'COMMENTARAO'
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"Why continue with so many state-owned enterprises?" by S L Rao

India's orientation to major government involvement in industrial development can be traced to the committee with then top industrialists, Purushotam Thakurdas, JRD Tata, G D Birla, Ardeshir Dalal, Shri Ram, Kasturbhai Lalabhai, A D Shroff and John Mathai, formed in 1942. It proposed the "Bombay Plan" for India's economic development. The industrialists said "no development...will be feasible except on the basis of a central directing authority." This meant directing investment to desired areas.

The Plan proposed doubling per capita income within fifteen years. Industrial productivity had to grow by five times, and industrial planning had to be focused on the development of capital goods industries. The Centre was to invest heavily in starting industrial enterprises. These were basic and key industries-transport, pharmaceuticals, armaments, aircraft, cement, steel, aluminum, machinery, power, etc. (State governments soon started their own). Most of the funding would be raised by government, especially through borrowings abroad. Private investment would be directed into desired directions through industrial licensing.

Professional management in India was not well-developed at the time. The only trained cadre was the civil services that administered the country. Civil servants were drafted to set up and run these state-owned enterprises (SOEs). A few non-bureaucrats were brought in- DV Kaput, V Krishnamurthi, Prakash Tandon, Yogi Deveshwar, etc. But there were few such, and the bureaucracy developed remote control of SOEs through, rules, procedures and many approvals. Though over time, the enterprises developed their management cadres, the administration continued to exercise great control over them.

With liberalization from 1985 and abolition of licensing from 1991, private investment entered sectors reserved for government enterprises. Public sector monopolies were broken. SOEs faced competition. However, their inflexible mandates limited them to defined sectors. They could not diversify to improve profitability. The detailed controls by administrators in government over SOEs, on their expansion, diversification, technology imports and collaborations, royalties, building brand images through product quality, service, pricing and advertising, continued. These stunted managerial innovation and corporate growth. A culture of defensiveness, avoiding risk-taking and errors of judgment and losses, developed in SOEs. The three C's (CBI, CVC, CAG), were deterrents to bold decision-making in SOEs. The private sector is more tolerant of loss-making mistakes (provided they do not happen too often).

There are many examples of SOEs that fell behind as a result. Air India was prevented from replacing old airplanes for over ten years while private competitors took over profitable routes. Then they were compelled to buy planes for which Air India had no plans for utilization.

BHEL failed to upgrade its product technologies, resulting in loss of much business, especially for more advanced equipment, to foreign producers (China is a major example). It has failed to deliver equipment in time. Expansion of power supply and equipment breakdowns among users was the result.

Coal India, the most profitable SOE, supplies low quality coal, and misses supply commitments. The result: damage to expensive turbines; heavy shortfalls in power generation and fertilizer production; Imports at much higher costs; consequent higher costs to the economy and the consumer.

Defence enterprises were prevented from or postponed acquisition of technology. High imports of defence equipment benefited import agents and their local touts. The country despite its acclaimed engineering and software skills, imports a major part of its defense requirements because of government restraints on indigenous production. HMT's inability to keep pace with the modern electronic age made it a sick company. Bharat Electronics survived by supplying the non-government market and technology innovation. It was a rare exception.

NTPC missed every Plan target for new generation capacity mainly because it did not develop EPC (engineering, project, construction) capability, avoiding possible retribution if they lost on a project. NTPC had strong technical skills in power generation because of excellent selection and training schemes. NTPC benefited from being government owned, and almost a monopoly at the national level. Its owner gave it special tariff preferences and accelerated depreciation which bolstered cash flows.

BSNL and MTNL declined in the face of aggressive private competition and lack of innovative leadership.

State government owned SOEs are in worse shape. The best examples are the state electricity boards. They will lose Rs 100000 crores this year. They allow theft of electricity, give free to farmers, are headed by itinerant bureaucrats, and engineers hold managerial positions with little training.

Many SOE's are major drains on the productivity of the economy, and make frequent large calls on government funds.

Central government investment in SOEs is now Rs 729228 crores. Capital employed (paid-up capital + reserves and surplus +long-term loans-mostly from government) in 2011-12 was Rs 1,328,027 crores. Many SOEs are overstaffed, and labour productivity is low. In 2011-12, the 225 SOEs owned by government, made a net profit after tax of Rs 97512 crores. They paid out dividends of Rs 42627 crores, or 3.21 % on capital employed, and 43.71 % dividend payout. Interest payments were 4.9% on long and short term borrowings, mainly from government, much less than market rates. Loss making SOEs like Air India, ITI, BSNL, MTNL, and others, lost Rs 27602 crores. There are large fund infusions for them on the anvil. Plan outlay on SOEs in 2011-12 is estimated at Rs 190794 crores. Market capitalization of 44 listed SOEs has been declining. Thus, SOEs contribute little to government finances and make frequent financial demands.

The specious argument is made that SOEs contribute to the Exchequer by way of dividends, various taxes, interest on loans, etc, (total of Rs 160801 crores), and employing 13.98 lakhs. Private enterprises can claim similarly.

The hold of the bureaucracy on SOEs, stifles them in procedures and approvals, destroying initiative, and preventing organic and inorganic growth. SOEs also encourage bureaucrats and politicians to cheat the country as has been evidenced by many scams (last year, from coal mine allocations, spectrum sales and now in giving away the country's entitlements in airlines). Money

invested by government in SOEs today would be better spent on building physical and human infrastructure.

The private sector has the entrepreneurs and managers, and capacity to raise funds. It could run SOE's more efficiently as is proven by those privatized by the NDA government. Abuses can be avoided by strict, independent (not Ministerial) regulation that is fair and consultative, transparent, and up to date on market developments. Both private owners and government representatives of government owners can be made to perform and to behave.

A spate of "disinvestments" has seen government selling small percentages of equity in some SOEs. But they do nothing to improve autonomy, entrepreneurship or transparency in governance of SOEs. "Disinvested" SOEs remain under bureaucratic control. The government representatives unlike private owners, have no stake to make the SOE efficient and profitable.

Preventing Ministerial and bureaucratic interference in SOEs, putting them under independent regulatory surveillance, appointing career managers to run them, and paying them well, can make SOE's perform well even under government ownership. Good 'corporate governance', and independent Regulators like RBI, SEBI, ICAI, Registrar of Companies, CERC, TRAI and others, can ensure more autonomy in SOEs. Experiments to distance government from managements of public enterprises have failed.

The principal reasons (apart from the heavy hand of the bureaucracy) for poorly performing SOEs has been the lack of a holistic management ethos, lack of innovation, poor research and development, and risk tasking.

Some SOEs may need to continue under the state. They must be freed from the bureaucracy. All others must be gradually privatized, not disinvested. Management control should go out of government hands.
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