

# Impact of Privatization on Indian Economy

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## ABSTRACT

When the government sells a government department or entity to a private investor or increases the share of private investor above 50%, then this process is called privatization. In privatization the government's stake in a particular industry is reduced or eliminated. In an industry that involves both government and private investors, losses and profits are shared between the government and private investors. Most of the government decides to privatize those industries which are running in loss. Next we will discuss the advantages and disadvantages of privatization in detail. "While the case for economic reforms may take good note of the diagnosis that India has too much government interference in some fields, it ignores the fact that India also has insufficient and ineffective government activity in many other fields, including basic education, health care, social security, land reforms and the promotion of social change. This inertia, too, contributes to the persistence of widespread deprivation, economic stagnation and social inequity." - By Dr Amartya Sen & Jean Dreze.

Keywords : Indian Economy, Privatisation, Liberalisation, FDI

## I. INTRODUCTION

By 1991, there was an emergency financial situation in India, due to which the government had to sell even its reserve gold. There was no money on the government to pay salaries to government employees. It was time to declare an economic emergency. But in 1991, our Prime Minister and Industries Minister PV Narasimha Rao, made Dr. Manmohan Singh, who was then the Governor of RBI, Finance Minister to handle the economy and together with him very wisely pulled India out of this situation. Because to handle the economy of India at that time, the Finance Minister Manmohan Singh had wisely resolved through liberalization, due to which he is also called the harbinger of liberalization. At that time, the policy of liberalization was implemented for all companies in India, in which the requirement of license was abolished in all, except 18 sectors like health, chemical or human-harm industries etc. With

someone boosted to the global economy. Unnecessary bureaucracy was eliminated and thereby helped to eliminate the Specter Raj. At the same time, the government adopted the PPP model, which encouraged private partnerships in public sector undertakings, which was the beginning of the path of privatization. At the same time the government opened all the avenues of entry in India for foreign companies, which gave a promise to FDI and MNC and foreign products were also available in India easily and at a fixed price. This is how India's economy was handled at that time.

Since the beginning of economic liberalization in India, privatization remained dormant for almost a decade. The simple reason for this was that weak governments could not address many vested interests, from bribery bureaucrats and ministers to public sector trade unions. Further ideological resistance amongst India's elite has also been attributed to the

virtual absence of privatization in India's economic reforms. The President of India, in his inaugural address to the Parliament in the 2002 budget session, said, "It is clear that disinvestment in public sector enterprises is no longer a matter of choice. But an essential point is that the fiscal deficit on account of these enterprises will remain for a long time." Just as the external debt crisis undermined the early stages of economic reforms, and the financial crisis increased the cost of state-owned enterprises. Significant ideological changes have taken place in India with regard to effectiveness as well as the notions of the Indian state being a "guardian of public interest".

The Government of India's privatization program began as a disinvestment program aimed only at mobilizing resources to reduce the budget deficit by reducing the government's stake to 20 per cent. Accordingly, the program was labeled "disinvestment" and the term "privatization" was strongly avoided. After this, in the next phase, the government will invite external disinvestment up to 49 percent. Since it will still be majority and owned by the government and the fundamental character of the enterprise will remain unchanged, while it can mobilize even more resources to reduce the budget deficit. Then in the next phase, the government decided that it would sell 74 per cent of the equity to it, leaving it with a 26 per cent government stake which is enough to give it a strong voice in the venture. Eventually, one-time disinvestment became acceptable, initially for loss-making enterprises and later also for profitable enterprises. Thus, the government increased its commitment from mere privatization of ownership to privatization of control and during the 2000–01 budget debate, "privatization" was used by Finance Minister Yashwant Sinha to describe the government's program to reform SOES. A third dimension along

which the government's commitment to privatization expanded was the areas in which firms could be sold. This process led to an increase in services exports, limiting the current account deficit to an average of 1.1 per cent of GDP (Acharya, 2002). Rising capital inflows increased the country's foreign exchange reserves to \$55 billion by 2002. Although these results were not spectacular compared to high-growth Asian economies, they were better than India's previous record. Privatization was a way of curbing inflation by reducing the fiscal deficit (thereby limiting monetization of the deficit). One convenient way to raise foreign exchange was by the government, by selling state enterprises to foreign investors and increasing FDI.

One limit that the Indian government did not cross was the sale of control of a large, important firm to multinational firms, and with the sale of Maruti Suzuki in May 2002, that limit was crossed as well. Initially, for example, the Ministry of Petroleum argued that oil companies were strategic, but by 2000 the Cabinet Committee on Disinvestment had classified this as non-strategic. Eventually, only nuclear power, defense and railroads remained in the strategic category, and everything else deserved privatization. And even in the last two years, greater regulation and outsourcing of activities is increasing the role of the private sector. The debate over which areas were strategic for sure was controversial, but they ended with progressively narrower definitions, even though the party in power changed three times. However, there has been a significant increase in the commitment to privatization after the BJP-led governments came to power. Initially the auction of shares was confined to public financial institutions that over time they were expected to be sold to private investors. Equity was being offered to foreign institutional investors till 1996. This followed three concomitant trends—the government's desire to sell

SOES to "strategic investors", that is, to private investors, who would own a large block of shares (not necessarily 51 percent) and enjoy management control, according to regulations. Liberalization of direct investment, and the opportunity to list Indian firms on foreign stock exchanges through ADRS and GDRS. Thus, potential buyers of Air India included Singapore Airlines in partnership with Tata and Air France in partnership with the local Indian conglomerate, while foreign-owned parts.

## II. Relevance of the Study

In the year 1998-99, Prime Minister Shri Atal Bihari Bajpai made a statement in the Parliament regarding disinvestment that disinvestment or privatization is the only panacea to save public sector undertakings from loss. The opposition's reaction to this statement was that you cannot sell the family's silver to meet your daily tasks.

Because privatization is directly related to the economy of the country and the economy of the country is directly related to the citizens living in the country. We should know in which direction the country will go through privatization. For this we need to know the following facts

- What is the reason for privatization?
- Why should the government spend public money in each of the areas where there are already many successful private firms, and they are doing well in the market. The government is getting good tax from these firms. Like why the government should invest in NALCO while private companies like Hindalco are active in this sector and pay taxes to the government.
- Similarly, we should know that state-owned banks like SBI and UTI have P/E ratio of 6 and 5 respectively while their rival banks like HDFC have P/E ratio of 30.
- Similarly, state-owned gas company GAIL has a P/E ratio of 4.4 while a private sector gas company like Gujarat Gas has a P/E ratio of 15.
- Our government should stop competing with the companies doing excellent work in private sector because the government is getting tax in the form of profit from those companies.
- In law, the government should focus its attention on increasing the competition among the private sectors' businessmen so that they can provide the quality goods and services which directly benefit the public.
- The following points emerge from the study of privatization and the logic behind it-
- In the private sector, ownership leads to better use of resources and more efficient distribution of resources.
- Privatization got a boost across the world while Government Sector Companies realized that they could not meet the growing demands of the economy.
- One of the reasons for adopting the policy of privatization around the world was that the government has increased the tax rates excessively and the government has been unable to contain the deficit in the public sector undertakings.
- Apart from this, the commitments of the WTO and the new innovations in technology gave a boost to globalization. Government agencies are not able to adopt new technology etc. quickly whereas public enterprises may reorganize themselves slowly due to their proprietary nature. Hence the need for privatization is reinforced.
- Now government technology is available to control public monopolies such as in the Department of Power and Telecommunications,

consumer interests are better protected by competition and rules have been made to ensure that consumer interests are protected.

- The objectives of the disinvestment program are to make the Indian economy more advanced and useful to the changing society by improving the efficiency of public sector enterprises.
- The primary objectives of privatization of public sector enterprises are as follows
- To avoid controlling and restricting non-strategic enterprises for the government.
- For effective running and effective control of sectors like public health, family welfare, primary education etc., these should be put in the non-strategic category.
- There is a need to promote zoning to reduce the excessively rising public debt.
- Where the government is incurring losses, it is inevitable to put government money which is actually public money in such undertakings and such undertakings should be handed over to the private sector so as to improve their efficiency and thereby give the government a certain benefits in the form of tax.

### **Why privatization is required?**

As mentioned earlier, when the government's stake in a government industry is reduced or eliminated and the share of private investors increases, that process is called privatization. Most of the government sells, loss making enterprises, to private hands, this makes it easier for the government to fill its treasury, eliminates the responsibility of the government to run loss making industries, encourages private entrepreneurs to do their work.

- Whatever work the government does, it does it for the good of the public and not to earn profit, even if the government is running a company. But when the government sells a company to a private hand, the aim of the company is to earn

maximum profit and thus boost the economy of the country.

- The government is promoting its foreign direct investment by allowing private sector companies to invest in government-funded industries, which in turn is helping to fill the exchequer.
- India provides shareholding to various companies outside India and when such companies bring proposals to invest in India, it encourages foreign direct investment in the country and thus helps in increasing the capital of the country.
- Through disinvestment there will be a wider distribution of wealth through offering of shares of privatized companies to small investors and employees.
- The disinvestment will have a beneficial effect on the capital market as the increase in floating stock will help the market reach deeper.
- In many such sectors such as telecom, petroleum, etc., the end of public sector monopolies is providing relief to consumers through more choice and cheaper and better quality of products and services.

### **Objectives of the study**

To study the pre and post disinvestment financial impact of a public sector undertaking.

### **Area of the study**

To study public sector companies or undertakings which have been disinvested or privatized.

### **Data source**

- The data for research purpose has been obtained from the annual reports of the companies.
- Data for research purposes is taken from media publications of Times of India and Economic Time and Journal of Economic and Political Weekly.

- The following are the books which have been studied as a primary source  
Disinvestment in India by Pradeep Baijal,  
Privatization in India by Karan, Mishra RK,  
Privatization of Public Sector Undertakings by Jesiah Selvam,  
Disinvestment in India by Sudhir Nayab.  
Internet search has also been used in this.

### **Sample Design**

Data of Bharat Aluminum Company (BALCO) has been taken for the study.

### **III. Methodology**

The loss making public sector can be taken as a case study and the case of Bharat Aluminum Company (BALCO) is taken to evaluate the impact of financial performance before and after disinvestment. In this, computer aided financial data analysis of Bharat Aluminum Company (BALCO) has been done.

### **IV. Literature review**

The literature related to this research has been reviewed under various headings. The literature collected for its study focuses on various issues of privatization of public sector undertakings in the private sector. In this, literature related to economic issues to politics, literature related to social relations and literature related to management issues have been studied. From a review of the literature on privatization, it has been seen that a lot of studies have been done on various issues of privatization. And most studies have been done extensively in industrialized and high-income developing countries. It covers more studies of strategic sale of loss-making PSUs in a developing country like India and in this case there is not much study on privatization of the world. A study of several texts reveals how private

ownership converts the financial performance of loss-making privatized PSUs into profitable ones. No specific study has been done so far on how Bharat Aluminum Company (BALCO) loss making venture turns into profit after privatization. This study is being done to fill this gap. Further, the disinvested PSUs have been criticized from many angles which should be evaluated as per the prescribed guidelines on valuation.

In 2001, 51% ownership and management of Bharat Aluminum Company (BALCO) was transferred to Sterlite Industries India Limited. This resulted in a reduction in the workforce by 1,162 employees (from 6,429 to 5,267), and the result was very positive. The salary expenditure of the firm increased only by 22.83% but the productivity per employee registered an increase of 328.7%. The firm invested Rs 5,000 crore and set up a new 540MW power plant and 2.45 lakh tonne alumina smelter. Balco's efficiency increased to 115% and its exports increased from Rs 20 lakh to Rs 1,100 crore within 5 to 6 years. Similarly, Bharat Sanchar Nigam Limited (BSNL) was earlier known as Department of Telecommunications and was the only company in India to give the facilities of phones etc. MTNL (Mahanagar Telephone Nigam Limited) was functioning only in Mumbai and Delhi. During that time, BSNL was dominated by bureaucracy and its services were also not good. Consumers had to wait for five-five years to get a telephone connection. But, the privatization of the telecom system in 1991 changed the whole picture. Private companies from the country and abroad entered this sector. Then due to stiff competition BSNL had to change its working attitude. The actual change, however, was much less than the required change. Later the number of companies increased in this area and today its results are in front of everyone, today you can get a new phone connection within 15 minutes. Earlier, there was a

charge for listening to the call and the call rates were also very high and only rich peoples could use the phone but due to the competition of more companies today the prices have come down considerably and because of this the phone reach in every poor house today. Similarly in 1997, the Airports Authority of India had privatized four airports – Bengaluru International Airport (Bangalore), Indira Gandhi International Airport (Delhi), Rajiv Gandhi International Airport (Hyderabad) and Chhatrapati Shivaji International Terminus (Mumbai). Bengaluru International Airport and Shivaji International Airport were sold to GVK Group, and Rajiv Gandhi International Airport and Indira Gandhi International Airport were sold to GMR Group. The privatization of these airports has brought many benefits. There has been an increase in the efficiency (both productive and allocation) of airports and airplanes, in order to improve efficiency, modern management style and marketing skills have been adopted and better investment decisions have been taken. Along with this, a regulatory body named "Airport Authority of India" has been set up by the government to oversee the working of these air companies, which regulates the prices charged from the passengers, the safety of the passengers, the quality of the services provided, the quality of the aircraft and it will also monitor noise intensity and spatial planning etc of aircraft.

With a strong impetus towards privatization, the present government is emphasizing on reducing state ownership in most sectors. The dilution of the ownership approach, particularly in the last two years, has been replaced by a determination to transfer control. Reducing state ownership to the extent of shifting control to private hands for better performing state-owned enterprises is not an appropriate policy decision. This reflects closer alignment of the government's objective with

generating funds to bridge the fiscal deficit/debt gap, by sacrificing future profits for short-term capital gains. In contrast, the Indian CPSE performance revival plan should include a more structured approach that includes segmenting firms into different categories according to past performance, future profitability, industry characteristics and revival opportunities. The government should adapt the restructuring plan options according to these categories and segments.

The Indian state's approach to privatization over the years has been a revelation of sorts. The Finance Minister had expressed a bold resolve towards aggressive privatization of Central Public Sector Enterprises (CPSEs) with huge disinvestment targets announced in the last two budgets. Despite these exceedingly high goals, disinvestment policy remains a politically sensitive policy decision, with opposition and opposition from various parties. The political sensitivity surrounding this action explains the slow pace of implementation of the disinvestment policy since its inception. Not surprisingly, the amount received from disinvestment has been very less in the last few years.

#### **How is the public sector economy privatized?**

There are two ways to privatize sectors which were fully owned by the government.

**(i) By transfer of ownership:** This can also be done in two ways. In the first condition, the government completely removes the government ownership and government management from an industry and in the second way, it is sold to the public sector units.

**(ii) By disinvestment:** When the government sells some of the equity from public sector units to private investors, it is called disinvestment. This is what the government does so that the public sector units are financially strengthened and modernized.

**Government owned sectors or enterprises are privatized in the following manner**

- By selling shares of a sector to the public by auction or by offering an acquisition price to the public.
- By transferring government employees from the ownership of enterprises.
- By leasing the property with the right to buy.
- By selling the government property to the private sector.

**Benefits of Privatization**

Following are the benefits of privatization

- Private entrepreneurs provide better incentives to earn maximum in any industry which is better than public sector industries.
- Employees employed in private sector companies are paid on the basis of their work output whereas in public sector companies no such target is given.
- Employees doing good work in private sector companies are encouraged.
- Political interference is very high in public sector companies whereas private sector companies work for profit and there is little or no scope for political interference in this.
- Because the influence of politics in public sector companies is very high and the politics is for short term, therefore its goal is for short term. Whereas the goals of private sector companies are long term and so they work day and night to achieve their goals.
- When more companies in the private sector are present in the market, they increase mutual competition and due to which consumers benefit.
- When private companies engage in healthy competition in the market, the economy is bound to grow.
- Entrepreneurs are encouraged in private sector industries as entrepreneurs have the freedom to take their own decisions.
- When money is needed in a government enterprise, it takes a lot of time because there is usually a delay in the approval of funds in the government system and this is because the process of sanctioning funds in the government system is very complicated, whereas In private sector companies, money is immediately available at the time of need.
- Prior to 1991, the government's expenditure was much more than its earnings, as a result of which the fiscal deficit was increasing, only after that the government encouraged privatization in many sectors so that the government deficit could be reduced or eliminated.
- Foreign direct investment is encouraged in the country by private companies because India's market is wide because of the large population and many companies from abroad want to come in India to sell more and more foreign products.
- The coming of foreign companies to India strengthens the economy as it brings foreign money into India.
- Private companies keep renewing their structure to earn more and more, which increases their earnings and also helps the government to fill its treasury in the form of tax.
- Private companies have systematic and protected management due to which the private companies diversify the products according to the needs of the consumers and this gives enough options to the consumers to choose from in the market.
- Private companies focus more on increasing the efficiency of their management so that they

can meet their targets before the deadline and avoid any unnecessary formalities.

### **Negative effects of privatization**

Private sector companies increase or decrease the price of a product as per their wish, due to which private companies become a monopoly in the market. With the advent of more and more private companies, the prices of goods can become expensive due to monopoly because private companies work for their own profit and not for the interests of the society.

Due to privatization, there cannot be a situation of full employment in the country as private companies work for profit, and so does not hesitate to employ state-of-the-art machines to his advantage, which reduces the need for manual labor. Because of this, there is a lack of employment.

When public sector companies were sold to the private sector, many government employees opted for voluntary retirement because, it became difficult for them to operate under the conditions set by private investors.

With the entry of more companies in the private sector, they become monopolized and also fix the prices of the products according to their profit, which increases the inflation in the market.

### **V. Conclusion**

Bharat Aluminum Company has benefited as a result of the strategic sale of the PSU involving transfer of private ownership and control. But ownership or control cannot be attributed to gains in financial performance. In this the regulation of the economy plays an important role which also contributes to the

profitability of the privatized companies. Apart from this, the financial performance of several other companies involved in the strategic sale shows that post privatization there has been no significant improvement in the financial performance of these companies as compared to earlier.

Apart from this, sick and loss-making privatized companies will take some time to recover from the disease, only after that they will start making profit. There has been good profit from the sale of initial public corporation like NTPC, NHPC. Therefore, the Government of India has received a lot of cash from the strategic sale. By disinvestment, the people of India get a share in the company because they buy the shares of that company. In the long run, the shares of most disinvested companies have shown an increase. Therefore, disinvestment is the right step of the Government of India, but before privatizing any sector, the government should try disinvestment.

If the government wants to privatize a company, then its rules and laws should be decided by the government according to the interest of the public and under those rules and laws, any private sector company should be allowed to operate in its country. In this way the government can control the prices of producers and the exchequer can also be filled.

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