

REPORT

XI

DISINVESTMENT COMMISSION

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Note: The Tables contained in this Report are based on information received from the Management of the PSUs and other sources.

Part A

1 GENERAL RECOMMENDATIONS

1.1 STATUS OF PSUs REFERRED TO THE COMMISSION

Government have so far referred 72 PSUs to the Commission out of which eight stood withdrawn, leaving 64 PSUs for examination by the Commission. Out of this, the Commission had given its recommendations in respect of 49 PSUs up to the X Report. With the present Report, the Commission has given its recommendations in respect of 53 PSUs. This leaves 5 PSUs (excluding six referred to BIFR) for examination by the Commission. The Commission is in correspondence with the Government regarding PSUs which are already referred to BIFR.

The list of PSUs referred to the Commission is given in Appendix I. The list of PSUs withdrawn from the Commission is given in Appendix II.

1.2 PROGRESS OF IMPLEMENTATION OF COMMISSION'S RECOMMENDATIONS

The Commission has so far submitted ten Reports to the Government covering 49 PSUs referred to it. The gist of general recommendations and action taken by Government on them is given in Appendix III. The modalities of disinvestment recommended in respect of specific PSUs and action taken by Government is given in Appendices IV and V. The following table indicates the action taken by Government on the recommendations of the Disinvestment Commission on individual PSUs.

Table 1: Action Taken[@] on Recommendations of Disinvestment Commission

Accepted	Decision Deferred	Decision Implemented	Decision being Implemented	Decision Awaited
1. RITES [^] 2. MOIL [#] 3. OIL [#] 4. ONGC [#] 5. SAIL [#] 6. NTPC [#] 7. NHPC [#] 8. PGCL [#] 9. NLC [#]	1. FACT 2. NFL	1. MTNL ^{& **} (May.97) 2. CONCOR [*] (May.97)	1. GAIL ^{**} (Feb.97) 2. KIOCL(Mar.97) 3. MFIL (Feb.97) 4. EPIL (Nov.97) 5. HTL (Apr.97) 6. EIL (Nov.97) 7. IPCL (Mar.98) 8. HCIL (Dec.97) 9. R.Ashok(Nov.97) 10. U.Ashok(Nov.97) 11. BALCO(Apr.97)	1. ET&T(Dec.97) 2. RIC (Dec.97) 3. NALCO (Mar.98) 4. HCL (Aug.97) 5. NEPA (Nov.97) 6. HZ L ^{**} (Dec.97) 7. PHL (Aug.97) 8. AI (Aug.98) 9. PPCL (Dec.97) 10. CEL ^{###} (Aug.98) 11. HVOC (Dec.97) 12. SCI (Aug.97) 13. IBP (Nov.97) 14. HPL (Nov.97) 15. HLL ^{**} (Mar.98) 16. ITI ^{**} (Apr.97) 17. BRPL (Apr.97) 18. MFL ^{**} (Apr.97) 19. ITDC ^{**} (Feb.97) 20. HSCL (Mar.99) 21. STC (Mar.99) 22. MMTc (June,99) 23. NMDC (June,99) 24. PPL(June, 99) 25. PEC(June, 99)

Note : Information given in brackets indicate month and year of the Commission's recommendations.

[@] As per information communicated by Government (As on 1st February 1999).

[#] Commission had recommended that disinvestment be deferred in these PSUs pending fulfilment of certain specified conditions.

[&] Implemented in December 1997.

^{*} Implemented in November 1998.

[^] The Commission had not recommended disinvestment in this PSU

^{**} Some decisions reportedly have been taken by Government in respect of these PSUs, but no formal communication has been received by the Commission

It would be seen from this Table that out of 49 PSUs for which recommendations have been made to the Government, decision is yet to be taken/communicated in 25 cases. Out of 29 cases of strategic sale/trade sale recommended by the Commission (Appendix V), decision is awaited in 18 cases.

Part **B**

MECON Limited

Evolution

Metallurgical & Engineering Consultants (India) Limited (MECON) started its operations in 1959 for self-sufficiency in consultancy and engineering services, as the first three Integrated Steel Plants (ISPs) of Steel Authority of India Limited (SAIL) were being set-up with foreign technical collaborations.

Due to its close association with the steel industry in its earlier years of operations, MECON has been able to develop a strong technological base and engineering capabilities in the steel sector. Initially, MECON's scope of work included design, detailed engineering, project management etc. for the various expansions which took place at the ISPs. In 1979, MECON expanded its range of services to include Engineering Procurement & Construction (EPC) work for the steel sector, to achieve forward integration from the consultancy activity. The company has also been undertaking small consultancy assignments for parties outside the country, mainly in the steel sector.

The company has its head-office at Ranchi, Bihar and has more than 20 construction and design offices in the country, wherein it maintains design / engineering staff capable of handling relatively small assignments on their own.

MECON's entire paid-up share capital of Rs. 2.42 crores is owned by the Government of India.

Business

From its initial business of technical consultancy, MECON has forward integrated into equipment supply business. In the year 1997-98, the consultancy business (including project management) contributed about 53% of MECON's operating income and the balance came from the equipment supply business.

MECON's largest sphere of activity has been in the Steel industry. It has engineered six integrated steel plants and contributed substantially to others. MECON has also expanded its areas of activities, covering non-ferrous metals, mining, refractory, power plants & energy engineering coal and chemicals equipment & systems design for rolling mills, processing lines, coke ovens, coke dry cooling plants, BOF converter, gas cleaning plants, blast furnace equipment and a host of other related industries.

The company's involvement in the non-ferrous sector has been in the areas of aluminium, lead, zinc, bauxite & copper mining, lead & zinc smelting & refining, silver recovery, gold mining & beneficiation, etc. Major activities in these areas are in the public sector, for which the company has been providing varied services to public sector companies like Bharat Aluminium Company Limited, Hindustan Zinc Ltd., Hindustan Copper Ltd., Bharat Gold Mines Ltd., National Mineral Development Corporation Limited, Kudremukh Iron Ore Co. Ltd., etc.

Consultancy Business

Consultancy services provided by MECON are in the nature of preparation of feasibility reports, conducting market surveys, preparing detailed project reports, assisting in site selection, carrying out detailed engineering, etc. These consultancy services are provided in the areas of steel, power, petrochemicals, oil and gas etc. EPC services are provided mainly in the steel sector. Services related to project management include civil, structural work, supervision, erection, etc.

There is a wide variation in the scope of the assignments handled, which range from the smaller sized orders such as feasibility reports and market surveys reports (order size ranging from Rs. 0.10-0.20 crore) to detailed engineering and design (which could have an order value as high as Rs. 100 crore).

By virtue of rendering consultancy in the steel industry for the last 40 years, the company has developed strong in-house design capabilities in the steel industry. Further, the composite nature of the ISPs (which comprises several aspects such as captive power plants, roads, coal handling plants) has enabled the company to gain experience in other areas also.

While historically, almost the entire consultancy business for MECON came from the steel industry (especially SAIL), the company has made attempts to diversify its revenue base. However, still around 60-70% of the revenues comes from the steel industry. Within the non-steel sector, most of the orders procured by the company are relatively small in comparison to the orders the company has been getting in the steel sector. The typical order size in the non-steel sector is less than Rs. 1 crore. The penetration has been slow mainly because the respective fields already have well entrenched strong players such as Development Consultants in Power, Engineers India Ltd. in Petrochemicals, etc.

The order book size as on December 31, 1998 is about Rs. 275 - 280 crores, out of which the steel sector is expected to contribute Rs. 135-140 crore. This highlights the high dependence of MECON's consultancy business on the steel industry. However, in the medium to long term, as the company's reference list strengthens, the revenue diversity is expected to improve from the existing levels. It also needs to be noted that, while the current order book size appears to be comfortable, revenue generation out of the same could take time, given the slowdown in the economy.

Most of MECON's consultancy business is Indian based and the foreign consultancy business is comparatively insignificant. Most of the foreign consultancy carried out by MECON is in developing countries such as Saudi Arabia, Iran, Indonesia, Nepal, Nigeria, etc.

MECON's major competitors in the consultancy business are listed below:

Table 1 : Competitors in the Consultancy Business

Area	Competitors
Metals	M. N. Dastur & Co.
Petrochemicals	Engineers India Ltd. (EIL), Humphrey Glass
Power	Development Consultants, Desein, Tata Consultancy Services (TCS)
Roads	Consulting Engineering Services (CES), Rail India Technical Engineering Services (RITES), TCS
Ports	CES, RITES, EIL, Howe India.
Software	TCS, Wipro.

In the steel sector, MECON's major competitor is M.N. Dastur & Co. Among the two players, there has historically been a demarcation in the clientele among the ISPs and the private sector. MECON has traditionally been strongly positioned with the ISPs at Durgapur, Bokaro and Bhilai. In the other areas, the competition is well entrenched and MECON's entry has been slow.

The company has tied with the following foreign parties in various areas for the consultancy business:

Table 2 : Foreign Tie-Ups in the Consultancy Business

Foreign Party	Area of Tie-Up
Davy Distington, England	Process Control in Automation Industries
Central Engineering & Research Inc., China	Pulverised Coal Injection in Blast Furnace
Zeemag, Germany	Material handling for TNEB
White Industries, Australia	Coal Washery
Haskoning, Netherlands	Ports
BKH, Netherland	Environmental

Outlook for Consultancy Business

A demand-supply gap exists in the infrastructure sector. This could act as a demand driver for the consultancy services. Demand is likely to arise in the infrastructure areas such as power, roads, ports, refineries, etc. The company is yet to create a strong presence in the infrastructure areas.

The consultancy industry is characterised by strong entry barriers such as an established presence, a strong reference list and longer experience. In the long term, the large players with track records are likely to dominate the market. While this factor would be positive for MECON as far as the steel industry is concerned, it could work negatively in case of other sectors.

The sustained slowdown in demand and the strained liquidity position of most of the end consumers has led to stagnation in orders in the past. This has made the market increasingly price sensitive, thereby impacting the margins of most of the players. In the short to medium term, this scenario is likely to continue.

Supply Business

MECON entered the equipment & systems design and supply, for rolling mills, coke ovens, coke dry cooling plants, chemical plants, blast furnaces, BOF gas cleaning plants and continuous casting plants in the Early Eighties as a forward integration of their consultancy and project management services. This has in turn helped the company to enter into

Lump Sum Turn Key (LSTK) business.

Typically, in LSTK jobs, MECON arranges for equipment by contracting the same to sub-contractors, for which the company receives advance from the client for sourcing the equipment. The company takes responsibility for commissioning the project as per schedule and as per agreed parameters.

MECON's strong presence in the steel sector has helped it to enter the supply business, especially in the areas of rolling mills and coke oven batteries employed in the steel plants. This has enabled it to build a strong reference list as compared to other players. While among the private sector, the other players are likely to have comparable market shares, the company has a definite edge within the Durgapur, Bokaro and Bhilai steel plants.

While historically almost all of the supply business for MECON came from the steel industry (especially SAIL), the company has made attempts to diversify its revenue base. The business has gradually improved its customer diversity. It has been able to procure relatively small sized projects in the areas of copper, aluminium and zinc besides oil and gas, power plants, materials handling, chemical plants, gas cleaning plants etc.

Recently, MECON, in consortium with Zeemag, Germany and Mukund, India, was awarded a turnkey order from Tamil Nadu Electricity Board (TNEB) valued at about Rs. 241 crores. The order involves setting up material handling facilities, for TNEB's own plants, involving design, engineering, civil works, supervision, erection of structure and equipment supply. The order is significant for MECON both in terms of value and in respect of entry into a non-steel sector.

Of the balance order position, about 63.41% is from the non-steel sector. Within the steel sector, SAIL constitutes the largest portion of the balance order position. Thus, while, the company's dependence on the steel sector is still on the higher side, its attempts to diversify have received a boost with the TNEB order for material handling.

It needs to be highlighted that, in the supply business, payment terms from the customers are typically less favourable as compared to those in the consultancy business. Further, gross margins in supply businesses vary substantially from job to job. The supply business therefore has extreme variability in earnings. On the average, the gross margins are of the order of 7-8%.

The ratio of manpower deployed in supply business to the ratio of manpower deployed in consultancy business is about 20:100. Preliminary estimates suggest that the supply business is comparatively less profitable at the operating level.

The income from the supply business has been in the region of Rs. 80 - 100 crores (45 - 50% of Operating Income) during the last four years (except in 1995-96). In 1995-96, there was a substantial spurt in income from the supply business on account of equipment supply for a continuous casting project for Rourkela Steel Plant (RSP).

The major competitors to MECON in the Supply business are listed below:

Table 3 : Major Competitors in Supply Business

Area	Competitors
Steel	SMS, Demag, Hitachi, Kawasaki, Nippon, L&T, Mukand
Coke Ovens	Auto India, Krupp
Blast Furnace	Demag, TPE (Russia)

While the company has strong engineering skills in areas related to steel, the company has followed the strategy of tying up with international players in specific areas for projects in other sectors. At present, the company has entered into a number of MoUs / Collaborations. Some of the major foreign tie-ups are listed below:

Table 4 : Foreign Tie-Ups in the Supply Business

Foreign Party	Area of Tie-Up
Biazzi SA, Switzerland	Chemicals – RDX
Sumitomo Chemical Engineering Company, Japan	Petrochemicals – Butane
Giprokoks, Ukraine	Coke oven battery
Zeemag, Germany	TNEB material handling assignment

MECON is presently facing difficulties in prequalifications in LSTK tender, as it does not have significant track records in the business and it also does not have adequate financing capabilities to take an equity stake

in the projects, as is the current practice.

MECON has requested Government to infuse equity of Rs.150 crores in it to enable it to take a stake in the projects.

Outlook for Supply Business

The sustained slowdown in the economy and the strained liquidity position of most of the companies would impact the margins of most of the players, as in the consultancy business.

Turnkey projects by their very nature involve some risks. Typically, these projects involve payment of liquidated damages for deviation from project parameters and schedules. For successful execution of large turnkey projects, strong linkages in respect of technology, contractors / vendors and finance are required. Further, most large turnkey projects are awarded on the basis of competitive bidding, which requires sharp skills and strong tie-ups. Hence MECON's future business potential in this area would depend on its tie-ups and development of its capabilities.

Additionally, in the contracting / turnkey projects, the payments from customers are received only upon completion of certain milestones during which time a portion of the financing has to be done by the contractor. This coupled with the frequent delays in payments from the clients could lead to negative cash flows for the contractors for some periods of time.

A number of multi-national equipment suppliers and EPC contractors like Bechtel, ABB, Siemens, General Electric, etc., have entered the local market or are in the process of doing so. This is likely to result in a higher competitive pressure on MECON's supply business. Further, these EPC players are also willing to invest in the equity of the project, offering a strategic advantage over MECON.

Financial Analysis

Table 5 : Key Financial Figures of MECON Rs. Crores

	FY 98	FY 97	FY 96	FY 95	FY 94
Total Income	185.8	211.8	272.4	206.7	138.7
Non-operating income	7.87	10.92	12.21	9.28	8.26
Operating Profit	-7.06	-1.03	0.60	-3.45	0.47
PAT	1.6	8.3	10.2	5.4	7.1
Equity Capital	2.42	2.42	2.02	2.02	2.02
Tangible Networth	103.6	102.9	95.5	86.0	81.5
Gross Margin (%)	-3.8	-0.5	0.2	-1.6	0.3
Net Margin (%)	0.9	3.9	3.7	2.6	5.1
ROCE (%)	4.3	13.0	12.4	11.5	12.6
RONW (%)	1.6	8.1	10.7	6.3	8.7
Earning Per Share	6.69	34.38	42.27	22.27	29.13
Dividend (%)	22%	30%	40%	40%	40%

The company's turnover has varied significantly in the last five years. This is on account of the nature of the industry in which the company operates. Further, in 1997-98 the company's sales declined both in the consultancy as well as in the supply business. This was due to a slow-down in the economy and, in particular, in the steel industry, on which the company is heavily dependent.

For a company operating in an industry with widely varying turnover, the company's cost structure has contributed to its losses. The company has extremely high employee expenses, owing to which it has been making operating losses in the past. The employee costs comprised 43.6% of the operating income in 1997-98, an increase from 34.6% in 1996-97. While the large employee strength enhances the company's operating flexibility, it has also significantly impacted its cost structure.

The Net Profit Margin of MECON has decreased consistently from 5.1% in 1993-94 to 0.87% in 1997-98. In all the years, MECON has been able to show a positive profit after tax largely on account of the considerable non-operating income and cash adjustments.

The company's operations are highly working capital intensive, as is evident from the high level of receivables and payables. The working capital intensive nature of the company's operations can be attributed to the turnkey projects, in which the payments from customers are received only upon completion of certain milestones, and the current difficult liquidity position of the public sector clients of MECON.

Strengths and Areas of Concern

Strengths

Good domestic track record in the steel sector – The company has been operating in the steel sector for about forty years providing a formidable exposure to the technical issues in the sector

Proximity to PSU clients – The PSU nature of MECON and its past relationships position it competitively for business from its PSU clients

Experience in Lumpsum Turnkey jobs – As the activity in infrastructure and industrial sector increases, MECON's past experience as LSTK contractor, though limited, is likely to benefit MECON in procuring business

Large pool of qualified technical manpower – MECON's large pool of technically qualified and experienced professionals (more than two-thirds of the total employees) provides it an opportunity to consolidate in the existing business segments and enter new areas

Areas of Concern

Inadequate commercial orientation – In the current scenario of increasing competitive pressures lack of commercial orientation would further severely impact the viability of the organisation

High Average Age – This could result in a top management vacuum in three years' time

Locational disadvantage – Most of the existing and potential clients are located at metro locations and hence location of the largest operating base at Ranchi imposes logistical constraints especially in business development efforts

Adverse cost structure – High fixed costs result in consistent operational losses and declining net margins

Inadequate financial capacity and information systems – Essential in the consultancy business and also in the LSTK jobs

Excess manpower – The employee expenses, for a high employee base of about 3260 employees, take away a very large portion of the Operating Income resulting in losses at operational level

Recommendations

As can be seen from the above analysis, MECON has in the past played a major role in providing engineering consultancy support to the growth of steel industry in the country. However, the recent changes in the economy,

including the downturn in the steel industry, require a long-term business strategy that would enable it to build on its current strengths and complement them through strategic partnership, with other capabilities to cover areas of weakness, so that it could benefit from emerging opportunities and combat the competition of global consultancy and LSTK companies.

Another dimension of MECON that has emerged from the analysis is its strong manpower base. It has a large pool of qualified technical manpower. This pool is likely to be the target of new players, particularly the international consultancy companies and MECON has to address HRD with positive measures, building up employee loyalty and commitment.

The field of consultancy services and LSTK contracts over the years has become increasingly competitive with the entry of a large number of Indian and international companies. **Hence, the Commission is of the view that a consultancy company operating in a ‘non-core’ steel sector should be classified as non-core.**

There is a need to view the disinvestment in the case of MECON from the standpoint of strengthening MECON as an important domestic consultancy company which has played a prominent role in the industrial growth of the country and is seen to have a similar role in the vital infrastructural sectors in the future. MECON would, however, need to complement its strength in the area of trained technical manpower with access to better technology and finances and LSTK capabilities, if it has to successfully face competition from a large number of players, both domestic and international.

The Commission, therefore, recommends strategic sale of a minimum of 51% equity stake in MECON along with appropriate role in the management. A strategic partner would be able to add to MECON’s strengths in terms of technical consultancy and project management particularly LSTK capabilities, global acceptance and access to international funds, without, at the same time, eroding its strong domestic brand equity. This would also aid MECON in entering the non-steel and infrastructure sectors. The selection of the strategic partner should be done on the basis of global competitive bids from a set of pre-qualified bidders. Simultaneously, suitable reduction in manpower through VRS should be undertaken.

In the event of inadequate interest in the equity stake in MECON, the government would not have any other option but to close the company in view of the poor prospects of viability of the company in its current structure and positioning.

MSTC Ltd

Evolution

MSTC Limited was incorporated in 1964 as The Metal Scrap Trading Corporation Limited and its name was later changed to MSTC Limited. The company is a Government of India public sector enterprise under the administrative control of the Ministry of Steel and Mines.

The company was set-up with the primary objective of regulating the exports of surplus metal scrap arising in the country after meeting domestic demand. During the late 1970's, MSTC was made the sole canalising agency for imports of scrap (mild steel, stainless steel, high speed steel, and re-rollable scrap), with a ban on direct imports by private parties.

Currently, 90% of total shareholding is held by GoI, 3.77% by various Indian companies, 0.91% by Visveswaraya Iron and Steel Limited, and 5.47% by various individuals.

Business Analysis

MSTC is divided into three divisions, namely, the Foreign Trade Division (FTD), Domestic Trade Division (DTD) and Exports Division.

The FTD has been mainly involved in importing ferrous scrap in addition to small quantities of finished steel items. However, in the current year, owing to reduced scrap imports, the company has commenced import of other items like furnace oils and slab iron casting, among others.

The DTD is involved in domestic trading of both ferrous and non-ferrous scrap, while the Exports Division is not doing any business at present.

Table 1 : Division-Wise Volumes Traded and the Gross Margins

Traded Sales (Rs. Cr)	1997-98	1996-97	1995-96	1994-95	1993-94
FTD	14.21	97.40	134.06	165.77	143.27
DTD	497.83	440.37	399.67	288.39	240.00
Exports	-	0.22	3.39	7.04	1.03
Total	512.04	538.00	537.12	461.20	384.30
Gross Margin					
FTD	2.27	1.89	2.23	6.55	4.38
DTD	7.16	6.61	6.15	4.43	4.00
Exports		0.01	0.13	0.26	0.06
Total	9.43	8.50	8.51	11.25	8.44

The volumes traded through FTD have been fluctuating in the last four years, while the volumes of DTD have been increasing steadily.

Consequently, the share of DTD in the overall business has shown an increasing trend, from 42% in the year 1992-93 to 75 % in the year 1995-96. However, since historically the margins of DTD have been much lower than those of FTD, higher share of DTD in total business has resulted in lower overall profitability for the company.

Foreign Trade Division

During the late 1970's MSTC was made the sole canalising agency for imports of scrap, with a ban on direct imports by private parties. This rendered monopoly status to MSTC in imports of scrap. The customer base of FTD comprises of the secondary steel producers and Electric Arc Furnace (EAF) / Induction Furnace (IF) units etc.

The traded volumes of imports of scrap witnessed a substantial increase in the 1980s under the canalised era with rapid growth in the EAF and Induction furnace units, and the turnover of FTD from imports peaked at Rs. 700 crores in 1989-90.

However, on account of decanalisation of imports of scrap in February 1992, the imports of MSTC decreased sizeably thereafter as many of its customers started importing scrap on their own. Further, on account of the recession in the steel industry and closure of large number of Electric Arc Furnaces, the volumes of import decreased to zero by 1997-98. The larger players have moved towards integrated operations with increasing dependence on sponge iron/DRI/pig iron.

The reduction in import of scrap was also precipitated by the difficulty in recovery of receivables from some of its customers. Consequently, on account of the adverse market conditions and its bad experience in the past, the company decided to stop importing ferrous scrap since 1997-98. In recent times, the company has ventured into the import of steel related items like CR/HR Coils, HMS, pig iron and trading in other unrelated commodities like SKO/furnace oils, iron castings etc.

The counter measures taken by MSTC include Enhanced Credit measures, sale against Post Dated Cheques (PDC) instead of LCs/ Guarantees, venture into stockyard sales as against high-sea sales and diversification into new areas.

The gross margin of FTD had been declining after decanalisation with increasing dependence on other finance income vis-a-vis business.

In future, the scrap import turnover is expected to be low/negligible. The diversification into non-traditional areas may not be sustainable due to high degree of competition, MSTC's limited experience and lack of autonomy & slow decision making.

Domestic Trade Division

The Domestic Trade Division was formed in 1975-76, and its role was primarily to act as an agent to dispose off scrap from the four plants of SAIL viz. Rourkela, Bokaro, Bhilai and Durgapur. The volume of scrap handled at that time was around Rs. 20-30 crores. However, when MSTC got delinked from SAIL in 1982, it started providing scrap-disposal services to other entities such as government departments, the defence sector, etc.

The main business of DTD is to trade scrap (both ferrous & non-ferrous), stores, consumables & other disposable items. This division is also involved in marketing of various steel items like pig-iron, semis (ingot, blooms etc.) & finished products (longs & flats). Ferrous items, Non-ferrous item and Misc. items comprise about 80%, 15% and 5% of the division's turnover, respectively.

The main clients of the company are various PSUs and government bodies, such as ISP's in the government sector, various PSU's government departments like Ministry of Defence, Ordnance factory board, Ministry of Home affairs and State Government departments like SEBs, State Transport Corporations etc.

By virtue of MSTC's status as a PSU, as well as owing to the experience it has gained over the years in scrap disposal, MSTC has been getting substantial business from these bodies on a regular basis.

The company disposes scrap either through tenders / auctions / tender-cum-auctions, as explained below:

- ***Fixed price sale*** is typically held for homogenous materials like steel skulls and other homogenous scraps generated from steel plants. In these cases, MSTC arranges for a buyer for the scrap at a mutually agreeable price. For conducting these sales, MSTC charges a fixed amount of commission which typically works out to be in the range of 0.3% to 0.5% of the sale value.
- ***Auction /tender/tender-cum-auction sales*** are the more common type of sale agreements, and are typically organised for other non-steel plant

customers, as well as for non-homogenous scrap generated by steel plants. Here, MSTC merely acts as an agent to conduct auctions or announce tenders, on behalf of the selling company. The commission is linked to the value of the sale, and varies between 1.75% to 2.5%, depending on the seller.

In all the arrangements, MSTC acts as a mere agent and bears no risk of price fluctuations or non-selling of the items.

Increasing competitive pressure has resulted in declining spreads for the company. Margins of this division have remained low, but steady over the years, at around 1.5% of the value of domestic trade. While the margins from these operations are very low, the company is able to generate income indirectly, such as through interest earnings on earnest money deposits from the prospective buyers, etc.

The future prospects of DTD are expected to be adversely affected by the following factors :

- Reduction in scrap generation with better steel production efficiency & completion of the modernisation by many steel plants
- Continued low margins due to low importance accorded to the function – the customers have not been switching agents due to low importance accorded to the function of scrap disposal
- Negligible presence in the private sector

Financial Analysis

Profit After Tax (PAT) of MSTC has declined from Rs. 5.25 crores in 1994-95 to Rs. 1.79 crores in 1997-98, as MSTC, being a trading outfit, operates on very low spreads leaving little buffer for absorbing any event risk. Additionally, the company has relatively high fixed cost on account of its expenses on employees and administration. The company's employee cost has more than doubled from Rs. 2.42 crores in 1993-94 to Rs. 5.35 crores in 1997-98.

Table 2 : Financial Highlights

(Rs. Crore)

	FY 98	FY 97	FY 96	FY 95	FY 94
Total Income	26.09	109.23	147.82	183.46	151.88
Operating Profit	0.86	3.40	1.77	6.85	4.74
PAT	1.79	2.26	1.34	5.25	4.76
Equity Capital	2.2	2.2	2.2	2.2	2.2
Tangible Networth	50.97	49.62	47.8	46.9	42.3
Gross Margin (%)	3.3%	3.1%	1.2%	3.7%	3.1%
Net Margin (%)	6.9%	2.1%	0.9%	2.9%	3.1%
ROCE (%)	6.1%	8.9%	5.4%	24.1%	12.3%
RONW (%)	3.5%	4.6%	2.8%	11.2%	11.3%
Earning Per Share	0.81	1.03	0.61	2.39	2.16
Dividend (%)	20.0%	20.0%	20.0%	30.0%	17.7%

In line with the declining operating income and trading margins coupled with high level of fixed overheads, MSTC has been showing a loss at the OPBT (Operating Profit Before Tax) level in the past three years, the OPBT / Operating Income standing at a level of (-) 2.6% in 1997-98. The company has managed to show profits as the PAT level on account of the considerable non-operating income in the last three years, which stood at a level of Rs. 3.5 crores in 1997-98.

The company has receivables of around Rs 42.9 crores as at March 31, 1998, out of which Rs 40.85 crores has been overdue for over 6 months. The high receivables levels are mainly on account of the 'Post Dated Cheque transactions' mentioned earlier, as well as old debtors, where litigation is involved. Recovery of the above overdues seems difficult over the short-to-medium-term on account of the poor financial position of most of the defaulters, as well as long drawn out court procedures.

MSTC has a 60% equity stake in Ferro Scrap Nigam Limited (FSNL) with Harsco Corporation, USA holding the balance equity. The book value of this equity stake, as on 31 March 1998, was about Rs 45 crores.

Strengths and Areas of Concern

Strengths

Over 30 years Experience in the trading in the Metal Scrap.

Reasonably Wide Network of 10 regional offices and branch offices. Additionally, the company has also been able to build an extensive network of business contacts both within the country, as well as abroad.

Areas of Concern

Low future business potential and profitability – The future turnover and the profitability is expected to be low on account of reduced opportunities in traditional businesses, limited experience in non-traditional businesses and increasing competitive pressure

PSU Nature - Inability to respond fast to opportunities in the trading environment on account of government procedures

High Level of Receivables – An amount of Rs 42.9 crores, nearly 80% of the Networth, is locked in unrealisable debtors.

High Dependence on Government and PSUs for business

Low Margins – MSTC has incurred loss at the OPBT (Operating Profit Before Tax) level in the past three years and the company has managed to show positive PAT on account of the considerable non-operating income.

Recommendations

It is to be noted that State Trading, which was widely prevalent at one time, has been gradually phased out in most countries. This has led to loss of significant market opportunities for the government-owned trading companies in India. **The Commission feels that no public purpose would be served by MSTC being under the government ownership and control. Hence the Commission classifies MSTC as non-core.** Further, its viability as an enterprise under government ownership and management is doubtful.

MSTC has discontinued dealing with trading of scrap on its own account. MSTC is a large player engaged in the disposal of scrap and has a well established client base, it is likely to continue to get business from its

existing clients. However, given the low importance accorded to the scrap disposal function and the increasing competitive pressures, the profitability for this division is likely to be low. Also, the overall size of this market is expected to shrink, and consequently, the business at current levels may not be sustainable.

Additionally, the operations of the company are unprofitable, and it is on account of non-operating income that the company has been able to show profits. The business and financial outlook for the company in future therefore, appears to be bleak.

Given that the role played by the company could be easily performed by the private sector and that the government has no meaningful rationale for continuing in the business of scrap trading/disposal, **the Commission recommends sale of 100% GoI holding in MSTC alongwith MSTC's holding in FSNL.**

In case there is no investor interest in the company, the Commission of the view that there would be no option but to close down the operations of MSTC and liquidate all its assets and liabilities. In order to part finance its cost of closure, MSTC should also disinvest its stake in FSNL in favour of a strategic buyer.

Mineral Exploration Corporation Limited

Evolution

Mineral Exploration Corporation Limited (MECL) was established in October 1972 for planning, organising and executing time-bound mineral exploration programmes in the country. It became a Public Limited Company in July 1975 and it is under the administrative control of the Ministry of Mines. Prior to MECL, Geological Survey of India (GSI) was the sole agency for carrying out exploration work in the country, except for coal where exploration was carried out by Central Mine Planning & Design Institute Ltd. (CMPDIL), a subsidiary of Coal India Ltd., and Singareni Collieries Company Ltd. (SCCL). To give a commercial bias to mineral exploration and to bridge the gap between initial discovery of a mineral prospect and its eventual exploitation, functions such as detailed mineral exploration, equipment and personnel were transferred from GSI to MECL. The equity capital of MECL is Rs. 63.8 crore and is 100% owned by Government of India.

Industry Analysis

India has been endowed with a wide variety of mineral reserves. There are over 20,000 known mineral deposits and 84 minerals being mined with an aggregate annual production of about 500 mn tonnes. Mineral production in the country has increased from Rs.700 mn in the 50s to over Rs.330 bn in FY'97. Mineral resources are non-renewable and therefore, call for vigorous exploratory efforts for the discovery of new mineral deposits. This assumes a greater significance in a country like India which is a net importer of minerals and metals and is expected to remain so.

GoI has been taking steps towards the development of mineral resources through policy initiatives. The first attempt for development of minerals was the enactment of Mines and Minerals (Development and Regulation) [MMRD] Act of 1957, which essentially evolved from the Industrial Policy Resolution, 1956.

In March 1993, GoI announced a new "National Mineral Policy" (NMP) whose main objective was to develop mineral resources taking into account national and strategic considerations and to ensure their adequate supply, keeping in view the present needs and future requirements. To this end, the policy entrusted the State with responsibility of playing a more active role for mining and processing of minerals, either on its own or through private sector participation.

Subsequently, in January 1997, GoI announced relaxations in equity participation by foreign companies in the Indian mining and exploration sector, to encourage flow of foreign investments. The new policy encouraged private initiative and investment, both domestic and foreign. A number of foreign exploration and mining companies came to India. However, even after five years, most of these projects are yet to take off. This is because State Governments have not displayed the same kind of zeal and enthusiasm as was expected of them by the NMP. In most of the states, prospecting licenses (PLs) are yet to be awarded as there has been no clear-cut policy by the state governments regarding grant of licenses, evaluation of applications and clearances required. Further, states like Andhra Pradesh and Madhya Pradesh have reserved areas in favour of their state Corporations to carry out exploration.

So far the primary responsibility of development of basic geological data, fall on the Government. Financial constraints have resulted in very low outlays for mineral exploration. To illustrate, the expenditure incurred for mineral exploration in India (\$50 million per annum) is insignificant compared to that in other countries like Canada (\$528 million), US (\$396 million), Australia (\$462) and Indonesia (\$132 million).

Domestic Industry Structure

Mining and mineral exploration industry in India can be segregated into four distinct segments:

Survey & Exploration: This includes the following entities:

- GSI, involved in regional exploration, geo mapping surveys on land sea and air;
- MECL, into detailed exploration various minerals/ores ; and
- CMPDIL, engaged in detailed exploration for coal, preparation of project reports for new/expansion/reorganisation of mines including safety, and related R&D. CMPDIL is also a nodal agency for co-ordinating Science & Technology activities in coal and lignite.

Apart from these, there are a few small sized regional players who provide specialised services like drilling and mining.

Mining & Processing: This segment includes entities engaged in the commercial exploitation and/or downstream processing of ore. Public sector organisations include BALCO, Bharat Gold mines, HZL, HCL, NALCO, Sikkim Mining Corporation, CIL etc., and private sector companies include companies like HINDALCO, Sesa Goa etc. There are also other companies like Sterlite Industries and Birla Copper, which are only into processing.

Regulation & Conservation: Indian Bureau of Mines and Controller of Mining Leases are GoI bodies engaged in ensuring compliance with various laws concerning mineral exploration.

Research & Educational Institutions: Jawaharlal Nehru Aluminium Research & Development Centre, National Institute of Rock Mechanics, National Institute of Miners' Health and Indian School of Mines are GoI sponsored bodies engaged in R&D.

International Scenario

Internationally, there exist large integrated mineral exploration-cum-mining companies alongwith small scale prospectors known as “Junior Explorers”. Junior Explorers (numbering about 1400) have been extremely successful and have accounted for nearly half the significant gold and base metal discoveries over the last 25 years in North America and Australia. One of the reasons for the existence of a large number of prospecting companies is the transparency in the regulations particularly with respect to the prospecting licensee having the first right to mining leases (MLs). As a result, ‘juniors’ are able to share or even sell their “interest” in a prospected deposit to a larger mining company which would have the resources and expertise to bring them into commercial production. The strike rates of discovering a deposit which can be commercially exploited are extremely low and as such, the exploration programmes are high cost operations. Consequently, most of these ‘juniors’ are loss making but the occasional discovery of a suitable deposit results in super-normal profits. Till then, junior explorers are mainly funded by specialised, high-risk investment funds and individual speculators, hoping to share in the high returns from the occasional discovery. The downturn in the commodity prices has resulted in a cutback in the exploration budgets of mining companies. Consequently, mining majors have been doing away with their in-house exploration wings and entering into alliances with junior explorers, as a cost-cutting measure. These alliances are however, project-specific in nature.

As against the large number of junior exploration companies internationally, over the last two decades, no other major exploration company has emerged in India. Till then, companies like MECL would continue to depend on support from GoI.

Business Analysis

MECL is essentially a 'service' organisation: its efforts are directed at undertaking mineral exploration programmes to establish viable deposits for commercial exploitation. Accordingly, it provides allied services like drilling, mining, laboratory analyses and geophysical survey, etc.

MECL's mineral exploration programmes are of two types

- Promotional activities which are carried out on behalf of and funded by GoI; and
- Contractual activities which are carried out on behalf of other agencies including public sector, private sector and state governments.

Promotional Activities: GSI is involved in regional exploration, i.e., exploration on a large area which would give an indicative idea about the existence of mineral resources. Based on the data available with GSI, MECL chalks out its plans for carrying out promotional exploration programmes. These are finalised by the 'Standing Committee on Promotional Projects' in case of projects under Ministry of Mines (MoM) and by a Sub-Committee on Coal and Lignite in case of coal projects.

Priority Regional Exploration: Apart from detailed exploration, MECL acts as a sub-contractor to GSI and carries out Regional exploration, under the 'Priority Regional Exploration Programme'. Under this programme, the company has carried out over 20 mn meters of drilling for coal and 0.23 mn meters of drilling for lignite, over the last ten years.

Contractual Activities: MECL participates in tenders floated by various agencies for mineral exploration work. The company also gets mandates to carry out exploration activities from agencies like CMPDIL and acts as a sub-contractor.

MECL's clientele has been mainly GoI and public sector undertakings and its total revenues have been limited by the outlays for mineral exploration and related activities. Contractual and promotional work availability has thus, fluctuated widely, depending on the budgetary allocations of GoI and PSUs.

The share of promotional activities as a percentage of total revenues which

had been 35-40 between 1985 to 1990, has dropped to about 15 in FY'98. Since the objective of promotional exploration is to prove viable deposits in freehold areas and to ensure availability of a 'shelf' of mineral deposits for attracting investments, it is imperative that GoI continues to extend support for mineral exploration. The importance of promotional exploration is further accentuated by the fact that India is a net importer of metal and mineral products and is likely to remain so.

Recognising the acute shortage of funds for exploration programmes, GoI has created a Mineral Exploration Fund (MEF) for promoting sustainable activities for exploration and development of minerals. The MEF is envisaged to have a corpus of the order of Rs.160 mn, to be funded mainly by PSUs like National Aluminium Company Ltd (NALCO), Bharat Aluminium Company Ltd (BALCO), Hindustan Zinc Ltd (HZL) and HCL. Other modalities are yet to be worked out.

Drilling has been the main source of income for the company, contributing about 65 to 70%, followed by geology and mining (about 10-15% each).

Mineral exploration drilling involves drilling in soil and rock formations to obtain physical core and rock chip samples, primarily for evaluation by geologists. Exploratory drilling is necessary to confirm the existence of a mineral deposit as well as to determine whether there is sufficient deposits of minerals to justify development of a mine. MECL has the largest fleet of drills in the country for mineral exploration and related activities. It has the capability of drilling upto 1100 meters of depth and 76 mm diameter and caters to more than 60% of the mineral exploration needs of the nation. Over the last 25 years, the company has conducted over five million meters of exploratory drilling.

The drilling performance has been on decline in between FY'94 and FY'96. However, during the last two years there has been significant improvement in drilling performance mainly due to organisational restructuring, infusion of fresh capital, emphasis on maintenance of equipment, focus on business development etc.

MECL has a fleet of 146 drills, of which 102 are in operation. The company has not been able to upgrade its drills due to financial constraints and consequently the average age of the fleet is about 12 years.

For promotional exploration programmes, MECL gets payments as per the schedule of rates specified by GoI. Average rates during the last three

years for different minerals are given in the following table:

Table 1 : Average Rates for Minerals

Price (Rs./Metre)	FY'96	FY'97	FY'98
Coal	1560	1920	2148
Lignite	1079	1148	1209
Copper	3634	3870	4079
Gold	2899	3087	3254
Bauxite	2441	2600	2740

The rates had been fixed in 1990, with a cost escalation factor applicable every year. The rates are based on normative costs considering working environment, depth of borehole, strata and geological complexity pertaining to each mineral.

Mining

The company meets about 60 percent of the exploratory mining needs of the country. The main purpose of exploratory mining is to extract large samples (upto 1000 tonnes) of the minerals to carry out further studies for establishment of the quality of deposits. MECL currently has two ongoing exploration mining projects for bauxite and molybdenum.

Developmental mining is carried out mainly for coal and base metals (zinc and copper) and involves mine construction, i.e., construction of vertical/inclined shafts to provide access to the mineral deposit. The company is currently undertaking seven projects for HZL and various CIL subsidiaries.

The company has during FY'99, begun supplying ballast stones to Railways, for which it has obtained mining lease at certain areas near Ranchi. MECL also plans to enter into commercial mining of limestone, dolomite, sillimanite and fluorite in the state of Maharashtra, which are presently under leasehold of Maharashtra State Mining Corporation (MSMC). A joint venture is planned with MSMC for commercial mining of these minerals in the state.

Geological studies

MECL, with its large pool of talented geologists and geoscientists, carries out geological and economic evaluation of mineral deposits from initial reconnaissance to deposit parameter assessment. The company also carries out environmental and remote sensing studies, surface geophysical surveys etc. to support drilling activities. This is one of the key strengths of MECL

as, apart from being able to generate geological data through drilling, it can provide incisive geoscientific interpretation towards design of quality exploration programmes.

Further, the company has also offered its services to a number of foreign exploration and mining companies and their Indian subsidiaries like RGC Exploration Pty Ltd and Rio Tinto India Pvt Ltd.

The company's manpower strength is about 3,300 employees. This has been reduced due to implementation of VR scheme since FY 93. The maximum manpower requirement has been assessed at 2500 as against the present strength of about 3300.

Financial Analysis

The financial performance of MECL for the past five years is summarised as follows:

Table 2 : Financial Highlights (Rs.Crore)

	FY 98	FY 97	FY 96	FY 95	FY 94
Total Income	58.6	42.4	32.2	34.4	45.1
Operating Profit (PBDIT)	2.2	-1.2	-5.9	-6.8	-3.6
PAT	-2.5	-8.2	-12.2	-14.0	-11.9
Equity Capital	63.8	60.0	56.5	56.5	56.5
Tangible Networth	8.3	8.4	9.6	21.2	33.2
Gross Margin (%)	3.7	-2.9	24.4	25.2	24.7

(Other financial ratios are not shown as they are negative and hence meaningless)

Though MECL's total income grew from Rs.451 mn in FY'94 to Rs.586 mn in FY'98, the growth has been uneven, due to skewed availability of work orders and disruptions in work due to poor emphasis on repairs and maintenance. MECL has been incurring losses for the last five years due to lack of adequate work, high labour bill and low productivity. For the first time in five years, it earned profits before interest and depreciation in FY'98, largely due to the sharp jump (38%) in work done during FY'98. Employee cost as a percentage of total income has declined from 94 in FY'96 to 78 in FY'97 and further to 60 in FY'98, because of healthy growth in income coupled with reduction in manpower.

Due to mounting losses, MECL's networth has been significantly eroded. Accumulated losses stood at 87% of the paid-up equity capital and reserves as on March 31, 1998. Long term debt equity ratio and overall gearing at 0.40 and 0.53 respectively, as on March 31, 1994, increased

substantially to 4.12 and 4.54 as on March 31, 1998, due to erosion of networth and funding of capital expenditure/working capital through debt rather than equity. Interest coverage remained negative throughout the period.

Restructuring Measures: As the performance of MECL has been declining, GoI constituted an Expert Committee to conduct a diagnostic study of MECL and advise on strategies for restructuring. The major suggestions of the Committee are as follows:

- Manpower should be pruned to a level required for operation of 100 drills and 4000 metres of mine development on a regular basis.
- Productivity should be improved through replacement of substandard machinery and redesigning of incentive scheme for workers.
- GoI funding for promotional activities should be atleast 30% of the total work load and should be continued for atleast 3-5 years.
- MECL should consider
 - strategic alliance with leading foreign mining and exploration companies
 - exploration for Coal bed methane
 - applying for PL/ML for mineral prospects
- Financial restructuring package should include
 - Release of working capital loan of Rs.5 crore with interest waiver and moratorium
 - Equity infusion of Rs.10 crore during FY'97 to meet working capital requirements
 - Write off of accumulated loss of Rs.37.3 crore as on March 31, 1995 [Due to delay in implementation of revival plan, the Review committee suggested writing off accumulated losses of Rs.49.6 crore as on March 31, 1996]
 - Write off outstanding loans alongwith interest thereon (Rs.10.0 crore) as on March 31' 1995
 - Generation of Rs.3 crore through disposal of surplus land
 - Enhancement in cash credit limits by Rs.2 crore.

The revival plan as recommended by the Committee has been accepted by GoI The Financial restructuring package is under consideration of GoI, as per which MECL has sought the following relief measures :

- Accumulated losses as on March 31, 1997 (Rs. 53.75 crore) to be adjusted against equity
- GoI loans amounting as on March 31, 1997 (Rs. 21.29 crore) to be converted into equity and interest accrued (Rs.6.33 crore) to be written off/adjusted.

- Interest of GoI loans drawn during FY'98 and thereafter to accrue only from FY'2002, after a moratorium for three years for payments of interest and principal. Principal payments to be made in five equal instalments.

Strengths & Areas of Concern

Strengths

Highly skilled manpower: MECL is having the largest pool of technological skill comprising of geologists, geophysicists and mining engineers. This will enable the company to undertake more and more projects in future.

Large fleet of exploration equipment and facilities: MECL is having more 100 drills and are deployed throughout the country. This will enable the company to undertake projects in all parts of the country.

Potential opportunities: Since the country is having huge mineral reserves which are not yet fully explored, exploration companies in India has got potential opportunities to grow.

Areas of Concern

No Commercial orientation : MECL does not carry exploration work on its own and consequently none of its reports are saleable. MECL works as an extended arm of GSI.

Overstaffed: MECL's manpower strength is very high and hence it becomes uneconomical to operate on commercial lines.

Old, outdated, low productive drills: Even though MECL has large number of drills, many of them are old and outdated. Moreover, the productivity of MECL drills are very low.

Low value added services: As MECL does not have PL, the company will not benefit from any new findings. MECL will only be reimbursed for their work.

Competition: GoI, as a part of liberalisation process, is opening up the mining sector. This will enable large international mining companies to start their operations, which will affect MECL.

Recommendations

MECL was set up with a view to give commercial bias to mineral exploration and to bridge the gap between initial discovery of a mineral prospect and its eventual exploitation. However, during its 27 years of operation it failed to accomplish its objective as a commercial venture. MECL in the past had always worked as an extended arm of GSI and never got any Prospecting License (PL) in its name, which it could transfer

after the finding of mineral. Universally all mineral exploration companies start their exploration with the PL in hand, which would enable them to realise better value from their findings. As mentioned in the business analysis section, MECL is engaged in the promotional activities undertaken on behalf of GoI. However, over the years, its share of promotional activities as a percentage of total revenues reduced to 15% in FY 98 from about 30% in FY 94. With the falling share of its operations in promotional activities for GoI, the Commission is of the view that MECL's operations are no more Core. **Hence, the Commission classifies MECL as non-core.** Further, the Commission is of the view that, if the promotional work of MECL is very important to GoI, the same can be separated from MECL and could be merged with GSI (Geological Survey of India).

Mineral exploration activity is a capital intensive industry. In order to emerge as a leader in this sector, MECL has to make huge investments to upgrade its ageing drills, procurement of new equipments etc. With its current financial health, MECL would not be in a position to raise resources for investment. So far, MECL was getting budgetary support from GoI both as equity and loan and the same may not be available in future from GoI. Under these circumstances, the Commission is of the view that GoI has the following options.

1. **Implement a VR Scheme and allow MECL to continue their operations and apply for PLs.** Under this option, in order to make the offer attractive, downsizing of manpower would be necessary. MECL is having huge manpower and the Expert Committee's assessment of overmanning is to the extent of 800. In order to reduce manpower, GoI has to support MECL and the estimated outflow on account of VR would be Rs. 20 crore. As mentioned earlier, MECL undertakes only contractual assignments. The Commission is of the view that MECL should apply for PLs in all their future assignments. This will enable the company to realise better value once the exploration is successful. Further, this will attract national/international mining companies to acquire stake in MECL. Disinvestment of up to 51% GoI holding could initially be attempted once MECL acquires PL rights and succeeds in establishing commercially valuable reserves. Once this is achieved, GoI could consider disinvestment of its balance holding through public offering.
2. **Sell 100% equity of MECL on as is where is basis.** Even though the company is currently making losses, it has certain assets in the form of drills, technical expertise etc. This may be an attraction for

the prospective buyer, as many of the international mining companies are trying to establish their operations in India. This will enable GoI to realise some value and would stop further draft on the budget. The selection of strategic buyer should be undertaken through a globally competitive pre-qualified bidding process.

3. **Closure.** If none of the above options are viable, the Commission of is the view that Government should close down the operations of MECL and liquidate all its assets and liabilities.

Sponge Iron India Limited

Evolution

Sponge Iron India Limited (SIIL) was incorporated on March 18, 1975. SIIL was set up as a subsidiary of Andhra Pradesh State Industrial Development Corporation (APIDC), but it later became a PSU in which GoI owned majority of shares. SIIL set-up a Demonstration Plant of 30,000 tpa capacity to establish the techno-economic feasibility standard of manufacturing sponge iron suitable for steel making, using indigenously available iron ores and non-coking coals. The other reasons for setting-up the plant at that time were:

- Non-availability of coking coal of the required quality and quantity.
- Wide fluctuations in the availability of ferrous scrap for both the Primary and Secondary steel manufacturers.
- Need to find a substitute for the ferrous scrap used as feed stock in electric arc furnaces.
- Saving foreign exchange on import of iron scrap, a substitute for sponge iron.

The paid up share capital of SIIL is Rs. 32.58 crore with GoI and GOAP holding 97% and 3% of the equity respectively.

Industry Analysis

Sponge Iron industry was visualised and set up in India as an import substitute for scrap. Sponge iron is a metallic product produced by direct induction of high-grade iron ore or pellets in solid state. Sponge iron, a substitute for scrap, is a reduced form of iron ore into Direct Reduced Iron (DRI) or sponge iron. However, DRI has the disadvantage of rusting easily and it is, therefore, converted into Hot Briquetted Iron (HBI) by some producers.

There are primarily two routes to produce sponge iron - coal based and gas based. Coal-based plants use non-coking coal for converting iron ore into DRI in a rotary kiln. Gas based plants are large in size (typical one million tonnes), require higher capital investment, use iron ore and pellets blend as raw material and natural gas as reductant. Output is briquetted and is called hot briquetted iron.

The three gas based sponge iron plants in western India had been exporting substantial amount of their output. However, exporters of sponge iron faced certain infrastructural difficulties at the ports for berthing space and handling. However, the major issues in the recent past have been the

reduction of customs duty on scrap and the generation of huge amounts of scrap by the CIS countries. Moreover, the prices of natural gas, is roughly 2-2.5 times more than that in Venezuela (a country with similar gas based sponge iron industry).

Sponge iron is used as feedstock for mini steel plants/ induction furnaces (IF)/ electric arc furnaces (EAF). Mini steel plants use either sponge iron or scrap to manufacture steel. Steel melting scrap and DRI are two major inputs in electric steel-making through electric arc furnace and induction furnace routes. From the scrap availability point of view, as far as the integrated steel plants are concerned, the internal generation of scrap is coming down due to the increasing adoption of concast technology. It is expected that in future these plants will emerge as net purchases of scrap or DRI.

The sponge iron industry was originally visualised and set up as an import substitute for scrap for saving foreign exchange of the country. However, due to demand recession during the past few years, the sponge iron industry began exporting from 1992-93. After an initial rise during 1993-94, exports of sponge iron, mainly of the HBI grade, dropped to 6.6 lakh tonnes in 1994-95 from 7.2 lakh tonnes in 1993-94.

Table 1: Demand supply of metallics (Sponge iron / Scrap)

(Million tonnes)	1996-97	1997-98	1998-99	1999-00
Production				
Production by mini steel plants (longs)	4.95	6.03	6.48	7.61
Production of Flats	2.40	2.40	3.60	3.60
Total steel production	7.35	8.43	10.08	11.21
Requirement @ 1.1 (Total demand for Metallics)	8.08	9.32	11.08	12.33
Supply				
Sponge iron supply	5.97	6.28	6.40	6.40
Pig iron (to the extent of 5%)	0.40	0.46	0.55	0.61
Balance to be met through scrap/ Sponge iron imports	1.71	2.58	4.13	5.32

There might be a serious mismatch between the requirements of the metallics vis-à-vis domestic availability in India. As a result, India may be constrained to import metallics, causing a severe pressure on the country's foreign exchange situation. Therefore, the expected shortfall of metallics was not realised. In fact there has been a reduction in the production fuelled by low demand.

Sponge iron production increased by 6.8%, from 5 million tonnes in 1996-97 to 5.34 million tonnes in 1997-98. This increase has come from new capacities and increased utilisation from the existing plants. Nippon Denro's 10 lakh tpa plant was commissioned in mid-1994. The plant produced 4.57 lakh tonnes in 1994-95. Vikram Ispat's plant, which was commissioned in April 1993, produced 4.05 lakh tonnes in 1994-95 as compared to 95,000 tonnes in 1993-94. Prakash Industries achieved full capacity utilisation in 1994-95 producing, 1.5 lakh tonnes in 1994-95 as compared to 15,000 tonnes in 1993-94. Production from Essar Gujarat declined to 1.33 million tonnes in 1994-95 from 1.5 million tonnes in 1993-94. (The company had to shut down its plants for two months in 1994-95 due to non-availability of gas from GAIL and ONGC).

Demand for sponge iron has grown from 1.69 million tonnes in 1993-94 to an estimated 2.7 million tonnes in 1994-95, an increase of 62 percent. The improvement in demand is due to a number of factors : (1) Increased production from Electric Arc Furnace (EAF) units. The production by the EAF industry (both alloy steel and mild steel) increased by 13 per cent. Demand for alloy steel improved during the year due to increased demand from the automobile and engineering industries. (2) Reduced availability of scrap in the international market, due to increased demand from the EAF units in the US and Europe (the largest exporters of scrap) and the increasing usage of scrap generated in-house by steel plants for further value addition. (3) Domestic scrap availability has been declining because of Integrated Steel Plants (ISPs) are producing more steel through the continuous casting route (continuous casting technology generates 50 per cent less scrap)

Exports, mainly of HBI, declined to 6.6 lakh tonnes in 1994-95 from 7.2 lakh tonnes in 1993-94. During 1994-95, Essar Gujarat, the main exporter of sponge iron, exported only 5 lakh tonnes; Nippon Denro exported 1.6 lakh tonnes and Vikram Ispat 40,000 tonnes. Exports increased marginally from 3.72 million tonnes in 1996-97 to 3.74 million tonnes in 1997-98.

Domestic sponge iron (HBI and DRI) prices do not follow the landed prices of scrap as closely as they used to earlier. Firstly, the landed prices of scrap depend upon a number of variables such as freight costs, LC opening charges, (besides international prices, exchange rates, and customs duties). On the other hand, domestic sponge iron producers offer their product at a fixed price (including transportation charges) for a contractual period. Secondly, the oversupply in the domestic sponge iron industry has resulted in additional downward pressure on domestic prices.

Business Analysis

SIIL was initially set up with a capacity of 30,000 tonnes of sponge iron, which was doubled in 1985. The following table shows the production and sales of SIIL for the past five years.

Table 2 : Production and Sales of SIL

	1997-98	1996-97	1995-96	1994-95	1993-94
Installed Capacity (t)	60,000	60,000	60,000	60,000	60,000
Total Production (t)	57,610	51,402	55,605	50,375	48,500
Capacity utilisation (%)	96.0%	85.7%	92.7%	84.0%	80.8%
Total Sales (t)	45,905	55,778	53,165	50,858	43,898
Sale of Sponge Iron (t)	36,782	45,613	46,441	39,743	31,897
Sale of Briquettes (t)	9,123	10,165	6,724	11,115	12,001
Sale of Sponge Iron (t)	1,647	2,088	1,998	1,622	1,382
Sale of Briquettes (t)	427	460	289	464	543
Sale Price of SI (Rs.)	4,478	4,578	4,302	4,081	4,332
SP of Briquettes (Rs)	4,684	4,524	4,305	4,174	4,522

SIIL purchases iron ore from National Mineral Development Corporation (NMDC) supplied from Bailadila, which is about 300 kms from the plant. Average transport cost of iron ore is about Rs.500/ton in an average total price Rs.939/per ton in 1997-98. SIIL has indicated that it is planning to source the raw material from Bellary, which is about 350 Kms and hopes thereby to reduce cost. SIIL purchases coal from Singareni Collieries. The transport cost of coal is about Rs. 100/ton in a total average cost of Rs.1237/ton. The cost of iron ore, coal and limestone increased at a CAGR of 8.95%, 9.64% and 3.24% respectively. This includes the increase of both the base cost of raw material supplied by NMDC & Singareni Collieries and the cost of transport.

Efficiency factors indicate the usage of raw material and therefore the effect on cost. SIIL has efficiency factors of 1.88 and 1.27 for iron ore and coal respectively, during 1997-98. The accepted efficiency factors are 1.65 and 1.35 for iron ore and coal respectively. That is, for every ton of sponge iron produced, the usage of iron ore is 1.65 tons and coal is 1.35 tons.

Diversification of SIIL: SIIL set up a 7 MVA SAF for smelting pre-reduced SI/SI fines produced in the rotary kilns, into high quality low phosphorus, low sulphur pig iron. But cost of power, availability of power and low sale price of pig iron ensured non-profitable operations. The

project cost was Rs.3050 lakhs. As a consequence, SIIL commissioned a study by Dastur & Co to ascertain the possibility of converting the SAF plant into a manufacturing facility for Silico Manganese. Based on the technical report, the SAF plant was converted into a silico manganese plant. However, as the market prices for Silico Manganese too fell, SIIL did not deem it profitable to operate the plant. The plant is not being operated as on date. SIIL also cites the lack of working capital as another reason for the non-operation of the plant.

As the plant is embedded into civil construction structures, sale by stripping and individual units is not feasible. Nor can the plant be relocated. If a sale is contemplated, it has to be on an as-is-where-is condition.

SIIL supplies sponge iron predominantly in the south Indian states of Tamil Nadu, Pondicherry, Kerala, Karnataka, etc. This results in high transport cost.

Table 3 : Composition of Sales of SIIL

Year	Total Despatches Tonnes	Despatches to (in % ages)		
		AP	TN, Kerala & Pondicherry	Karnataka
FY 92	45242	52	10	3
FY 93	44157	43	11	1
FY 94	41447	32	44	4
FY 95	47652	46	38	12
FY 96	52575	21	51	7
FY 97	55778	16	84	
FY 98	45905	6	94	

The three states in which SIIL supplies sponge iron viz. Karnataka, Tamil Nadu and AP saw growth rates at 39%, 17% and -7% respectively. It can be observed that there is a fall in the intake in AP. Therefore, SIIL has to perforce sell its product in TN and Karnataka. While it has to contend with transport costs for supplies to other states, SIIL is in a better position in TN as Tamil Nadu Sponge has been closed. SIIL's market, as mentioned above, was virtually next door. SIIL was adversely affected by closure of AP Steels, which accounted for about 40% of its turnover. After closure of AP Steels, over the last 6 years, SIIL has been increasing supplies to IA/EAF units located in TN, increasing the cost of transport of end product, in comparison to local manufacturers.

SIIL produces sponge iron and briquettes for sale. The sale price of briquettes is slightly higher than sponge iron. The manufacturing process also generates 'fines' which is a waste product and it is sold at a very low price. SIIL has been selling its product at an average price of Rs. 4,581 per ton (for the year ended 31/3/98), which compares fairly with the industry average of about Rs. 4,996 per ton. Bellary Steels average sale price in 1997-98 was Rs.4,716 per ton. However, the average price realisation during the nine months beginning April 98 has shown a continuous fall from Rs.4,057 per ton to Rs.2,463 per ton. The fall in the average price can be attributed to an increase of the quantum of fines/waste products in the sales mix. In the last two months ending December 98, the percentage of fines was 34% and 42%. The reasons could be:

- A reduction in the production due to lack of demand or other market conditions.
- Cutback in production due to poor recovery of receivables or a high incidence of default in receivables.
- Sale of fines accumulated over the past six months.
- Offer of discounts for cash purchases.

SIIL's labour cost per tonne is the highest in the industry at Rs.1089. SIIL employs 536 persons (as on 30/06/99). SIIL's labour cost in 1997-98 was Rs.628 lakhs whereas that of Bellary Steels was Rs.393 lakhs for a capacity of 60,00 tons of sponge iron and 100,000 tons of steel products.

SIIL has been able to effect a reduction of about Rs.80 /per ton in the power cost by setting up a captive generation plant from waste heat recovered. SIIL has a requirement of about 1.5 MW per annum for operating the sponge iron plants. The silico manganese plant would have a requirement of about 22.5 MW. SIIL has a captive generation plant of 4.5 MW capacity. The power is generated from the waste gases produced from the kilns manufacturing sponge iron. It is also proposed to set up another 4.5 MW of captive power generating unit from waste heat from the expanded sponge iron plant.

Financial Analysis

The financial performance of SIIL for the past five years is summarised as follows:

Table 4 : Financial Highlights (Rs.Lakh)

	FY 98	FY 97	FY 96	FY 95	FY 94
Total Income	2957	2780	2879	2682	2534
Operating Profit (PBDIT)	400	619	702	675	625
PAT	-368	-117	12	-148	-237
Equity Capital	3258	3258	3145	2845	2808
Tangible Networth	2943	3280	3296	2967	3128
Gross Margin (%)	13.5	22.2	24.4	25.2	24.7

(Other financial ratios are not shown as they are negative and hence meaningless)

An analysis of SIIL shows up the following:

- The CAGR for sale price is only 1.86% over the past 6 years, as against the increase of raw material at a CAGR of about 8% to 9%.
- The production has been at a high level but efficiency factors seem to affect the usage of raw material adversely.
- There is distinct decline in the quantity produced and sold.
- Discounts are separately accounted. Therefore, the actual sale value could be lower.

SIIL has two types of loans both provided by the GoI-Interest free loans and interest bearing loans. Interest cost per ton has been steadily increasing from about Rs. 512 in 1992-93 to Rs. 793 in 1997-98. In absolute terms, SIIL had an interest expense of Rs. 251 lakhs in 1992-93, which increased to Rs.457 lakhs. SIIL has been transferring an amount of Rs. 200 lakhs (approximately), every year from 1995-96, to capital account representing the interest on loans pertaining to setting up of the SAF/ silico manganese plant. Therefore the actual interest cost is higher. SIIL has been capitalising the interest cost pertaining to SAF/silico manganese plant stating that the commercial production has not been commenced. The interest costs are mounting as there is no source of income, especially from the SAF/silico manganese plant. In addition, SIIL has not provided for a cumulative penal interest of Rs. 634.78 lakhs upto 31/3/98, indicating that such loans in the past have been waived by the GoI.

The non-capitalisation of the SAF/silico manganese plant has led to a non provision of depreciation of Rs.166.71 lakhs.

Strengths and Areas of Concern

Strengths

Good technology base: SIIL was set up to establish the technology of manufacturing sponge iron. The technological capability of SIIL is excellent which enables it to offer consultancy services both in India and abroad.

Areas of Concern

Small plant with very low capacity: SIIL's capacity is very small when compared with the total industry. The plant size of SIIL makes it uneconomical when compared with its competitors.

Diversification not yielding benefit: SIIL's diversification into SAF/silico manganese plant at an approximate cost of Rs.40 crore is lying unused. This has resulted in huge interest cost.

Far away from the market: SIIL was originally set up with a view to cater to the needs of AP Steels which was located close to SIIL. But after the closure of AP Steels, SIIL has to despatch its products to longer distances. This has resulted in higher transportation cost and hence, the product becomes uncompetitive.

Large labour force: SIIL's labour cost is substantially high when compared with its competitors. This has resulted in higher cost of production for sponge iron by SIIL.

Overcapacity in Industry: Sponge iron is a substitute for scrap. In the past, when scrap was in short supply, more and more producers set up new production facility. The steel industry is currently in recession and hence, there is an overcapacity in the sponge iron industry.

Recommendation

SIIL is engaged in production of sponge iron, which is one of the primary input in steel making through EAF/IF route. SIIL was set up with a view to establish the technology to manufacture sponge iron. The company was successful in establishing this, which resulted in creating more and more capacities in India. This, to an extent substituted the import of scrap that resulted in savings of foreign exchange. However, today, there are large number of producers producing sponge iron in India and SIIL's capacity vis-a-vis the total industry capacity is negligible. **Under these circumstances, the Commission classifies SIIL as non-core.**

SIIL's current financial health is under stress. This is primarily due to

adverse market conditions and its past capital expenditure. SIIL's diversification to SAF and later conversion into silico manganese plant still remains a non-starter. Due to higher labour cost, interest and depreciation, the operations of the company have become unviable. Continuing the operations of SIIL under GoI control will continue to be a draft to the exchequer. SIIL's funding of capital expenditure was primarily met out of equity and GoI debt. The recovery of these loans alongwith interest accrued and due on these loans is doubtful. Under this circumstance, **the Commission recommends disinvestment of 100% of GoI equity in SIIL after cleaning up the balance sheet i.e. by writing off GoI loans and accumulated interest thereon. This will enable the buyer to start the operations of SIIL on a clean slate and would result in a better valuation of SIIL. Simultaneously with the move for disinvestment, manpower reduction through VRS would have to be undertaken, so as to improve investor interest in the company.**

Appendices

APPENDIX I

List of PSUs referred to the Commission

First List - September, 1996

S No	Name of the PSU	
1	Air India	AI
2	Bharat Aluminium Co. Limited	BALCO
3	Bharat Earth Movers Limited	BEML
4	Bharat Electronics Limited	BEL
5	Bongaigaon Refineries & Petrochemicals Limited	BRPL
6	Container Corporation of India Limited	CONCOR
7	Engineers India Limited	EIL
8	Fertiliser & Chemicals (Travancore) Limited	FACT
9	Garden Reach Shipbuilders & Engineers Limited	GRSEL
10	Gas Authority of India Limited	GAIL
11	Hindustan Aeronautics Limited	HAL
12	Hindustan Copper Limited	HCL
13	Hindustan Latex Limited	HLL
14	Hindustan Zinc Limited	HZL
15	Hotel Corporation of India Limited	HCIL
16	HTL Limited	HTL
17	IBP Co.Limited	IBP
18	India Tourism Development Corporation	ITDC
19	Indian Petrochemical Corporation Limited	IPCL
20	ITI Limited	ITI
21	Kudremukh Iron Ore Co. Limited	KIOCL
22	Madras Fertilisers Limited	MFL
23	Mahanagar Telephone Nigam Limited	MTNL
24	Manganese Ore (India) Limited	MOIL
25	Modern Food Industries (India)Limited	MFIL
26	National Aluminium Co. Limited	NALCO
27	National Fertilisers Limited	NFL
28	National Hydro Power Corporation	NHPC
29	National Thermal Power Corporation Limited	NTPC
30	Neyveli Lignite Corporation Limited	NLC
31	Northern Coal Fields Limited	NCF
32	Oil India Limited	OIL
33	Oil & Natural Gas Corporation	ONGC

34	Pawan Hans Helicopters Limited	PHL
35	Power Grid Corporation of India Limited	POWERGRID
36	Rail India Technical & Economic Services Limited	RITES
37	Shipping Corporation of India Limited	SCI
38	South Eastern Coal Fields Limited	SECF
39	Steel Authority of India Limited	SAIL
40	Western Coal Fields Limited	WCF

Second List - March, 1997

1	Hindustan Vegetable Oil Corporation Limited	HVOC
2	Nepa Limited	NEPA
3	Electronic Technology & Trade Dev. Corpn. Limited	ET&TDC
4	Hindustan Prefab Limited	HPL
5	Ranchi Ashok Bihar Hotel Corporation Limited	R-ASHOK
6	Pyrities, Phosphates & Chemicals Limited	PPCL
7	Central Electronics Limited	CEL
8	Engineering Projects (India) Limited	EPIL
9	Utkal Ashok Hotel Corporation Limited	UL-ASHOK
10	Rehabilitation Industries Corporation Limited	RICL

Third List – October, 1998

1	Minerals and Metal Trading Corporation	MMTC
2	State Trading Corporation of India Ltd	STC
3	Project & Equipment Corporation of India Ltd.	PEC
4.	Hindustan Steel Works Construction Ltd.	HSCL
5.	Metal Scrap Trade Corporation Ltd.	MSTC
6.	Metallurgical and Engineering Consultants (I) Ltd.	MECL
7.	National Mineral Development Corporation Ltd.	NMDC
8.	Sponge Iron India Ltd.	SII
9.	Paradeep Phosphates Ltd.	PPL
10.	Mineral Exploration Corporation Ltd.	MEC

Fourth List – January, 1999

1.	Heavy Engineering Corporation Ltd. (BIFR)	HEC
2.	Hindustan Organic Chemicals Ltd.	HOCL
3.	Hindustan Insecticides Ltd.	HIL
4.	Indian Drugs & Pharmaceuticals Ltd. (BIFR)	IDPL
5.	Hindustan Antibiotics Ltd. (BIFR)	HAL
6.	Bengal Immunity Ltd. (BIFR)	BIL
7.	Smith Stanistreet & Pharmaceuticals Ltd. (BIFR)	SSPL
8.	Bengal Chemicals & Pharmaceuticals Ltd. (BIFR)	BCPL

Fifth List – April, 1999

1.	Bharat Heavy Electricals Ltd.	BHEL
2.	CMC Ltd.	CMC*
3.	Rashtriya Chemicals & Fertilizers Ltd.	RCF
4.	Rashtriya Ispat Nigam Ltd.	RINL

* Later withdrawn by the Government.

APPENDIX II

List of PSUs withdrawn from the Commission

1. Bharat Earth Movers Limited	BEML
2. Bharat Electronics Limited	BEL
3. Garden Reach Shipbuilders and Engineers Limited	GRSEL
4. Hindustan Aeronautics Limited	HAL
5. South Eastern Coal Fields Limited	SECF
6. Western Coal Fields Limited	WCF
7. Northern Coal Fields Limited	NCF
8. CMC Limited	CMC

APPENDIX III

General Recommendations by the Commission and action taken thereon by Government.

A. General Recommendations

1. Establish Disinvestment Fund (I:3.1, II:1, V:1 and VII:1)

The proceeds from the disinvestment may be placed separately in a 'Disinvestment Fund' and the National Renewal Fund should also be merged with this Fund. The resources of the Fund may be primarily used for

- temporary funding of losses of some PSUs in preparation of disinvestment,
- for providing benefits to workforce found to be surplus
- for conducting the publicity campaign for the disinvestment of PSU shares

The Fund would also help the government in undertaking disinvestment at the most opportune time in the market for maximum realisations.

A reasonable percentage of Disinvestment Fund should be earmarked for funding social infrastructure for promoting rapid growth of the economy.

Action Taken : According to Government communication, Fund had been set-up in September 1996. Details regarding the scope or purpose are not available.

2. Delink the disinvestment process from the Budgetary Exercise of Government (IV:1)

Linkage of the implementation of disinvestment with the budgetary exercise may hinder achievement of the larger objective of the disinvestment exercise.

Action Taken : Decision awaited.

3. Standing Empowered Group (I:4.1)

Given the advisory nature of the Commission, the Commission recommends formation of a Standing Empowered Group (SEG) to ensure smooth implementation of its recommendations. SEG may also be entrusted with the selection of Financial Advisors, supervision of the overall sale process and decisions on instrument, pricing, timing, etc. SEG could comprise the Cabinet Secretary, Secretaries of the Ministry of Finance, Department of Public Enterprises, Administrative Ministry of PSU alongwith the CEO of the concerned PSU.

Action Taken : Core Group has been empowered as recommended.

4. Transfer of Management (V: 1)

While selling a substantial stake in the Undertaking, management would be transferred to the strategic buyer and the time frame for a further dilution of its share holding, where necessary, as agreed with the strategic buyer.

Action Taken : Decision Awaited.

5. Reduction of Government Equity (V: 1)

The Commission also recommended that in the interest of establishing credibility with the strategic buyers, the Government may, where necessary, keep its direct share holding below the level of investment being offered to the strategic bidder by divesting some portions of its equity to multilateral financing institutions, private equity funds, mutual funds and a few select PSUs, who have business interest in the particular PSU being disinvested.

Action Taken : Decision Awaited.

6. Referral of PSUs to the Commission (V:1)

The matter whether a PSU should be considered by the Commission for disinvestment or not should be sorted out between the SEG and the administrative ministry before the referral to the Commission. This would avoid wastage of the Commission's time and efforts and Government resources. Also, the subsidiaries of PSUs should not be referred to the Commission, as the decision in this regard would have to be taken by the Boards of Management of the concerned parent PSU.

Action Taken : Government has decided not to refer subsidiaries of PSUs to the Commission.

7. Voluntary Retirement Scheme (II:1 and IV:1)

Commission recommends that Government should frame a clear cut policy statement on the terms of VRS on a stable and long term basis and also suggest a modality for the implementation of VRS. A pension cum insurance scheme could be thought of as an alternative to a one-time payment.

Action Taken : Decision awaited

8. Disinvestment without reference to the Commission (III:1 and IV:1)

Disinvestment of the PSUs whether through Joint Venture participation or strategic sale not referred to the Commission, is likely to deny the benefits of detailed consideration by an independent body. Therefore, Government should review the position and decide whether such cases should be kept outside the purview of the Commission.

Action Taken : Decision awaited

9. Public Offer of equity by the PSUs referred to the Commission (III:1)

Primary issue by any PSU referred to the Commission, without involvement of the Commission, would be inconsistent with the terms of reference of the Commission to take a co-ordinated view or to recommend a mix between primary and secondary disinvestment.

Action Taken : Decision awaited

10. Disinvestment Package (IV:1)

The Commission reiterates that undertaking disinvestment without implementing the general recommendations of the Commission, - in particular those relating to corporate governance, managerial autonomy, managerial remuneration, accountability, incentives, professionalising the Board of Management and restructuring where necessary - would result in undervaluation of Government shares and loss to the national exchequer.

Action Taken : Decision awaited

11. Restoration of Monitoring and Supervision Powers (VII:1 and VIII:1)

The Commission is of the view that the disinvestment process can be an important instrument for building up a lean and strong public sector and for providing funds for development. The amendment dated 12 January 1998 of the terms of reference of the Commission has considerably diluted the role of the Commission in the disinvestment process. It limits even its advisory functions apart from removing overall monitoring and supervisory functions. The role of Commission as an advisory body without powers of monitoring and supervision of the overall disinvestment process renders the Commission ineffective. Therefore, the powers of monitoring and supervision as envisaged in the earlier Government notification dated 23 August 1996 should be restored.

Action Taken : Decision awaited

12. Setting Up of Full-time Implementation Machinery (VII:1 and VIII:1)

In order to get the best prices for the shares disinvested by Government, particularly in the undertakings that will remain in the public sector, it is essential to time the sale under favourable market conditions. Timely action to select the financial advisers and a close watch on market conditions are necessary to get the best results. The Commission therefore recommends that a full time **implementation machinery** under the Ministry of Finance including public sector merchant bankers be set up under Government with a clear mandate. This machinery will select financial advisers and put through the sale of shares, either through offer of sale or by strategic sale and get the best price for the shares within a reasonable price band, that should be approved in advance by Government.

The implementation group should seek the advice of the Commission whenever necessary and be subject to the overall supervision of the Commission.

Action Taken : Decision awaited

13. Presenting the Commission Report in its entirety before the Cabinet (VII:1)

The Commission is not aware if all its recommendations have been taken before Cabinet for decision. The Commission would emphasise that both its general and specific recommendations should not be filtered by official groups but should be placed before the Cabinet in their entirety to enable Government to appreciate the interconnected strategy of the various recommendations and take decisions thereon. The Chairman of the Commission may be invited, wherever necessary, to the meetings of the Cabinet, to offer clarifications on the recommendations of the Commission.

Action Taken : Decision awaited

14. Disinvestment through Strategic Sale to optimise realisation under the present state of Capital Markets (VIII:1)

In view of the present state of the Indian and Overseas Capital Markets, offerings in these markets may not achieve optimum realisation. The Commission, therefore, suggests giving a big push to strategic sales of

PSUs recommended by the Commission. At the present juncture, the advantages of such a big push operation for strategic sales are many. They are :

1. Since strategic sales depend not on capital market conditions but on the intrinsic value of the concerned enterprises, they can be undertaken straightaway.
- 0 The response to the offer of strategic sales will send the right signals about the confidence of the international community in the Indian economy. This will also stimulate foreign direct investment in India.
- 1 Substantial amounts of foreign exchange can be earned to strengthen our foreign exchange reserves.
- 2 Successful strategic sales will boost the confidence of the Foreign Institutional Investors and induce their increasing support to the Indian capital market. This will also encourage domestic investors. Even the GDR market is likely to pick up as a result of successful strategic sales.
- 3 Government's realisation from proceeds of disinvestment would be substantial.

Action Taken : Decision awaited

B. Guidelines on Modalities

1. Offer of Sale (I:4.2 and II:1)

"Book building" process similar to that followed in the international market for GDR issue should be followed for Domestic Offer of Sale to institutions also.

Action Taken : Book Building followed in GDR issues.

2. Strategic Sale (I:4.2 and V:1)

Detailed and transparent procedure for the selection of strategic partners recommended including the selection of Financial Advisors for strategic sale. In order to ensure that the strategic partner brings in necessary technological and financial inputs the selection should be made through a process of pre-qualification.

The Government should assure the strategic buyer of its commitment to withdraw from the PSU by spelling out the details, including the time frame. The restructuring and VRS measures should be implemented before inviting the offer for strategic sale for realising the efficiency gains in the disinvestment proceeds.

The Commission recommends that the Government may keep its direct share holding below the level of investment being offered to the strategic bidder by divesting some portion of its equity to multilateral financing institutions, private

equity funds, Mutual funds and a few select PSUs who have business interest in the particular PSU being disinvested.

Action Taken : Process for selection of global financial advisors for the strategic sale of BALCO and KIOCL has been initiated.

3. Selection of Intermediaries (I:4.3 and V:1)

Detailed and transparent procedure for the selection of all intermediaries for the Offer of Sale of shares either in domestic or international market. The financial advisors need not evaluate the disinvestment options recommended by the Commission.

Action Taken : Accepted

4. Retailing of PSU shares to Small Investors and Employees (I:4.4)

Detailed procedure for offer of shares to small investors and employees has been recommended by the Commission. The Commission has also recommended on the maximum number of shares and the discount to be offered to small investors and employees.

Sale of shares of the PSUs, especially the profit making ones, to the small investors would broad base the shareholding.

Action Taken : Accepted

5. Recommendation on Joining the NSDL (II.1)

In order to enable the PSUs to prepare for meeting the demands of the capital market, Commission recommends that all PSUs which were earlier disinvested and which are proposed for disinvestment to join the NSDL.

Action Taken : Accepted

6. Audit of Disinvestment Transactions (V:1)

It would be desirable to conduct an audit of the disinvestment transaction within six months by C&AG with the involvement of professionals familiar with working of the industry and capital markets. This provides opportunities for improving the quality of subsequent disinvestment transactions.

Action Taken : Decision Awaited

C. Recommendations on Delegation of Autonomy

Commission has recommended delegation of autonomy on a graded scale as given below :

1. Professionalising the Board of Directors (I:3.4)

The Commission recommends that the Government initiate necessary steps to select experts and professionals from outside the Government as non-executive Directors on the Board of Directors of PSUs.

Action Taken : Government has decided to broadbase Boards of PSUs by inducting at least three non-official part-time Directors (four for Navratna PSUs). Government has also specified that such Directors should be at least one-third of the total strength of the Board. These Directors would be selected by Search Committee comprising of Chairman, PESB; Secretary, DPE; Secretary of the Administrative Ministry; and some eminent non-official(s).

2. Provision for Elected Directors (I:3.4)

Government, in the interest of efficient management of the PSU, should enable election of Directors who would represent the minority shareholders in the PSUs. Also the Government should enable election of employee representatives on the Board of Directors in proportion to the extent of employee shareholding.

Action Taken : Decision Awaited

3. Selection of Top Management (I:3.4)

The Commission recommends that the Public Enterprise Selection Board (PESB) should be broad based. PESB has to be given more powers to select the CEOs and other functional directors without going to the Appointments Committee of the Cabinet. Minimum tenure of five years for the CEOs and Functional Directors are recommended and the age of superannuation be relaxed, if necessary, for this purpose.

Action Taken : Decision Awaited

4. Salaries and Incentives for Top Management (I:3.4)

In order to attract and retain talents, the salaries and allowances for CMDs in Schedule (A) post should be raised to Rs. 50,000 per month immediately and should be reviewed and brought in line with industry in a gradual manner. Similar revision should be undertaken for all in other Schedules.

Action Taken : Decision Awaited

5. Autonomy in Price Fixation (I:3.4)

PSUs should be fully empowered on par with the private sector units to determine

the prices of their products and services.

Action Taken : Decision Awaited

6. Accountability (I:3.4)

Present MoU should be revamped in order to measure the performance of PSUs more qualitatively with reference to meaningful and challenging targets. Performance assessments should be carried out at routine intervals by a joint team of the Secretary of Ministry, CEO and an outside senior professional.

Action Taken : Accepted

7. Setting up of Pre-Investigation Board (I:3.4)

An independent specialised institution viz., the Pre-Investigation Board is to be set up to evaluate the instances of malfeasance in PSUs. It should evaluate all questionable commercial decisions at the Board level to determine whether the decisions were taken with malafide or corrupt intent. The members of the Pre-Investigation Board could include among others retired top executives from the financial sector, former CEOs of leading PSUs and professionals with relevant business experience.

Action Taken : Decision Awaited

8. Strengthening the Investor Interface (I:3.4)

PSUs in general should equip themselves to meet the investor queries by setting up investor relations group. This group should regularly communicate with the investors and update them with the performance of the PSU.

Action Taken : Decision Awaited

Apart from the recommendations in respect of corporate governance, mentioned above, which are applicable to all PSUs, the Commission recommends additional autonomies to Moderate Performers and Strong Performers.

9. Moderate Performers

(i) Powers to Dispose of Assets (I:3.4)

Board of Directors should be empowered to transfer assets to a subsidiary or for the propose of outright sale, with requiring Government approval.

Action Taken : Decision Awaited

(ii) Freedom of Investment within certain limits (I:3.4)

The Government should enhance the investment limits in cases where banks or institutional lenders have appraised and financed the projects and link the limits to the turnover and requirement of funds in the medium term.

Action Taken : Category* I PSUs have been allowed to incur capital expenditure on new projects, modernisation, purchase of equipment, etc. upto Rs. 300 crores or equal to their networth, whichever is lower while Category* II PSUs have been given a limit of Rs. 150 crores or upto 50% of their networth, whichever is lower.

10. Strong Performers

(i) Powers to form joint ventures (I:3.4)

The Board of Directors of these PSUs should be empowered to form joint ventures with Indian or foreign companies so long as the other partner holds less than or equal stakes, without prior approval of the Government other than the regulatory approvals as applicable to private sector.

Action Taken : Category I PSUs have been empowered to establish JVs and subsidiaries in India by investing upto Rs. 100 crores or 5% of their networth in any one project or 15% of their networth in all JVs/subsidiaries put together. Category II PSUs can invest upto Rs. 50 Crores or 5% of their networth in any one project or 15% of their networth in all JVs/subsidiaries put together to establish JVs and subsidiaries in India.

(ii) Full freedom with regard to investments (I:3.4)

The Commission has recommended complete autonomy to these PSUs with respect to investment decisions subject to the condition that these projects are appraised and financed by banks or institutional lenders or where the total requirements of funds are met from internal accruals.

Action Taken : The autonomy granted to strong performers is same as that granted to the moderate performers.

* *Category I PSUs* are PSUs that have made a profit in the last three years continuously and earned pre-tax profits of more than Rs.30 crores or more in at least one of the three years and have a positive net worth. *Category II PSUs* are PSUs that have made profit for the last three years continuously and have a positive net worth.

APPENDIX IV

Recommendations for 49 PSUs and Action Taken by Government

Recommendations		Government Action
1.	Modern Food Industries India Limited (MFIL) (I:5.1) Sale of entire Government shareholding on an as-is-where-is basis	Decision being implemented
2.	Gas Authority of India Limited (GAIL) (I:5.2) -25% disinvestment through GDR Autonomy under Strong Performer Criterion Implement TL Sankar Committee Recommendations	Decision being implemented
3.	Indian Tourism Development Corporation (ITDC) (I:5.3) Handing over the hotels located in prime locations to established hotel chains to run on long term structured contract on lease cum management basis. The hotels in other locations may be demerged into separate companies and Government to sell 100% of its equity in those new companies.	Decision awaited
4.	Bharat Aluminium Company Limited (BALCO) (II:2.1) Immediate disinvestment of 40% of the equity to a strategic partner with an agreement to dilute Government holding to 26% through public issue within 2 years. The Government to disinvest its balance holding of 26% in full at an appropriate time in future	Decision being implemented
5.	Bongaigaon Refineries and Petrochemicals Limited (BRPL) (II:2.2) Strategic sale of 50% of Government holding with an agreement to further dilute to 26% or below through public offer at a later date.	Decision awaited.
6.	HTL Limited (HTL) (II:2.3) 3 options for disinvestment - <ul style="list-style-type: none"> • Sale of 100% shares in HTL along with ITI in the process of Strategic Sale • 50% of shares of HTL may be offered to a strategic partner through a global competitive bidding • if none of the above options is feasible, straight sale of assets of the company through competitive bidding 	Decision being implemented

Recommendations		Government Action
7.	ITI Limited (ITI) (II:2.4) Immediate reduction of manpower through VRS and hiving off the Defence Division in Bangalore and merge with Bharat Electronics Limited followed by strategic sale of 50% of the shares with an agreement to reduce the Government holding to 26% through public offer to Indian institutions, small investors and employees later	Decision awaited.
8.	Madras Fertilisers Ltd (MFL) (II:2.5) Recommended to initiate negotiations with National Iranian Oil Company to change the terms of agreement which would permit sale of 50% of the shares in the company to a strategic partner	Decision awaited.
9.	Manganese Ore India Limited (MOIL) (II:2.6) - No immediate disinvestment	Accepted
10.	Container Corporation of India Limited (CONCOR) (III:2.1) -10 million shares offer to institutional investors and public and at a later stage the company could go in for fresh issue of 12.5 million shares thereby reducing the Govt's share to 51%	Decision implemented.
11.	Kudremukh Iron Ore Company Limited (KIOCL) (III:2.2) Strategic sale of 30% and induction of the strategic partner in the management. There should be an agreement with the strategic partner for further dilution of Government equity to strategic partner and public offering within 2 years.	Decision being implemented.
12.	Mahanagar Telephone Nigam Limited (MTNL) (III:2.3) - 60 million shares in GDR market and 28.3 million shares in domestic market through book building Financially restructure – by formation of a new company for raising funds for DoT Grant of Autonomy under Strong Performer Criteria.	Decision implemented.
13.	Oil India Limited (OIL) (III:2.4) - Disinvestment and Company's IPO only after company's prospects are clearly established through the outcome of exploration activities in the North Bramhaputra area and Government's policy on APM	Accepted.

Recommendations		Government Action
14.	<p>Oil and Natural Gas Commission Ltd. (ONGC) (III:2.5) -Disinvestment after the organisational changes are in position and Government's policy on APM.</p> <p>(X:2.3) – Disinvestment should be deferred until investor confidence in ONGC improves. Government and ONGC should take steps to improve investor perception. Thereafter disinvestment can take place in the foreign and domestic market up to 49 per cent when market conditions are favourable.</p>	Accepted.
15.	Rail India Technical & Economic Services Ltd (RITES) (III:2.6) - No disinvestment	Accepted.
16.	<p>Hindustan Copper Limited (HCL) (IV:2.1) - Two options suggested:</p> <ul style="list-style-type: none"> • HCL to implement the expansion programme and also restructure the ICC mining operations by closing down mines through VRS. Afterwards, Government to divest 51% of its holding through a strategic sale. The balance 22% to be disinvested through offer of sale to domestic institutions, small investors and employees • Immediately disinvest 51% through a strategic sale and after restructuring and expansion, disinvest balance 22% through offer of sale to domestic institutions, small investors and employees 	Decision awaited.
17.	Pawan Hans Helicopters Limited (PHL) (IV:2.2) - Recommends writing off the Westland loans together with interest. Offer the entire Government holding to ONGC. If ONGC not interested, sell the entire holding of Government to an investor.	Decision awaited.
18.	Power Grid Corporation of India Limited (POWERGRID) (IV:2.3) Disinvestment only after entire electricity sector is fully restructured.	Accepted
19.	Shipping Corporation of India Ltd (SCI) (IV:2.4) Government to disinvest 40% of its holding to oil refineries, (30% to public sector and 10% to private sector refineries). This can be followed by the company's own equity raising.	Decision awaited.

Recommendations		Government Action
20.	Engineers India Limited (EIL) (V:2.1) GoI to hold 26% for retaining the character as an Indian Consultancy company in strategic areas; GoI to disinvest 30% equity stake in the company along with appropriate role in management; 10% to employees under ESOP; 10% to public sector oil companies and other user PSUs; 24% through public offer to domestic investors after the strategic partner is inducted.	Decision being implemented.
21.	Engineering Projects (India)Limited (EPIL) (V:2.2) GoI firstly to try disinvestment of 74% of its holding as approved by Cabinet; in the absence of satisfactory response, closure and sale of asset	Decision being implemented.
22.	Hindustan Prefab Limited (HPL) (V:2.3) GoI to offer 74% of its holding to a strategic buyer	Decision awaited.
23.	IBP Limited (IBP) (V:2.4) GoI to hold 26% and offer upto 33.9% of the company's equity out of GoI holding of 59% to strategic buyer	Decision awaited.
24.	National Thermal Power Corporation (NTPC) (V:2.5) - No disinvestment presently	Accepted
25.	NEPA Ltd. (NEPA) (V:2.6) Immediate sale of 51% to a strategic partner which could go up to 100%	Decision awaited.
26. 27.	Ranchi Ashok Bihar Hotel Corporation and Utkal Ashok Hotel Corporation Ltd. (V:2.7,2.8) ITDC to disinvest 100% holding in favour of any private entrepreneur	Decision being implemented.
28.	Electronics Trade and Technology Development Corporation (ET&T) (VI:2.1) ET&T to discontinue all its operations with immediate effect and sale of assets of the company	Decision awaited.
29.	Hindustan Vegetable Oils Corporation Ltd. (HVOC) (VI:2.2) hiving off breakfast food division and sell off 100% ; Close down of operations in vanaspati and packaging of refined oil	Decision awaited.
30.	Hindustan Zinc Ltd. (HZL) (VI:2.3) 25% equity to be offered to strategic partner with role in management	Decision awaited.
31.	Hotel Corporation of India Ltd. (HCIL) (VI:2.4) The hotels at Mumbai and Delhi to be sold as separate units; Initiate dialogue with J&K government for Centaur Srinagar and AI to decide about the flight catering services	Decision being implemented.

Recommendations		Government Action
32.	National Hydroelectric Power Corporation Ltd. (NHPC) (VI:2.5) No disinvestment presently	Accepted
33.	Pyrites Phosphates & Chemicals Ltd. (PPCL) (VI:2.6) Initiate action to sell Amjhore and Saladipura units to strategic buyers and close down Dehradun operations	Decision awaited.
34.	Rehabilitation Industries Corporation Ltd. (RICL) (VI:2.7) With immediate effect discontinue all the operations and sale of assets	Decision awaited.
35.	Fertiliser and Chemicals Travancore Ltd. (FACT) (VII:2.1) Offer a minimum of 51% equity to strategic buyer along with management control	Decision awaited.
36.	Hindustan Latex Ltd (HLL) (VII:2.2) Offer a minimum of 51% equity to strategic buyer along with management control	Decision awaited.
37.	Indian Petrochemicals Corporation Ltd. (IPCL) (VII:2.3) Offer 25% equity to strategic buyer along with management control	Decision being implemented.
38.	National Aluminium Co. Ltd (NALCO) (VII:2.4) Offer of sale of upto 30% equity to retail as well as institutional investors including a GDR issue of 15%	Decision awaited.
39.	National Fertiliser Ltd (NFL) (VII:2.5) Offer a minimum of 51% equity to strategic buyer along with management control	Decision awaited.
40.	Neyveli Lignite Corporation Ltd (NLC) (VII:2.6) No disinvestment, presently.	Accepted
41.	Steel Authority of India Ltd (SAIL) (VII:2.7) No disinvestment, presently. Government assistance in writing –off IISCO’s losses and sale of IISCO. Conversion of SAIL’s SDF dues into equity.	Accepted
42.	Air India Ltd (AI) (VIII:2.1) Infusion of Rs. 1000 crore as equity, followed by strategic sale by issue of new shares reducing Government holding to 60%. Subsequent offer of sale of 20% to domestic investors.	Decision awaited.
43.	Central Electronics Ltd (CEL) (VIII:2.2) Priority to CEL’s performance improvement. One year to reduce manpower through VRS and another year to improve performance. If substantial surplus manpower reduction is not achieved, disinvest CEL through a trade sale after hiving-off defence related operations.	Decision awaited.

Recommendations		Government Action
44.	<p>Hindustan Steel Works Construction Ltd. (HSCL) (IX:2.1)</p> <p>Government should try to close down the enterprise. If it does not find it feasible to do so, the only alternative would be to continue the enterprise by meeting recurring annual cash losses of around Rs. 60-70 crores per annum, after meeting statutory liabilities of Rs. 136 crores.</p>	Decision awaited.
45.	<p>State Trading Corporation (STC) (IX:2.2)</p> <p>- Offer of entire GoI holding to a strategic buyer, after reserving 5% share for employees who opt for VRS at a discount to the strategic buyer's price. Manpower reduction through VRS should be undertaken simultaneously with the decision for disinvestment.</p>	Decision awaited.
46.	<p>Minerals and Metal Trading Corporation of India Ltd. (MMTC) (X:2.1)</p> <p>Offer of 51% equity through strategic buyer alongwith reduction in employee strength through implementation of suitable VRS. Offer of sale to public, when the value of the residual equity holding of government increases as a result of transfer of management control.</p>	Decision awaited.
47.	<p>National Mineral Development Corporation Ltd. (NMDC) (X: 2.2)</p> <p>Offer of shares up to 20-25% to selected JV partner in return for joining hands with NMDC in their overseas venture(s). Subsequently disinvestment through offer of sale. If disinvestment of up to 20-25% to selected JV partner is not feasible, equity up to 49% should be sold in stages in domestic or international market.</p> <p>Government should retain 51% of the equity till an effective regulatory mechanism is put in place to regulate exploration and export of iron ore.</p>	Decision awaited.
48.	<p>Paradeep Phosphates Ltd (PPL) (X: 2.4)</p> <p>Disinvest not less than 51% holding through strategic sale. The strategic sale should be initiated simultaneously with the implementation of FRS-II. Later, GoI can disinvest its balance holding through public issue to realise better value for its remaining holding.</p>	Decision awaited.

Recommendations		Government Action
49.	<p>Projects & Equipment Corporation Ltd. (PEC) (X: 2.5)</p> <p>No disinvestment at present.</p> <p>In case there is no significant increase in the turnover and profitability of PEC from the exports from the small and medium scale industries within two years, the Government should offer 100% equity in the company to a strategic buyer. In the absence of investor interest in PEC, there will be no alternative but to close the company.</p>	Decision awaited.

APPENDIX V

Disinvestment Modalities Recommended in Report I to X and Action Taken by Government

Modalities of Disinvestment	No.	Names of PSUs	Status of Government Decision				
			Accepted	Deferred	Implemented	Being implemented	Awaited
Trade Sale	6	ITDC, MFIL, HCIL, R-Ashok, U-Ashok, PHL				MFIL, HCIL, R-Ashok, U-Ashok	ITDC**, PHL
Strategic Sale	23	HTL, ITI, BALCO, BRPL, KIOCL, MFL, EIL, HPL, IBP, NEPA, HZL, PPCL, NFL, FACT, IPCL, HCL, SCI, HLL, AI, HSCL, STC		NFL, FACT		HTL, BALCO, KIOCL, EIL, IPCL	ITI**, BRPL, MFL**, HPL, IBP, NEPA, HLL**, PPCL, HCL, HZL**, SCI, AI, HSCL, STC, MMTC, PPL
Offer of Shares	5	GAIL, CONCOR, MTNL, NALCO			CONCOR, MTNL**	GAIL**	NALCO, NMDC
No Disinvestment	1	RITES	RITES				
Disinvestment deferred*	10	OIL, ONGC, MOIL, NTPC, NHPC, NLC, POWERGRID, SAIL, CEL	OIL, ONGC, NTPC, MOIL, NHPC, PGCL, SAIL, NLC				CEL**, PEC
Closure/sale of assets	4	EPIL, ET&T, HVOC, RICL				EPIL	ET&T, HVOC, RICL
Total	49		9	2	2	11	25

* Pending fulfilment of certain specified conditions.

**Some decisions have reportedly been taken by Government in respect of these PSUs, but no formal communication has been received by the Commission.