivity impact
17.	2007	Vadlamannati	Econometrics model
18.	2009	Ivo Sever et al.	Modern economic policies in recession
19.	2010	Sunil and Rachita	Performance of public sector banks
20.	2011	Ruchira Singh	Sovereign debt crisis
21.	2011	Hemal Pandey	Effect of corporate governance structure

Metallurgical & Engineering Consultants (India) Limited (MECON), Mineral Exploration Corporation Limited (MECL), Projects & Development India Ltd. (PDCIL), and Hindustan Insecticides Ltd. (HIL). Overall, the MoU system has helped CPSEs: improve top- and bottom-line performances, upgrade process and systems, address corporate governance imperatives, increase corporate autonomy, and improve accountability.

3.2.4 Measures of Financial Performance

The select/major studies relating to the measurement of financial performance have been listed in Table 3.5.

Barbro (1985) examines 12 Swedish cases. He observes that the cost-benefit analysis does not seem preferable as a basis for decision making where ordinary business accounts are available. Albeit ordinary business accounting, expressed in annual reports, does not give an altogether true and valid picture (Burchell et al. 1980), it is less subject to manipulation and less biased than the cost-benefit analysis. Considerations, therefore, need to be given to produce a better basis for decision making.

Vickers and Yarrow (1991) measure profitability of the public and private industrial firms in the UK from 1970 to 1985. They find the average profitability for private firms is consistently higher. On an average, the ratio of gross trading profit (before allowance for stock appreciation and depreciation) to net capital stock for privately owned companies has been about three times higher than the nearest equivalent measure for public corporations (the ratio of gross trading surplus to net capital stock).

Sarkar et al. (1989) examine the combined balance sheet of 541 public limited companies whose financial details are summarized in annual reports of Reserve Bank of India (RBI). They measure return on capital employed (ROCE), return on total assets (ROTA), and return on shareholder's equity (ROSE). They contend that the profit before interest and tax (PBIT) to the total net assets is a suitable measure to assess the total impact on the economy, PBIT to effective capital employed to assess the effectiveness of the management and profit after tax (PAT) to net worth from shareholders' point of view. They conclude that profitability to capital in India appears to be rather low in both private and public enterprises.

Jain (1988) has given emphasis on operational and allocational efficiency criteria to judge the financial performance of Industrial Finance Corporation of India (IFCI), a leading development bank of that time. Operational efficiency criteria should be used to judge its efficiency as financial institution and allocational efficiency criteria for its developmental functions.

Sheikh (1990) describes that the PSEs have not lived to their expectations due to variety of factors. In particular, there has been growing concern over their poor financial performance and the consequent financial burden upon developing countries (like India) which is viewed as unsustainable in the long run.

Boardman and Vining (1989, 1992) compare the performance of private corporations (PCs), state-owned enterprises (SOEs), and mixed enterprises (MEs) among the largest non-US industrial corporations (500 in number); among them 419 were PCs, 58 SOEs, and 23 MEs. For analysis, they used four profitability measures: (1) return on equity (ROE), (2) return on assets (ROA), (3) return on sales (ROS), and (4) net income (NI). In addition, they used two measures to examine aspects related to efficiency, viz, (5) sales per employee and (6) sales per rupee of asset.

The model contained dummy variables for SOEs and MEs, thereby making PCs the benchmark. In order to reflect the competitive position of each firm, they included assets, sales, employees, and a measure of (international) market share. Assets, sales, and employees measure size; they reflect economies of scale and, to some extent, market power. In order to control for the competitive/regulatory environment of the industry, they included concentration and dummy variables for each industrial sector and each country. Concentration is measured by a four-firm concentration ratio. The concentration ratio is the percentage of an industry's employees accounted for by the four largest firms in an industry. The results showed that on an average, the ROE of PCs is 14.5 % higher than that of SOEs and 18.4 % higher than MEs. PCs generally have higher performance than the rest in terms of profitability and efficiency.

Kumar (1992) measures performance of privatized companies and classifies companies into two categories: first, where enterprise performance before and after divestiture is compared and, second, where enterprise performance after divestiture is compared to some benchmark.

In the case study approach, the performance of the enterprise before divestiture is compared with its performance after divestiture, attributing any observed changes to the divestiture. This approach, however, is applicable only in a static environment. In reality, changes in enterprise performance could be driven by changes in the economic environment rather than by divestiture. Thus, in individual case studies, it is difficult to segregate the effect of divestiture from other factors such as growth of economy, policies of liberalization and deregulation. Another drawback with the case study approach is selection bias. One tends to study only "interesting" cases leading to subjective judgment. However, if we take large number of firms simultaneously, then the effect of compounding factors might be expected to "average out."

Murli (1993) suggests a modified regression technique (known as polar regression) to discriminate between financial ratios to isolate a set of more significant ratios appropriate for performance analysis, vis-à-vis other financial ratios.

Megginson et al. (1994) have used the set of following financial ratios to measure the financial impact resulting from privatization:

- For profitability: return on sales (ROS), return on assets (ROA), and return on equity (ROE).
- For operating efficiency: sales efficiency (sales (inflation adjusted)/number of employees) and net income efficiency (net income/number of employees).
- For employment: total employment (in terms of total number of employees).
- For leverage: debt to assets and long-term debt to equity.
- For payout: cash dividend/net income.
- For capital investment: capital expenditure to sales and capital expenditure to assets.
- For output: real sales (nominal sales/consumer price index).

They used Wilcoxon signed-rank test as their principal method to test for significant changes in the variables. This procedure tests whether the median differences in variable values between the pre- and post-divestiture samples is zero.

Emphasis is given on ratios which have used current year "flow" measures such as sales. Return on sales (ROS) was considered more representative of profitability. They have used two measures of efficiency: inflation-adjusted sales per employee and real net income per employee. As partial productivity measures, these are only suggestive of efficiency measures of greater interest, such as total factor productivity.

The mean and median profitability, real sales, operating efficiency, and capital investment spending of their sample firms increased significantly (in both statistical and economic terms) after divestiture. They also documented significantly lower leverage ratios and higher dividend payments after divestiture.

Boubakri and Cosset (1998) have examined the change in the financial and operating performance of 79 companies from 21 developing countries that have experienced full or partial privatization during the period from 1980 to 1992.

They used accounting performance measures adjusted for market effects as well as unadjusted accounting performance measures. Both unadjusted and market-adjusted results show significant increases in profitability, operating efficiency, capital investment spending, output, employment level and dividends. They also find decline in leverage following privatization, but this change is significant only for unadjusted leverage ratios.

Bradbury (1999) examines the financial performance of New Zealand Government Computing Services (GCS). GCS is required to be as profitable and efficient as comparable businesses. He also emphasizes that from the point of view of the equity holder, cross-sectional comparison requires an examination of the returns earned by firms with similar systematic risk characteristics.

The author states that accounting ratios are used to assess the financial performance despite their well-known shortcomings. The prime performance measures are return on equity (ROE), return on assets (ROA), and return on revenue (ROR). Growth in revenue is also measured. Similar measures are employed in major studies that utilize accounting ratios to examine economic performance (Rumelt 1974; Boardman and Vining 1989; Karpoff and Rice 1989). The financial performance, in terms of return on equity, shows a steady improvement during the transition from a government department to a state-owned enterprise (SOE). The mean ROE during pre-SOE period (1985–1988) is 15.5 % compared to 24.6 % over the SOE period (1989–1994).

Jain and Yadav (2005) have measured financial performance of the central PSEs (classified in service and manufacturing groups) in India. Relevant data relating to return on total assets (ROTA) of PSEs indicates that service enterprises have better profitability than manufacturing enterprises during the aggregate period (1991–2003), whereas return on capital employed (ROCE) is substantially higher than ROTA for manufacturing PSEs compared to service PSEs.

Sangeetha (2005) uses regression technique with dummy variable approach to measure the performance of PSEs. The study captures this with a dummy variable *autonomy* that takes the value of 1 in period “t” if the enterprise had signed an MoU in period “t – 1.” It is hypothesized that signing of MoU by a PSE will have positive impact on its profitability performance.

Gupta (2005) has cautioned that the before/after estimators are not reliable if there are significant changes in the overall state of the economy between these years or if there are changes in the life-cycle position of some of these privatized firms. The author has used fixed effects regression with dummies to describe the results. Using fixed effects and instrumental variable regression, they find that partial privatization, in which minority shares of state-owned firms become available on stock markets, has a positive and highly statistically significant impact on the operating performance of firms. Partial privatization leads to an increase in the productivity of labor and output without layoffs. Hence, results support the managerial view that improved managerial efficiency is a significant factor in explaining the effect of privatization on performance.

Amiti and Konings (2007) are of the opinion that liberalization affects productivity. Their study has been carried out separately by identifying the impact of input and output tariffs. They find that the reduction in tariffs has positive productivity effects in Indonesia.

Vadlamannati (2007) has used econometric models to measure the impact of deficit variables on privatization. The empirical results show that the connectivity of disinvestment and privatization in relation to these variables is very feeble and weak in view of the very small and slow-paced disinvestment program, which the country has witnessed all these years.

Ivo Sever et al. (2009) have shown the abilities of modern economic policy in providing the answer on important issues brought by recession and crisis of the Croatian economy (short-term solutions, they also extend to a longer horizon as well). It provides basis for the new economic policy to overcome the recession as well as to assist the recovery of production in the Croatian economy. The results of their research show that the causes of recession and economic crisis in Croatia only partly refer to the external origin and are dominated by internal factors. Among those factors, the crucial one is the application of the so-called stabilization program in 1993 and related policy of overvalued and stable exchange rate.

The evaluation framework of anti-recessionary economic policy indicated that Croatian economic crisis was partly the consequence of external factors such as declining marginal efficiency of capital, insufficient demand, the privileged status of the dollar, and its dual use. In terms of evaluation of the causes of recession and crisis of the Croatian economy, it was found that the main problem for Croatian society and economy is not a global recession. Over-indebtedness of the state and of economic entities, which disturbs all economic balances, is the fundamental problem. It is a consequence of application of the so-called stabilization program of 1993.

Sunil and Rachita (2010) give emphasis to appraise the efficiency, effectiveness, and performance of 27 public sector banks (PSBs) operating in India. They suggest that in their drive to improve overall performance, PSBs should pay more attention to their income-generating capabilities (i.e., effectiveness) relative to their ability to produce traditional outputs such as advances and investments (i.e., efficiency).

Ruchira Singh (2011) opines that the downgrade of US credit rating by Standard and Poor's, along with weak economic data from there and the lingering European sovereign debt crisis, has stoked fears of a second recession after the one that followed the bankruptcy of financial service firm Lehman Brothers in September 2008.

Hemal Pandya (2011) examines the effect of corporate governance structures, particularly board structure and CEO duality, on the performance of selected Indian Banks. Using samples of public and private banks operating in India, he examines the relationship between CEO duality and the proportion of independent directors on firm performance as measured by return on assets (ROA) and return on equity (ROE). Results show that there is no significant relationship between corporate governance structures and financial performance of the banks.

3.3 Gaps Identified in the Literature

The literature survey shows that there are potentials for further inquiry which focuses on the policies and reforms of public sector enterprises primarily in terms of disinvestment and Memorandum of Understanding (MoU). There is no

comprehensive study which has covered the entire universe of PSEs to examine the impact of disinvestment and MoUs on financial performance of PSEs in India. The present study makes an attempt to fill this void.

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