REPORT III

DISINVESTMENT COMMISSION

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INTRODUCTION

This is the Third Report of the Disinvestment Commission[1] following the presentation of the First Report on 20th February, 1997 and the Second Report on 17th April, 1997. In the first two Reports, several recommendations have been made for improving corporate governance and enhancing the value of shares in the Central Public Sector Undertakings to be sold by the Government. These are contained in the general recommendations in Part B of the First Report and Part A of the Second Report. Different modalities for disinvestment have also been recommended for the nine PSUs covered in the first two Reports. Transparent and competitive procedures for disinvestment have also been suggested in these Reports. Apart from general analysis and recommendations, this Report contains specific recommendations for six more PSUs.

[1] Constituted vide Government notification No.11013/3/96-Admn. dated 23rd August, 1996

1. GENERAL ISSUES ON DISINVESTMENT AND RECOMMENDATIONS

The First Report of the Commission was submitted more than three months ago. The Honourable Finance Minister had indicated in his budget speech that " the Government intend to proceed with the disinvestment in the three companies covered in the First Report along the lines suggested by the Commission" . It is hoped that further steps for actual implementation of the Commission's recommendations in these three companies and decisions in respect of the other six companies covered in the Second Report submitted in April, 1997 would be expedited. The Commission would like to point out that unless there is speedy implementation of the recommendations made in the successive reports of the Commission, it would be difficult to achieve disinvestment of the order of Rs. 4800 crores as envisaged by Government for 1997-98 nor the other objectives of the disinvestment process itself.

The Commission is concerned that delays in taking a view on the recommendations of the Commission on individual PSUs particularly where these relate to bringing down Government's share holding to below 50 per cent or strategic sale, could have adverse impact on the relationship of the concerned PSU with their financing bankers and institutions, major creditors, and their investors where equity or debt has already been placed with private investors. The delays, similarly, may adversely affect negotiations that the concerned PSU might be carrying on with regard to joint ventures, long term collaboration and similar arrangements. On this ground too, there is a need to reduce to the minimum the time lag between the submission of reports on individual PSUs by the Commission and Government's decisions thereon.

The Government has so far referred 50 PSUs to the Commission. In the preamble to the terms of reference for the Commission it has been stated that the Commission is being constituted in pursuance of the Common Minimum Programme (CMP) of the United Front. The CMP refers to the various aspects of public sector and states that ".... it is widely acknowledged that the public sector required to be reformed and restructured .... the Government will identify public sector companies that have comparative advantages and will support them in their drive to become global giants .... other profit making and efficient public sector companies will be strengthened and their managements professionalised .... sick or potentially sick public sector companies will be rehabilitated through a menu of options .... the question of withdrawing the public sector from non-core and non-strategic areas will be carefully examined

.... the Government will establish a Disinvestment Commission to advise the Government on these steps .... Any decision to disinvest will be taken and implemented in a transparent manner .... revenues generated from such disinvestment will be utilised for health and education and a part of such revenues will be earmarked to create an Investment Fund which will be used to strengthen other public sector enterprises". Subsequent announcements of policy have clarified the levels of disinvestment in core and non core industries. In core industries disinvestment could go up to 49% and in non core industries it could go up to 74% or more.

In the 50 PSUs so far referred to the Commission there are both core and non-core PSUs. The Commission's recommendations made so far cover both categories of PSUs. The Commission has also proposed in some cases measures for restructuring and strengthening the PSUs prior to disinvestment. A Disinvestment Fund has also been recommended not only for strengthening PSUs and restructuring them before disinvestment to enhance share values but also for providing benefits to workers likely to become surplus in cases of restructuring or closure. The main intention in making these recommendations for the creation of the Fund and its use is to ensure, and demonstrate, that the proceeds of disinvestment are used for long term benefits to the budget and the economy. In this connection it would be relevant to quote the 22nd Report of the Parliamentary Standing Committee for Industry presented to the Parliament on the 22nd April, 1997. " The Standing Committee hopes that the Disinvestment Commission will have a moderating influence on the government and the nation's 'crown jewels' . . . are not frittered away."

One of the major objectives in establishing the Disinvestment Commission is to introduce transparency and establish the credibility of the disinvestment process. As noted above the Government is yet to announce decisions on the recommendations made in the first two reports of the Commission. At the same time disinvestment in some other loss making PSUs has reportedly been suggested without reference to the Disinvestment Commission. The Commission would like to point out that such a course, if pursued, will not only be contrary to the major objectives and the terms of reference of the Commission but also prevent the Commission from taking a coordinated view of disinvestment in PSUs in accordance with a broad based strategy. In this context it would be relevant to note that the Parliamentary Standing Committee on Industry in its 20th Report presented to Parliament on 30.8.1996 has also observed that " . . . to suggest that the (Disinvestment) Commission will prepare long-term plans of disinvestment only for public sector undertakings that are referred to it will severely limit its authority."

One other term of reference (No.V) of the Commission requires the Commission "to recommend a mix between primary and secondary disinvestment taking into account the Government's objective, the relevant PSU's funding requirements and the market conditions". This term of reference recognises the need for coordination between the disinvestment of Government's equity and the funding requirements of the relevant PSU. In the case of PSUs referred to the Commission, this has been kept in view while making specific recommendations. However, the Commission has received a communication from government that in particular cases of PSU's own requirement of funds, their public offer of shares could proceed independently of the proposed disinvestment and the Commission could then take due note of such "primary disinvestment" while making recommendations for disinvestment of Government shares in those PSUs. This has been justified on the ground that PSUs should have the autonomy of raising resources. While this shows a welcome change in the attitude to PSUs, the Commission is of the view that such an approach on this limited issue will be inconsistent with the terms of reference and will not enable the Commission to take a coordinated view or to recommend a mix between primary and secondary disinvestment. The need for coordination arises from the following considerations. Flotation of additional primary equity in the capital market by the PSU will reduce the percentage of Government holding. This will restrict the scope for disinvestment of the shares in the PSU by Government. In those cases where disinvestment has already taken place the exercise of such autonomy may result in some of the core sector PSUs going out of the Public Sector as a result of dilution of Govt. holding below 51%. In other cases the scope for disinvestment will be substantially reduced by some PSUs going for additional equity raising well ahead or in excess of their assessed needs. This may also create an overhang of shares and reduce the realization on disinvestment of Government shares. It is also possible that in certain cases debt may be a better alternative to raising equity for meeting the funding requirements of the PSUs. It is therefore suggested that Government reviews this position.

The Commission would like to draw attention to another important area of 'corporate governance' relating to the composition of the Board of Directors of PSUs in which disinvestment has already taken place. Such disinvestment has taken place in 39 PSUs before the Commission was constituted. Further disinvestment would be required in many of them and indeed some of them are already included in the 40 PSUs referred to the Commission. It has, however, been noted that even where disinvestment has already taken place, by and large, there has been no change in the composition of the Board of Directors to

give representation to the non-government share holders. In order to improve the investor perception of PSUs, and to enhance share value in subsequent disinvestment, it is necessary for Government to induct immediately representatives of non-government shareholders into the Board of Directors. This can be done by amending the Articles of Association where necessary to provide for election of Directors and by Government exercising its rights as the majority shareholder to enable the election of competent nominees of non-government shareholders. This recommendation has already been covered in Part B of the First Report relating to provision for elected Directors. A further recommendation has also been made to induct experts and professionals from outside as non-executive directors. For inspiring investor confidence in the disinvesment process, for enhancing Government's receipts and for promoting efficient management of the PSUs, it is important to implement these recommendations along with other recommendations in Part B of the First Report and Part A of the Second Report.

There are also reports about the Government giving greater autonomy to nine selected PSUs which have been identified as having the potential to become global giants. The Commission welcomes this move. However, the Commission is of the view that the requisite autonomy should be granted to all PSUs, particularly those being considered for disinvestment, to improve investor perception of these Undertakings as also for enduring improvement in their performance and enhancing disinvestment proceeds. The Commission has already made recommendations for a graded delegation of autonomy for three categories of PSUs, namely, general autonomy to all PSUs, additional autonomy to moderate performers and full autonomy to strong performers. The Commission hopes that a comprehensive view will be taken for providing greater autonomy to all PSUs on the basis of its recommendations.

2. SPECIFIC RECOMMENDATIONS

2.1 Container Corporation Of India Limited

Evolution

Container Corporation of India Limited (CONCOR) was incorporated in 1988 under the Ministry of Railways with the objective of transporting international and domestic cargo by way of containers through the Indian Railways (IR).

Indian exports and imports are increasingly getting containerised and containerised cargo constituted about 6.8% of the total traffic handled by Indian ports in 1994-95. Assorted cargo called break-bulk, was increasingly transported by road rather than the railways. In addition, the break-bulk cargo had the potential to generate higher revenues per tonne per kilometre than any other segment. CONCOR was therefore established to cater to the growing market for assorted cargo and regain the market share from the road sector.

The paid-up capital of CONCOR as at March 31, 1996 was Rs. 64.99 crores and the Government of India had disinvested 23.06% of its holding in two tranches in FY1992 and FY1994. The current shareholding pattern is as follows:

Table 1 Shareholding pattern (%)

Share holder	Holding
Government of India	77
Morgan Stanley	11
SBI Capital Market Ltd.	5
Henry Schroders	4
Jardine Fleming	2
Public	1
TOTAL	100

The shares of CONCOR were listed on the Bombay Stock Exchange (BSE) in February, 1996 and the share prices have shown a high volatility varying from a low of Rs. 86 in Feb. 96 to a high of Rs. 432 in April, 1997. Weighted by market capitalisation, the average traded price in 1996-97 was Rs. 287 with an average volume of 40,000 shares. The closing share price on the BSE on 28th May, 1997 was Rs. 585.

Industry Analysis

Containerisation - Rationale

Containerisation brought the benefits of road transport to the rail sector. Movement of assorted cargo in minimum units became possible directly from the place of production to the place of consumption. This led to the free flow of cargo between different modes of transport - roads, rail and waterways. Thus, containerisation has been used widely by all developed nations in international traffic. Containers were also adopted as basic storage units by shipping lines world wide for moving break-bulk cargo.

Structure & Government Policy

The multi-modal transport industry caters to the transport of assorted cargo. The main players in this industry are CONCOR, IR and road transporters. The main activity of these operators is to consolidate cargo and then transport it from production centres to consumption centres either by rail or road.

Till 1990s the sector was highly regulated and the Customs did not allow private parties to move import/export containers by road. They were also not allowed to set up any bonded warehouses and thus, there was a shortage of inland container depots (ICDs).

The sector today, is largely liberalised. A large number of transport and freight forwarding companies have acquired the status of Multi-modal Transport Operators (MTOs). Private enterprises have been allowed to set up and operate ICDs with rail head and Custom Bonded Inland Container Depot (CFS) without rail head facilities, with the necessary approvals. This has resulted in a rapid expansion of business and has increased inland penetration of containers from Indian ports to the ICDs. The number of containers that move to the hinterland from the ports has increased from 9.7% of the total traffic in FY 91 to about 26% of the total traffic in FY 96 and is expected to go upto 36% by the year 2000. The GoI has also passed the MTO Act in 1993 to regulate the growth of the industry.

Even though the terminal operations have been fully liberalised, haulage operations by rail remains a monopoly of CONCOR.

Market Size and Competition

The cargo from international traffic formed around 44 million tonnes or 20% of the total exports and imports in FY 96. CONCOR transported nearly 8.5 million tonnes of international cargo and nearly 2.2 million tonnes of domestic cargo in

1995-96. In the international traffic, the rest of the cargo was taken by road while in the domestic sector it was taken by IR and the road sector.

CONCOR receives 63% of its traffic in the Delhi-Bombay corridor. The Bombay/JNPT ports account for 58% of the total container traffic in India. The company is well placed on high traffic paths-both in terms of infrastructure and haulage.

The main competition to CONCOR is from the road sector. Movement of goods through road-even though not economical-is ideal because of its flexibility, door-to-door services, greater reliability and speed. These factors have contributed to the success of the road sector in the seventies and eighties.

On the other hand, movement of goods through road has its own problems such as :

- The main road network comprising national and state highways has not matched the traffic growth. Much of the expansion of the road network has been through building of rural network.
- Inadequate road network has led to higher transportation costs.
- There are delays due to congested sections, existence of railway level crossings, octroi posts and other tax barriers.

Taking all the above factors into consideration and given the long distances involved between the main inland production centres and the gateway ports, a properly functioning system for movement of containers by CONCOR, on rail would have a distinct comparative advantage over road in the long term. CONCOR is a natural monopoly player because of the support received from IR. Thus, CONCOR's competitive position is strong and is likely to remain so in the medium to long term.

Business Analysis

The activities of CONCOR can be divided into two primary and non-overlapping operations viz., haulage of containers and terminal activities.

Haulage of containers involves charging the customer for carrying the containers and paying freight charges to the IR who provide the pathways.

The activities at the origin and the destination form the terminal activities. CONCOR renders two types of services. It provides revenue seeking activities such as handling manual labour for stuffing and destuffing the containers with

cargo and mechanical loading and unloading through forklifts and cranes. Apart from this, CONCOR undertakes all documentation and clearance activities. The second service is rent seeking which is by way of ground rent and warehousing charges for providing storage space and proper upkeep of in transit containers.

The percentage of revenue from each of these operations for the last two years is given below :

Table 2 Break up of revenue

Activity	FY95	FY 96
Haulage	79%	77%
Terminal Handling	21%	23%
Total	100%	100%

As can been seen from the above table three fourths of CONCOR's revenues comes from haulage. A profitability analysis of the haulage activities and terminal activities reveals that CONCOR makes 36% operating profits on freight and has 18% profitability on terminal activities which is quite high when compared with companies in developed markets. This is due to the fact that CONCOR is able to pass on all freight increases to the customer because of its monopoly status and because of the large freight differential between rail and road haulage.

CONCOR's growth in the period FY92 to FY96 has been much higher than the growth rates of total international traffic. This has been possible due to increased containerisation of break-bulk traffic and also increased penetration of containers to the hinterland.

As shown in the table above, CONCOR gets 23% of its revenues from terminal handling operations. The company has built 16 ICDs in areas of large traffic. This well placed distribution network would pre-empt traffic from going to any fresh entrant. The threat from freight forwarders is therefore minimal.

In summary, it may be mentioned that CONCOR's performance with respect to growth in container traffic and increase in distribution network has been commendable. The company has capitalised on its monopoly status to pass on costs to consumer, but the management needs to be proactive against future competition.

Financial Analysis

The financial performance of CONCOR for the past five years is given below:\

Table 3 Financial Performance

Rs.Crores	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	389.4	217.3	114.5	81.1	50.0
Operating Profit	110.7	53.1	27.2	15.9	13.3
Profit after Tax	53.1	22.9	20.8	15.3	11.1
Equity Capital	65.0	65.0	65.0	65.0	47.0
Tangible Net Worth	181.4	136.9	116.9	98.5	65.3
Gross Margin (%)	28.4	24.4	23.8	19.6	26.6
Net Margin (%)	13.6	10.5	18.2	18.8	22.2
ROCE (%)	56.4	34.2	23.4	22.8	26.8
RONW (%)	29.7	16.7	17.8	15.5	17.0
Earnings Per Share (Rs.)	8.17	3.52	3.20	2.35	2.36
Dividend (%)	12.0	6.0	4.0	2.7	1.1

CONCOR's operating income has grown at a compounded rate of 67% and the profit after tax has grown at a rate of 41% over the five year period as given in the above table. The figures reflect the high growth rates in the industry and CONCOR's ability as a monopolist to pass on costs to the end user.

High operating margins have been contributed by increasing volumes and ability to pass on major costs to the end user. Improvements in cabotage traffic (carrying domestic break bulk traffic in containers such that empty container flow is reduced) also has resulted in improving profits in the last two years. With its earnings increasing by three times over the last three years, and a relatively low level of capital employed, the ROCE has exhibited a phenomenal growth rate.

Strengths and Areas of Concern

Based on the above business and financial analysis, the strengths and areas of concern for CONCOR are as below :

Strengths

Monopoly status The operations of CONCOR are in the nature of a monopoly. CONCOR's monopoly would remain unchallenged in rail haulage till IR provides equal level playing field to all players; this is unlikely in the short-term. Further, gestation time of nearly 3-4 years would be required for any new private sector container projects to go on-line.

Widespread Distribution Network CONCOR has 16 ICDs and 10 CFSs spread across the country. Moreover CONCOR has developed a strong equation with the shipping industry which is expected to help consolidate business.

Huge untapped market Containerisation has not really got off in India and as per a NCAER study (1993), it is estimated that intercity containerised cargo potential is 113.53 million tonnes. Thus, there are significant opportunities for growth for CONCOR.

Areas of Concern

Competition from the Road sector Road is an ideal medium for gathering non-bulk cargo even though it is not economical. This is because of certain factors which contribute to the success of road transport such as flexibility, door to door service, reliability and speed.

Competition from private freight forwarders and consolidators After the liberalisation and opening up of this sector, a large number of transport and freight forwarding companies have acquired the status of MTOs. Of these 10 are foreign companies. CONCOR is expected to face competition from these players.

Reliance on Indian Railways CONCOR's dependence on the railways is total. The business projections of CONCOR have to be matched by corresponding expansion of the Railway's capacity to handle the volumes especially in the busier corridor like Mumbai-Delhi.

Recommendations

From the foregoing analysis CONCOR seems to be well entrenched with little threat of competition in the immediate future. Its well organized distribution net-work, planned investment in rolling stock and technological improvements in operation would enable it to hold its own and maintain its market share. Its strong links with the Railways give it further competitive advantage.

The Commission has classified CONCOR in the core group of PSUs. A detailed analysis of the company would further reinforce this view. Its links with the Railways are critical for its operational efficiency. It also has a large volume of assets on lease from the Railways. It also has access to the railway personnel which enables close coordination with the Railways and contributes to improving efficiency in operations. For all these reasons CONCOR, in the

view of the Commission, should continue to be in the core sector and disinvestment in the company should be only upto a maximum of 49%.

The requirement of funds for CONCOR for its capital expenditure programme needs to be taken into account before taking a decision on further disinvestment in the company. Over the next 5 years the business plan of CONCOR would envisage capital expenditure of Rs. 253 crores towards development of terminals, Rs. 380 crores towards rolling stock additions, Rs. 120 crores towards technological improvement in area of terminal handling operations, communications, database management and investment in specialised break-bulk containers. The rolling stock investment is covered by a World Bank loan of Rs. 380 crores. The other requirements would need to be raised by CONCOR on its own.

Government have already disinvested to the extent of 23% in the company in FY 92 and FY 94. The shares are mostly held by foreign financial institutions. Its current debt-equity ratio is low but the World Bank loan of Rs. 380 crores which would become repayable after 2002 could limit its ability to raise further debt in the market for its projected capital outlay. A public issue that would enable the company to raise Rs. 250-300 crores would need to be considered. **Taking this into account the Commission recommends that disinvestment of Government holdings may be restricted to 100 lakh shares and the company may also go in for public issue of 125 lakh shares. This would bring down Government holding to around 51%.**

It is recommended that a book building process be adopted for disinvestment to institutional investors in the Indian market which could be followed with a retail offering to small investors at a discount of 10% to the institutional price. As has been mentioned in Report II of the Commission, it is suggested that CONCOR should join the National Securities Depository Limited (NSDL) before any issue is contemplated from either the company or from the government. In addition to the benefits of dematerialisation, the other benefit to small investors is that they can buy shares in quantities much less than the normal tradable lots which can also be traded on the National Securities Exchange (NSE) without any discount for odd lots.

2.2 Kudremukh Iron Ore Company Limited

Evolution

Pursuant to an agreement between the Government of India and Government of Iran, Kudremukh Iron Ore Company Limited (KIOCL) was incorporated as an 100% export oriented unit (EoU) in 1976 for mining low grade iron ore available in the Western Ghats. The arrangement was to supply iron ore concentrate to the National Iranian Steel Corporation (NISC) and the financing of the entire project which was estimated at Rs. 647 crores was to be borne by the Iranian government. However, due to the overthrow of the regime in Iran, the new Iranian government reduced the funding for the project and the Government of India had to supplement the balance project cost. The arrangement for supply of iron ore concentrate also fell through due to continued problems in Iran. KIOCL had to find a new customer for its product. While the plant was designed to produce 7.5 million metric tonnes per annum (mmtpa) for supplying to NISC, KIOCL had to make various process and plant modifications for meeting the requirement of a new customer from Romania which resulted in scaling down the plant capacity to 6.8 mmtpa.

In 1987, KIOCL undertook a project to set up a 3 mmtpa pelletisation plant in Mangalore. KIOCL is now in the process of expanding this capacity of the pelletisation plant to 4 mmtpa by enhancing the capacity of the existing plant by 0.5 mmtpa and by setting up a new shaft pelletisation plant with 0.5 mmtpa capacity.

The share capital of KIOCL as at March 31, 1996 is high at Rs. 634.51 crores on account of the conversion of debt into equity by the Government in the eighties in order to reduce the interest burden on the then loss making company. This conversion Government had disinvested about 1% of its holding in January 1995 to GIC and its subsidiaries, mutual funds and employees. KIOCL's shares are listed on the Bangalore and Chennai Stock Exchanges but no trading has taken place in the scrip.

Industry Analysis

Iron Ore

Iron ore constitutes the basic raw material for the manufacture of steel. Since the demand for iron ore moves in conjunction with the total steel production, the iron ore industry is cyclical in nature, with each upswing and downswing phase lasting about 3-4 yeas as shown in the table below :

Table 1 World Steel & Iron Ore Production

Year	Crude Steel (MT)	Iron Ore (MT)
1995	724	955
1994	730	931
1993	723	921
1992	737	951
1991	710	980
1990	786	991
1989	780	964
1988	737	946
1987	714	921
1986	719	910

In the medium term, it is estimated that the demand for steel will show a downward trend from the developed countries. Any subsequent growth in demand is likely to come mainly from the developing countries especially from the Asian region.

The total iron ore imports by the consuming countries in 1995 were 423 mmtpa, which are expected to grow to about 480 mmtpa by the year 2000. Almost 90% of the increase in the import demand in this period is expected to be from Asia, especially China, Korea and Taiwan.

Globally three leading iron ore companies namely CVRD, BHP and RTZ control nearly 35% of the world iron ore production and the ten largest companies together control almost 60% of the world iron ore supply. The major iron ore producing countries and their production and exports levels in 1995 are given below:

Table 3 World production and export of iron ore

Countries	Production (mmtpa)	% share	Exports (mmtpa)	% share
China	239.0	24.6	-	-
Brazil	167.8	17.3	125.0	7.4
Former Soviet Union	136.0	14.0	32.0	7.4
Australia	128.7	13.3	126.2	29.3
United States	58.4	6.0	-	-
India	57.5	5.9	28.5	6.6
Canada	37.0	3.8	30.1	7.0
South Africa	32.3	3.3	19.6	4.5
Sweden	19.9	2.1	15.4	3.6
Venezuela	16.1	1.7	10.7	2.5
World Total	970.7		430.5	

Prices of Iron ore are typically negotiated at the beginning of each year. The prices of iron ore follow the steel prices with approximately a two year lag as they are based on the demand pattern of the previous year. In 1995, international prices firmed up with an increase of 7.9% and 5.8% in the prices of lumps and fines respectively. In 1996, prices further increased by 5% and 6% respectively. The prices of pellets increased by 12% in 1995 and 6-7% in 1996.

India is the sixth largest producer of iron ore in the world with a 6.6% share of world trade in FY 95. Iron ore production in India has grown from 55.6 mmtpa in FY 91 to 66.2 mmtpa in FY 96. In India, the major reserves of iron ore are located in the states of Madhya Pradesh, Bihar, Orissa, Goa and Karnataka. The supplies from Goa, Madhya Pradesh and Karnataka are presently exported. The two major steel producers in India viz., SAIL and TISCO meet their requirements of iron ore from their own captive sources. A profile of major iron ore producers is given in the table below :

Table 4 Profile of Iron Ore Producers

	KIOCL	NMDC	Sesa Goa Limited
Nature of Ore	Low grade ore (38% Fe content)	High grade ore (66% Fe content)	Medium-high grade (60-63% Fe content)
Products	Concentrate, Pellets	Lumps, CLOs, Fines	Lumps, Fines
Market	Exports - 93% Domestic - 7%	Exports - 52% Domestic -48%	Exports - 97% Domestic - 3%
Major Customers	Iran, Japan, China, Turkey, Taiwan	Japan, Domestic sales	Japan,China Western Europe
Sales (mmtpa)	6.23	14.36	4.13

Iron Ore Pellets

Iron ore pelletisation capacity is globally available in 20 nations with an installed capacity of 264 mmtpa. Worldwide around 18 million tonnes of pellets were exported in 1994. The major producers of pellets in the world are located in the USA and in Russia. Together they account for 52% of the world capacity.

Pellets account for about 80% of total DR feedstock used in the manufacture of Direct Reduced Iron (DRI). The DRI capacity has been increasing rapidly in gas rich countries as well as in India, requiring increased quantities of pellets

owing to growth in world electric arc furnace (EAF) steel production. High steel scrap prices (the primary raw material for production of EAF steel) results in increased demand for DRI and HBI.

Business Analysis

KIOCL is a 100% EoU which primarily exports iron ore in the form of concentrate and pellets. KIOCL's product mix consists of blast furnace (BF) pellet feed, DR pellet feed, high silica concentrate, broken pellets or chips and pellet fines. The break-up of exports is given in the table below:

Table 4 Exports

FY	Concentrate (mmt)	Pellets (mmt)
1996	3.65	2.58
1995	3.44	2.25
1994	4.20	2.34
1993	3.36	1.38
1992	3.92	2.15

KIOCL currently exports concentrate and pellets to 8 nations, most of them in the Asian continent. 70% of the KIOCL's sales are routed through long term FOB contracts except for China where the sales are through yearly contract. KIOCL's supplies are largely restricted to geographically proximate countries.

The average realisation per ton (fob) from exports for pellets have been about 35-40% higher than concentrates and have fluctuated within a narrow band over the past five years. KIOCL's domestic sales realisation per tonne has however been higher but the volumes have been much lower.

Although domestic realisations are much higher than exports, KIOCL prefers to export its products due to greater reliability of offtake by the foreign customers. Long term export contracts have helped KIOCL to plan its production even though realisations thereunder may be lower than the domestic realisation. As a 100% EOU, there is in any case a limit on the extent of sales in the domestic market.

KIOCL's mines are located in the Aroli Gangamula range of Western Ghats with average iron content of 38% while the iron content in the NMDC mines at Bailadila is about 66%.

Out of the total mineable reserves of about 430 MT in the existing mines, the ore available as on date for mining is about 165 MT. In addition, mineable reserves from the Nellibeedu deposits are estimated at about 80 MT. Taking into account all these factors, a reasonable forecast of the mine life is about 12-13 years. However, if the mining lease for the Gangrikal deposits is obtained by the company, the life of the mining deposits can be enhanced by a further period of 20 years.

Due to the inferior nature of ore, KIOCL has to undertake greater degree of benefiication of the ore for improving the iron content. Power and consumable stores and spares utilised in the manufacturing process account for 70% of the cost of sales. The cost of power, fuel and utilities account for 27% of the operating income of KIOCL where as for NMDC it is quite lower. Similarly, the consumable stores account is much higher in case of KIOCL when compared with NMDC.

KIOCL has 2447 employees on its rolls as at 31st March, 1995. Employee cost as a percentage of operating income is lowest for KIOCL (6%) when compared with other players in the industry like NMDC (13%) and Sesa Goa (7%).

KIOCL plans to enter downstream value addition through manufacture of 0.155 mmtpa of low phosphorus-low sulphur pig iron and 0.05 mmtpa of ductile iron spun pipe annually at Mangalore through a joint venture with Mecon and MSTC. The total estimated project cost is Rs. 328 crores and KIOCL's share of equity would be Rs.45 crores. The plant is expected to be commissioned within six to nine months.

Financial Analysis

The financial performance of KIOCL for the past five years is given below:

Table 5 Financial Performance

(Rs. Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	476.5	373.9	415.1	316.8	388.3
Operating Profit	139.0	79.0	108.7	105.4	145.1
Profit after Tax	95.0	57.6	93.9	99.9	138.3
Equity Capital	634.5	634.5	634.5	634.5	634.5
Tangible Net Worth	859.4	784.8	740.0	664.5	583.2
Gross Margin (%)	29.2	21.1	26.2	33.3	37.4
Net Margin (%)	19.9	15.4	22.6	31.5	35.6
ROCE (%)	11.7	6.1	10.8	11.6	20.1
RONW (%)	11.1	7.3	12.7	15.0	23.7
Earnings per Share (Rs.)	1.50	0.91	1.48	1.57	2.18
Dividend (%)	3.25	3.0	3.0	3.0	0

Gross margins have been continually decreasing since FY 92, but it has shown an upward movement in FY 96 mainly due to higher realisation in the iron ore market and more economical power, fuel, stores and spares usages. The non-operating income from inter-corporate advances which was 9.3% of the total operating income in FY 93 fell to 1% in FY 96 leading to a widening gap between gross margin and net margin. The power and fuel cost constitutes a major element of cost (27%) is due to the power intensive primary operations for beneficiation of ore. Power costs are expected to increase in future due to the substantial power tariff hike by Karnataka State Electricity Board. The power tariff went from 0.75 per kwh in FY 92 to Rs. 3.75 in FY 97.

KIOCL's return on capital employed has declined over the five year period between FY 92 to FY 96. KIOCL has a very high equity and zero debt due to the conversion of the loan of over Rs.375 crores by the Government into equity. Notwithstanding this, the dividend given by the company, which was zero in 1992, has stagnated around 3% thereafter. The interest foregone by the Government on a loan of more than Rs.375 crores over several years has made the company to show ROCE of 20% in 1992 which has since declined to 11.7% in 1996. The earning per share is hardly Rs.1.50.

KIOCL had made intercorporate deposits of more than Rs. 100 crores in FY 1992 and FY 1993 to some public sector companies. The repayment of interest and principal has been outstanding for the last four years. In the event of writing off these loans, the future profitability of the company could be substantially affected by a one time provisioning.

Strengths and Areas of Concern

Based on the above industry, business and financial analysis, the strengths and areas of concern of KIOCL are as below :

Strengths

Mining Company with downstream value addition facility KIOCL is in the business of extraction of iron ore. However, it has set up a pelletisation plant which improves the realisation. The company has also ventured into a number of downstream projects like pig iron, ductile iron pipes and coking ovens, etc.

F*ully mechanised and integrated operations* KIOCL's operations are fully mechanised and integrated right from captive mines to port facilities. For transporting the ore from Kudremukh to Managalore port, KIOCL has laid a 67 km long pipeline which gives sizable savings in transportation costs keeping in view the difficult terrain from Kudremukh to Mangalore.

Facility of captive berth for exports KIOCL being a 100% EoU, has a captive berth which can handle ships upto 65000 DWT. All the exports of KIOCL are handled through this berth.

Low employee cost The total employee cost as a percentage of operating income is the lowest for KIOCL as compared to other major players in the industry.

Areas of Concern

Low quality iron ore resulting in high cost The iron ore available in KIOCL's mines has an average iron content of 38% where as for steel making, iron content in the ore should be above 60%. Thus, a greater degree of beneficiation of the ore is required. This has resulted in increased cost for power, fuel, consumable stores and spares etc.

Depleting reserves Keeping the current levels of extraction of 22 mmtpa, the reserves may last for about 12-13 years. Even though the company has applied for fresh mining leases, there is uncertainty due to environmental regulations.

Management Process The past management process and philosophy with regard to the operations of the company and the investments made have not really helped KIOCL to position itself strongly for future growth.

Recommendations

The Commission has earlier classified KIOCL as a core group PSU. Having examined in detail the working of the company and the structure of the iron ore industry the Commission has now decided to review this classification. KIOCL processes low grade iron ore and beneficiates and pelletises it for export. It is an EOU unit and 93% of its production is exported. It has a market share of 11% in the production of iron ore in the country and 23% of iron ore exports. There is already significant private sector presence in the industry. In the light of the above, the Commission has decided to categorise KIOCL as a non core PSU.

On an analysis of the company it would be seen that the company faces certain short-term and long-term issues which need to be tackled effectively on a priority basis.

The existing mining lease would sustain the company's operations for about 8 years. The Nellibeedu deposits in respect of which prospecting work has been completed would extend the period by another 4-5 years if the mining lease could be obtained. In the longer run the company would need to obtain mining lease for the more substantial Gangrikal deposits which, however, is be-set with problems on account of opposition from environmentalists. The company has, therefore, an assured life of operation of about 12-13 years in its current business.

The company's agreement with Karnataka Electricity Board (KEB) for supply of power has run into trouble with the KEB claiming a much higher tariff for power supply than estimated by the company. The company has a claim of over Rs. 100 crores as arrears by the KEB on past supplies and also substantially higher power tariff in the future. Since the operations of the company are highly power-intensive, this has serious implications for the company's viability.

Faced with such prospects the company today could be said to be at the crossroads. Certain critical decisions would need to be taken to extend the operating life of the company through prudent and effective diversification programmes. The company is today without a permanent Chief Executive. **There is urgent need for strengthening the management of the company. A competent Chief Executive needs to be appointed immediately and the Board of Directors also needs strengthening by the induction of competent professionals from outside.**

Given the fact that the company has about 12-13 years of assured operating life and that major decisions regarding diversification need to be taken to ensure the future viability of the company, **the Commission feels that this would be the opportune time for inducting a strategic partner into the company. Selection of the partner may be made in accordance with the recommendations of the Commission contained in the First Report, after the necessary pre-qualification procedure. Government has already disinvested about 1% its holding in the company and is left with 99% of the equity of Rs. 634.51 crores. The strategic partner may be offered 30% of equity to start with and also inducted in the management of the company.. The Government may also enter into an agreement with the strategic partner providing for a further dilution of Government equity to the extent of 43% within two years, through a combination of further offer of equity shares of 10% to the strategic partner and public offer of the balance to the domestic institutional investors and the retail investors. This would leave 26% of the equity with Government. Such phased disinvestment would also enable the Government to realise a proper value for its shares and would balance the need for immediate management intervention in the company for business restructuring by inducting a suitable strategic partner with the possibility of securing higher value for Government shares while disinvesting beyond 30% in the next two years particularly if the Gangrikal deposits were to be available for exploitation by the company.**

KIOCL has a very high equity base thanks to the conversion of Government loans over Rs.375 crores into equity in the eighties. This would indicate the need for capital restructuring in the company before bids for strategic partnership are invited. The terms of conversion of a part of the Government equity into secured long term loan should take into account the fund requirements of the company for business restructuring and the company's ability to service the loan. Care should be taken not to lessen the attractiveness of the company to the strategic partners. The Financial Adviser to be appointed by the SEG for valuation and drafting the terms and conditions of the bid for strategic sale should be specifically asked to consider this for Government to take the appropriate decision.

Another factor which needs to be reflected in the valuation is the establishment of the subsidiary venture KISCO for production of pig iron and ductile iron spun pipes which is expected to go on stream by the end of 1997. The

commissioning of these plants will add significantly to the value of the company and increase its attractiveness to potential strategic partners.

2.3 Mahanagar Telephone Nigam Limited

Evolution

Mahanagar Telephone Nigam Ltd. (MTNL) provides basic telecom services in two metros cities of Delhi and Mumbai. The company commenced operations in April 1986 after taking over the management control and operations of the basic telecom network in the two cities from the Department of Telecommunications (DoT). The separation of MTNL from the parent was intended to achieve various objectives such as clearing the large backlog of waiting applications and improving the quality of telecom services, etc. One of the main objectives of forming MTNL was to raise necessary financial resources for telecom development in areas managed by MTNL as well as DoT.

MTNL has an equity base of Rs. 600 crores. As of date, the government has disinvested 34.27% of its holding in the following tranches:

Table 1 Past Disinvestment

Tranche	Year	%	Avg. Price Realised per share (Rs.)	Amount Realised (Rs.Crs)
I	FY 92	20.00	46.3	555.6
II	FY 94	12.82	171.9	1321.9
III	FY 96	1.45	156.3	136.0
	Total	34.27		2013.5

MTNL shares are listed on the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). The closing price of the scrip was Rs. 283.50 as on May 28, 1997 on the BSE. The 52-week high/low on the BSE was Rs.300 and Rs. 185 respectively. MTNL has a dominating 8% weight in the BSE-Sensex (second only to SBI with 8.03%). Its price movements have shown an 84% correlation with the BSE-Sensex.

The past disinvestments were made mainly in favour of financial institutions, mutual funds, and nationalised banks. Among all financial institutions, the UTI is the largest non-governmental share holder with about 14% stake. The current shareholding pattern of MTNL is as given below:

Table 2 Share Holding Pattern

Name of the Shareholder	% age holding
Govt. of India	65.73
Financial Institutions	16.95
Foreign Inst. Investors	14.24
Banks and MFs	2.74
Public/Others	0.34
Total	100.00

Industry Analysis

Upto March 1996, the national fixed telecom network comprised 12 million direct exchange lines (DEL) of which about 22% were operated by MTNL. The national telephone density in India is quite low at 1 line per 100 persons (Lph); however, the telephone penetration levels in Delhi and Mumbai are 10 and 13 respectively. A comparison with other countries in the Asia- Pacific region shows that the telephone density even in the metro cities of Mumbai and Delhi is still quite low.

The Indian telecom industry is government controlled. The DoT is at present the only fixed-line operator. While basic telephone services for Delhi and Mumbai are provided by MTNL, the Videsh Sanchar Nigam Ltd., (VSNL) provides international telecom services.

In the context of a pressing need for better and more extensive telecom facilities, the government realised that the rate of expansion of telephone services could be accelerated to the desired extent only if private sector funding and enterprise was permitted. The National Telecom policy enunciated by the government in 1994 ended the monopoly of DoT in basic telecom services and paved the way for the entry of the private sector. The policy also paved the way for the entry of the private sector in value added areas such as radio paging, cellular services, etc. As far as basic services were concerned, it was also decided that in each operating area, there would be two operators, viz., one being DoT/MTNL (in Delhi and Mumbai) and the other a private operator.

However, the progress of implementation of privatisation has been tardy. As a result, the expected competition to MTNL from the private sector has not emerged and the monopoly status of its operations is likely to continue for some more time.

Notwithstanding this, the company has evolved counter strategies to meet emerging competition. These include offering value added services such as Integrated Services Digital Network (ISDN) which will help MTNL to offer a wide range of value added services like fax, voice mail and video conferencing through a single line. Other enhanced features which are being contemplated are intelligent networks, wireless in local loop (WILL) etc.

Business Analysis

MTNL offers basic telephone services, telex, dedicated leased lines, multimedia services, voice mail service etc. to consumers in Delhi and Mumbai. As of March 31, 1996 MTNL had 2.6 million lines. Over the past five years, the company has aggressively expanded switching capacity at a CAGR of 18% as shown in the table below:

Table 2 Additions to Switching Capacities

During the Year	1996	1995	1994	1993	1992	CAGR
Switching Capacity (A)	3.1	2.6	2.1	1.8	1.6	17.9
DELs added (Mn)	0.4	0.4	0.3	0.2	0.1	
Total DELs (B)	2.7	2.3	1.9	1.6	1.4	16.9
B/A (%)	87	88	90	90	87	

As a consequence, there has been a fairly sharp decline in the waiting period for new connections from over 11 years in FY 91 to a few months currently. MTNL expects to be in a position to provide telephone services “on demand” from FY98.

An issue relating to the performance of MTNL is the issue of interconnectivity charges which is payable to DoT whenever its networks are accessed. Although these charges are essentially levied on the revenue from long distance calls, MTNL in practice pays them on the total calls to DoT (including local calls) due to the difficulty associated with segregating revenue from Subscriber Trunk Dialling (STD) and non-STD charges. In addition, DoT has proposed an increase in the interconnect charges, while MTNL has requested for continuing status quo for some more time.

Network Technology

MTNL's switching exchanges compare very favourably with switching exchanges in other countries in the world with about 91% of its lines being electronic of which 83% are digital. The company has constantly upgraded its network as reflected in the increasing proportion of digital lines. The network performance parameters in terms of call completion and fault rates have improved substantially over the period FY 91 to FY 96 mainly due to technological upgradations. At the current levels, the call completion and fault rates have generally shown steady improvement, as shown in the table below:

Table 4 Network performance of MTNL

For the year	FY96	FY95	FY94	FY93	FY86
Call completion - local (%)					
-Mumbai	90	93	92	89	93
-Delhi	95	95	95	95	77
Call Completion -STD (%)					
Mumbai	88	89	86	85	24
Delhi	89	88	87	85	30
Fault Rates (Nos./100Lines					
-Mumbai	11	19	19	17	21
-Delhi	23	23	26	23	35

An analysis of the customer profile and revenue generation reveals that:

- about 10% of the customers contribute 90% of revenues. These are typically commercial establishments.
- about 70% of the revenues are contributed by STD and ISD calls taken together.
- about 40% of the total traffic is accounted for by incoming calls for which no share of revenue is received by MTNL from DoT.

Financial Analysis

The financial analysis for the past five years is presented in the table below:

Table 5 Financial Performance

(Rs.Crores)	FY96	FY 95	FY 94	FY 93	FY 92
Operating Income	3518.6	3015.1	2521.7	1860.8	1573.0
Operating Profit	1847.8	1649.8	1390.3	1061.7	885.2
Profit After Tax	691.2	576.7	377.0	208.4	164.3
Equity Capital	600.0	600.0	600.0	600.0	600.0
Tangible Net Worth	2736.9	2127.2	1610.6	1326.4	1166.0
Gross Margin (%)	52.5	54.7	55.1	57.1	56.3

Net Margin (%)	19.6	19.1	14.9	11.2	10.4
ROCE (%)	19.1	18.7	18.8	17.1	17.7
RONW (%)	28.4	30.9	25.7	16.7	15.0
Earnings Per Share	14.9	13.3	11.8	12.4	11.5
Dividend (%)	20	10	10	8	6

From the above table it is evident that despite the low growth in revenue per DEL (CAGR of 6% during the five years ended FY96) MTNL's total income grew impressively at a CAGR of 22.3% mainly due to aggressive line expansions. However, revenue per line registered a sharp increase from Rs. 12706 in FY93 to Rs. 15172 in FY94. This was mainly due to a tariff increase and the introduction of the 3-minute unit call (for billing purpose) in May 1993. With no equity dilution and a good track-record of growth in profits, EPS has registered an impressive growth of 43% during the five years ended FY96.

Strengths and Areas of Concern

Strengths

Continued Monopoly Status: Even with the privatisation of the telecom sector, the monopoly status of MTNL will continue for some more time due to the tardy progress of privatisation. In addition, the relatively low telephone densities even in these two metro cities is expected to help the company to grow further and thus retain its strong position. MTNL's depreciated network and high cash generation is expected to provide it with high financial flexibility in a technology and capital intensive business.

Technological Capabilities: MTNL has the benefit of integrating equipment supplied by different companies with different technological standards. As such, the company is placed in a unique position of understanding and integrating technologies into the switching network. This is expected to provide a competitive advantage to the company.

Skilled Manpower: MTNL has on its rolls, the most technically qualified and experienced workforce in the industry. However, there could be poaching from the private sector companies once they are operational.

Areas of Concern

Skewed Consumer Mix: Currently about 10% of the customers of MTNL account for 90% of the revenues. This skewed mix of consumers makes MTNL vulnerable to skimming strategies by competition. The private operators are expected to skim the high end users by resorting to aggressive pricing

strategies. MTNL with its present level of autonomy and given the present regime of accountability may not be able to match such strategies.

Overmanning: As against the international norm of about 8-10 employees per thousand lines, MTNL has about 23 employees per thousand lines indicating substantial overmanning. However, the company has frozen all recruitment during the past three years notwithstanding aggressive capacity expansions. As a result, it has attained impressive increases in employee productivity levels. Efforts towards reducing the extent of overmanning would need to be sustained.

Lack of Autonomy in operations: The pace of project implementation in MTNL is adversely affected by the obligation to participate in DoT's centralised equipment procurement process. There is need for greater delegation of powers to the Board of the company.

Recommendations

The Commission has already classified MTNL in the core group of PSUs. MTNL enjoys a virtual monopoly position in the provision of basic telephone services in the metropolitan areas of Delhi and Mumbai, competition being offered to a limited extent by operators of cellular phone service. While Letters of Intent (LOI) have been issued by DoT to Hughes-Ispat in Mumbai and HFCL in Delhi, it will be another year or two before any competition emerges in these areas for MTNL. While Hughes-Ispat has accepted the LOI, the LOI issued to HFCL is now sub-judice. The Telecom Regulatory authority of India (TRAI) has now come into existence and is expected to take over from DoT the regulatory functions in the field. It is, therefore, expected that over the next 3-4 years the nature of the industry will undergo a major change. The top segment will sooner or later get saturated and the competition will percolate down the line to the entire range of services. The TRAI will also have a role to play in bringing this about. That would be the time for a review of the position of MTNL as a core PSU and to consider disinvestment beyond 49%. For the time being the classification of MTNL as a core PSU is retained and, therefore, disinvestment is recommended only upto 49%.

Already 34.27% of MTNL shares has been disinvested leaving a balance of 14.73% or 88.3 million shares for disinvestment. The earlier disinvestment was mainly in favour of FIs, Mutual Funds and Nationalized Banks. Given the strength of MTNL in a high growth area such as telecom services, MTNL's shares would attract considerable interest among investors abroad.

The domestic market may also find it difficult to absorb a very large issue of this size. **The Commission, therefore, would recommend a GDR issue of 60 million shares (10%) and the appropriate timing may decided by SEG keeping in view the market conditions. MTNL's shares are already listed and actively traded with a sizeable weightage in the BSE Sensex. Soon after the GDR issue through the book building process a domestic offer of the balance 28.3 million shares consisting of 4.73% of the equity may be made to the institutional investors and to small individual investors at a discount over the institutional price.**

It is proposed that a book building process be adopted for disinvestment to institutional investors in the Indian market which could be followed with a retail offering to small investors at a discount of 10% to the institutional price. As has been mentioned in Report II of the Commission submitted in April, 1997, it is suggested that MTNL should join the National Securities Depository Limited (NSDL) before any issue is contemplated from either the company or from the Government. In addition to the benefits of dematerialisation, the other benefit to small investors is that they can buy shares in quantities much less than the normal tradable lots which can also be traded on the National Stock Exchange (NSE) without any discount for odd lot.

However, preparatory to disinvestment the Commission recommends that Government should address certain issues relating to corporate governance, and autonomy to MTNL. The policy of liberalization in the telecom sector has posed a challenge to MTNL and it has to respond by framing suitable strategies to counter competition and sustain its growth and profitability. Apart from upgrading the existing network of telephones and offering value-added services, MTNL would need to improve its service quality and customer relationship. In particular it would need to offer special treatment and resort to aggressive pricing strategies in the segment of high users which constitutes 10% of its total number of customers but contributes 90% of its revenues.

MTNL is not one of the 'Navratnas' selected for grant of greater autonomy. **However, considering its impressive track record over the past 10 years, the Commission considers it to be a "Strong Performer" and recommends full autonomy to the Board of Directors to enable it to conduct its operations successfully in the increasingly competitive environment.** In particular the following issues are highlighted for immediate attention.

- The Board of Directors should be broad-based in line with the Commission's recommendations in its First Report with the induction of a few reputed professionals with expertise in areas like finance and marketing. Since already 34.27% of the equity has been disinvested, Government should consider giving representation to these shareholders in the Board of Directors.

- Even after establishment of MTNL as a company, it still functions in many ways like other unincorporated circles of DoT. Over 99% of its staff and officers continue to be on deputation and even the top management personnel are reported to be transferred in and out by DoT without consultation with MTNL management. MTNL would need to phase out deputation from DoT according to a declared plan of absorption by offering senior executives attractive emoluments as recommended in the First Report of the Commission through performance related contracts for a period of 5 years.

- The Board of Directors of MTNL would need to be given full autonomy to enable them to take crucial decisions covering long-term business plans, tariff fixation and rationalization, choice of appropriate technology, selection of equipment and purchases without the need for consultation and prior approval by DoT in these matters. In particular MTNL should be kept out of the centralized tendering system of DoT.

- MTNL borrows funds from the market which are on-lent to DoT as part of the latter's funding requirements. As on March 31, 1996 MTNL had on-lent Rs.5932 crores to DoT. In this process, some of the transactional costs which are quite substantial are being absorbed by MTNL and consequently this depresses profitability and hence share value. It is recommended that all cost relating to the funds already raised for the DoT should be fully reimbursed to MTNL. In future MTNL may require funds for expansion programmes in the existing and new metro regions. In such a situation, MTNL may not be able to borrow further funds for DoT as the debt:equity ratio is already quite high. It is therefore recommended that the resource raising function for DoT if required, should be taken away from MTNL and should be vested with some other entity.

In a service sector like telecom, a public sector undertaking even after grant of full autonomy to the Board of Directors would have to face some constraints.

Accountability on detailed micro commercial decisions to a multiplicity of institutions like Ministries, Parliamentary Committees, the Central Vigilance Commission (CVC) and the comptroller and Auditor General (CAG) could act as constraints in dealing with competition, especially in the matter of differential pricing and discount policy. The Commission would like to reiterate the observation made in its First Report that "the audit by the CAG and the examination of PSUs by the Committee on Public Sector Undertakings (COPU) may need to take into account the changing commercial environment in which PSUs are operating and the need for PSU managements to take quick entrepreneurial decisions to promote the interest of the company and the shareholders". The Commission has also recommended the establishment of a Pre-investigation Board to protect the management against action in respect of even bonafide commercial decision. Follow-up on these recommendations will be particularly crucial in the case of MTNL as its management gears itself to face the threat of competitors "skimming the cream" with their aggressive sales and pricing policies.

2.4 Oil India Limited

Evolution

Oil India Limited's (OIL) origin dates back to the time when oil was first discovered in Assam in 1889. The Government of India which was a joint venture partner with Burmah Oil Company took over the latter's share holding in full in 1981.

OIL's primary activities are exploration, production and transportation of hydrocarbons. The contribution of various products and services to the total sales in 1995-96 was as follows: crude oil (90%), natural gas (5%), Transportation charges (3%), and LPG (2%). The company started exploration of hydrocarbons in upper Assam and has currently extended offshore exploration to Rajasthan, Uttar Pradesh and the Saurashtra region.

Presently, the government holds 98.12% of the equity of Rs. 143 crores with the balance being held by the employees of the company. The company's shares are currently not listed.

Industry Analysis

The demand for petroleum products is driven by the economic growth rate. For the last two decades, the growth rate of petroleum consumption in India has been higher than the growth of the Gross Domestic Product of the country. Thanks to this high growth rate in consumption, the development of hydro carbon resources available in the country has become a critical economic necessity.

In India, there are twenty six sedimentary basins covering around 1.78 mn. sq.km. The presence of hydro carbons has been established in nine sedimentary basins, while commercial production has been carried out in six of them. Exploration activity was intensified after the oil crisis in the seventies and eighties. This resulted in the major discoveries of the offshore Bombay High Field and the Gandhar Oil & Gas Field in Cambay basin.

Domestic crude oil production became stagnant in 1990 mainly on account of the following :

- Most of the fields including Bombay High reached a plateau with a number of wells requiring shutdown for repairs.
- No significant discovery of hydrocarbon after the discovery of the Neelam Oil Field in the Bombay High in 1987.

To supplement production, efforts were made to increase production through the use of enhanced oil recovery programmes. Inspite of this, it is expected that the domestic production will remain more or less stagnant over the next few years unless there are significant discoveries.

There is no integrated company in the petroleum sector in India. The upstream oil exploration and production (E&P) sector in India is a duopoly of the national oil companies - OIL and Oil & Natural Gas Corporation Ltd. (ONGC). In the downstream sector, refining and marketing are done by a number of companies. In the case of Indian Oil Corporation Ltd. (IOCL), Hindustan Petroleum Company Ltd. (HPCL) and Bharat Petroleum Co Ltd. (BPCL), they carry out both the activities. Madras Refineries Ltd. (MRL), Cochin Refineries Ltd. (CRL) and Bongaigoan Refineries and Petrochemicals Ltd. (BRPL) market their produce through other oil companies. Lastly, IBP Ltd. (IBP) only markets petroleum products but does not do any refining on its own.

A comparison of the upstream companies on the basis of oil reserve characteristics is shown in the table below:

Table 1 Reserves position of crude Oil and Gas (1995-96)

Reserve Characteristics	Unit	ONGC	OIL
Proven + indicated Crude Oil Reserves	MMT	726.50	64.55
Proven + Indicated Gas Reserves	BSCUM	642.80	88.10
Crude Oil Production	MMT	31.89	2.80
Gas Production	BSCUM	20.87	1.43
Total Production (Oil & Oil Eq.)	MMT	52.76	4.23

Note : MMT is Million Metric Tonnes and BSCUM is Billion Standard Cubic Meters

As can be seen from the above table, OIL is approximately 1/11th of the size of ONGC in terms of production and reserves. Almost 92% of the domestic production is contributed by ONGC and 8% by OIL. Domestic production accounts for nearly 55% of the total crude consumption of the country with the balance being met through imports.

The demand for crude has increased steadily at a CAGR of 3.3% over the last decade and was 61 MMT in FY 96. However, domestic production which was 34.6 MMT in FY 96, has not kept pace with the growth in demand as a result of which the country had to resort to increased imports. This trend is expected to continue in the future too.

The declining oil reserve profile and the resource crunch with the national oil companies have prompted the Government to permit and encourage private sector investment in the E&P sector. Private participation has been sought by inviting bids for exploration, development and surveys. As part of these policy initiatives, the Government has formulated the New Exploration and Licencing Policy (NELP) in February, 1997. Some of the highlights of the NELP are:

- Companies including the national oil companies will be paid international oil prices for production from new discoveries.
- Royalty payments will be fixed on ad valorem basis instead of the present system of specific rates.
- Royalty payments for exploration in deep waters will be charged at half the rates for offshore areas for the first seven years after the commencement of commercial production.

Pricing & Distribution

The sector came under complete government control in 1981 with the nationalisation of OIL. Since then, the administered price of crude oil and natural gas has been applicable to both OIL and ONGC. Under the Administered Pricing Mechanism (APM), the pricing of crude oil is fixed taking into account 15% post tax return on capital employed which in turn is based on the normative costs of the two E&P companies. The APM for crude oil is revised periodically by the Oil Co-ordination Committee (OCC). Though revisions are to be done once every three years, there have been delays in the past. At present the administered price of crude is around USD 13 per barrel which is well below international prices. The distribution of both crude oil and natural gas is also decided by the Ministry of Petroleum and Natural Gas.

Technology

Technology is a vital factor in E&P activities. Improvements in technology improve probabilities of success, reduce risks, lower finding and development costs and facilitate access to difficult terrain. Improved technology also reduces the threshold structure sizes and enables even marginal fields to become commercially viable.

Business Analysis

OIL's operations are in Assam, AP, Rajasthan, Uttar Pradesh, Orissa and offshore Saurashtra. While OIL's drilling activities have been satisfactory in terms of the eighth five year plan targets, production has remained more or less stagnant at around 2.8 MMT mainly due to:

- Blow-out in a high potential area (Dikom) in 1992-93 leading to loss of one drilling rig and a well for one year
- Intermittent local problems in the operational areas
- Declining production levels from old fields

The last mentioned factor is expected to impact production costs significantly over the medium term. The share of production of crude oil from old and declining fields has dropped from 67% in FY 94 to 44% in FY 97 and is expected to drop down further to 25% in the near future. The future operating strategy of the company therefore is to concentrate its exploration activities in the North-East, especially in the virgin areas of the north bank of Brahmaputra which are estimated to have large hydrocarbon potential.

OIL's technological competence in terms of drilling technology employed is comparable with ONGC; however there is a gap when compared with the drilling technology adopted by the international E&P companies.

Reserves

The crude oil reserve position of OIL as on April 1, 1996 indicated a total balance recoverable quantity of 64.55 MMT. The North East region contributes a significant portion of this and thus is of strategic importance for OIL. At the current level of production, the balance recoverable reserves will last for another 21-23 years.

In the case of natural gas, the balance recoverable reserves are estimated at 88.10 BSCUM. At the current level of production, these gas reserves will last for another 60-62 years.

Financial Analysis

The financial performance of OIL for the past five years is indicated in the table below:

Table 2 Financial Performance

(Rs.Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	1045.1	986.5	919.6	723.1	616.0
Operating Profit	344.5	365.7	267.4	155.2	101.1
Profit After Tax	206.5	258.2	97.8	37.8	46.4
Equity Capital	71.33	70.0	28.0	28.0	28.0
Tangible Net Worth	1853.5	1653.5	895.8	798.7	627.2
Gross Margin (%)	32.9	37.0	29.0	21.4	16.4
Net Margin (%)	19.7	26.1	10.6	5.2	7.5
ROCE (%)	17.8	18.7	14.6	8.1	10.5
RONW (%)	11.1	15.6	10.9	4.7	7.4
Earnings Per Share	28.9	36.8	34.9	13.4	16.5
Dividend (%)	30.0	24.0	24.0	16.0	16.0

Beginning in FY 95, the company has started following the Successful Efforts Method (SEM) of accounting for recognising its income and expenses related to the exploration and drilling and development activities. The SEM is the generally accepted standard accounting policy for E&P companies. Because of this, the financial results of FY 96 and FY 95 are not strictly comparable with those of earlier years.

However, on a broad level, profitability has largely been determined by increases in Administered Prices of crude and exploratory write-offs as also due to the effect of the changed accounting policy. OIL's cost structure is comparable to ONGC because of similar royalty /cess on crude, comparable operating costs and depletion rates. In fact, OIL's performance is comparable to the mid-sized exploration and production companies internationally.

Strengths & Areas of Concern

Strengths

Future market prospects bright: Domestic crude oil demand in 1995-96 was estimated at 61.9 MMT out of which only 55% was met by domestic production. Thus, there is considerable scope for OIL to increase its production.

Strong Financial Position: OIL has built up a strong reserve position at about Rs. 1853.5 crores as against a paid up equity of Rs. 71.33 crores.

Operational efficiency comparable to ONGC: OIL compares favourably with ONGC on most efficiency parameters except manpower costs which are marginally higher.

Areas of Concern

Operational areas are subject to localised difficulties: OIL's exploratory regions are concentrated in the North East which holds promising hydro carbon potential. However in the past, OIL's production and drilling targets have been affected by local disturbances, poor road conditions, and difficulties in land acquisition.

Lack of Autonomy in decision making: In the past, OIL has lost on opportunities due to delays in decision making resulting from inadequate Board level autonomy. With the entry of the private sector in this field, it is desirable that adequate autonomy be granted to OIL consistent with its status as a "Strong Performer" as per the norms laid down by the Commission in its First Report.

Recommendations

The Commission has already categorised OIL to be in the Core group of PSUs. Disinvestment in OIL would be conditioned by a realistic assessment of the company's prospects and earnings in the short-term which will determine the value of its shares and its requirement of funds for investment in its capital projects and consequently its need to take recourse to an initial public offering (IPO) on its own.

Owing to delays in decision making, OIL has lost out business opportunities in promoting joint ventures and has suffered considerable pruning of its new exploration programme in the last five years. After it ventured into exploration outside the North-East region, it has been to some extent successful in Rajasthan. Currently its exploration activities in the North Bank of Brahamputra are expected to be profitable and success in this area will on the one hand increase its requirement for capital outlays but also improve earnings and share value.

The current policy of APM denies a proper value for its output from the old areas. Policy changes towards dismantling APM and giving international prices for its output as in the case of new fields would significantly improve its internal resource generation and will also make a substantial impact on the share value. Under this scenario, thanks to the improvement in internal

generation, the company's need to look for resources through debt or through further issue of equity would be greatly reduced and prospect for disinvestment by Government would be enhanced.

Taking into account all these factors, the Commission recommends that disinvestment of Government shares as also company's own IPO need not be considered for the present and could be considered after a year or so when the company's own prospects would be clearly established through the outcome of exploration activities in the North Brahmaputra area and Government's policy on APM. The scope for disinvestment of Government shares could then be determined after balancing the requirements of the company for equity issues. Any disinvestment prior to this could result in a loss to exchequer as an announcement regarding the dismantling of APM would significantly improve the share value both for disinvestment and for the company's own IPO. The Commission would like to review the position after a year and make specific recommendations on disinvestment in the company. The company's immediate requirement of funds could be covered through appropriate borrowing arrangements.

2.5 Oil And Natural Gas Corporation Limited

Evolution

The Oil and Natural Gas Directorate was formed in 1955 to explore and develop the oil and natural gas resources in the country. As the structure of the Directorate was found to be inadequate for the effective execution of the task of oil exploration and production (E&P) it was converted into a statutory body the Oil and Natural Gas Commission in October, 1959 by an Act of Parliament. In 1994, it was incorporated as a public limited company under the Companies Act as Oil and Natural Gas Corporation Ltd. (ONGC).

ONGC's principal activity is the exploration and production of crude oil and natural gas which constituted about 73% and 23% respectively of its turnover of about Rs. 13000 crores in FY 96. It also processes gas and condensate into value added products like liquefied petroleum gas (LPG), natural gasoline liquid etc.

In FY 94, the government disinvested 2% of its shares to mutual funds, financial institutions, etc. In the same year, ONGC also issued 2% of its shares to employees. According to the current share holding pattern, Government holds 96% of the share capital of Rs. 1426 crores. The shares of ONGC are listed on the Bombay Stock Exchange (BSE) and was registered a high and a low of Rs. 273 and Rs. 120 (Rs. 10 paid up) respectively in 1996. The closing price as on 28th May, 1997 was Rs 253.25.

Industry Analysis

The demand for petroleum products is driven by the economic growth rate. For the last two decades, the growth rate of petroleum consumption in India has been higher than the growth of the Gross Domestic Product of the country. Thanks to this high growth rate in consumption, the development of hydro carbon resources available in the country has become a critical economic necessity.

In India, there are twenty six sedimentary basins covering around 1.78 mn. sq.km. The presence of hydro carbons has been established in nine sedimentary basins, while commercial production has been carried out in six of them. Exploration activity was intensified after the oil crisis in the seventies and eighties. This resulted in the major discoveries of the offshore Bombay High Field and the Gandhar Oil & Gas Field in Cambay basin.

Domestic crude oil production became stagnant in 1990 mainly on account of the following :

- Most of the fields including Bombay High reached a plateau with a number of wells requiring shutdown for repairs.
- No significant discovery of hydrocarbon after the discovery of the Neelam Oil Field in the Bombay High in 1987.

To supplement production, efforts were made to increase production through the use of enhanced oil recovery programmes. Inspite of this, it is expected that the domestic production will remain more or less stagnant over the next few years unless there are significant discoveries.

There is no integrated company in the petroleum sector in India. The upstream oil exploration and production (E&P) sector in India is a duopoly of the national oil companies - ONGC and Oil India Limited (OIL). In the downstream sector, refining and marketing are done by a number of companies. In the case of Indian Oil Corporation Ltd. (IOCL), Hindustan Petroleum Company Ltd. (HPCL) and Bharat Petroleum Co Ltd. (BPCL), they carry out both the activities. Madras Refineries Ltd. (MRL), Cochin Refineries Ltd. (CRL) and Bongaigoan Refineries and Petrochemicals Ltd. (BRPL) market their produce through other oil companies. Lastly, IBP Ltd. (IBP) only markets petroleum products but does not do any refining on its own.

A comparison of the upstream companies on the basis of oil reserve characteristics is shown in the table below:

Table 1 Reserves position of crude Oil and Gas (1995-96)

Reserve Characteristics	Unit	ONGC	OIL
Proven + indicated Crude Oil Reserves	MMT	726.50	64.55
Proven + Indicated Gas Reserves	BSCUM	642.80	88.10
Crude Oil Production	MMT	31.89	2.80
Gas Production	BSCUM	20.87	1.43
Total Production (Oil & Oil Eq.)	MMT	52.76	4.23

Note : MMT is Million Metric Tonnes and BSCUM is Billion Standard Cubic Meters

As can be seen from the above table, OIL is approximately 1/11th of the size of ONGC in terms of production and reserves. Almost 92% of the domestic production is contributed by ONGC and 8% by OIL. Domestic production accounts for nearly 55% of the total crude consumption of the country with the balance being met through imports.

The demand for crude has increased steadily at a CAGR of 3.3% over the last decade and was 61 MMT in FY 96. However, domestic production which was 34.6 MMT in FY 96, has not kept pace with the growth in demand as a result of which the country had to resort to increased imports. This trend is expected to continue in the future too.

The declining oil reserve profile and the resource crunch with the national oil companies have prompted the Government to permit and encourage private sector investment in the E&P sector. Private participation has been sought by inviting bids for exploration, development and surveys. As part of these policy initiatives, the Government has formulated the New Exploration and Licencing Policy (NELP) in February, 1997. Some of the highlights of the NELP are:

- Companies including the national oil companies will be paid international oil prices for production from new discoveries.
- Royalty payments will be fixed on ad valorem basis instead of the present system of specific rates.
- Royalty payments for exploration in deep waters will be charged at half the rates for offshore areas for the first seven years after the commencement of commercial production.

Pricing & Distribution

The sector came under complete government control in 1981 with the nationalisation of OIL. Since then, the administered price of crude oil and natural gas has been applicable to both OIL and ONGC. Under the Administered Pricing Mechanism (APM), the pricing of crude oil is fixed taking into account 15% post tax return on capital employed which in turn is based on the normative costs of the two oil producing companies. The APM for crude oil is revised periodically by the Oil Co-ordination Committee (OCC). Though revisions are to be done once every three years, there have been delays in the past. At present the administered price of crude is around USD 13 per barrel which is well below international prices. The distribution of both crude oil and natural gas is also decided by the Ministry of Petroleum and Natural Gas.

Technology

Technology is a vital factor in E&P activities. Improvements in technology improve probabilities of success, reduce risks, lower finding and development costs and facilitate access to difficult terrain. Improved technology also

reduces the threshold structure sizes and enables even marginal fields to become commercially viable.

Business Analysis

ONGC's primary function is to exploit India's petroleum resources. The company is not engaged in any refining activity, nor does it distribute natural gas and petroleum products.

ONGC's production is concentrated in six sedimentary basins out of which a major part comes from offshore installations in the Mumbai Regional Business Centre (Bombay High). Among the other areas, the Western Regional Business Centre (Cambay, Kutch, Saurashtra) contribute around 20% of crude oil and 14% of natural gas production.

Natural gas is available for distribution after meeting internal requirements. However, in the past, natural gas has had to be flared due to nonavailability of infrastructure of gas pipelines, variation of demand pattern of committed users, etc. However, over the years, the flaring of gas has come down from around 34% of total production in FY 1990 to 6% in FY 1996.

Crude oil and natural gas have been major contributors to income and profits in the past. In FY 1996 crude oil contributed to around 62% of profits and the balance was accounted for by the sale of natural gas, LPG etc.

In addition to its core activities of E&P, ONGC is also engaged in carrying out several non core activities ranging from providing logistics and support system to maintenance.

Reserves

The reserve position of ONGC as on April 1, 1996 indicated a total balance recoverable crude oil reserves of 726.5 MMT. Out of this total, Bombay High contributes significant portion and thus is of strategic importance for ONGC. Production from Bombay High has been regulated since FY 92 for improving reservoir health and for rectification programmes for existing oil wells.
At the current level of production, the balance recoverable reserves will last for another 20-22 years.

In the case of natural gas, the balance recoverable reserves has been estimated at 642.8 BSCUM. At the current level of production, these gas reserves will last for another 30-32 years.

It must be mentioned that most of the exploration efforts so far have been concentrated in the known petroliferrous basins both onshore and offshore. This indicates that the easy to find oil has already been discovered in the prospective basins. Thus the exploration strategy in the future will have to concentrate on deep water basins (offshore) and frontier areas (onshore). These would involve substantial investment and could be called "high risk and high return" ventures.

Financial Analysis

The past financial performance of ONGC is shown in the table below :

Table 2 Financial Performance

(Rs.Crores)	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	13436	13614	8052	8668	8110
Operating Profit	6376	6618	3927	3687	3586
Profit After Tax	1945	2345	1595	788	408
Equity Capital	1426	346	343	343	343
Tangible Net Worth	17600	15448	12746	10777	9500
Gross Margin (%)	47.4	48.6	48.7	42.5	44.2
Net Margin (%)	14.5	17.2	19.8	9.0	5.0
ROCE (%)	13.3	17.9	18.3	12.8	12.3
RONW (%)	11.8	14.2	16.3	7.8	6.2
Earnings Per Share	13.6	58.1	55.8	23.0	11.9
Dividend (%)	14	20	18	18	18

Total income has shown a CAGR of 13% over the past four years ending March 31, 1996.

The improvement in profitability in FY 1994 in terms of gross and net margins and other ratios was mainly due to increase in net realisable prices given to ONGC in September, 1992 and April, 1994. This resulted in a total increase in revenues by about Rs. 800 crores. Profit after tax has shown a higher growth rate during the same period. During FY 95 and FY 96, profitability has shown a declining trend. This is due to the fact that there has been no change in the net crude oil price realised by ONGC since April, 1993 inspite of increased cost of production. Also, during FY 1996, ONGC had carried out a critical review of all wells in progress and had written off the cost of wells with no techno economic significance. This resulted in lower operating profit and net margins in FY 1996 as also lower return on capital employed inspite of write back of revenues of about Rs. 300 crores due to changed accounting polices.

Strengths & Areas of Concern

Strengths

Dominant Position in the Petroleum Sector: ONGC accounts for more than 91% of the domestic crude oil production and 94% of the crude oil production in India. This dominant position is also reflected in the strong financial position of the company with financial reserves of nearly Rs. 18,000 crores.

Changed Policy Environment: NELP presents an opportunity to ONGC to surrender less promising blocks and concentrate on more promising blocks. In addition, ONGC will get a number of benefits in new finds (international prices, lower royalty, abolition of cess, etc.). However, it is difficult to predict volume of production from new finds.

Areas of Concern

Lack of Managerial Autonomy: Considering the size of the company and its scope of operations, the delegation of powers to ONGC is inadequate. Due to this, a number of potentially viable projects were affected due to delays in decision making.

Declining Levels of Reserve Replacement Reserves: For any E&P company, it is essential that it is able to replace its production of hydrocarbons with new discoveries and the absence of any major find in recent years is a cause of concern for ONGC.

Recommendations

ONGC is undertaking a detailed review of its operations. It is reported that diagnostic studies have been completed and after discussions with the company and the Ministry of Petroleum and Natural Gas, recommendations would be made by the consultants. Reorganisation of ONGC on this basis will be undertaken after that. This entire process is expected to be completed over the next 2 years. This corporate reorganization and restructuring is expected to have a beneficial impact on the operations and performance of the company.

Apart from this, ONGC as in the case of OIL would stand to benefit by the changes in the petroleum policy being contemplated by the Government, especially with regard to pricing of crude oil produced from the existing fields. The switchover from APM to international prices for its production would add considerably to ONGC's operating margins and profits. **The Commission recommends that disinvestment in ONGC be considered after the**

organizational changes are in position and the new pricing policy is known. That would be the time to clearly assess ONGC's own requirement of funds and to plan the disinvestment of Government shares and the company's IPO requirement in a coordinated matter. Any disinvestment prior to this could result in a loss to the exchequer, as an announcement regarding the dismantling of APM would significantly improve share values. The Commission would review the position from time to time and make its recommendations at the appropriate time.

2.6 Rail India Technical And Economic Services Limited

Evolution

Rail India Technical and Economic Services Limited (RITES) was incorporated in 1974 under the Ministry of Railways with the object of rendering consultancy services primarily in all facets of rail transportation technology and management both in India and abroad. With technical and managerial support from Indian Railways, RITES has established itself as a leading international consultancy organisation in railway related technology. RITES has executed projects in developing countries of Asia and Africa. Several of these projects have been funded by major international financial institutions like the World Bank, the Asian Development Bank, UNDP, etc.

Major customers in India are the Indian Railways, central and state governments and their organisations like PSUs and SEBs. There are also a few private sector companies in its client list.

Since the mid-eighties, the company has followed a strategy of diversification from consultancy for the railways to that for the entire transport sector. It entered into consultancy for highways, ports & harbours, inland water transport, urban transportation, airports and other related areas. In FY 96, these sectors contributed to about 35% of the total turnover of Rs. 109 crores, while the balance was accounted by its core business of railway related consultancy.

The current equity capital of the company is Rs. 1 crore with the entire equity being held by the Government of India. The reserves and surplus are significant at about Rs. 91 crores as at March 31, 1996.

Industry & Business Analysis

The field of technical consultancy in India is dominated by a number of leading private sector and public sector organisations. Since expertise in specific technical areas is essential, the market for consultancy is clearly demarcated into various niche segments, with no firm specialising in all segments. RITES started operations by rendering integrated design services, institutional management and technical support for new railway projects and rehabilitation and modernisation of existing railway systems. In addition, the company has diversified into new areas to become a multi-disciplinary transport consultancy. The break-up of income over the past decade reveals that the income is broad based as shown in the table below.

Table 1 Break up of Income

(Rs. Crores)	FY 96	FY 93	FY 89	FY 87	FY 84
Consulting fees - Dom.	48.1	28.4	15.1	14.4	2.8
Consulting fees - Intl.	12.4	12.5	57.3	15.3	15.9
Inspection fees	9.4	8.3	4.8	3.4	2.0
Exports of RS	21.2	-	-	-	-
Sub-Total	91.1	49.2	77.2	33.1	20.7
Other income	18.8	10.1	2.9	1.6	1.1
Total Income	109.9	59.3	80.1	34.7	21.8

The consultancy income from domestic business has grown at an average rate of 18% over the last six years. The domestic income comprises income from both railway related and non-railway groups such as Ports, Highways, Airports, Quality Assurance, etc. Railway related business still constituted about 65% of the company's turnover in FY96. Inspection services and operations and maintenance of railway related projects have maintained a share of 15% of the total turnover in FY96.

However, foreign consultancy income has been declining over the last decade. The exception has been the sharp increase in the revenue in foreign consultancy in FY 89 which was on account of the Iraq project. This was later foreclosed in FY 90 due to the United Nations sanctions.

Analysis of Railway Related Services

Foreign projects: India's level of railway technology (partly manual and partly mechanical) is ideally suited to the projects coming up in the developing countries. These projects are typically funded by development institutions like the World Bank, African Development Bank, etc. Internationally, India's share of consultancy business was 1.2% of the total business and it ranked 13th.

RITES has drawn up plans to arrest the declining trend in foreign consultancy income. It is making all out efforts to enter new markets particularly to take up rehabilitation and maintenance projects for coaches and locomotives. It also plans to play an active role in the privatisation of railway lines which is an emerging segment in the international market. The company has recently secured consultancy contracts from the Railways of Malaysia, Botswana, Cambodia, etc.

Inspection Services : For third party inspection services, the principal client is the Indian Railways. The company has secured ISO 9000 certification for its inspection services. RITES also provides consultancy services to clients to enable them to obtain these certifications and is also attempting to become a

certification agency itself. The inspection service business has reached stable levels and is expected to continue to provide a steady stream of revenue and profits to the company.

Quality assurance services : RITES has specialised expertise in quality assurance services in power equipment, coal and oil sectors. Although, RITES has to face competition from domestic and international consultants, it is expected that this business will grow steadily in the domestic market.

Export of Rolling Stock : Over the last two years, RITES and Indian Railway Construction Corporation Ltd. have been permitted to export rolling stock on behalf of the Indian Railways. RITES has already exported diesel locomotives, passenger cars including air conditioned coaches, and spares to Vietnam, Bangladesh, Chile and Peru. RITES is able to supply an integrated package consisting of hardware, after sales service, spares, training and even Operations & Maintenance services of rolling stock on the client's railway system. However, the prospects of exports appear to be uncertain in the medium term because of change in the demand pattern from client countries, and competition from China, South Korea, and Romania whose domestic steel costs are relatively lower.

Operation and Maintenance: RITES has a strong track record in the business of operation and maintenance of locomotives, wagons and equipment. This business from PSUs, private sector and foreign railways is on a growth path.

In summary, the railway related business is expected to remain a monopoly and its profitability is expected to be sustained over the long term.

Analysis of Infrastructure Sector Services

Highways : The privatisation of highway sector is yet to take off significantly in India and future growth is dependent upon the inflow of funds. Unlike in the railway sector, RITES position in the international market in highways is relatively weak when compared with consultants from the developed countries.

Ports : The business in this sector is slated to grow significantly. RITES is involved in major ongoing projects like Ennore, Kandla and Kakinada, and has tied up with international consultants for different projects.

Urban Transportation: RITES is handling the Delhi Mass Rapid Transit System and other projects. RITES has a strong market position as it is

involved in almost all major on-going projects. It plans to diversify further in the field of urban planning, water supply, sewerage and waste disposal.

Project Management: RITES provides project management services to building work, industrial parks, ropeways, amusement parts and airports, inland waterways, energy management and environmental engineering. These sectors are expected to grow with the liberalisation of the economy and entry of private capital in the infrastructure sector.

In summary, the consultancy business for the infrastructure sector is competitive and it is expected to become more so with the entry of foreign capital and international consultants.

Financial Analysis

The financial performance of RITES for the past five years is given below:

Table 2 Financial Performance

Rs. Crores	FY 96	FY 95	FY 94	FY 93	FY 92
Operating Income	91.0	68.0	53.6	49.3	44.8
Operating Profit	23.2	21.2	13.8	10.7	8.3
Profit after Tax	15.7	12.2	8.3	7.5	4.8
Equity Capital	1.0	1.0	1.0	1.0	1.0
Tangible Net Worth	91.8	77.6	66.3	58.7	50.9
Gross Margin (%)	25.5	31.1	25.7	21.8	18.5
Net Margin (%)	17.3	17.9	15.4	15.2	10.8
ROCE (%)	11.2	11.7	8.7	7.5	6.5
RONW (%)	17.1	15.7	12.5	12.8	9.5
Earnings Per Share (Rs.)	157.40	122.0	82.86	75.00	48.36
Dividend (%)	60.0	50.0	45.0	40.0	37.5

The company is financially in a strong position due to consistently high profitability, low funding requirements, large investments and a small equity base. However, the company's profits have been depressed significantly due to the mounting interest liabilities on its over due loans taken for the execution of the Iraq project.

The company took on a construction and operations & maintenance contract for Iraq Railways in FY 89. RITES had borrowed about USD 8.9 millions both in Indian rupees and US dollars to execute this contract on a deferred payment basis.

However, due to the UN sanctions against Iraq, the five year contract was foreclosed in FY 90. The company has been accruing interest on deferred receivables and the total amount receivable from Iraq amounted to USD 63.2 millions as at March 31, 1996. Against this income is the interest payable to banks on loans taken for the project. The total assets representing the above transactions in the books of RITES stood at Rs. 101.2 crores while the liabilities on this account was Rs. 114.7 crores in FY 96. These transactions continue to be translated in the books at the exchange rates prevalent on the date of the respective transactions. Therefore the assets and liabilities shown in the books are lower as compared to the actual value at the current exchange rates.

The extent of liabilities is quite significant and it is likely that a one time provision could wipe out the networth of the company.

Strengths and Areas of Concern

Based on the above business and financial analysis, the strengths and areas of concern of RITES are as below :

Strengths

Strong linkage with Indian Railways RITES has a unique advantage as it is among the only consultancy organisations in the world to be associated with an operating railway. As a company wholly owned by the Government under the administrative control of the Railway Board, it has the flexibility of drawing upon the large pool of talent available with the Indian Railways as and when required.

Expertise in railways consultancy Two thirds of the company's consultancy services are railway related and the company has developed expertise in this field. RITES has an established track record in advising foreign railway systems especially in the area of operations and maintenance.

Manpower quality and cost The company has a large base of experienced and qualified technical manpower which is available at much lower costs when compared with international levels. Thanks to its access to railway personnel at short notice, it is able to maintain a lean and efficient staff structure.

Importance assigned to development of infrastructure sector RITES has developed expertise to handle various projects in the areas of highways, ports, airports etc. Significant investments in the coming years are being planned in these sectors and this will have a positive effect on RITES.

Strategic alliances with foreign consultants RITES has strategic alliances with foreign consultants in the fields of port development, airport projects etc. Collaborations with Haskoning of Netherlands, METOC of UK and Nipping Ku of Japan in the ports sector are in place. An MoU has been signed with Jurtere Perunding Zaaba, consulting engineers of Malaysia for business and technical co-operation to identify projects suitable for joint ventures. RITES is also part of an international consortium which is bidding for project management of Senai Airport of Malaysia. This will help RITES participate in the infrastructural projects in the country as well as abroad. RITES's international experience -though principally in railway projects- is likely to prove useful in the era of international competitive bidding.

Track record and extensive work experience In the domestic business, the organisation has demonstrated capability in implementing projects from concept to commissioning stage both in the railways and other infrastructure sectors. There are few organisations in the government who can compete with RITES in terms of expertise, cost and quality which lends it a competitive advantage especially with government and PSU clients.

Areas of Concern

Marketing The organisation's marketing abilities are relatively weak especially in international markets. The infrastructure available in terms of communication, software tools etc., for effective marketing in foreign countries is limited vis a vis its competitors especially in the international market.

Dependence on a few large clients The company is dependent on a few large clients like the Indian Railways, PSUs and state governments for the major part of its business.

International experience mainly confined to railway projects The company has limited expertise in the areas of urban transport, port development etc. which are fast growing segments of consultancy business.

Uncertain timing of the growth in the infrastructure sector Though the infrastructure sector requirements are extremely high, there could be a long waiting period before this sector actually takes off, considering the huge amount of resources required for it.

Competition The business of consultancy services is becoming intensely competitive and there are a large number of domestic and foreign companies in the fray. Cost may not remain a key competitive advantage as foreign consultants move in and recruit local talent and use advanced technological tools.

Recommendations

While considering disinvestment in the company, the following factors need to be taken into account.

RITES has been able to source its skilled manpower requirements and other consultancy manpower not only from the Railways but also from other Government departments.

Its PSU status has helped RITES secure assignments from Governments -both Central and State - and PSUs. This, however, may not be sustainable in the long run.

RITES has received support from the Indian Railways in its operations in terms of business and manpower as also infrastructure. In a sense, RITES provides the cutting edge to the globalization efforts of Indian Railways in terms of exports of materials and rolling stock as also project expertise.

The equity base of RITES is rather low.

From the above, it is seem that the balance of advantage is in favour of RITES continuing as a public sector undertaking for some time to come. The uncertainty surrounding the Iraqi dues would also preclude any disinvestment effort till that issue is satisfactorily resolved. There is not likely to be a favourable response from small investors or institutions to a limited offer of shares in the company. The Commission does not, therefore, recommend any disinvestment in RITES.

MINISTRY OF INDUSTRY
(Department of Public Enterprises)
RESOLUTION
New Delhi, the 23rd August, 1996

No. 11013/3/96-Admn. - In pursuance of the Common Minimum Programme of the United Front, Government hereby constitutes a Public Sector Disinvestment Commission, initially for a period of three years.

2. The composition of the Commission will be as follows :-

1. Shri. G.V. Ramakrishna, Full-time Chairman
2. Shri. Dipankar Basu, Part-time Member
3. Shri. M.R.R. Nair, Part-time Member
4. Dr. Suresh Tendulkar, Part-time Member
5. Dr. D.M. Nanjundappa, Part-time Member

The commission will have a full-time Secretary who will be appointed separately.

3. The broad terms of reference of the Commission are as follows :-

I. To draw a comprehensive overall long term disinvestment programme within 5-10 years for the PSUs referred to it by the Core Group.

II. To determine the extent of disinvestment (total/partial indicating percentage) in each of the PSU.

III. To prioritise the PSUs referred to it by the Core Group in terms of the overall disinvestment programme.

IV. To recommend the preferred mode(s) of disinvestment (domestic capital markets/international capital markets/auction/private sale to identified investors/any other) for each of the identified PSUs. Also to suggest an appropriate mix of the various alternatives taking into account the market conditions.

V. To recommend a mix between primary and secondary disinvestments taking into account the Government's objective, the relevant PSU's funding requirement and the market conditions.

VI. To supervise the overall sale process and take decisions on instrument, pricing, timing, etc. as appropriate.

VII. To select the financial advisers for the specified PSUs to facilitate the disinvestment process.

VIII. To ensure that appropriate measures are taken during the disinvestment process to protect the interests of the affected employees including encouraging employees' participation in the sale process.

IX. To monitor the progress of disinvestment process and take necessary measures and report periodically to the Government on such progress.

X. To assist the Government to create public awareness of the Government's disinvestment policies and programmes with a view to developing a commitment by the people.

XI. To give wide publicity to the disinvestment proposals so as to ensure larger public participation in the shareholding of the enterprises; and

XII. To advise the Government on possible capital restructuring of the enterprises by marginal investments, if required, so as to ensure enhanced realisation through disinvestment.

4. The Disinvestment Commission will be an advisory body and the Government will take a final decision on the companies to be disinvested and mode of disinvestment on the basis of advice given by the Disinvestment Commission. The PSUs would implement the decision of the Government under the overall supervision of the Disinvestment Commission.

5. The Commission while advising the Government on the above matters will also take into consideration the interests of stakeholders, workers, consumers and others having a stake in the relevant public sector undertakings.

S. TALWAR
Joint Secretary