UNIT: 3

DISINVESTMENT AND PRIVATIZATION

**What is Disinvestment?**

Disinvesting is a strategy by which an investor offloads or disposes of an asset or a partial stake in the asset. Disinvesting is an exit strategy that means taking out an existing investment. Disinvestment policies are commonly followed by governments to allocate resources more efficiently. For example, the Indian government recently announced that they will carry out disinvestment in BPCL, a government oil and gas subsidiary.

Disinvestment by the government means the market activity through which the Government conducts sale or liquidation of Government-owned assets. Such assets usually refer to the Government’s ownership stake in Central Public Sector Enterprises (CPSEs) and state public sector enterprises (SPSEs), but are not limited to that. Government assets also include project undertakings and other fixed assets.

### Why Disinvestment is done?

* Reducing the financial burden on the Government finances
* Opening up markets for private firms, which eventually leads to better capital markets and efficient allocation of resources
* Supporting the [liquidity](https://tavaga.com/tavagapedia/liquidity/) measures in the market by aiding to consumption and demand as the need arises
* Raise money to facilitate long-term Government goals of growth and development in the country
* Channelize resources to more productive avenues and projects by reducing the capital expenditures on existing non-performing assets or loss-making firms
* Improve the Return on Investment (ROI) of underperforming firms

**Types of Disinvestment:**

From a general point of view, the disinvestment in India can be categorized in the following manner:

1. **Organizing the market segment**: A company may disinvest in one of its underperforming divisions, as other divisions continue to deliver higher profitability while demanding similar resources and expenditure. Such a disinvestment strategy is to shift the focus of the company on the divisions performing well and to scale them up.
2. **Offloading unnecessary assets**: A company is cornered into adopting this strategy when the acquisition of an asset does not fit its long-term strategy. Companies post-merger are stuck with assets they do not intend to use. A company may choose to disinvest in acquired assets and instead focus on their competitive abilities.
3. **Social and legal considerations**: A company may have to disinvest if they cross a certain threshold limit in the market holding to enable fair competition. Another example is of an endowment fund pulling out of investments in energy companies given environmental concerns.

From a government point of view, the disinvestment strategy can be of the following types:

* **Minority Disinvestment**: The Government wishes to retain managerial control over the company by maintaining the majority stake (equal to or more than 51 percent). Because public sector enterprises cater to the citizens, the Government needs to be able to influence company policies to further the interests of the general public. The Government generally auctions the minority stake to potential institutional investors or announces an offer for sale (OFS) inviting participation by the public.
* **Majority Disinvestment**: The Government gives up the majority stake in a government-held company. After the disinvestment, the government is left holding a minority stake in the company. Such a decision is based on strategic grounds and policies of the Government. Typically, majority disinvestments are done in the favor of other public sector enterprises. For example, Chennai Petroleum Corporation Limited, formerly known as Madras Refineries Limited is a group company of Indian Oil Corporation after disinvestment by the Government. The idea is the consolidation of resources in a company which ultimately leads to operational efficiency.
* **Strategic Disinvestment:**The government sells off a PSU to usually a non-government, private entity. The intention is to transfer the ownership of a non-performing organization to more efficient private players in the market and reduce on the financial burden on the government balance sheet.
* **Complete Disinvestment/Privatization**: 100 percent sale of Government stake in a PSU leads to the privatization of the company, wherein complete ownership and control are passed onto the buyer.

**Disinvestment v/s Privatization**

Privatization is the partial or complete sale of Government-owned assets to a privately held firm or a group of individuals where the Government gives up majority control to the buyer of assets. Privatization can be done by:

* Stake sale of Government-owned equity in PSUs
* Lifting regulations restricting private participation in Government-regulated industries
* Offering public services contracts to private corporations
* Offering subsidies on various business activities

