DRAFT
Restricted Circulation

70927

PUBLIC ENTERPRISE REFORM IN ANDHRA PRADESH (1999 -2005)

Issues and Challenges

Rajni Khanna
Economist
Poverty Reduction and Economic Management (PREM), South Asia
The World Bank

May 2006

ACRONYMS

APPML	Andhra Pradesh Paper Mill Limited
DFID	Department for International Development
DIL	Digvijay Investments Ltd
GFCL	Godavari Fertilizers & Chemical Limited
GoAP	Government of Andhra Pradesh
GoI	Government of India
IS	Implementation Secretariat
PE	Public Enterprises
PED	Public Enterprises Department
PSE	Public Sector Enterprises
SC/BC	Schedule Caste / Backward Class
SLPE	State Level Public Enterprises

Acknowledgements

I wish to thank officials from the Government of Andhra Pradesh, particularly the Public Enterprise Department and the Finance Department for their continued interaction and discussions on the reform program. Special thanks to Ms. Janaki R.Kondapi, Principal Secretary, PED and her staff for their support and co-operation in undertaking this study and providing the valuable information. I would like to thank Kapil Kapoor, Sector Manager, Vinaya Swaroop, Lead Economist, Shekhar Shah, Economic Advisor and Anand Rajaram, Lead Economist, The World Bank for their very useful comments on this paper. Finally, I thank, Vidya Kamath, The World Bank for her assistance in putting this document together.

Table of Contents

Tables

Figures

1. **Structure of this note**: This note aims to document Andhra Pradesh's experience in reforming its State Level Public Enterprises (SLPE's) since the last seven years and the main issues going forward. The note is organized in seven sections. Section I discusses the backdrop of state-wide reforms, in particular public enterprise reforms, undertaken by the state of Andhra Pradesh in late nineties. This section lays the rationale and importance of the reform program in the light of deteriorating performance of PEs in the state. Section II discusses the approach taken by the government, the key element of which was "carrying all stakeholders along". The next section discusses the design of the program: a phased approach with all the essential building blocks like the legal and institutional structures, a social safety net program, a good communications strategy and factoring in environmental issues through audits upfront. Section IV and V discuss the implementation arrangements and the definitions of reforms respectively. Section VI documents the achievements and progress of the program under phase I and II in the last seven years. Section VII discusses the implementation issues; challenges faced during various stages of the program and the government's response to the same. The last section concludes with a review of key challenges going forward.

I. The Turnaround

2. **AP has made significant progress in its PE reform program**. Relative to other states, AP's PE reform program has been impressive and is becoming best practice in India, with a number of delegations from other states visiting AP to learn about its experiences. Like most other states, Andhra Pradesh had a large number of State Level Public Enterprises (SLPEs), many of which were making huge losses adding to the fiscal stress of the state. The state decided to embark up on a reform program which was well planned and executed. This resulted in a number of enterprises being closed, privatized, restructured or divested in between 1999 and 2006. As of February 2006, GOAP has privatized, closed, restructured or divested in 77 enterprises since the start of the program in 1999. Of these, 12 enterprises have been privatized, 24 have been closed, 32 downsized and restructured and another 9 divested in.

3. **A number of factors contributed to these achievements.** These were political support from the top, the creation of IS and its commitment to the program, the development of a TA program to build institutional capacity, and the early attention that was paid to developing a program to mitigate the social impact of reform.

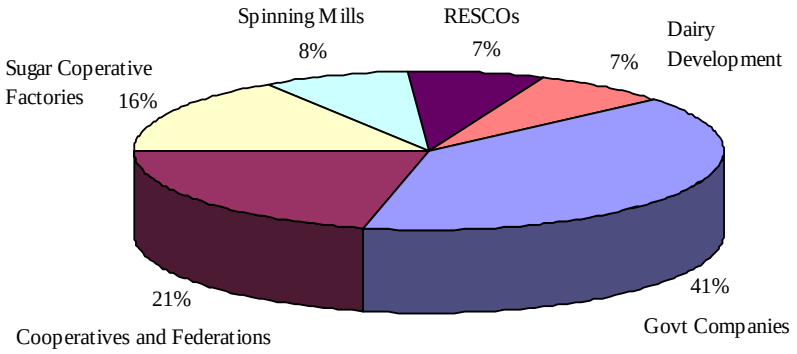
4. **Government of Andhra Pradesh's (GoAP's) state-wide reform program**: GoAP embarked on an impressive reform program in late nineties to foster economic growth and development through improvement of state's financial resources and introduction of sector specific reforms in many sectors of the economy. The government aimed to achieve a higher growth rate and improvement in the quality of life of its citizens by promoting efficiency and competition in all sectors of the economy. Government's commitment was to reduce the involvement of the public sector in economic activities and concentrate on good governance and provision of social services such as health and education. This paradigm shift involved restructuring/closure/privatization of state owned enterprises.

5. **Role of Public Sector in State's economy**: Historically the public sector has played an important role in the economic development both at the Central and State level. However, over

the years there has been a serious deterioration in the performance of many Public Sector Enterprises (PSEs), which today are proving to be a drag on the economy. State enterprises in AP (and other states) suffer from over manning and poor management and have become a vehicle for inefficient use of resources. Most enterprises seek assistance from the government through grants, subsidies, loans, deferment of interest/tax payments etc.

6. **Andhra Pradesh has the highest number of State Level Public Enterprises (SLPE's) in India:** The PE sector in Andhra Pradesh consists of 128 government-owned enterprises, including 60 cooperatives. Of these, 119 are wholly or majority owned by the government, while 9 are joint stock companies in which the government holds a minority share.

Figure 1: State Level Public Enterprises (SLPEs) in Andhra Pradesh

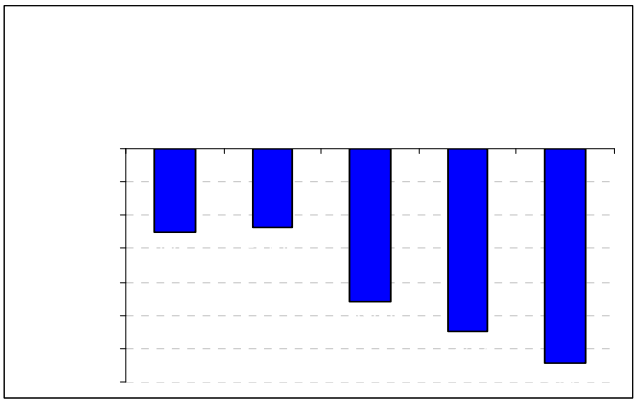


7. **Nearly half the PEs are loss-making:** 62 out of a total of 128 SLPEs in the state are loss making contributing to net accumulated losses of nearly Rs.3000 crores. States like West Bengal, Bihar and Kerala with fewer number of PEs have higher accumulated losses.

Table 1: State Level Public Enterprises: Select Indian States (March 2002/03)

State	Approx. no. of SLPE's	Approx no of loss making SLPEs	Net Accumulated Loss * (Rs crore)	No. of SLPE's privatized/closed
Andhra Pradesh	128	62	2919	51
Kerala	111	52	3510	10
Karnataka	85	30	1888	14
West Bengal	82	62	7062	0
Orissa	72	22	2372	20
Maharashtra	66	44	1775	0
Tamil Nadu	59	33	N/A	7
Bihar	54	12	5060	0

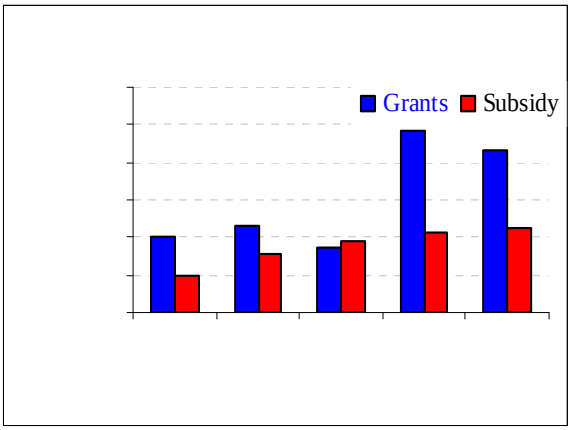
Source: Department of Disinvestment, GoI, website
* The figures indicated are only of those SLPEs which have finalised their accounts (could be as low as 25-30% of companies).



	Actuals				
	1996-97	**1997-98**	**1998-99**	**1999-00**	**2000-01**
Share Capital	3042	3155	4629	4947	5796
Loans	1822	2168	2266	4086	4914
Interest Accrued & Due	152	171	146	128	143
Grants	2029	2327	1753	4875	4338
Subsidy	991	1576	1897	2136	2244
Incentives	3	1	1	9	1
Current Liabilities payable to Govt	166	164	229	221	242
Outstanding Guarantees	6345	6890	8847	11783	14779
Contingent Liabilities on Govt	146	127	138	166	0
Other liabilities on Govt	0	0	0	0	0
State Govts Committed Resources	8205	9561	10921	16402	17677
Total State Govt's committed resources	**14696**	**16578**	**30828**	**28351**	**32456**

③ State Government's committed resources (share capital, loans, grants, subsidies etc.) to these enterprises have grown at a compounded annual rate of 21% from 1996-97 to 2000-01 (Table 2), accounting for nearly 13% of the Gross State Domestic Product (GSDP) in 2000-01. Further, there is a high correlation between increasing accumulated losses and resources being pumped in.

- Direct support like grants and subsidies alone increased from 3.4% of GSDP in 1996-97 to 5.6% in 1999-2000, coming down by a little less than a percent in 2000-01, the first year of the reform program.[1]
- Indirect support in the form of guarantees increased by 23% per annum. The energy sector cornered 63% of the guarantees[2], followed by 10% in the housing sector.



9. The finding of this study establish beyond doubt the imperative for reform of the public enterprises which despite increasing resource allocation were suffering huge losses year after year, straining the state's fiscal position. There was an urgent need to reverse this inefficient use of scarce resources and divert them to more productive sectors.

II. Design and Strategy

Process

10. **White paper on PE reform and Privatization:** While the need and rationale for public enterprise reform was well known; its translation into practical program required careful planning and execution. GoAP took a first step in this direction by documenting a draft strategy paper for privatization. The paper was approved by the Cabinet in February 2001 and subsequently discussed in the Legislative Assembly. The main purpose of the paper was to clarify GoAP's objectives and to state its policy intentions and strategy for continuing the reform program in a clear and unambiguous manner so as to build broad-based consensus and send a clear signal of government commitment to reform.

The paper highlighted the following key objectives for PE reform:

- To foster sustainable economic and social development and a competitive market economy that encourages investment, employment, and trade;
- To increase ownership, management and control of economic activities by the private sector;
- To withdraw government from commercial activities and reduce and eventually eliminate government financial support to commercial enterprises;
- To promote effective corporate governance, autonomy and accountability in enterprises in which government would retain interest;
- To bring in modern technology, management practices, accountability and private investment for value addition;

[1] Majority of the grants (91%) were issued to AP Transco. Civil Supplies and AP Irrigation Development. Similarly, 91% of the subsidies were issues to just one entity, the Housing Corporation.
[2] The guarantees issued to AP Power Finance Corporation not included. If included, guarantees to energy sector would be 81% of the total guarantees of GoAP.

③ To increase public expenditure in infrastructure, education, health and poverty alleviation efforts.

11. **State-wide consultation with all stakeholders:** The government was keen to develop a widely acceptable approach taking into account experiences of privatization elsewhere. The approach was to focus on maximizing the beneficial impacts of such a reform program and minimizing any short-term negative impact. The policy paper also provided guidelines for an open and transparent process, including detailed implementation procedures for privatization and closure, voluntary retirement program, and for dealing with environmental issues. The government conducted widespread consultations across all stakeholders through a series of workshops inviting comments/feedback on the program and seeking public understanding and support.

Essentials of a good design

12. **Initial reform efforts were ad-hoc and unplanned**: Initial reform efforts were started on an ad hoc basis in the early 1990s with the privatization of two units (refrigerator and auto) of Hyderabad Allwyn and the closure or merging of four smaller firms (Republic Forge, AP Scooters, AP State Essential Commodities, and AP Urban Development Housing). A Working Committee was set up in 1995 to examine the PE sector as a whole and make recommendations on the strategy and options for individual enterprises. The Committee carried out a large number of options studies which were submitted to the Cabinet Sub-Committee (CSC) for approval.

13. **What made AP's PE reform a success story?** In 1998, the government thought through the PE reform program in a systematic and sequenced manner. One can list at least five factors in the design of the program that made it's implementation successful. *First*, was to start the proram with a modest program; *second*, setting up of the required institutional and legal structures; *third*, designing the Social Safety Net Program (SSNP) for the displaced and offering a Voluntary Retirement Scheme (VRS) to employees in these enterprises; *fourth*, a good communications strategy and *finally*, an early program to take the environmental impact into account. All these important but often ignored ingredients contributed to making the implementation of the program less controversial and more acceptable to all stakeholders. These are discussed in greater detail below:

i) A phased approach

14. ***GoAP tested waters first through a modest program to overcome any teething problems.*** Based on the Committee's work and CSC approvals, a Phase I program was drawn up with the support of a multi-sector World Bank Project (Andhra Pradesh Economic Restructuring Project) in 1998. Phase I initially consisted of 12 small and medium enterprises, and was later expanded to cover a total of 19 firms. The initial list of firms included a mix of closed units (e.g. spinning mills) and ongoing corporations (e.g. Nizam Sugars Ltd, Irrigation Development Corporation), while the 7 units that were added later included spinning and sugar mills.

15. Phase II of the reform program consisted of 68 enterprises which were to be addressed over a period of five years (2002-2007). These consisted of 9 firms in which government planned to off-load its minority share holding through disinvestment; several manufacturing and trading firms where the private sector was firmly entrenched and the government's role was to be phased out (mostly cases for privatization); firms which are no longer relevant (cases for closures); and

the remaining enterprises that had both commercial and social obligations (cases for restructuring). The target was to address 15 enterprises each year.

ii) Institutional and Legal Structures

16. **Right kind of institutional and legal structures were put in place through donor grant funding.** The success of privatization and realization of benefits required changing the then institutional framework and legal structures in the state. A special Implementation Secretariat (IS) was created and housed in the Public Enterprises Department (PED). IS works under the supervision and guidance of the Principal Secretary of PED, who is also the Chairman of the IS. As a semi-autonomous entity, IS is staffed by local professional experts (in finance, law, media, labor) hired from the private sector. IS is responsible for implementing the PE program. A DFID funded technical assistance program was put in place to finance the costs of the local and foreign experts recruited to provide technical advice and manage consultant contracts of IS as well as of the social safety net program that was developed to provide training and redeployment services to affected workers.

iii) Reforms with a human face: Social Safety Net Program

17. **An excellent social safety program was designed to mitigate the social impact of reforms.** There are several stakeholders in the public enterprise system. Government defined stakeholder as someone who was directly affected as a major stakeholder, namely, employees, suppliers and consumers. The approach has been to ensure that the interests of workers and consumers are protected with minimum adverse impact. A SSNP was designed for displaced workers. This program has two distinct components: *One*, the Voluntary Retirement Scheme (VRS), which is essentially aimed at easing the impact of job loss by providing a severance package. *Two*, counseling and retraining for redeployment of the displaced workers so that over a period of time they can be reintegrated into the emerging labor market or become self-employed.

Voluntary Retirement Scheme

18. Government issued guidelines in January 1996 for a VRS based on the VRS program formulated by the Government of India (GoI) for Central Public Sector Enterprises. These guidelines have been amended from time to time. According to the scheme, an employee of a State Level Public Enterprise (SLPE) or cooperative institution with 10 or more years of service or 40 or more years of age, who has been identified as surplus, is eligible for VRS @45 days ex-gratia for every completed year of service, besides the terminal benefits as admissible to him/her. Employees who do not qualify for VRS would be given minimum compensation of Rs. 30, 000. Those who qualify but do not take VRS will be compensated under the Industrial Disputes Act.[3] Eligible employees have up to three months to exercise the VRS option and payment is made on a lump-sum basis within 60 days from the acceptance of VRS.

19. In January 1996 the State Renewal Fund (SRF) was created with an initial capital of Rs. 5 crores to provide resources for the financing of VRS as well as providing retraining and redeployment support.

Counseling, Retraining and Redeployment

[3] Equivalent to 15 days of wages for each year of service plus other legal dues.

20. This part of the program was put in place based on the results of a survey of 2000 workers to understand as to how workers use the VRS money discharged under phase I of the program. A program of counseling and retraining was designed for workers in areas in which they are interested and for which they are suitable so that they can find avenues in the emerging labor market. Some of the popular training programs include hotel management, driving, fashion design, e-commerce, CAD/CAM etc. Assistance is also provided for rehabilitating the retrained workers to find jobs in areas in which skills have been acquired. There are success stories both at an individual and group level of people who have been provided training/counseling.

iv) Communication Strategy

21. **A good information campaign put to rest a lot of fears about the PE reform program.** GoAP's communication Strategy, an essential and crucial element of the reform program, is aimed at proper dissemination of news and views relating to disinvestment and privatization, primarily through the print and visual media and through other publicity mediums like brochures and pamphlets. The program helps to shape public opinion on seemingly controversial issues through making available facts and figures involving the reform of any particular enterprise. Details of the activities undertaken by the IS, the SSNP etc. are published and disseminated periodically through the newsletter. One of the recent productions is a short film on privatization: "Face to Face" in English and Telugu. The film deals with different aspects of privatization and its impact on the life of various stakeholders. In March 2002, the web-site of PED was launched, reiterating GoAP's commitment of transparency in the PE reform process.

v) Environmental Audits

22. **Environmental safeguards were addressed upfront through mandatory environmental audit for each and every enterprise.** In order to address an environmental concerns relating to privatization of SLPEs, the IS ensures that as soon as an enterprise is cleared for privatization, an environmental audit is conducted to ascertain the existing and future environmental liabilities that may arise. The environment audit encompasses issues relating to land use, quality of surface and ground water (with potential contaminations), identification of aerial emissions and its impact on the atmosphere, compliance with various standards etc. It also includes raw-material, wastewater and waste disposal methods and health and safety aspects covering various facilities required for the safety of the workforce, etc. A copy of the audit report is made available to the registered bidders for their due diligence on environmental issues. The enterprise is asked to furnish Pollution Control Board's consent duly complying with the conditions if any before the enterprise is handed over to the purchaser.

III. Implementation Arrangements

23. Once the institutional arrangements in the form of PED, IS etc. were in place, it was important to work out the implementation arrangements for carrying out a socially and politically challenging program. GoAP followed the process bulleted below:

- ③ For any unit that has been identified for reforms, an options study is carried out with the help of professional consultants. The consultants present their findings with diagnosis of the nature of problem the unit is faced with, and give various reform options. In case the enterprise does not have any social or regulatory role to play or has outlived its utility, as per it's mandate, the option usually is to privatize or close it.

- Options study is discussed in series of meetings between the head of PED, the IS team, the concerned administrative departments and Managing Director of the enterprise to take into account the pros and cons of alternate options.
- The draft reform options, taking everyone's comments into account are then presented to the Cabinet-Sub-Committee[4] (CSC), which has been delegated powers by the cabinet. This committee goes into each of the options in depth.
- It is the CSC which takes the final decision keeping the technical, social and political situation in mind.
- Once a decision is taken, the chairman IS, the team of experts and specialists implement the same.

24. **Infusion of professional and technical expertise along with in-house expertise made the implementation arrangement less disputable and more credible**. The implementation process sailed through for most enterprises with minimum controversy as options presented before the cabinet were backed by technical and professional advice. Everyone involved directly or indirectly with the enterprise was consulted, their views documented and all positives and negatives were considered before any suggestions were made to the deciding authority. This made the whole process more objective and less politically driven.

25. **While a good implementation arrangement is necessary, it is the strong political support at the highest level that is a must for successful implementation.** Right through the reform process the then Chief Minister (CM) had reiterated his party's commitment to PE reform. This commitment was seen in cabinet's decision making, budgetary allocations for VRS and providing legal or other support needed to overcome bureaucratic or other delays in moving the reform process forward. The reform process slowed down for almost a year between the change of government at the state level. However, six month after resuming office, the present CM and ruling party stated that there would be no change in the pace or direction of the PE reform process.

IV. Closure Privatization/Disinvestment/Restructuring

26. The PE reform program has laid out four reform options for an enterprise that has been identified for reform, namely: closure/privatization/disinvestment and restructuring. However, how one defines each of these could vary from individual to individual or from one state government to another. This paper goes by government's definition of reform with a few caveats.

27. **Closure and Privatization less ambiguous than restructuring**: Closure and privatization are by and large clearly defined and both the achievement of targets and reform impacts can be relatively easily measured. Closure, for instance, is achieved when the company ceases operations, employees are paid VRS, and a liquidator is appointed. The impact can be measured as once a company is closed it no longer receives or should receive budgetary support. Similarly, privatization is achieved when the sale and purchase agreement is signed and assets are handed over to a private buyer. As in closure, the company should no longer receive government support and the economic impact can be measured in terms of efficiency and other improvements. In some cases where units have been classified as closed, it is recognized that the process of formal

[4] Which has now been replaced with a "Group of Ministers".

closure may take much longer as technically such unit would have to be removed from the books of registrar and Accountant General. In that sense there may be units which have been "substantially closed", which may be regarded as "closed" by the government. Similarly in cases where cooperatives have been classified as "privatized", these have in fact been sold as on-going business to private entities or government's equity has been paid back.

28. **Disinvestment:** GoAP has successfully disinvested in 7 listed enterprises. However, it may be useful to distinguish between those enterprises where it had management control (only 1, GFCL, see box 2), and those where it had only minority financial stake. This would help clarify "financial stake disinvestment" in all but one enterprise.

29. **Restructuring a grey area**: Compared to closure and privatization, however, restructuring is somewhat of a grey area and is less easily defined and its results are less easily measured. At present, restructuring is considered achieved by IS when, following CSC orders, the enterprise issues VRS orders and initiates the VRS process, and, in some cases, when smaller nonviable assets are sold by the corporation. While downsizing can be an important part of the restructuring process, it may not address the fundamental underlying problems of the enterprise. Other policies—such as mergers and rationalization, pricing policies, competition policies, imposition of hard budget constraints not just from governments but also from inter-corporate loans and financial sector, institutional changes—may be equally important, and it is not clear to what extent such reforms are included as part of the restructuring process. In some cases, particularly for enterprises with social obligations, broader sector studies might be needed to see if other instruments or policies more broadly—for example, housing or land policies—can be used to provide social support rather than using PEs as a vehicle in this regard. VRS payments for enterprises that are restructured (as compared to closed or privatized) can also be problematic in the sense that rehiring risks are greater, or that employment may increase again over the medium-term after downsizing takes place—both of which affect the returns on downsizing and the sustainability of VRS payments. The results of restructuring are also not so easy to measure. In terms of fiscal impact, for instance, the companies remain state-owned and may still continue to receive government support.

30. Given that 27 enterprises in Phase II have been restructured rather than closed or privatized, it is thus important that these be monitored closely and going forward: (i) there is a clear definition of restructuring put in place; (ii) that any VRS payments in the context of restructuring are clearly tied to a broader restructuring program that is undertaken to ensure that efficiency improvements are achieved and sustained; and (iii) that a system be established to ensure that employees who have taken VRS are not rehired in other PEs or the public sector more broadly.

V. Achievements and progress made to date

31. **AP has made significant progress in its PE reform program**. Keeping in mind the definitions in the previous section, as of February 2006, GOAP has privatized, closed, restructured or divested in 77 enterprises since the start of the program in 1999. Of these, 12 enterprises have been privatized, 24 have been closed, 32 downsized and restructured and another 9 divested in. A detailed summary by Phase I and Phase II is provided below, along with a preliminary analysis of fiscal impact and a discussion of the issues in related areas.

a) Phase I (1999-2001)

32. The Government initially identified a mix of 12 small to medium PEs and cooperatives to be closed or privatized between 1999 and 2001. Given implementation difficulties in some of the cases, the list of enterprises was subsequently expanded in 2000 to cover an additional 7 units (all sugar and spinning cooperatives), bringing the total number of units in Phase I to 19. Phase 1 implementation was supported by APERP through financing of severance pay, development of a social safety net for redundant employees, and strengthening of implementation capacity with a technical assistance (TA) program funded by DFID.

Table 3: Phase I Reform Program

S.no	Name of the PSUs	Privatization/Closure/ Restructuring	Total no. of Employees	No. of employees relieved under VRS	Amount released towards VRS (Rs. crores)
1	AP State Irrigation Dev. Corp	Restructured	2,540	2,101	34.3
2	AP State Agro Ind. Dev. Corp	Restructured	950	656	17.0
3	AP Small Scale Ind. Dev. Corp	Closed	509	509	7.1
4	AP State Meat Dev. Corp	Restructured	420	387	2.2
5	Allwyn Watches Ltd	Closed	2,100	2,100	29.9
6	Nizam Sugars Ltd	Privatised	5,250	3,527	67.8
7	AP State Textile Dev. Corp	Closed	184	78	2.4
8	AP Handcrafts Dev. Corp	Restructured	230	24	0.2
9	Rajahmundry Coop. Spg. Mills	Privatised	770	763	8.6
10	Nellore Coop. Spg. Mills	Closed	530	530	5.0
11	Adilabad Cotton Growers Spg.	Privatised	687	682	6.9
12	Nandyala Coop. Spg. Mills	Operations closed	483	483	1.9
13	Parchur Cotton Growers Coop. Spg. Mills	Privatised	414	414	2.8
14	Chirala Coop. Spg. Mill	Closed	468	468	5.9
15	Chilakaluripeta Cotton Growers Coop. Spg. Mills	Closed	543	543	1.7
16	Hanuman Junction Coop. Sugar Factory	Privatised	338	87	1.4
17	ASM Coop. Sugars	Privatised	458	224	1.6
18	Nandyal Coop. Sugars	Privatised	273	179	1.8
19	Nagarjuna Coop. Sugars	Privatised	238	229	0.9
	Sub-Total		**17,385**	**13,984**	**199.5**

33. Initially progress was slow. Frequent changes in the head of PED/IS, lack of clearly defined institutional responsibilities between PED and IS, lack of delegation in decision-making, the steep learning curved faced by IS, and teething troubles on the TA front were some of the factors that helped slow the process down. Political interference was also an issue. In some cases, decisions to close enterprises were revisited and postponed. In others there were delays in completing sales, or frequent re-tendering of units to achieve a higher price. Problems in the privatization of Nizam Sugars Ltd. (NSL), in particular, contributed to delays[5]. The case delayed

[5] After bids were received and evaluated for NSL's 8 units, an unsolicited non-compliant bid, which was inferior to the other bids, was received from Goldstone Ltd. (GEL). While CSC decided to re-advertise the units, the decision was reversed in favor of the unsolicited proposal. Cabinet subsequently decided to adopt a "Swiss Challenge" method of

the process substantially but in the end its resolution sent a strong signal of government commitment to maintaining transparency in the privatization process.

34. With the appointment of a new head of the IS in August 2001, and the subsequent resolution of the NSL case, the pace of the program picked up and Phase I was virtually completed. 18 of the 19 units have been closed, privatized, or restructured. One unit (Nandyala Cooperative Spinning Mills), which was to be privatized is stuck in a court case. However, operationally it has been closed, with VRS paid to all 483 employees. These 19 enterprises had 17,385 employees of which approximately 14,000 were given VRS, costing the ex-chequer nearly 200 crores.

35. Gross proceeds from the sale of enterprises and assets amounted to Rs.141 crores, of which Rs.94 crores were used to discharge liabilities of both secured and unsecured creditors. Net revenues were transferred to the SRF. Given the poor financial condition of PEs, the benefits of privatization are not expected to come in the form of revenues but rather in terms of savings to the government in terms of future expenditures as well as a reorientation of government's role away from productive activities and towards sectors of critical social importance.

36. Of the 14,000 people who were offered VRS under Phase I, nearly 9,000 were surveyed, 8,000 counseled and 5,500 trained under the SSNP. A little over one third (35%) of the people were redeployed.

Box 1: SSNP – Life after VRS ?

Meher Fatima working with Allwyn Watch Company was paid a VRS of Rs. 1 lakh after 12 years of service in 1998. She was provided training in fashion technology for six months through SSNP. In 2004, she is not only self-employed but also provides livelihood to eight other women at her fashion boutique. With an initial investment of Rs. 40,000 (out of her VRS proceeds), her entity is worth over 3 lakhs. The employees in her outfit save up to Rs. 10 to 20 per day under a thrift and credit scheme.

b) Phase II (2002-2007)

37. Phase II of the public enterprise reform program started in 2002 and consisted of 68 enterprises which were to be addressed during the next 4 to 5 years. This number has now increased to 71, with one enterprise (Voltas) where the government disinvested and two more enterprises, which were not in phase II[6] being brought into the ambit of reforms under phase II program. Interestingly, while the number of enterprises in phase II is nearly three and half times those in phase I (71 in phase II compared to 19 in phase I), the total number of employees involved is more or less the same (around 17,000).

38. Of these 71 enterprises, until March 2006, 58 have been closed/privatized/restructured or disinvested in. A target of 15 each in 2002-03 and 2003-04 and 14 in 2004-05 was achieved. In 2005-06, so far 14 enterprises have been addressed. Since the start of the program, 4 enterprises have been privatized, 18 closed, 27 restructured and another 9 divested in.

---

privatization in which GEL would be allowed to match a superior competing proposal in a fresh round of bidding. After considerable effort, and to ensure fairness and transparency, the IS obtained agreement that GEL would not be granted any special privileges in the bidding process. In April 2002, CSC approved Delta Paper Mill (DPM) as the preferred bidder in a joint venture with NSL. Subsequently GEL filed a case in the High Court alleging prejudice and bias in the process, but in August 2002 the Court dismissed all GEL claims and the NSL-DPM joint venture was allowed to proceed.

[6] Sugarfed and Girijan Co-operative Corporation

39. Gross proceeds from the sale of enterprises and assets amounted to Rs. 76 crores, of which Rs. 66 crores were used to discharge liabilities. In addition the government received Rs. 223 crores through disinvestment, almost all of which was used to discharge liabilities. Overall, total receipts from sale/privatization/divestment under phase I and II so far are to the tune of Rs. 441 crores of which Rs. 384 crores have been used to discharge liabilities. However, as mentioned earlier, the major savings of the PE reform program are in the form of future expenses that would have been incurred on these loss making enterprises in terms if infusion of equity, subsidies, grants and guarantees. According to one estimate based on a study commissioned by IS, GoAP would save close to Rs. 300 crore annually as a result of these reforms.

Table 4: Phase II Reform Program : A snapshot

Total number of enterprises in Phase II	68
Enterprises added later	3
No. of enterprises privatized	4
No. of enterprises closed	18
No. of enterprises restructured	27
No. of enterprises divested	9
Total number of employees before VRS	17663
Number of Employees after VRS	11326
Cost of VRS (Rs. Crores)	95.36
Gross proceeds from sale of assets (Rs. Crores)	299
Amt. of liabilities discharged (Rs. Crores)	290

40. VRS has been offered in 24 enterprises. While the total number of employees in phase II was 17,663, VRS was offered to only 6,337 employees a number much less than those in phase I. Also, the cost of VRS was nearly half (Rs.95 crores as compared to Rs. 200 crores) in phase I, as the number of units restructured under phase II was much larger.

41. Of the 6,337 people who were offered VRS under Phase I, nearly 1,700 were surveyed, 1,375 counseled and 936 trained under the SSNP. Again, nearly 40% of those trained were redeployed.

42. **Disinvestment a success story**: During the phase II reform program, GoAP disinvested in 9 enterprises mopping up Rs. 223 crores as divestment proceeds which went into the SRF. Most of these enterprises were making huge losses and were dependent on government subsidy.

43. While disinvestment in GFCL is an exemplary story, the overall disinvestment in seven listed companies was successful. Competitive bidding, appointment of professional valuers, and discharge of sales tax and other contingent liabilities by the state government, helped raise the confidence of bidders, resulting in sale prices which were much higher estimated prices. For example, in the case of Andhra Pradesh Paper Mill Ltd. (APPML), the share price of Rs. 131 per share paid by Digvijay Investments Ltd. (DIL), represents a sizeable premium over the then stock

market price of Rs. 110 per share[7]. Except in the case of GFCL, in all other cases GoAP sold its minority financial stake in the enterprise.

Box 2: GFCL disinvestment: A crowing moment for the AP PE reform program

Godavari Fertilizers and Chemicals Limited (GFCL) was set up in 1981 and started commercial operations in 1988. Unable to cope with the changing economic scenario including competition from the more established and efficient private sector, the company started running huge losses, becoming more and more dependent on government subsidy over the last 6 to 7 years. Faced with real threat of survival the company drew up a modernization plan that envisaged an investment of over Rs. 900 crores (including infusion of fresh equity by GoAP to the tune of Rs. 32 crores). GoAP decided to divest its shareholding in GFCL, in line with its policy and objectives of PE reforms.

The whole bidding process was transparent, fair and equitable to both domestic and foreign bidders. Five bidders, including two global fertilizer players[8] submitted bids to stake claim in GFCL. The bid process was under SEBI regulations, wherein unsuccessful bidders were prohibited from offering counter bids after the pronouncement of offer price for the mandatory public offer by the preferred bidder. Also included in the bid form was an escalation clause to enable GoAP to maximize the offer price in case the preferred bidder proposed to offer any higher price for the mandatory public offer.

Coromandel Fertilizers Ltd., a Chennai based company was selected as the preferred bidder. The whole process from tendering to signing of the sale-purchase agreement was accomplished in a record time of two months. The GoAP received Rs. 103 crores (Rs. 124 per share), approximately 12.5 times its initial investment. There is widespread agreement this sell off is in the interest of all stakeholders (customers, mostly farmers, the 2000 plus strong network of dealers and the employees of GFCL). This is perhaps the biggest state level privatization in the non-power sector in India to date, which due to its transparent and objective process won accolades even from the unsuccessful foreign bidders.

VI. Implementation issues: Challenges and Response to Challenges

44. The Government of AP faced a number of challenges which affected the pace and implementation of the PE reform program in the last 7 to 8 years. Some of these were:

- Initial adverse reactions from public at large to the privatization program for fear of loss of jobs and livelihoods.
- Non-cooperation and unnecessary delays by vested interests in updating of accounts and financial position of enterprises; valuation of assets, title verification and environmental audits.
- Dealing with unsolicited bids or unconventional bid processes like the “Swiss Challenge” (discussed above in the case of NSL).
- Cases stuck under Bureau of Financial Reconstruction (BIFR) in the case of sick companies.

[7] It was 6.5% higher than the price estimated through Discounted Cash Flow (Rs. 123 per share); 5.4% higher than estimated on the basis of industry price earnings ratio (Rs. 124); and 59% higher than the average yearly high/low (Rs. 82 per share).

[8] South African Government-owned Foskors Ltd. and Tunisian Government-owned company Groupe Chimique Tunisien (GST).

- Disputes in stock valuation.
- Host of problem in discharge of secured liabilities and statutory dues.
- Poorly informed or deliberate misinformed campaigns against the reform program.
- Time consuming Legislative Assembly questions.
- Constitution of House Committees to look into particular cases.
- Litigations and court cases.
- Long delays in winding up an enterprise due to a few illiquid, unmarketable assets.
- Difficulties in monitoring performance of enterprises that were restructured.
- Difficulties currently being faced in obtaining information from enterprises privatized on their performance.

45. Despite the above, the reform program has continued unabated. What made it possible? A host of factors including the following:

- Strong political commitment to the reform program by all ruling parties.
- A good institutional framework by way of creation of IS.
- Excellent leadership and efficient work allocation in the IS helped steer the program in the right direction in an effective manner.
- A good communications strategy: publication of the white paper on PE reforms, stakeholder consultation and information campaign on rationale and benefits of reforms.
- Transparency in operations and bidding process; successful dealings in processes like the "Swiss challenge" and other court cases.
- Strategy of Reforms with a Human Face: the SSNP with VRS and Counseling.
- Addressing environmental concerns through environmental audits before privatization.
- Technical Assistance for IS from DFID.
- Introduction of mechanism of Memorandum of Understanding (MoU) between GoAP and PSEs that were restructured to promote effective corporate governance, autonomy and accountability to sustain growth and competition.

VII. Key Challenges and the Way forward

46. **Phase III reform program:** Twenty-seven enterprises had been excluded from the Phase II action plan. These include large labor-intensive enterprises (such as AP State Roads Transport Corporation, Singareni Collieries) that are considered to have high political and social costs in terms of redundancies and where preparatory work will be required before private participation is feasible. Also excluded are enterprises with social obligations (e.g. Cooperative Bank, SC/BC Finance, Civil Supplies Corporation) or those with a developmental function that are likely to require restructuring. Together, this group of 27 enterprises, and largely a group of six or so enterprises within this group, accounts for the bulk of the budgetary burden, accounting for close to 85 percent of total government support to the PE sector in the last five years.

Table 5: List of Enterprises not included in Phase II action plan of PE Reforms

Name of the SLPE	Total number of employees	Percentage of employees
AP State Road Transport Corporation (APSRTC)	122737	52%
A P State Civil Supplies Corp Ltd.,(APSCSCL)	1439	1%
AP State Housing Corporation Ltd.,(APSHCL)	3495	1%
Singareni Collieries Company Ltd (SCCL)	97931	42%
Others (remaining 23 enterprises)	10160	4%
Total	**235762**	**100%**

47. In terms of employment as well, these enterprises have 2.3 lakh employees out of the total of 3.3 lakhs that were there before the start of the reform program. Even today 70% of the employees are in enterprises which have not been included in phase I or II. Of these 2 enterprises alone (APSRTC and Singhereni) account of 94% of the employment in these 27 enterprises.

48. Having established all systems (institutional set up, legal and financial expertise, social and political obligations and fiscal impact), the time is right for the government to move into the next phase of the reform program. Encouraged by the gains and experience of PE reforms in phase I and II, government is initiating the third and final phase of the program. Option studies and decisions thereof relating to the balance 27 enterprises will be undertaken over the next 2 to 3 years.

49. **Post closure formalities**: Even though 24 enterprises have been closed and workers paid VRS, there are a number of post-closure formalities which are still on-going. The IS monitors the work of the liquidators for getting the accounts updated for crystallization and discharge of liabilities etc. Complete completion of liquidation of these enterprises takes quite sometime and is likely to continue for a few years beyond the reform program.

50. **Dealing with pending and future legal challenges**: So far there are about 120 legal cases pending in different courts relating to PE reforms carried out so far. Monitoring and disposal of these is a daunting task. This requires a lot of time consuming paper work and preparation. This is done in close consultation with the Advocate General and other counsel for expeditious and favorable disposal of these cases. With phase III of the reform program, that is larger than both the phases I and II together, the magnitude of this is likely to increase and the department needs to seek legal advice on how to pre-empt and reduce the impact of this as the government moves forward.

51. **Monitoring the performance of restructured enterprises:** Some enterprises where the government would retain interest were restructured with the aim of promoting effective corporate governance, increased autonomy and better accountability. In the restructured enterprises, surplus staff were offered VRS and certain activities which were no longer relevant were gotten rid of. The IS has undertaken the task of signing MoUs with restructured enterprises, which will form the basis of monitoring their performance over the next few years.